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Consolidated Commentary

Budget 2017/18

South Africa

Preface

The South African Minister of Finance, Pravin Gordhan, delivered his 2017 Budget Speech to Parliament on Wednesday, 22 February 2017.

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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Personal Income Tax

General
A new marginal tax rate of 45% has been introduced and will be applicable to individuals with taxable income exceeding R1.5 million per annum. Tax rebates and the levels of all taxable income brackets, will be increased by 1% from 1 March 2017 (see tax tables in Deloitte Quick Tax Guide - 2017/18).

These new rates also increase the effective capital gains tax rate.

The tax rate applicable to trusts will also increase from 41% to 45%.

Comment: *The combined effect of all these adjustments is that individuals at higher-income levels will be paying more tax. Whilst rebates and tax brackets are being adjusted, the changes are below the expected level of inflation and hence provide limited real relief to taxpayers.*

Dividend withholding tax
As mentioned elsewhere in this Commentary, the withholding tax rate on dividends has been increased from 15% to 20%, effective 22 February 2017.

The rationale behind this increase is to eliminate any tax arbitrage opportunities which may arise between companies and individuals (for example, individuals may choose to earn their income in the form of dividends rather than salaries in an effort to avoid a higher tax bracket).

Comment: *This amendment will also affect lower and middle-income earners who may be fortunate enough to hold shares in a company (e.g. shareholders in a B-BBEE scheme).*

It was however cautioned that this tax credit may possibly be reduced, or not increased, in future as part of the funding framework for the proposed National Health Insurance scheme.

Withholding tax on immovable property disposed of by non-residents

To align with the increased effective capital gains tax rate, it is proposed that the withholding tax rate applicable to the disposal of immovable property by non-residents be increased as follows:

	From	To
Individuals	5%	7,5%
Companies	7,5%	10%
Trusts	10%	15%

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Retirement reforms

The following amendments are proposed in relation to the retirement reforms:

- Where individuals have elected to retire on a date other than normal retirement age, no provision is made for the tax-free transfer of lump sum benefits between retirement funds. It is proposed that the tax laws be amended to permit the tax efficient transfer from a retirement fund to a retirement annuity fund, subject to the applicable Fund rules.
- It is proposed that the 12-month restriction placed on employees joining a newly-formed employer umbrella fund be removed.
- It is proposed that the overall annual cap of R350 000 allowed as a tax deduction for retirement fund contributions be spread over the tax year when determining monthly employees' tax.

Comment: *The proposed spreading of the tax deduction limit over the tax year will, in certain circumstances, result in employees paying more employees' tax upfront and then having to claim a refund on assessment.*

Tax Incentives – learnership allowance and employment tax incentive

The learnership tax incentive programme has been extended until 2022 and has been revised to provide more support for scarce skills.

The employment tax incentive (ETI) programme, which has thus far only had modest positive effects on youth employment, has been extended until 2019 to allow for further review.

Increase in bursary threshold

It is proposed that the limits for the provision of bursaries be once again increased so that tax exempt bursaries may be provided to the relatives of employees earning up to R600 000 per tax year (previously R400 000).

The amount of the bursaries that may be provided tax-free will also increase from R15 000 to R20 000 for NQF levels below 7 and from R40 000 to R60 000 for NQF levels above 7.

Comment: *The increase in the limits is welcomed as this will provide employers with a greater scope to award bursaries to relatives of employees without adverse tax consequences for those employees.*

Transfer duties

The threshold at which transfer duties become payable has increased from R750 000 to R900 000.

Tax-free savings accounts

The annual tax-free savings allowance, which were introduced in the 2016 tax year, will increase from R30 000 to R33 000.

Comment*: The increase is welcomed.*

Amendments to the foreign employment income tax exemption

Currently, if a South African resident works in a foreign country for more than 183 days a year, his or her foreign employment income earned is exempt from tax, provided certain conditions are met. It has been noted that this exemption for foreign employment income appears to be excessively generous and that it may result in the South African resident not paying any tax on that foreign employment income in South Africa or any other jurisdiction (for example, if he/she exercises the foreign employment in a country like Dubai).

It is therefore proposed that this exemption be amended so that the foreign employment income will only be exempt from tax in South Africa if it is subject to tax in the foreign country. If no tax is payable in the foreign country on the foreign employment income, the tax resident will no longer enjoy the exemption and will be subject to tax in South Africa on that income.

Comment: *TIt is unclear whether this proposed amendment will also be applicable to the remuneration earned by any person working as an officer or crew member of a ship, who otherwise qualifies for the exemption.*

Overall, this amendment should create greater equity amongst taxpayers. However, there are still issues as certain tax residents would pay tax at a lower rate than others if they are in a lower tax rate jurisdiction.

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Employee share schemes

In 2016, anti-avoidance measures relating to the liquidation of restricted shares in an employee share incentive scheme in return for exempt dividends were introduced to tax the dividends received. It is proposed that the capital gains tax provisions relating to such transactions be aligned with the income tax provisions.

Reimbursive travel allowances

It proposed that reimbursive travel allowances only be subject to monthly employees' tax to the extent that the allowances exceed the rate reimbursed or distance travelled, as fixed per notice in the Government Gazette.

Comment: *As reimbursive travel allowances are not currently subject to employees' tax, the proposed amendment will potentially increase the tax withheld from employees on a monthly basis if the rate exceeds the rate fixed by SARS.*

Trust anti-avoidance measures

Currently, a recently-introduced anti-avoidance measure exists which is aimed at curbing the tax-free transfer of wealth to trusts through the use of low-interest or interest-free loans. Where such low-interest or interest-free loans are made, the anti-avoidance measure deems the "foregone" interest on the loan to be a donation that is subject to donations tax at a rate of 20%.

To avoid the circumvention of this anti-avoidance measure by certain taxpayers who are now making these low-interest or interest-free loans to a company owned by the trust, it is proposed that the scope of this anti-avoidance measure be extended to cover this perceived abuse.

It is also proposed that this anti-avoidance provision should not apply to trusts that are not used for estate planning purposes, for example employee share scheme trusts and certain trading trusts.

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Dividend withholding tax:
Currently, dividends paid to shareholders (not being local companies) are subject to a 15% withholding tax which results in a combined effective statutory tax rate of 38.8%. In order to reduce the difference between the combined effective statutory tax rate and the proposed top marginal personal income tax rate of 45%, it is proposed that the dividends tax rate be increased to 20% with effect from 22 February 2017. This will increase the combined effective statutory tax rate to 42.4%.

The exemption and rates for inbound foreign dividends will also be adjusted in line with the new proposed rate, effective for years of assessment commencing on or after 1 March 2017.

Withholding tax on Immovable property sales:
The withholding tax imposed on the sale of immovable property by non-residents is not a final tax, but rather an advance payment of the non-resident's tax liability for capital gains tax. As mentioned elsewhere in this Commentary, it is proposed that this withholding tax be increased to be in line with the increased effective capital gains tax rates effective from 1 March 2016. The rates will increase from 5% to 7.5% for individuals, from 7.5% to 10% for companies and from 10% to 15% for trusts.

Debt forgiveness issues:
Alignment of the tax treatment of debt foregone for mining companies -

Mining companies are allowed to deduct certain capital expenditure in full in the year incurred, limited to mining taxable income before the deduction of any capital expenditure. Any excess capital expenditure not claimed may be carried forward to the following year. The result is that where a debt that has been used to fund mining capital expenditure is waived, cancelled, forgiven or discharged, it will result in a recoupment of the amount of the debt forgiven without first reducing the balance of any capital expenditure carried forward.

This treatment is currently not in line with other companies that are allowed to reduce the base cost of a capital asset still on hand before any recoupment is recognized. It is therefore proposed that the treatment of debt forgone for mining companies be brought in line with the treatment applied to other companies.

Comment: *We agree with this proposal.*

Alignment of the tax treatment of debt forgone for dormant companies or companies under business rescue -
Forgiveness of debt generally gives rise to a recoupment of expenditure or a capital gain. Paragraph 12A of the Eighth Schedule to the Income Tax Act provides relief in respect of a debt that is cancelled, waived, forgiven or discharged between companies within the same group of companies in the case where such debt was used to acquire a capital asset. This relief however does not extend to section 19 which provides for a recoupment in the case where a debt has been used to fund any deductible expenditure or allowances assets. This disparity can become a hindrance in the case of dormant companies or companies under business rescue as such companies would, in most cases, not have the resources to pay any tax due on the recoupment. It is therefore proposed that the group relief offered under paragraph 12A be extended to section 19.

Comment: *We welcome this proposal.*

Debt settled for consideration other than cash -
Due to the current economic environment, debtors commonly enter into compromises with their creditors whereby a creditor issues shares to the debtor for an amount equal to the face value of the debt. There is some uncertainty as to whether the cash should flow in such instances and this has resulted in a number of rulings being request from SARS in this regard.

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It is therefore proposed that the conversion of debt into equity be allowed. However, any interest that will be capitalized as part of the conversion will be recouped to the extent that such interest was previously claimed as a deduction.

Comment: *We agree with this proposal, however whether interest capitalized should be treated as a recoupment is debatable.*

Addressing the abuse of artificial repayment of debt -
It is proposed in the 2017 Budget that a review of certain arrangements between debtors and creditors involving short-term shareholdings that are structured in such a way to circumvent the income tax implications of a debt forgiveness be undertaken in order to introduce measures that prevent such circumventions.

Addressing the abuse of disguised sale of shares using share buybacks:
It was proposed in the 2016 Budget 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, in substance, is a share sale transaction. Such a scheme can have the effect of the existing shareholders whose shares have been repurchased not paying tax as they have received an exempt dividend or a tax-free return of contributed tax capital (as the base cost of shares is reduced before a capital gain is triggered). It is now proposed that specific countermeasures be introduced to curb the use of such share buyback schemes.

Interaction between the "in duplum" rule and the statutory tax legislation:
The "in duplum" rule currently protects debtors by limiting the total amount of interest a creditor may charge (it may not exceed the outstanding principal debt). Various anti-avoidance provisions in the Income Tax Act may be undermined by the "in duplum" rule, especially in the case of low-interest or interest-free loans. It is therefore proposed that the tax rules dealing with low-interest or interest-free loans be amended to explicitly exclude the application of the "in duplum" rule.

Comment: *The proposal gives no indication of what the amendments entail.*

Contributed tax capital:
Contributed tax capital (CTC) in broad terms refers to the amount of subscribed capital in a company. It is reduced by any amounts of CTC which have been returned to shareholders. The return of CTC to shareholders does not constitute a dividend and consequently is not subject to dividends withholding tax. Government has apparently identified a mechanism whereby companies with foreign parents increase their CTC and this increased CTC can then be returned to foreign shareholders thereby avoiding dividends withholding tax. In addition, unless the local company is "property rich", the return of CTC will have no capital gains tax consequences.

It is proposed that amendments be made to tax legislation to prevent the perceived abuse of the definition of CTC.

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Corporate reorganization rules:
Tax rules for the assumption of contingent debt -

In terms of an asset-for-share transaction, certain assets can be moved to a company free of tax if the only consideration received by the seller is shares in the buyer and the assumption of certain debts. The "debt" which can be assumed only includes unconditional obligations and does not include contingent liabilities such as, for example, a provision for post-retirement medical aid funding. It is proposed to expand the asset-for-share transaction relief to include the assumption of such contingent liabilities.

Interplay between real estate investment trusts (REITs) and the corporate reorganization rules -

There are anomalies which would preclude REITs from obtaining tax relief from reorganization transactions. It is proposed to amend the rules to enable the relief in terms of the corporate reorganization rules to apply to transactions involving REITs.

Collateral and securities lending arrangements:
Limited tax relief applies where ownership passes between two parties of certain financial instruments in terms of a collateral or securities lending arrangement. In 2016, this relief was extended to include listed government bonds.

It is proposed that an amendment will be introduced in the current year to extend the existing relief to include listed foreign government bonds.

Third party backed shares:
Where preference shares are issued which are backed by third party guarantees, the dividends on such shares are taxed as ordinary revenue and not as exempt dividends. An exception to this anti-avoidance provision arises where shares are issued for a "qualifying purpose", for example the acquisition by a BEE shareholder of shares in an operating company.

The "qualifying purpose" exemptions are, in government's view, too narrow and consequently may impede legitimate transactions.

It is consequently proposed that the current exemption from this anti-avoidance provision "be further refined to cover all qualifying purposes". The reference to "all qualifying purposes" presumably means that the intention is to expand the circumstances which would constitute a "qualifying purpose".

Dividend stripping rules:
The Income Tax Act has rules which target dividend stripping avoidance schemes. These rules are intended to deal with the situation where, just prior to the disposal of shares in a company, the controlling shareholder causes the company to declare a large dividend thereby reducing the value of the shares for capital gains tax purposes. Consequently, if a company declares a dividend which is not subject to income tax or dividends withholding tax, the dividend can in certain circumstances be added to the proceeds for capital gains tax purposes on the disposal of that company.

This avoidance rule only applies where the dividend is funded by an amount owing to the acquirer of the shares or a connected person in relation to such acquirer or it is funded by a loan which is guaranteed by the acquirer or a connected person.

Government has identified schemes whereby loans to fund the pre-sale dividend are obtained from third parties other than the acquirer or anyone connected to him. It is consequently proposed that these dividend stripping rules be expanded to cover third-party loans which are used to fund dividend payments prior to the disposal of shares.

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Financial sector issues:
Amendments to section 24JB and tax allowances for doubtful debts for banks -

Section 24JB of the Income Tax Act provides for the taxation of financial instruments based on the mark-to-market principle for banks, certain members of banking groups and brokerage houses. With the transition in the accounting standard for financial instruments from IAS39 to IFRS9 and the resultant changes in the impairment model to be adopted by these financial institutions, the historic SARS directive applicable to registered banks concerning tax allowances for the provision for doubtful debts has recently been the subject of discussion.

The 2017 Budget proposes changes to section 24JB to:

1) follow the accounting treatment prescribed by IFRS9 except with regards to impairment losses since IFRS9 provides for the recognition of impairment losses based on expected future losses as well as incurred losses; and
2) incorporate the principles of the existing SARS directive into section 24JB.

Comment: *The current SARS banking directive is narrow in its application and it is hoped that, with the proposed amendments to section 24JB, the rules for bad debt provisioning be extended to include, for instance, short-term loan providers and similar financial institutions. It is hoped that the rules provide clear guidance for the determination of the doubtful debt provision available for deduction by these institutions and that its determination is not overly complex or administratively burdensome given the proposed departure from accounting principles.*

Amendments to section 8F to override the provisions of section 24JB -

Section 8F of the Income Tax Act is an anti-avoidance provision which deems the interest incurred in respect of the debt instruments which contain equity-like features to be a dividend in specie in certain circumstances. If the borrower is a bank or financial institution subject to section 24JB then, based on current law, one can argue that a deduction of the interest incurred is permissible notwithstanding the provisions of section 8F. It is proposed to introduce an amendment to make it clear that section 8F will override the provisions of section 24JB so as not to permit a tax deduction.

Comment: *The proposal seems appropriate and curbs the potential mismatch which could be exploited by a bank or financial institution subject to section 24JB.*

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Mismatch between debt reduction rules and section 24JB -

In the context of banking group, a mismatch currently exists in certain circumstances with regards to debt reduction rules where a bank or financial institution subject to section 24JB can benefit from a tax deduction for the write off of a debt granted to a fellow group company but the fellow group company is not required to take into account the benefit for tax purposes in terms of paragraph 12A of the Eighth Schedule. The Budget proposal is to prohibit such mismatch.

Comment: *The proposal seems appropriate and curbs the potential mismatch which could be exploited by a bank or financial institution subject to section 24JB.*

Long-term insurers and introduction of Solvency Assessment and Management (SAM) -

The pending introduction of SAM impacting long-term insurers will result in a change in the tax reserving basis for long-term insurers. Whilst a number of tax amendments have been made to date, there are still concerns regarding the application and interpretation of the tax amendments and it is proposed that further amendments be made to address these concerns.

Comment: *It is hoped that National Treasury will continue to engage industry on the matter prior to tax amendments being drafted and tabled before parliament given the complex nature of the determination of a long-term insurer's actuarial reserves.*

Business incentives:

Mining environmental funds -

Section 37A of the Income Tax Act provides for a tax deduction for contributions made to qualifying environmental rehabilitation trusts established by mining companies to satisfy their environmental obligations. Recent changes to environmental legislation has impacted the rehabilitation financial provisioning requirements for mining companies. It is proposed that changes be made to section 37A to take into account the changes in the financial provisioning requirements. It is also proposed that the legislation be tightened to curb potential abuse arising from the use of trust funds for purposes other than rehabilitation.

Comment: *The legislation with regards to rehabilitation trusts is already restrictive which detracts from the use of rehabilitation trusts and results in many mining companies opting rather to use insurance policies to provide financial guarantees for rehabilitation to the Department of Mineral Resources. It is hoped that the amended legislation provides a regime which is simple and provides an incentive for mining companies for complying with their financial obligations for rehabilitation.*

Partial ownership of land donated under land reform initiatives -

It is proposed that amendments be made to the Income Tax Act to provide for a donations tax and capital gains tax exemption for instances of partial land ownership changes pursuant to the Government's land-reform initiatives.

Refinement of venture capital regime -

Government has gradually been making changes to the venture capital company regime to encourage investment in small and medium-sized enterprises. Past amendments have resulted in a substantial increase in venture capital companies. It is proposed that further changes be made to the regime to remove impediments to investment, such as rules relating to investment returns and the qualifying company test.

The scope of relief for international donor funding organizations -

Currently, the Income Tax Act provides an exemption from income tax for "foreign donor funding organizations". The 2017 Budget Review notes that "the tax treatment of these donor organizations is not aligned".

This comment seemingly refers to the fact that such organizations should, from a policy perspective, be exempt from both income tax and withholding taxes and that proposed changes will be made to give effect to this.

Transitional proposals for assisting micro businesses grow into small and medium sized enterprises -

It is proposed to provide transitional measures for micro businesses (being businesses inter alia with an annual turnover of less than R1 million) to migrate to the small business corporation regime (being businesses inter alia with an annual turnover of less than R20 million) so as to provide some relief from unforeseen tax liabilities and administrative penalties on transition.

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Tax implications of acquisition of foreign intellectual property (IP) by South African multinationals

Section 23I of the Income Tax Act was enacted to prevent the erosion of the local tax base by way of South African groups developing IP locally and then assigning such IP to foreign entities in low-tax jurisdictions, followed by the licensing of the IP back to South African taxpayers in return for royalty payments. Section 23I essentially prohibits tax deductions in respect of royalties incurred by South African taxpayers for the use of or right to use such "tainted IP".

It has been acknowledged in the Budget that this anti-avoidance provision may dissuade South African-based groups to develop offshore IP further locally where they would like to do so for purely commercial reasons. Accordingly, a relaxation of the rules will be considered.

Comment: *A moderation of the rules set out in section 23I will be welcomed to the extent that they are too restrictive and discourage legitimate commercial IP development in South Africa.*

Special tax dispensation for foreign investors

It is proposed that a special tax dispensation be introduced for foreign investors who invest in funds in South Africa for onward investment into the rest of Africa and the world.

Comment: *This relief is welcomed as it should make South Africa a more favourable investment location for foreign investors, and particularly as a financial services hub for Africa.*

Tax relief from foreign exchange gains or losses

The concept of a 'domestic treasury management company' was recently introduced to provide relief for certain South African companies from having to recognise foreign exchange gains or losses for tax purposes. However, the criteria to be a domestic treasury management company are thought to be overly restrictive. The Finance Minister has now proposed that these criteria be relaxed.

Comment: *The concession that multinational groups may for tax purposes ignore fluctuations between the Rand and other currencies is welcomed. The proposal to broaden the targeted audience of the relief is also appreciated and will hopefully aid in South Africa becoming a destination of choice for large multinational groups focused on expanding their international presence, particularly in so far as Africa is concerned.*

Offshore foreign trusts and controlled foreign companies

It has been proposed that legislation be introduced to curb the use of offshore trusts and controlled foreign companies which reduce a taxpayer's liability for tax in South Africa.

Comment: *We have some concerns about this proposal, particularly if it is punitive and if it applies too broadly. We note that a similar proposal was made in the 2015 Budget Speech but that no legislation was subsequently introduced.*

South Africa's position on the base erosion and profit shifting (BEPS) project

The Finance Minister acknowledged the work being undertaken by the Davis Committee in general and referred to South Africa's involvement in the BEPS project. South Africa's position on the 15 actions recommended by the OECD/G20 BEPS project is summarised below.

- Digital economy – Foreign multi-nationals rendering electronic services to local customers are already required to register as South African VAT vendors. The regulations are under further review. South Africa is also a member of the Task Force for the Digital Economy which needs to consider direct taxes in the context of the digital economy.

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- Hybrid mismatches – South African tax legislation already has detailed rules deeming dividends on certain shares to be income and deeming interest on hybrid debt instruments to be dividends where appropriate. Further refinements may be considered in future.
- Controlled foreign company (CFC) rules – South Africa has detailed CFC legislation and it was in fact recommended as a model to consider by the other countries.
- Interest deductions – South Africa has implemented detailed legislation to prevent the erosion of the tax base by way of excessive interest deductions. Treasury will review the legislation in light of the OECD proposals and continue its focus on curbing excessive debt financing.
- Harmful tax practices – South Africa took part in the Forum on Harmful Tax Practices and completed a self-review of preferential regimes.
- Treaty abuse – New treaties entered into will comply with the project's minimum standards, while the multilateral instrument (see below) will take care of existing treaties. South Africa has opted to apply the principal purpose test to deal with treaty shopping. In terms thereof, an entity may be denied the benefits of a tax treaty if it is reasonable to conclude that obtaining such benefit was one of the main purposes of entering into any transaction.
- Permanent establishment (PE) status – South Africa will follow the recommendations to prevent entities from artificially avoiding PE status by fragmenting a cohesive business into smaller operations. These preventative measures will be incorporated in future tax treaty negotiations.
- Transfer pricing (TP) – SARS is updating the TP Practice Note in line with the OECD TP Guidelines and the BEPS project and, specifically, the agreed approach to ensure the appropriate pricing of intangibles.
- Data analysis (measuring and monitoring) – South Africa will continue to work with other countries to curb BEPS through improved statistics and evaluation.
- Mandatory disclosure – The South African reportable arrangement rules have been used as a benchmark in the BEPS Action 12 recommendations.
- TP documentation – The regulations on country-by-country reporting and compulsory transfer pricing documentation were gazetted by the Minister last year.
- Dispute resolution – The South African treaty model will be updated to include the minimum standards. South Africa has not committed to mandatory binding mutual agreement procedure arbitration.
- Multilateral instrument – South Africa is among a multitude of countries that have reached consensus on the multilateral instrument, adopted in November 2016, with the aim to incorporate BEPS recommendations into the existing network of bilateral treaties.

Comment: *The David Committee has issued several reports under the BEPS actions, essentially in line with the broader OECD recommendations. In many areas, South Africa already has the legislation in place to address many of the BEPS concerns raised. The regulations on country-by-country reporting and compulsory TP policy documentation have now also been gazetted. It will be interesting to observe new developments on the direct tax regime in the context of the digital economy and the renegotiation of South Africa's tax treaties.*

Exchange Controls

There were four items in the Budget Speech which relate to Exchange Controls. These were as follows:

1) **Capital account management**
It is intended that the National Treasury will undertake a review of its capital flows management framework, which will include Exchange Controls. This review will be against best practice in other developing economies.

Comment: *This is clearly something that will affect the Exchange Controls regime and depending on the outcome and decisions taken, may result in freeing up capital flows in and out of South Africa.*

2) **Inward listing review**
Some years ago Treasury decided to permit inward listings i.e. listings by foreign entities on South African exchanges. It is now intended to revisit this and Treasury will begin a consultation process with interested parties on new inward listings, loops and trusts. The intention is to discourage tax inversion where companies relocate their legal domicile to lower tax jurisdictions while retaining material assets and operations in South Africa.

Comment: *The original inward listing concession had a lukewarm reception and whilst some foreign companies did inward list, the extent thereof was far below expectation.*

There were foreign companies that wanted to inward list but who had South African shareholders making it effectively a loop structure. Measures were put in place to avoid this or conditions were imposed but it was very unattractive for the resident shareholders.

Clearly the intention is now to revisit this and to see where and how inward listing can be encouraged, even with loops and trusts in the mix but without having the so called tax inversion. It will probably take some time before anything firm comes out of these discussions.

3) **Intellectual Property**
It is proposed that companies and individuals will no longer require Reserve Bank approval for standard intellectual property transactions. It is also proposed that the "loop" structure restriction for all intellectual property transactions be lifted provided they are at arm's length and fair market price (loop structures prohibit residents from holding any South African asset directly or indirectly through a non-resident entity).

Comment: *After numerous representations, this matter has at last been addressed. The devil will probably be in the detail as it is not clear what will constitute a "standard intellectual property transaction". However, it does appear that going forward South African residents will be able to export intellectual property and perhaps even licence it back to South Africa. The former was something that required specific approval in the past and the latter something the Reserve Bank consistently declined (see also comments under International tax in this Commentary).*

4) **Exchange traded funds referencing foreign assets**
It is proposed that collective investment scheme management companies, registered and regulated by the appropriate authorities, be permitted to list exchange traded funds referencing foreign assets on South African exchanges. These funds will not be subject to macro-prudential limits on amounts that may be invested offshore. Institutional investors and Authorised Dealers will be able to invest in such funds but subject to their macro-prudential limits. Such funds will be classified as foreign assets for prudential purposes.

Comment: *In the past, collective investment scheme management companies from time to time endeavoured to issue over the counter derivative instruments referencing foreign assets which they then wanted to sell in the local market, often to other institutional investors who then arguably circumvented their prudential limits. This met with resistance from the Reserve Bank. This has clearly been revisited and, in order to control such activity, it was decided to permit the issue thereof but only as an exchange traded fund listed on a local exchange. Clearly issuing such an instrument will not affect the issuer's prudential limit but it will affect that of the purchaser if an institutional investor. It does, however, broaden the investment possibilities for institutional investors.*

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Transitioning interest calculation rules under the Tax Administration Act (TAA)
Amendments are proposed to the transitional provisions contained in the TAA (section 270) to clarify the transitional rules for the calculation of interest on tax debts. At present, the TAA provisions dealing with interest are not as yet effective (interest is currently calculated in terms of the relevant underlying tax Act). Amendments to the transitional provisions are aimed at ensuring that these provisions do not give rise to inconsistencies, or the under or over-accrual of interest.

Decisions by SARS
It is proposed that all decisions of SARS will now be subject to the remedies under Chapter 9 of the TAA (Dispute Resolution), including objection and appeal.

Currently, certain decisions by SARS are not subject to objection or appeal. By way of example, an estimate assessment issued by SARS in terms of section 95 of the TAA is not subject to objection or appeal. The proposed amendment to make all decisions subject to the remedies provided for in the TAA is welcomed as it strengthens the rights of taxpayers.

Accrual of interest payable by SARS
It is proposed that interest payable by SARS (which may accrue over a number of tax years) be deemed to accrue to the recipient on the date of payment thereof by SARS. The amendment is welcomed as it is aimed at reducing the administrative burden on the taxpayer. Taxpayers will consequently not have to reopen prior tax years and account for the interest in the relevant prior tax years.

Low-interest or Interest-free Loans
Amendments are proposed to explicitly exclude the application of the "in duplum" rule to tax rules dealing with low or interest-free loans thereby ensuring that the effectiveness of the tax rules are not frustrated. In terms of the "in duplum" rule interest ceases to accrue on a debt where the total amount of the interest equals the outstanding principal debt.

Approval of Public Benefit organisations (PBOs) receiving Tax-Deductible Donations
An amendment is proposed to the Income Tax Act to confirm the approval process of PBOs receiving tax-deductible donations.

Section 30 of the Act contains detailed provisions for the approval of PBOs, being those organisations inter alia carrying on the public benefit activities listed in Part I of the Ninth Schedule to the Act. The current EI1 application form issued by SARS makes provision for the approval of PBOs carrying on public benefit activities listed in Part I and Part II of the Ninth Schedule. However, only approved PBOs carrying on public benefit activities listed in Part II of the Ninth Schedule may issue s18A certificates entitling donors to an income tax deduction on contributions made. We assume that the proposed changes will be incorporated into section 30 to confirm the current approval process.

Transfer Duty
As mentioned elsewhere in this Commentary, government proposes to raise the duty-free threshold on purchases of residential property from R750 000 to R900 000, effective 1 March 2017. This increase in threshold will provide relief to lower and middle-income households.

Withholding of amounts from payments to non-resident sellers of immovable property
As mentioned elsewhere in this Commentary, rates of withholding tax on payments to non-resident sellers of immovable property will be increased as follows:

- from 5 per cent to 7.5 per cent for individuals,
- from 7.5 per cent to 10 per cent for companies, and
- from 10 per cent to 15 per cent for trusts

The increased rates are aimed at achieving parity with the increased effective capital gains tax rates over the last few years.

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Whilst many South Africans gave a sigh of relief that there will be no change yet to the long standing VAT rate of 14%, there were still a few surprises which may cause a dent in the pockets of most South Africans.

Zero-rating of fuel to be removed
One of the revenue generating areas that government will investigate over the next year is the removal of the zero-rating of fuel in respect of the 2018/19 year of assessment. This means that fuel will become 14% more expensive. Government has committed to look into ways of softening the impact on transport costs by either freezing or decreasing the fuel levy.

Broadening the scope of electronic services
Foreign entities supplying electronic services to South African consumers have been required to register for VAT since 1 June 2014. The Regulation governing the definition of electronic services is being updated to broaden the scope of electronic services as well as remove any uncertainties and practical difficulties. The list of electronic services will now be broadened to include cloud computing and other services which are provided using online applications. This means that a South African consumer will be charged 14% more for certain electronic services that are obtained from a foreign supplier.

There was an undertaking to provide further clarification where the law has not been very clear and more guidance has been required, as well as concessions relating to unfair tax treatment.

Clarifying the VAT treatment on leasehold improvements

It has been proposed that certain amendments be made to the VAT Act (1991) to give effect to the VAT treatment in respect of the time and value of supply of leasehold improvements on leasehold property. To date, the VAT Act has been unclear in respect of the VAT treatment of leasehold improvements which have been made by a lessee to a leasehold property during the period of a lease agreement. Once clarified, vendors should not experience any difficulties in applying the law relating to leasehold improvements.

VAT vendor status of municipalities
Municipalities that were required to be disestablished or merged with other municipalities following the local government elections in August 2016, will be pleased to know that transitional measures will be provided to assist with VAT de-registrations or new VAT registration processes.

Amending the definition of 'Resident in the Republic' for VAT purposes
Foreign entities that are currently "effectively managed" by a South African company fall within the definition of "resident of the Republic" for VAT purposes because of the link to the definition of "resident" in the Income Tax Act. Consequently, these entities are not enjoying any zero-rating benefits relating to supplies of goods or services to them. If the foreign company is not required to be registered for VAT, the VAT that is incurred by the foreign company will become a permanent cost to its business. It has been proposed that the definition of "resident of the Republic" in the VAT Act be amended to provide for such situations which is in keeping with the spirit of the law of being a destination based tax.

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Repealing the 2011 amendment dealing with the value to be placed on Inter-Warehouse sales
It is proposed that an amendment to the VAT Act which was made in 2011 but never implemented due to administrative and compliance complexities, be revoked with retrospective effect. This amendment dealt with the valuation of imported goods that were not entered for home consumption but instead stored in a licensed warehouse, where the payment of VAT and Customs duties were postponed, and subsequently sold to another licensed warehouse. The amendment was to give effect to the value to be placed on the sale of the goods whilst in the warehouse which was the higher of the value of the goods when cleared for home consumption, the actual amount of money paid or the open market value.

Prior to this amendment, the valuation of the goods was deemed to be the lower of these amounts. Vendors will be pleased that they can continue to use the lower value when declaring a supply of goods before they are cleared for home consumption.

Postponing the 2015 amendment dealing with the VAT treatment of the National Housing Programme
Certain amendments that were made to the VAT Act in previous years are only taking effect from 1 April 2017. However, National Treasury and the affected Municipalities are more likely than not only prepared to give effect to the amendment in two years' time. This amendment was to abolish the zero-rating of the supply of goods and services for government's national housing programme.

Clarifying the zero-rating of international travel insurance
Vendors will be pleased to know that further clarity will be provided with respect to the zero-rating of international travel insurance.

There is still uncertainty regarding how far the zero-rating provisions can be extended with respect to the supply of international travel insurance including, for example, whether zero-rated international travel insurance covers a traveler whilst in a hotel room and not actually travelling or where the person is still in his country of departure.

The clarification will be well received by both travelers as well as suppliers of short-term insurers providing international travel insurance.

Clarifying the VAT treatment of services supplied in onnection with particular movable poperty situated in an export country
The tax treatment of services that are supplied directly in connection with "movable property", such as securities and shares, will be clarified. The VAT Act currently allows for the zero-rating of services that are supplied directly in connection with movable property situated in an export country at the time the services are rendered. The uncertainty that vendors are faced with relates to whether securities or shares held in a foreign incorporated company, that are listed on the JSE, could be seen to be movable property situated in an export country.

We look forward to the changes that will be made to the VAT Act which will clarify the tax treatment of these services.

Delinking of diesel fuel levy refunds from the VAT system
Following a comprehensive review of the administration of the diesel fuel levy refund system, government has released a Discussion Paper for public comment. The proposal is to delink the refunds from the VAT system and for the creation of a standalone, simplified diesel fuel levy refund administration system.

Customs & Excise Duties

Introduction
The Minister of Finance announced specific changes, and proposed others, to the current South African Customs and Excise legislation.

These changes, most of which are listed in this document, became effective immediately (unless specified otherwise) upon tabling these proposals in Parliament on 22 February 2017.

Note that simplified product descriptions and dutiable quantities are used below. Readers are advised to refer to the official product classifications and rates, as published by the South African Revenue Service (SARS), when classifying products and applying rates.

Specific Excise Duties

Alcoholic Beverages
The amended rates of Excise duty on alcoholic beverages increase the duty-cost for the final consumer to the following figures:

- Malt beer R 1.47 per 340ml can
- Unfortified wine R 2.71 per 750ml bottle
- Fortified wine R 4.63 per 750ml bottle
- Sparkling wine R 8.60 per 750ml bottle
- Other fermented beverages R1.47 per 340ml bottle
- Spirituous beverages R 56.50 per 750ml bottle

The abovementioned increases are estimated to bring in an additional R1.28 billion in revenue.

Tobacco products
Excise duty on Tobacco increases range between 8% and 9.5%, with the main changes to products listed below:

- Cigarettes R 14.30 per packet of 20
- Cigarette tobacco R 16.07 per 50g
- Pipe tobacco R 4.56 per 25g
- Cigars R 75.86 per 23g

The abovementioned increases are estimated to bring in an additional R656 million in revenue.

Amendments will be considered in the Tax Administration Laws Amendment Act for the marking, tracking and tracing of locally manufactured and imported tobacco products to account for further implementation requirements.

Fuel Taxes

General Fuel Levy
The general fuel levy will increase by 30c / litre (repetition of 2016). From past experience, the bio-diesel fuel levy has always been 50% of the diesel fuel levy. Accordingly, the figures below are based on an assumption that the same percentage increase will incur in 2017, but this is subject to confirmation as no reference to this specific levy has been made.

This will increase the general fuel levy rate to the following figures:

- Petrol R 3.15 per litre
- Diesel R 3.00 per litre
- Bio-diesel R 1.50 per litre

The increase will take effect on the 5 April 2017 and is estimated to bring in an additional R3.2 billion for the upcoming year.

Government will look to expand the VAT base in 2018/19. As mentioned elsewhere in this Commentary, it is proposed that the zero-rating on fuel be removed, subject to consultation leading up to the 2018 Budget. To mitigate the effect of this on transport costs, it has been indicated that government will consider combining this change with either a freeze or a decrease in the fuel levy.

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Road Accident Fund (RAF) levy
The RAF levy will increase by 9c per litre, resulting in a levy of R1.63 per litre. The increase will take effect on 5 April 2017.

No further details were provided in terms of the replacement of RAF with a Road Accident Benefit Scheme as mentioned in the 2016 Budget Speech.

Diesel Refund Administrative System
The 2015 Budget announced a review of the administration of the diesel refund system, including the delinking of the diesel refund system from the VAT system and the creation of a stand-alone diesel refund administration. A discussion paper outlining the options for a simplified administrative system was published for public comment on 15 February 2017. The legislative amendments to give effect to changes to the diesel refund system will be developed following public comment.

Other Taxes

Sugar Tax
In February 2016, government proposed that a tax on sugary beverages be implemented on 1 April 2017. Over the past year, the National Treasury published a draft policy paper and consulted with industry associations and other interested parties on the possible implementation of this tax.

Following this process, the following aspects relating to this proposed tax have been revised:

- A broader World Health Organisation definition will be applied to cover both intrinsic and added sugars in sugary beverages.
- ·The sugar content will remain the base on which the tax is applied because it is well suited to public health goals.
- The proposed tax rate will be 2.1c / gram for sugar content in excess of 4 gram / 100ml for ready-to-drink beverages and 50 per cent of the rate for concentrated beverages.
- Some of the revenue will be used to support health-promotion interventions as part of a strategy to fight non-communicable diseases.

Government has announced that this tax will be implemented as soon as the necessary legislation is approved by Parliament and signed by the President.

Carbon tax
The main aim of the proposed carbon tax is to put a price on the environmental and economic damages caused by excessive emissions of greenhouse gases. A secondary aim is to change the behavior of firms and consumers, encouraging them to use cleaner technology.

The proposed carbon tax and the date of implementation will be considered further in Parliament this year.

The latest developments on the draft Carbon Tax Bill include the following:

- During the first phase of the tax (until 2020), there will be no impact on the price of electricity.
- A revised regulation for the carbon offset allowance, enabling firms to reduce their carbon tax liability, will be published by mid-2017.

General Customs

Disclosure of Trade Statistics
It is proposed that the current legal authorization for the sharing of trade statistics with organs of state be reviewed for its appropriateness and possibly amended.

This guide is based on the Budget proposals tabled in Parliament by the Minister of Finance on 22 February 2017. These proposals are, however, subject to approval by Parliament. The information contained in this guide is for general guidance only and is not intended as a substitute for specific advice in considering the tax effects of particular transactions. While every care has been taken in the compilation of the information contained herein, no liability is accepted for the consequences of any inaccuracies contained in this guide.

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