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RE: ANNEXURE C SUBMISSION FOR THE 2016 BUDGET CYCLE

Provided below are SAIT's comments relating to Annexure C proposals. The proposals contained herein mostly relate to anomalies, but the perceived "policy" impact is noted for consideration. These comments are being sent both to the technical level and the policy level of the National Treasury as a matter of protocol.

GENERAL BUSINESS TAX

1. Hybrid Shares (Section 8EA) – Historic BEE arrangements (effective date relief)

Problem statement

Many section 8EA guarantee arrangements involving black economic empowerment partners fall afoul of section 8EA due to excessive guarantees and obligations the imposed by lenders. Prior to the introduction of section 8EA, these excessive guarantees and obligations were often added simply as a matter of standard practice to make preference shares as equivalent to debt as possible. Many of these BEE preference share arrangements now find themselves trapped (not just the one brought forward to National Treasury and SARS in 2014). The section 8EA charge upon redemption of these preference shares will significantly eliminate any earnings accrued (and can leave BEE investors in a loss situation). The main issue lies with multiple preference share schemes offered by the International Development Corporation (IDC).

An attempt has been made to informally address these issues by reviewing the possibility of simply cancelling the offending guarantees and obligations prior to redemption, but these cancellations give rise to the potential application of the General Anti-Avoidance Rule (GAAR). The issue was taken to the GAAR committee but the official GAAR committee statement was inconclusive. The goal is to remove these BEE schemes from their current tax trap with a clean slate going forward.

Proposed solution

Taxpayers should be allowed to redeem or restructure offending preference share instruments within 12 or 18 month period from the issue of window relief legislation without triggering section 8EA if the preference shares were issued before the effective date of section 8EA (i.e. 1 April 2014). This window period should clean-out the historic problem without adversely exposing Government going forward.

2. Hybrid Shares (Section 8EA) – References to 'Issuer' *(wording)*

Problem Statement

In determining whether an enforcement right or obligation exists in respect of a share, section 8EA(3) provides that no regard must be had to enforcement rights or obligations enforceable against *inter alia*: "any issuer of a preference share if that preference share was issued for a qualifying purpose", any persons who hold more than 20% of the shares in such issuer or any company which forms part of the same group of companies as the issuer.

However, the definition of both 'enforcement right' and 'enforcement obligation' specifically exclude rights or obligations enforceable against the issuer of the preference share concerned. Based on these definitions, where the rights or obligations are enforceable against the issuer of the preference share, section 8EA would not be applicable and an examination of the remainder of the provisions of this section is not required. The references to "issuer" in section 8EA therefore appear redundant.

Proposed Solution

The references in section 8EA(3) to the issuer of the preference shares should be deleted. Alternatively, the definitions of ‘enforcement right’ and ‘enforcement obligation’ require amendment.

3. Hybrid Debt (Section 8F) – Instruments payable on demand (clarification)

Problem Statement

Paragraph (c) of the definition of ‘hybrid debt instrument’ excludes long term connected person loans where the ‘instrument is payable on demand’. In terms of common law, an instrument which does not have a specific repayment term is repayable on demand. However, it is unclear whether the common law position would suffice for purposes of paragraph (c) or whether the section requires that the loan agreement specifically state that the loan is repayable on demand.

Proposed Solution

We recommend that paragraph (c) is amended to specifically state either that “the instrument is payable on demand in terms of contract or otherwise” or that “the instrument is payable on demand in terms of the loan agreement” (depending on the Government’s intention).

4. Hybrid Debt (Section 8F) – Loans made conditional on solvency during periods of distress (factual anomaly)

Problem Statement

If a company is in financial distress, the company may be required to subordinate shareholder loans in order to obtain sign-off of the financial statements by the auditors. To this end, the auditors require the company and its shareholders to enter into a formal subordination agreement. This subordination agreement typically provides that, notwithstanding any terms to the contrary in the loan agreement, the company will not make any payments under the shareholder loan until such time as the assets of the company fairly exceed the liabilities of the company. This condition of payment (i.e. total value of assets cannot fall below liabilities) appears to trigger paragraph (b) of the “hybrid instrument definition” of section 8F(1).

Proposed Solution

We submit this subsequent subordination of shareholder loans should not fall within the hybrid instrument test because the initial loans were valid but temporarily forced into subordination as part of a business rescue attempt to protect the business. To deny deductions for interest payments during this period will only aggravate a deteriorating situation. We submit that these scenarios should be specifically excluded from section 8F via legislation or SARS interpretation.

5. Debt reduction (Section 19) – Enhanced debt relief during economic distress (small policy)

Problem statement

If the debt of a taxpayer is reduced and the debt was expensed for ordinary revenue items or allowance assets, special rules apply under section 19 to reduce attributes (e.g. tax cost) or the trigger is ordinary revenue. Section 19 is fairly new and was intended to supplant the rules for debt cancellation (along with paragraph 12A of the Eighth Schedule, which was intended to address capital expenditure). The purpose of section 19 is to ensure that taxpayers given debt relief are not subsequently burdened with a tax obligation that taxpayers cannot afford. Section 19 effectively replaces the section 8 recoupment regime for many cancellations.

Unlike paragraph 19A, debt cancellation can give rise to taxable income (not just attribute reduction). As a general matter, indebted taxpayers will often have excess loss carryovers so the excess loss carryovers can be used to absorb the income. However, excess losses may not always exist. For instance, a temporary cessation of trading could result in the loss of excess loss carryovers under section 20. In addition, excess debt to be cancelled may occasionally exceed excess loss carryovers. In these scenarios, the burden of tax on debt relief could again arise.

Proposed solution

It is recommended that section 19 mirror paragraph 12A in that attributes should be reduced first and if no attributes remain, no taxable income should arise. In making this suggestion, we are cognisant that debt creation and cancellation could be a potential avoidance area. Therefore, this suggestion is perhaps best limited to scenarios where the debt relief occurs under a formal business rescue process.

6. Limit on Debt Owed to Exempt Persons (Section 23M) – Level of Control (small policy)

Problem Statement

Section 23M limits deductions when interest payments are made to exempt creditors. The purpose of this anti-avoidance rule is to prevent excessive deductions in terms of shareholders who are economically indifferent as to whether instruments held are shares or debt because the nature of the instruments can be changed at will due to the shareholder's level of control. In the base case of concern, a sole shareholder of a company can choose debt or shareholder loans without consequence (and can effectively change the nature of the instruments without economic consequence).

At issue is the level of the ownership test for section 23M. A 50 per cent level is completely insufficient to exercise the kind of control necessary for an exempt party to be indifferent as to whether the interests are shares or debt. A 50 per cent shareholder simply cannot choose and reconfigure these interests in isolation from other shareholders (i.e. lacks the unilateral control to be indifferent as to whether the instrument is a share or debt).

Minimum request: The 50 per cent threshold should at least be changed to a "more than" 50% level as a demonstration of control. This change would match the international standard of other EBITDA cross-border limitation rules.

Note: We again repeat that this test remains a significant challenge for mining companies because companies with mining rights are required to have a minimum 26 per cent minority due to the BEE empowerment codes imposed by the Department of Minerals and Energy. In order to make these rights more affordable, debt is often held by the majority mining company (with preference shares not being an option given their risk to the required BEE percentages). Relief again should be considered in this regard.

7. Company formations (section 42 – Employees receiving shares (wording)

Problem statement

In the case of unlisted companies, valid transfers to a section 42 transfer must either receive a qualifying level of shares (e.g. 10 per cent of the transferee company). The transferor can alternatively receive section 42 treatment if the transferor is a full-time employee of the transferee (as a demonstration of long-term commitment). The purpose of these tests is to ensure that the transferor has a continuing stake in the target company in one form or another so as to justify rollover versus sale (i.e. cash-out) treatment.

The problem stems from the technical language. More precisely, future employees appear to be able to satisfy threshold entry into the provision only if the company will be engaged in rendering a service. This limitation makes no sense. It was intended that the employee should simply be required to be engaged on a full-time basis of rendering services to the company at issue. Stated differently the goal was for the employee to be actively involved in the transferee business / the service or non-service nature of the business is irrelevant.

Proposed solution

The company service requirement should be dropped. The natural person should instead be required to provide services to the transferee company on a full-time basis (as a full-time employee or as full-time contractor).

8. **Share-for-share swaps (section 42 and paragraph 11(2)(l) of the Eighth Schedule) - Return to Historic Paradigm (anomaly)**

Problem statement

The rules for share-for-share swaps have become confused due to multiple amendments. The initial purpose of section 43 was to allow for share-swaps on the same basis as other equity swaps. However, this rule was subject to avoidance and was accordingly curtailed.

The result is a mess. Section 43 applies only to the conversion of Property Unit Trusts into REITs. This amendment probably should apply only to pre-existing Property Unit Trusts and terminated after a certain date. The bigger problem is paragraph 11(2)(l) of the 8th Schedule. The swap of shares in a narrow setting (e.g. subdivision, consolidation and par conversion) treats the event as a non-disposal but fails to account for the base cost in the new shares.

Proposed solution

Paragraph 11(2)(l) should be deleted and the old paragraph 78 should be restored. The old paragraph 78 treated the disposal as a non-event with a rolled-over base cost in the new shares. The base cost of the new shares under paragraph 11(2)(l) conversions is uncertain (and could even be at market value despite the lack of tax imposed on conversion).

9. **Reorganisations (Section 44) – Amalgamations where the debt assumed exceeds the value of the assets transferred (anomaly)**

Problem Statement

The definition of amalgamation transaction in section 44(4)(1) makes no reference to the issue of shares by the resultant company. Moreover, section 44(4) states that the provisions of section 44(2) and 44(3) will not apply to the extent that assets are disposed of in exchange for consideration other than *"an equity share or shares in that resultant company or the assumption of qualifying debt"*. It would therefore appear that the provisions of section 44 could be used to transfer assets to a resultant company solely in exchange for "the assumption of debt".

Proposed Solution

We recommend that the provisions of section 44 expressly require that the shareholders in the amalgamated company must acquire shares in the resultant company as part or whole of the consideration received.

Amalgamations are ultimately transactions where equity interests are being combined. Parties surrendering old shares for consideration that fail to receive new shares in the new amalgamated company cannot be said to be part of the reorganisation. Shares are to be exchange for new shares – not just for the assumption of debt.

FINANCIAL INSTITUTIONS

10. Collateral Arrangements (e.g. sections 22(4B) and (9) & paragraph 11(2)(n) of the 8th Schedule) – Inclusion of debt (small policy)

Problem Statement

In 2015, collateral arrangements were allowed with shares (subject to a 12-month time-frame). More specifically, taxpayers could transfer title to securities without being subject to tax as long as the transfer is economically equivalent to collateral. The purpose of this relief was to provide the banks with flexibility when dealing with the increased BASEL requirements.

The main shortcoming with the amendment is the failure to include government debt and listed company debt within the proposed relief measure. Banks prefer cash as the highest form of margin (i.e. collateral) but cash is scarce in this arena. Therefore, the dominant form of second-level collateral is government debt and listed debt because these forms of debt are the closest equivalent to cash. Government debt is of the highest value, then parastatal debt and then listed company debt as a general matter. Shares are used only in the last instance at a much higher margin cost.

Proposed solution

Government debt and listed company debt should be included within the collateral arrangement relief measures.

11. REITS (Section 25BB) – Liquidating distributions (anomaly)

Problem statement

The REIT rules are generally designed to shift rental income from REITs to investors. The intention was to provide for this shift via a deduction / ordinary revenue system with each REIT subsidiary paying the net operational rent up the chain (i.e. from REIT subsidiaries ultimately to REIT unit holders). Capital gains of commercial and industrial buildings can be disposed free of tax for reinvestment. Capital profits were never intended to be part of the distribution system.

At issue are liquidations of wholly-owned REIT subsidiaries within REIT groups. These REITs should be allowed to liquidate tax-free under section 47. However, because these liquidations fall within the definition of "qualifying distribution" under section 25BB(1), these distributions are deductible for the liquidating payor and generate ordinary revenue for the parent company payee. The deduction is meaningless for the payor because the liquidating company will no longer exist. The ordinary income received by the parent company creates a second problem because this revenue can only be effectively eliminated via a further distribution (meaning that the yield of the capital buildings distributed will have to be removed from the group to eliminate the unintended tax).

The homemade answer to this problem is the use of intra-group sales involving notes. The intra-group sale by a subsidiary is tax-free because REITs are free from capital gains tax. The selling subsidiary receives a note from the parent company in exchange with the note arrangement remaining in perpetuity. The note cannot be removed via a liquidation because the liquidating distribution generates ordinary revenue. Many REIT groups now have multiple "note holding" subsidiaries of this nature.

<u>Proposed solution</u>

REIT section 47 liquidations should be removed from the "qualifying distribution" definition of section 25BB(1). This removal would mean that these dividends would be tax-free (neither deductible for the payor nor includible by the payee).

BUSINESS (INCENTIVES)

12. Section 12P (Exempt Grants) – Double Loss of Tax benefits (Anomaly)

<u>Problem statement</u>

Although the receipt and accrual of grants is technically described as exempt, the relief is more akin to deferral. We note that mere deferral is a far cry from exemption because the loss of tax attributes may, in unique circumstance, be too high a price to be paid for the exemption. Others find the complexity (and resultant uncertainty) of tracing the exemption to tax attribute reduction as burdensome.

Proposed solution

We request that section 12P be optional so taxpayers can avoid the risk of attribute or the complexity of the relief if so desired.

Problem Audits

In making this suggestion, we note that certain SARS auditors are taking positions that could result in a double loss of tax attributes as a price for the exemption.

Example: Facts. Manufacturer undertakes a training programme which is funded by 11th Schedule exempt grants. The training costs R500 000 and the grant covers these costs.

Outcome. Some SARS audit officers take the position that the section 11(a) deductions for training are denied because the training is aimed at the grants (exempt income). The tax attributes of the taxpayer are additionally reduced due to the section 12P tax attribute reduction rules. It should be noted that we believe that the section 11(a) deductions should be allowed because the training objective is ultimately intended to generate business revenue (as opposed to receiving the grant). However, if this harsh view potentially exists, many would simply prefer to accept the grant as taxable without have to face the possible denial of section 11(a) deductions along with the section 12P loss in tax attributes. We would also suggest that this issue be clarified by way of SARS interpretation.

13. Special Economic Zones (Section 12R) – Domestic Connected Person Sales (Practical anomaly)

Problem Statement

Taxpayers operating within special economic zones receive a 15 per cent rate in lieu of the normal 28 per cent rate. In order for a company to qualify for this lower rate, the company must generate 90 per cent of its income from the zone (amongst other requirements). The 2015 tax amendment act further requires that no more than 20 per cent of the transactions take place with local resident companies or local permanent establishments of foreign companies.

While the anti-avoidance concern has legitimacy, the anti-connected person rule fails to take into account business realities. Larger local businesses will often use this zone as a single business activity within a local supply chain. A domestic subsidiary will be formed for the new operation to utilise the zone for tax purposes (pursuant to the 90 per cent local activity rule), which will generally be an extension of an existing business as opposed to a stand-alone operation. The net result is that integrated chain zone businesses of this kind will no longer qualify for the incentive.

Proposed solution

The 20 per cent test should be dropped. The SEZ company should be subject to transfer pricing rules in respect of both domestic and foreign connected person transactions.

14. Research & Development (Section 11D) – Timing of Requests (administrative)

Problem statement

Taxpayers need more time to initiate the process for the R&D deduction. Many R&D processes occur within ongoing projects in larger companies and co-ordination with the tax department is often lacking. Smaller businesses and entrepreneurs may be aware of the tax incentive but often fail to properly co-ordinate with their tax advisor until after tax year-end when returns are due. Therefore, the deduction should be arguably allowed even before application.

Proposed solution

One potential solution is to allow for an applicant to apply after-the-fact as long as the application is lodged by close of financial/tax year-end (this mirrors closely with the "old" R&D tax incentive). This approach has the advantage of still demanding speedy information from taxpayers while not labouring taxpayers unduly with an overly strict pre-approval approach.

15. Research & Development (Section 11D) – Size of Committee (administrative)

Problem Statement

The Committee process is far too cumbersome in part due to the unwieldy size of the committee.

The number of Committee members (7) is simply too large, meaning that the regularity of meetings is harder to obtain for quorums and decision-making is far too protracted. A smaller number of members should suffice without any reduction in analysis (especially given the Ministerial oversight).

Proposed solution

The committee members required should be reduced to two members – one from DST and one from SARS. National Treasury should be involved only if a split vote arises (i.e. removing National Treasury from day-to-day operations, leaving only policy involvement). This reduction would reduce the restraint on resources and allow for multiple committees if desired.

BUSINESS (MINING)

16. Mining CAPEX (Section 36) – Ongoing Environmental rehabilitation (anomaly)

Relief for environmental expenditure is spotty. A specific regime exists for deductible payments to a closure rehabilitation trust / company with the regime effectively acting as a semi-government controlled deductible reserve. Environmental rehabilitation that occurs during the life of a mine may also be deductible under section 11(a) as long as the costs are not of capital in nature.

However, mining environmental tax relief does not apply to environment treatment, recycling and waste disposal assets (see paragraph (e) of the section 36(11) "capital expenditure" definition) utilised during the existence of mining operations. Ongoing environmental expenditure should be encouraged as opposed to delayed reclamation.

Proposed solution

We would suggest that these capital expenditures be allowed at 100 per cent subject to ring-fencing under section 36 at least on par with CAPEX environmental expenditure for manufacturing (see section 37B).

17. Mining CAPEX (Section 36) - Social and labour plan infrastructure (small policy)

Problem statement

The Mineral and Petroleum Resources Development Act requires mining companies to undertake a social and labour plan as a condition for acquiring and maintaining mining licenses. The purpose of these plans is to uplift the local community (including the upliftment of employees) or even to migrate a local community to a different area. These plans require financial commitments that can be recurring or of a capital nature. Capital expenditure for the benefit of the community includes roads, schools, community centres and sewage/water treatment facilities.

Ongoing expenditures will typically be deductible under section 11(a) via case law (see the *Warner Lambert* decision, which involved expenditure required by the Sullivan principles) and should be deductible as a concomitant business expenses. At issue is social capital expenditure. Capital expenditure can only be deductible at a 10 per cent per annum rate to the extent that the expenditure falls under paragraph (d) of the section 36(11) "capital expenditure" definition. These expenditures must be directed mainly toward employees or to facilitate mineral expenditure. All other social and labour plan capital expenditures are simply not deductible (see paragraph (e) of the section 36(11) "capital expenditure" definition).

We do not believe that capital expenditure required by social and labour upliftment should be treated less favourably in tax terms. These costs are an involuntary imposition by government and effectively operate as a "quasi-tax" or as sunken costs for a mineral license with the denial of a deduction acting as an implicit double tax. Most capital expenditure license costs are fully deductible (see paragraph (e) of the section 36(11) "capital expenditure" definition) and social / labour capital expenditure should be seen in the same light.

Proposed solution

We would accordingly request that capital expenditure for mining social and labour plans be treated as akin to all other ancillary employee / community mineral capital expenditure. Therefore, the 10 per cent spread of paragraph (d) of the capital expenditure should be expanded to include all social and labour plan costs as opposed to the limited items currently selected.

PUBLIC BENEFIT ORGANISATIONS

18. NPOs and wealth taxes (policy)

Problem statement

Many non-profit organisations fail to achieve public benefit organisational status under section 30 due to a lack of administrative compliance due to size or need. These organisations may not generate sufficient funds to require exemption or do not see the strong necessity of obtaining tax-deductible donation status. Some non-profits are engaged in altruism falling outside the neat confines of the 9^{th} Schedule (such as non-profit mechanisms for empowerment entrepreneurs).

Although these non-profits may not be interested in pursuing exemption or tax-deductible donation status, donors may be discouraged by taxes that encumber their donations. These additional charges specially include the Donations Tax and the Estate Duty.

Proposed solution

Payments to non-profits under the Non-Profit Organisation Act but outside section 30 should still be free from Donations Tax and Estate Duty.

INTERNATIONAL

19. Deductible foreign taxes (section 6quat(1C)) – Foreign extractive royalties (wording)

Problem Statement

As a general matter, foreign taxes are deductible. However, this deduction does not extend to foreign mineral and oil royalties due to the narrow definition contained in section 6quat(3) (which specifically excludes foreign mineral and oil royalties). While this exclusion makes sense in respect of rebates (i.e. credits), foreign royalties should be deductible. Taxpayers are presumably taking this deduction under section 11(a) (but see section 23B).

Proposed solution

The exclusion of mineral and oil royalties from the "taxes on income" definition contained in section 6quat(3) should be limite

20. Deductible foreign taxes (section 6quat(1D)) – loss of carryovers (small policy)

Problem statement

Given the recent changes to the Income Tax concerning foreign tax payments, foreign taxes may only be deductible (versus the eligibility for rebates), especially in regards to certain African withholding taxes. As discussed many times before, these withholding taxes can leave certain cross-border operations at a loss because of the gross nature of these charges.

However, these excess losses are wasted due to the existence of section 6quat(1D). This subsection simply eliminates the excess losses. We see no reason for this limitation. While we understand that international practice limits credits in one form or another, we see no precedent for a limitation in respect of the deductions.

Proposed solution

It is proposed that section 6quat(1D) be deleted in its entirety (or at least in respect of companies).

21. Cross-Border Interest Withholding (section 50D) – Collective Investment Scheme Debt (Anomaly)

Problem Statement

Interest payments by collective investment schemes do not receive exemption from withholding tax. This exemption was previously removed as superfluous. It was assumed that the flow-through nature of the collective investment scheme meant that the underlying items (e.g. government and listed debt) held by the entity would similarly result in exemption automatically.

The problem is that the "payment" focus does not technically flow-through in the case of collective investment schemes. Income flows-through only from a receipt and accrual perspective – no precedent exists for this flow-through in respect of a "payment" focus.

Proposed solution

Payments by collective investment schemes should be exempt from cross-border holding in respect of the underlying items that would otherwise be exempt as a matter of fair competition. In the very least, government bond and listed bond interest paid by a collective investment scheme should be exempt.

22. Cross-Border Interest Withholding (Section 50D) - Parastatal Debt (policy)

Problem statement

At present, interest from government debt is exempt from cross-border withholding. This exemption applies in respect of debt owned by all three-tiers of government. However, this exemption does not apply to the parastatal debt.

We question whether this policy makes sense given the strong need of debt funding required by the parastatals, especially in a global funding landscape that is steadily becoming more and more difficult. Withholding taxes as applied to parastatals will only increase the cost of debt funding, including the corresponding Government guarantees.

Admittedly, many tax treaties exist to eliminate these interest charges. However, treaty countries such as Germany and Japan limit the withholding rate to 10 per cent (not to zero). In addition, plans exist to eliminate the 0 per cent treaty rate for interest in respect of certain countries.

Proposed solution

Companies that are directly or indirectly owned by any of the three tiers of Government should be exempt for the cross-border withholding tax.

23. Foreign currency (section 24I) – Currency derivatives (anomaly)

Problem Statement

The definitions associated with foreign currency mark-to-market taxation are outdated, especially in terms of derivatives. The rules only list "forward exchange contracts" and "foreign currency option contracts" – not all foreign derivatives in a modern IFRS sense (see section 24JB). Although it could be argued that the terms "forward exchange contracts" and "foreign currency option contracts" are defined expansively, the gap has left unnecessary room for interpretation that largely works to the detriment of the Government. All of these instruments, especially hedges, need to be squarely within the definition.

Proposed solution

The terms "forward exchange contracts" and "foreign currency option contracts" should be replaced. The revised definitions should directly refer to derivatives under section 24JB. All value changes should be taxed accordingly without regard to special rules (similar to section 24JB). *Query:* What is the overlap between section 24I and section 24JB?

24. Foreign currency (section 24I) – Currency hedges against non-currency assets

Problem statement

The currency rules do not adequately address the problem of currency hedges against non-currency financial assets (e.g. shares). The result is a mismatch, where the currency gain or loss is taken into account without a corresponding connection to the underlying. This mismatch can be hindrance to legitimate cross-border transactions because a proper hedge of this nature could be undermined by tax falling on an economically neutral situation. This mismatch can also be used to create artificial losses.

Proposed solutions

Currency items hedges against non-currency items for purposes of IFRS should be excluded from section 24I.

VALUE-ADDED TAX (proposals stem from prior submissions made earlier in the year)

25. Cash-basis (Section 15 of the VAT) – Small Business Companies (policy)

Problem Statement

Section 15(2)(b) allows only natural persons (and unincorporated bodies of persons) to register on the cash payments basis. It is submitted that section 15(2)(b) should be extended to incorporated persons (e.g. companies), especially small businesses.

Numerous small businesses are struggling to maintain positive cash flows. Accounting for output tax on the invoice basis only worsens the situation because VAT is often payable long before the underlying cash yield is received. Accounting for VAT on the invoice basis is especially problematic for vendors who render goods or services to government and to large businesses that insist on extended credit terms. Government can take as long as two years to pay for tenders. Even large private firms often take as long as 90-to-120 days to make payment (e.g. it is not unheard of for some larger companies to use their leverage with smaller contractors to delay payment). It is further submitted that the invoice basis places a substantial compliance burden on small businesses who often rely on cash-flows (as opposed to invoice accounting) in order to run their daily businesses.

Proposed solution

It is proposed that the relief of section 15(2)(b) be extended to incorporated entities. Many small business entrepreneurs form companies to reduce risk or as a viable form of operation to obtain tenders. The proposed expansion would be of great assistance to many small businesses.

To curb avoidance, transfers between connected persons should remain on an invoice basis if one of the persons that are party to the supply operates an invoice basis. In addition, it is proposed that companies registered on the payments basis must still account for output tax on the invoice basis (despite the payment basis registration) should the value of a single item exceed R100 000. This limit would match the R100 000 limit for natural persons and unincorporated bodies (section 15(2A)). It is further submitted that section 22(3) would adequately address any avoidance that may occur by forcing recipients registered on the invoice basis to account for output tax if those recipients have not been paid to the supplier registered on the payments basis within 12 months.

26. Transfers of partnership interests (section 51) – Deemed Dual Levels (anomaly)

Problem statement

Upon close examination, two issues exist when transferring partnership interests (e.g. ownership of unincorporated enterprises). Firstly, while section 51 recognises the business of a partnership as a separate enterprise, the relationship of the partners to the partnership is unclear. Secondly, partnership enterprises that are transformed into an independent branch do so without relief.

Section 51 seeks to make the transfer of a partnership (e.g. unincorporated persons) equivalent to the sale of a company but does so only at one level. Under section 51(2), the transfer of a partnership interest has no impact on the taxable enterprise of the partnership as long as two or more partners remain and the partnership enterprise actively continues. This continuation mirrors the impact of the transfer of shares in a company. The question is what rights are being transferred – underlying partnership assets or the partnership interests.

> *Company Share Transfer Example:* Shareholders X, Y and Z each own 100 ordinary shares in a company, and the company is engaged in a manufacturing enterprise. Shareholder X sells all 100 ordinary shares to Shareholder T. Under basic VAT principles, the manufacturing enterprise carries on as before. Shareholder X is viewed as selling a financial service (section 2(1)(d) of the VAT Act), which constitutes an exempt supply (section 12(1)(a) of the VAT Act).

> *Partnership Transfer:* Partners A, B and C each own interests in a partnership amounting to 1/3rd each. The partnership is engaged in a retail enterprise. Partner A sells all of its 1/3rd interest in the partnership to Partner T. Under section 51(2) of the VAT Act, the manufacturing enterprise carries on as before. However, for purposes of the VAT Act, what is Partner A selling – the partnership interest or 1/3rd of the partnership assets?

Proposed solution

In order for the supply of a partnership interest to be truly equivalent to the supply of a company interest (i.e. shares), the supply should be viewed as financial service (i.e. an exempt supply) – not the supply of a proportion of underlying partnership assets. Given that section 51 views the partnership enterprise as something separate from the partners, the partners should be viewed as holding and transferring partnership interests (much like the holder and transferor of shares in a company).

27. Transfers of partnership interests (section 51) – Terminations (anomaly)

Problem statement

Many partnership transfers have no bearing on the continuance of the partnership enterprise because the partnership maintains two or more partners. However, certain transfers can reduce partnership interests to a single owner, thereby converting the partnership into a branch. This conversion to a single owner triggers VAT even if the underlying business remains operating as before.

> *Partnership Transfers:* Holding Company owns all the shares of Subsidiary M and Subsidiary N. Subsidiary M and N each own 50 per cent of the interest of Partnership, the latter of which engages in a manufacturing enterprise. Subsidiary M transfers all of its 50 per cent interest in Partnership to Subsidiary N. Partnership automatically dissolves once all partnership interests are held by Subsidiary N, thereby converting the partnership enterprise into a branch. Section 51(2) does not apply to the overall transaction because only one partner remains.

Proposed solution

The conversion of a partnership to a branch should be viewed as a continuation under section 51(2). No VAT should apply.

28. Educational services (section 12)

Problem statement

The rules around education create an institution versus service bias. More specifically,

> "the supply by a school, university, technicon or college solely or mainly for the benefit of its learners or students of goods or services (including domestic goods and services) necessary for and subordinate and incidental to the supply of services referred to in sub-paragraph (i) of this paragraph, <u>if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging</u>." (emphasis added)

It is evident that the exemption applies to educational services supplied by registered educational institution (i.e. registered in terms of applicable acts). In practice, it is common cause for schools, universities, colleges and technicons to additionally provide other educational services that are not accredited in terms of any act. These educational courses are similar to those provided by other companies and institutions, the latter of which are not registered as schools or higher educational institutions. The net result is an uneven playing field. The VAT Act generally exempts specific types of supplies as opposed to specific persons making those supplies.

It is questionable why the focus in this instance falls on the nature of the institution as opposed to the nature the education provided. The rules should be based solely on the educational services provided without regard to the nature of the institution.

Secondly, section 12h(ii) also exempts from VAT the supply of goods or services which are necessary for (and subordinate and incidental to) the supply of any educational services by the above institutions. However, the exemption applies only if the goods or services are supplied for a consideration in the form of school fees or tuition fees. Schools, universities, colleges and technicons most often supply services which are necessary for, subordinate and incidental to the supply of the actual educational services for a consideration that is distinctly separate from the school fees or tuition fees. These amounts include registration fees, re-marking fees etc. This technical separation often leaves these latter education services in a taxable position (even though these fees are integral to the tuition charge despite the formal separation per the invoice). No reason exists to penalise these ancillary services solely based on form.

Thirdly, the exemption applies to domestic goods / services supplied solely or mainly for the benefit of students and learners if the goods / services are supplied for a consideration in the form of payment for board <u>and</u> lodging. The term "board and lodging" implies that both food and accommodation need to be supplied –

the supply of food or lodging in isolation is insufficient. Currently, most institutions supply lodging only, with separate canteen facilities should students wish to buy meals.

Please do not hesitate to contact us should you have any further queries.

Yours sincerely,

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