24 November 2016

The National Treasury

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The South African Revenue Service

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RE: ANNEXURE C FOR 2017 BUDGET: COMMENTS PERTAINING TO PERSONAL INCOME TAX ISSUES

We have attached the comments from the SAIT Personal Income Tax Work Group on the Annexure C tax proposals for the 2017 Budget pertaining to key personal income tax issues. We appreciate the opportunity to participate in the process and would welcome further dialogue.

Please do not hesitate to contact us should you need further information.

Yours sincerely

Jaco La Grange

Chair of the Personal Income Tax Work Group

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PERSONAL INCOME TAX

1. LOAN OR CREDIT ADVANCED TO A TRUST BY A CONNECTED PERSON – DEEMED DONATION

Legal nature of the problem and the detailed factual description of the relevant transaction

The proposed section 7C(3), as per the **Taxation Laws Amendment Bill, 2016** (TLAB2016), states that the determined amount must, for purposes of Part V of Chapter II (which deals with donations tax) "*be treated as a donation made to that trust*".

A donation is defined in section 55 of the **Income Tax Act, 1962** (ITA) to mean "*any gratuitous disposal of property including any gratuitous waiver or renunciation of a right*." In terms of section 54, donations tax is "*…paid…on the value of any property disposed of…under any donation by a resident…*". The donations tax is subject to exemptions contained in section 56 which stipulates the instances where "*donations tax shall not be payable in respect of the value of any property which is disposed of under a donation - …*" It is not totally clear based on the wording of the proposed section 7C(3) read with these donations tax sections, that an amount that is treated as a donation will be properly regarded as property disposed of for purposes of the donations tax.

Proposed solution / recommendation

We recommend that the wording of the proposed section 7C(3) be clarified along the lines of the amount determined will "*be treated as the value of the property disposed of under a donation*".

2. SECTION 9HA AND SECTION 25

Legal nature of the problem and the detailed factual description of the relevant transaction

The amendments that took effect on 1 March 2016, had the effect of a significant increase in the normal tax payable at date of death. This followed from, as was explained in the Explanatory Memorandum, the principle that "*gains and losses of whatever nature will, in terms of the unified rules, be triggered on a person's death with the current exceptions being preserved*." It was further explained that "*subsequently, income received by or accrued to the deceased estate will be taxed in the hands of the deceased estate and roll-over relief will be provided in respect of transfers from the deceased estate to any heir or legatee.*"

In the SARS CGT guide it is mentioned that the "*amendments will impact on persons holding allowance assets, trading stock, livestock and produce on date of death and on the need to register deceased estates for tax purposes.*" One of the main reasons for the increase in the tax at date of death is the new treatment of trading stock, livestock and produce at hand at date of death.

The position before 1 March 2016, was that the capital gain at death was the difference between the tax value of trading stock, the standard value of livestock and the fair and reasonable value of produce and its market value (which constitutes proceeds for capital gain purposes). It is therefore only included in taxable income to the extent of the inclusion rate applicable at the time of death.

After 1 March 2016, the market value at date of death is included in income and the difference is included in taxable income in full.

The same principle applies, to a lesser extent, to allowance assets (or assets qualifying for depreciation allowances).

Proposed solution / recommendation

It is submitted that the transfer of the assets from the deceased to his or her deceased estate, is essentially a transfer between connected persons. It is therefore recommended that the transfer of trading stock livestock and produce at hand at date of death be done at its relevant tax values. The inclusion in normal income must then happen in the estate when the property is disposed of by the executor, or transferred to the heirs.

3. SECTION 23(M) – DEDUCTION OF COST OF TRAINING PAID FOR BY EMPLOYEES FROM THEIR OWN POCKETS

Legal nature of the problem and the detailed factual description of the relevant transaction

Section 10(1)(q) of the ITA provides an exemption in respect of any *bona fide* scholarship or bursary granted to an employee by his/her employer (subject to certain conditions).

However, should said expenditure not be settled in such a manner but incurred by an employee, he/she will not be able to claim a deduction in consequence of the provisions of section 23(m) of the ITA.

Since most professional bodies require continued professional development / training on an annual basis in order to maintain membership, the inability to deduct related expenditure creates a discrepancy between the situation where expenditure is funded by employers and one where this is not the case.

Proposed solution / recommendation

It is submitted that deductible training/education expenses relating to an individual's trade be exempted from the application of section 23(m) of the ITA.

4. CLAUSE 5(C) OF THE TAX ADMINISTRATION LAWS AMENDMENT BILL, 2016 – THE DEFINITION OF "REMUNERATION" IN PARAGRAPH 1 OF THE FOURTH SCHEDULE TO THE ITA: INCLUSION IN REMUNERATION (OVERSIGHT)

Legal nature of the problem and the detailed factual description of the relevant transaction

The proposed amendment causes dividends, contemplated in paragraphs (dd), (ii), and (jj) of the proviso to section 10(1)(k)(i) of the ITA, to be included in remuneration. SARS, and all employers (and related parties) in the case of these dividends could be impacted.

We understand that the removal of this proposed amendment from the TALAB was an oversight.

Proposed solution / recommendation

We recommend that the specific dividends not be included in remuneration.

5. RESIDENTIAL ACCOMMODATION – CAPPED DEDUCTION

Legal nature of the problem and the detailed factual description of the relevant transaction

In accordance with paragraph 9(7A) of the Seventh Schedule to the ITA, a taxable benefit arises in respect of residential accommodation provided by an employer to an employee. The taxable benefit arises when the employee has been provided with residential accommodation either free or charge or for a rental consideration payable by the employee that is less than its rental value as determined in the legislated provisions dealing with the taxation of benefits provided by an employer to an employee.

With regard to accommodation provided to foreign nationals working in South Africa, accommodation provided by an employer to an employee whose usual place of residence may result in a nil value benefit for a period of 24 months, to the extent the value of the taxable benefit derived from the occupation of the residential accommodation does not exceed **R 25 000** per month.

The monetary cap of R 25 000 per month was introduced in 2008. Since then there has been an increase in property rentals, which, together with the fact that the taxable value of benefits provided to expatriate employees is usually borne by employers (thereby creating a further taxable benefit (being a tax gross-up), has materially lessened the impact of said exempt amount.

Proposed solution / recommendation

The monetary deduction value of R 25 000 per month should be reviewed to take into account property rental increases.

6. SECTION 11(K) AND PARAGRAPH (2A) OF THE SEVENTH SCHEDULE TO THE ITA

Legal nature of the problem and the detailed factual description of the relevant transaction

Nature of 'employer' & 'employee'

As proposed in the TLAB2016, in terms of a new paragraph (2A) of the Seventh Schedule to the ITA, and for the purposes of paragraph 2 of said Schedule, a partner will be deemed to be an employee of the partnership.

In SAIT's previous comments to this insertion it was stated that "*there is specific concern that this may have other consequences on partners in general. It would cause problems with other taxable benefits where the partner is not, at common law, an employee of the partnership*."

SAIT felt that as the purpose of this amendment is to provide "*clarity that for purposes of the application of fringe benefit tax" in the context of contributions to funds, the suggestion is that the clause should only apply for purposes of paragraph 12D.*"

One of the requirements in the definition of 'employer' in paragraph 1 of the Seventh Schedule and also in the Fourth Schedule, is that the 'employer' must be a person. Judge Cloete (in Chipkin (Natal) (Pty) Limited v CSARS) said that "*the definition of 'person' in s 1 does not include a partnership and a partnership is not a person at common law.*"

Paragraph 2, of the Seventh Schedule, applies where a taxable benefit has been granted by an employer to his employee in respect of the employee's employment with the employer. As the individual partner is not an employee in employment with the partnership (employer), one of the requirements for the paragraph to apply is not present.

It is accepted that section 11(k)(i)(bb), which allows as a deduction, 27,5 per cent of the higher of the person's –

(A) remuneration (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as defined in paragraph 1 of the Fourth Schedule;

(B) taxable income …

It is not clear why it was necessary to introduce paragraph 2A in the Seventh Schedule.

In terms of proviso (iv) of this sub-section then and for the purposes of this sub-section, a partner in a partnership must be deemed to be an employee of the partnership and a partnership must be deemed to be the employer of the partners in that partnership;

The reason, in our view, why this was done is found in proviso (iii) to section 11(k). It provides that any amount contributed by an employer of the person for the benefit of the person must, to the extent that the amount has been included in the income of the person as a taxable benefit in terms of the Seventh Schedule, be deemed to have been contributed by the person.

The problem is that for most, if not all, partners, the section 11(k) deduction will be based on their taxable income, rather than on their remuneration. This is simply because a partner doesn't derive remuneration in employment form the partnership.

SAIT acknowledges that the portion of the amount contributed by the partnership should be available to the partner concerned for purposes of section 11(k). The inclusion thereof in the Seventh Schedule is not the correct way to achieve this.

Withholding of employees' tax (PAYE)

In addition, an 'employer' is defined in the Fourth Schedule to include any person who pays or is liable to pay any person any amount by way of 'remuneration', and any person responsible for the payment of any amount by way of remuneration to any person under the provisions of any law.

Paragraph 2(1) of the Fourth Schedule places an obligation on an "employer" who is a resident of South Africa or a representative employer in the case of an employer who is not a resident, to withhold employees' tax from any amount which the employer pays or becomes liable to pay to an "employee" by way of "remuneration", unless SARS grants an alternative authority.

The definition of 'remuneration' contained in the Fourth Schedule includes any amount required to be included in paragraph (i) of the gross income definition, but excludes the taxable benefit arising from the right of use of motor vehicle, read with paragraph 2 of the Seventh Schedule.

In this regard, should a partner be regarded as an 'employee' of such partnership, the three elements (i.e. an employer, an employee and the payment of remuneration), will be present in order for an employees' tax withholding obligation to exist for the partnership.

In other words, to the extent the partnership provides any benefit or advantage to the employee such as the use of residential accommodation to the partner or provides any other benefit as envisaged in paragraph 2 of the Seventh Schedule (other than the right of use of a motor vehicle), such partnership will be required to register as an employer for the purpose of withholding and remitting employees' tax in respect of certain benefits it provides to the partners.

This will result in a significant administrative burden for the partnership to register as an employer in these circumstances.

Proposed solution / recommendation

It is proposed that section 11(k) should be amended: Proviso (iii), of section 11(k), should apply to an employee in the normal sense of the word and a new proviso should be added to cater for the contributions envisaged in proviso (iv). This proviso should state that the contributions envisaged in proviso (iv) should be deemed to have been contributed by the partner.

To the extent that the above is not acceded to, SAIT proposes that, to avoid the situation where a partnership is obliged to register as an employer for the purpose of withholding and remitting employees' tax in respect of certain benefits enjoyed by the partners, the wording of the new paragraph 2A in the Seventh Schedule be reworded to suggest that the partner is deemed an employee for the purpose of subparagraphs 2(k) and 2(l) of the Seventh Schedule, which deals with contributions made by the partnership to a pension, provident or retirement fund on behalf of the respective partners, but not for employees' tax purposes.

7. INTRODUCTION OF PARAGRAPH 19(6) TO THE FOURTH SCHEDULE DEALING WITH ESTIMATION OF PROVISIONAL TAX

Legal nature of the problem and the detailed factual description of the relevant transaction

Inclusion of paragraph 19(6) to the Fourth Schedule provides that if a provisional taxpayer has not submitted an estimate **four months** after the last day of the year of assessment (i.e. by 30 June each year for individuals with a February year-end), such taxpayer will be deemed to have submitted a nil estimate for the purposes of paragraph 20.

Paragraph 20 dealing with the penal provisions relating to the underestimation of provisional tax, makes reference to the final or last estimate of taxable income.

The revised wording of both paragraphs 19 and 20 do not clarify the following specific aspects:

(a) Timing of the levying of the paragraph 20 penalties in the case of underestimations – i.e. whether the penalties envisaged in paragraph 20 will only be levied after June each year, i.e. four months after the end of the year of assessment when the final tax estimate is due or whether the penalty will be levied at the end of February when the second provisional tax return and payment is due;
(b) Where the taxpayer submits an estimate at the end of February and fails to submit a last estimate in June, will the February submission and payment not be considered when determining the paragraph 20 penalty?
(c) Whether the extension of the window period to June, removes the requirement to submit a third provisional tax return (7 months after tax year-end).
(d) Practical aspects of submitting a last estimate in June each year, i.e. will there be a separate return/Form IRP6 for this purpose with relevant payment reference and identification details.

Proposed solution / recommendation

The wording of the legislation contained in paragraph 20 should be clarified to indicate the positions referenced in (a) – (b). A draft guide should be issued to cover the practical aspects detailed in (d) above.

8. PROVISIONAL TAX THRESHOLD

Legal nature of the problem and the detailed factual description of the relevant transaction

The definition of "provisional taxpayer" has been amended in 2016 to include –

"(a) any person (other than a company) who derives income by way of –

(i) any remuneration from an employer that is not registered in terms of paragraph 15"

but excluding (ito para (dd)(B)) any natural person who does not derive any income from the carrying on of any business, if –

…(BB) the taxable income of that person for the relevant year of assessment which is derived from interest, dividends, foreign dividends, rental from the letting of fixed property and any remuneration from an employer that is not registered in terms of paragraph 15 does not exceed R30 000”.

The inclusion could affect a number of individuals who earn remuneration from, say, household employers.

Proposed solution / recommendation

It is suggested that would it not be more practical to amend the threshold in the exemption to be equal tax threshold.

9. CLAUSE 69(A) OF THE TLAB2016: DEFINITION OF "RETIREMENT FUNDING INCOME" IN PARAGRAPH 12D OF THE SEVENTH SCHEDULE - RETROSPECTIVE APPLICATION

Legal nature of the problem and the detailed factual description of the relevant transaction

The effective date for the proposed changes in terms of clause 69(a) is 1 March 2016. We submit that the retrospective effect would result in practical problems with payrolls already having been run and employees' tax payments having been made to SARS. The resultant interest and penalties could not be justified as being fair under the circumstances.

Proposed solution / recommendation

We propose that the amendment only be effective from 1 March 2017 in order to allow employers (and payrolls) to adequately address the matter and process the fringe benefit in the correct period.

10. PARAGRAPH 10 OF THE EIGHTH SCHEDULE TO THE ITA

Legal nature of the problem and the detailed factual description of the relevant transaction

Since 2001, the inclusion rates have increased significantly without any adjustment for the inflationary effect on the capital gain itself.

The inclusion rate for capital gains, in order to arrive at a taxable capital gain, was set at a low percentage when the tax on capital gains was introduced. In a briefing by the National Treasury's Tax Policy Chief Directorate to the Portfolio and Select Committees on Finance (Wednesday, 24 January 2001), it was stated that:

> *"The capital gains will not be indexed for inflation. The combined benefits of the 'low inclusion rate' and deferring accrued capital gains until realisation should more than compensate for the effects of inflation in a moderate-inflation environment."*
>
> And
>
> *"… the potential impact of inflation was one of a number of considerations (though not the primary factor) that informed the decisions to have moderate (low) "inclusion rates" of capital gains in taxable income, thereby partially adjusting for inflation."*

Capital assets, by their very nature would be assets held by the taxpayer for a longer period. It is clear, form the above, that the use of an inclusion rate, and a low one at that, was to partially adjust for the effect of inflation on the capital gain realised on the disposal of a capital asset.

In 2001, the inclusion rates were set at 25% and 50%. With effect 1 March 2012, it increased to 33,3% and 66,6% respectively. And, with effect 1 March 2016, it has been increased to 40,0% and 80,0% respectively. No adjustment was made to compensate for the effects of inflation in an inflation environment.

Proposed solution / recommendation

It is proposed that the Eighth Schedule be amended to provide for an adjustment to be made to compensate for the effects of inflation on the capital gain on the disposal of an asset.

11. PARAGRAPH 80(2A) OF THE EIGHTH SCHEDULE

Legal nature of the problem and the detailed factual description of the relevant transaction

Paragraph 80(2A) of the Eighth Schedule was introduced with effect from 1 March 2016, along with a number of other related amendments pertaining to capital gains arising from disposals by employee share trusts. This provision seeks to prevent, in certain situations, the operation of paragraph 80(2), the so-called 'conduit pipe principle' with respect to gains arising on the disposal of trust assets which are vested in beneficiaries of the trust. In the situations targeted by paragraph 80(2A), any such gain would be taxed in the trust and not in the hands of the beneficiary.

Paragraph 80(2A) applies where a gain is vested in a beneficiary holding an equity instrument (to which section 8C applies), and that gain is so vested by reason of, *inter alia*, that equity instrument also vesting in terms of section 8C.

A recent Ruling application to SARS has confirmed that the provision may result in capital gains tax being charged to the trust, and income being charged to the beneficiary/employee in terms of section 8C, on the same amount.

We also note the proposed amendments to section 8C(1A), with effect from 1 March 2017. The revised provision seeks to include in a taxpayer's income any amount (with certain exceptions) received or accrued in respect of a restricted equity instrument held by that taxpayer. Such amounts would include, *inter alia*, proceeds of disposals made by employee share trusts and distributed to beneficiaries, where such beneficiaries' interest in the trust (e.g. units) constitute restricted equity instruments.

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The revised section 8C(1A) ensures that capital gains received by the holders of restricted equity instruments will be taxed as income. Section 8C(3) already ensures that the market value of such instruments is taxed on vesting. Paragraph 80(2A) goes the extra step of levying CGT on the trust if a capital gain is vested in a beneficiary, whose interest in the trust also vests in terms of section 8C.

In combination, the provisions can result in a gain being subject to CGT in the trust and income tax in the hands of the individual. Furthermore, it appears to be SARS' view that this double taxation is intentional.

Proposed solution / recommendation

It is difficult to see the policy justification for subjecting disposal proceeds from an employee share trust to both capital gains tax and income tax. Although we understand that National Treasury are concerned about contrived arrangements whereby such trusts are used to generate lower tax rates for employees, i.e. 16.4% on capital gains rather than 41% on income, the revised section 8C(1A) would seem to solve this problem once and for all.

In other words, the mischief targeted by paragraph 80(2A) is where a gain is subject to CGT when it should be subject to income tax. In instances where income tax is paid by the employee on the disposal proceeds, no such mischief exists.

The recently inserted paragraph 80(2A) therefore exists only to create an additional tax charge in the trust, even when the disposal proceeds will be subject to income tax in the hands of the employee. We therefore recommend that the non-disposal rule in paragraph 64C be extended such that it applies when the proceeds of a disposal are included in any taxpayer's income in terms of section 8C. This will ensure that the anti-avoidance intention of paragraph 80(2A) is achieved in instances where the disposal proceeds are not subject to income tax in the hands of the beneficiary/employee.

The impact of these amendments may also have unintended consequences on employers, in cases where an ESOP Trust was in use before the amendments, leading to possible CGT in the ESOP trust, which tax will be borne by the employer in many instances.

12. RATES OF ESTATE DUTY AND DONATIONS TAX

Legal nature of the problem and the detailed factual description of the relevant transaction

In their first interim report on estate duty the Davis tax committee, noted that the "estate duty rate was reduced from 25% to 20% with effect from 1 October 2001 to coincide with the implementation of CGT." The rate at which donations tax was levied was also reduced from 25% to 20% with effect from 1 October 2001.

The 2001 Explanatory Memorandum acknowledges that "the imposition of both capital gains tax and estate duty may have an impact on the liquidity of the deceased estate, it is proposed that the estate duty rate be reduced from 25 per cent to 20 per cent." It continued by explaining that "in line with the reduction in the estate duty rate and the treatment of a donation as a disposal for capital gains tax purposes, it is proposed that the donations tax rate be reduced from 25% to 20%."

Since 1 October 2001 the inclusion rate of capital gains has been increased (as mentioned earlier in this submission), which resulted in a higher tax payable at death and on donation. In addition, the amendments to the Income Tax Act, with the introduction of section 9HA and the substantial changes made to section 25, also resulted in higher taxes payable at date of death. This of course, have a direct impact on the liquidity of the deceased estate.

Other than a reduction in the rate of estate duty or donations tax, it is the annual exclusion, in the year of death of the individual, currently at R300 000, that provides some relief here. It has however, not been adjusted since 1 March 2012.

Proposed solution / recommendation

It is proposed that the exclusion, in paragraph 5 of the Eighth Schedule, in the year of assessment that the person dies, be significantly increased. The exclusion should similarly be extended to apply to a capital gain that arises from the disposal of an asset.

13. TEXTUAL CORRECTIONS REQUIRED IN ITA

13.1 Section 11(nB)

Section 11(nB) of the ITA allows a deduction of "*so much of any amount contemplated in paragraph (cA) of the definition of "gross income" received by or accrued to any person as is refunded by that person*".

In 2014, para (cA) of the definition of "gross income" was amended by deleting sub-paragraph (i) which contained the words "*is a natural person*" and this was moved to the new para (cB), with the result that restraint of trade payments received by or accrued to natural persons now fall within para (cB) of the definition of "gross income".

Consequently, s 11(nB) should be amended to refer to "*any amount contemplated in paragraph (cA) <u>or (cB)</u> of the definition of "gross income*".

This amendment should be effective from the date that para (cA) and (cB) were amended, that is, from 1 March 2015.

13.2 Section 6quat(1B), proviso (i) of sub-paragraph (a)

Section 6quat(1B), proviso (i) of sub-paragraph (a) refers to "*in determining the amount of the taxable income that is attributable to that income, proportional amount, taxable capital gain or amount, any allowable deductions contemplated in sections 11 (n), 18 and 18A must be deemed to have been incurred proportionately in respect of income derived from sources within and outside the Republic*".

And, s 6quat(1D) provides that "*(1D) Notwithstanding the provisions of subsection (1C), the deduction of any tax paid or proved to be payable as contemplated in that subsection shall not in aggregate exceed the total taxable income (before taking into account any such deduction) attributable to income which is subject to taxes as contemplated in that subsection, provided that in determining the amount of the taxable income that is attributable to that income, any allowable deductions contemplated in sections 11 (n), 18 and 18A must be deemed to have been incurred proportionately in the ratio that that income bears to total income.*"

As sections 11(n) and 18 have been deleted and repealed respectively, the references to these sections should be removed and the amendment should be effective from dates on which the respective sections were deleted (1 March 2016 in the case of s 11(n)) and repealed (1 March 2014 in the case of s 18).

A search also should be made through the remainder of the Act to ensure that all other references to these sections have been amended accordingly.

13.3 Definition of "investment income" in paragraph 1 of the Sixth Schedule

Paragraph 1 of the Sixth Schedule provides that '**"investment income"** means -

"(i) any income in the form of annuities, dividends, interest, rental derived in respect of immovable property, royalties, or income of a similar nature; and
(ii) any proceeds derived from the disposal of financial instruments".

As "foreign dividends" are defined separately in s 1 of the ITA, "foreign dividends" should be added to sub-paragraph (i) (the definition of "investment income" in s 12E(4)(c) specifically includes "foreign dividends").

13.4 Definition of "exempt dividend" in paragraph 1 of the Eighth Schedule

Para 19(3) of the Eighth Schedule provides that "(*b*) **"exempt dividend"** means any dividend or foreign dividend to the extent that the dividend or foreign dividend is -

"(i) not subject to any tax under Part VIII of Chapter II; and

(ii) exempt from normal tax in terms of section 10 (1) (k) (i) or section 10B (2) (a) or (b)"

Should sub-para (ii) not refer to "section 10B(2)" without limiting this further to foreign dividends exempt only under sub-paragraphs (a) and (b)?

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