TAX AMENDMENTS – 2013

By Werksmans Tax Practice

This year's Taxation Laws Amendment Bill (the Bill), which has now been passed by Parliament and is awaiting the President's signature, is not much different in size in terms of number of pages, than its counterparts in the past few years. This year, however, most of the amendments are of a highly technical and textual nature, and the substantive amendments are fewer in number than in previous years. One possible reason for this is the loss of a few key people at Treasury, which resulted in a reduced capacity to bring in amendments.

INTRODUCTION

As in prior years, this publication deals only with the substantive amendments that are likely to be of general interest, and excludes comment on highly technical or esoteric amendments; such as those relating to the mark-to-market rules for financial institutions, the new method of taxing international shipping companies, and so on.

In preparing this publication we have attempted as much as possible to use plain language and to limit the amount of technical complexity. The "price" of this, and bearing in mind that this is a summary, is that one sacrifices technical precision in the process. Accordingly this publication should be seen as nothing more than a high-level overview, and not as a legal reference.

A number of the amendments have different effective or commencement dates, which will be detailed where appropriate. Except for these, the amendments to the Income Tax Act (the Act) are (in accordance with usual practice) deemed to come into operation for the commencement of tax years ending on or after 1 January 2014 (i.e. they will apply, for example, for years ending 28 February, 30 June and 31 December 2014), but for some reason the Bill does not state this explicitly.

AMENDMENTS AFFECTING MAINLY CORPORATES

New hybrid debt and hybrid interest rules

In the past two years, significant changes were made to the rules relating to hybrid equity instruments (principally redeemable preference shares) in the amendment and enactment of sections 8E and 8EA of the Act. Section 8F of the Act dealt with hybrid debt instruments, which essentially were debts compulsorily convertible into equity, where the interest was, in such case, disallowed as a deduction and treated as a dividend.

Section 8F of the Act has been completely rewritten, and a new section 8FA of the Act introduced. In essence, both seek to achieve the same end; namely, that in appropriate circumstances, where the underlying debt has more equity-like features than debt-like features, the interest will not be allowed as a deduction - and will be treated as a dividend subject to dividends tax.

In section 8F, a hybrid debt instrument is defined to mean an interest-bearing instrument having at least one of the following features:

- the company is obliged to convert or exchange the instrument for shares, except if the market value of the shares is equal to the amount owed at the time of conversion or exchange;
- the obligation to pay is conditional upon the market value of the assets not being less than its liabilities, i.e. the debt must not be subordinated conditional upon the solvency of the company; or
- the company owes the amount to a connected person (as defined) and is not obliged to redeem the debt within thirty years from the date of issue of the instrument, or from the end of the year of assessment (but debts payable on demand are excluded from this provision).

The treatment of the interest as a deemed dividend applies only in the particular year where the debt is considered to be a hybrid debt instrument, i.e. it is not a case of once a hybrid, always a hybrid.

Certain exemptions from the rules are offered in respect of the following:

- debts owed by a small business corporation (as defined);
- tier 1 or tier 2 capital instruments issued in terms of the Banks Act;
- approved debts in terms of the Short-Term Insurance Act or Long-Term Insurance Act; and
- linked units (i.e. shares and debentures which trade as a linked unit) in a company where the linked unit is held by a long-term insurer, a short-term insurer, a pension or provident fund or a REIT, but only where the holder holds at least 20% of the linked units, they were held before 1 January 2013, and at the end of the previous tax year 80% or more of the value of the underlying assets was directly or indirectly attributable to immovable property (note that this exemption falls away on 1 January 2016).

Section 8FA of the Act is similar save that it applies to hybrid interest rather than to the instrument itself. Hybrid interest means interest with any one of the following characteristics:

- the amount of interest is not determined with reference to a specified rate of interest, or with reference to the time value of money; or
- the rate of interest is increased by reason of an increase in profits of the company, in which case the hybrid interest will be so much of the amount of interest as has been determined with reference to the increased rate of interest in excess of the interest that would have been determined based on the lowest rate of interest during the current and previous five tax years.

Once again, any such interest is disallowed and is treated as a dividend subject to dividends tax.

The exemptions in section 8FA are essentially the same for section 8F.

Both sections come into operation on 1 April 2014 and apply to interest incurred on or after that date.

Interest limitation rules

Introduction

In 2011, section 23K of the Act was introduced to limit the amount of interest which could be deducted where, in short, a purchaser acquired shares in a company and then undertook a restructuring, typically by way of a debt push-down arrangement, in order to achieve a deduction for the interest paid on the loan funding used to finance the acquisition. The purpose of section 23K was to limit the erosion of the tax base, particularly where the interest was earned by lenders not subject to tax in South Africa, for example, non-residents and exempt institutions.

Because of the discretionary nature of the section, it was always intended to be a temporary measure, pending the introduction of permanent rules with more objective criteria. These have now been introduced, with the result that section 23K will cease to apply to the relevant debt (or refinancing thereof) incurred from 1 April 2014.

At the same time certain other interest limitation rules were introduced.

Debts owed to non-taxable persons

These are covered by section 23M of the Act, and essentially the provision seeks to limit the interest to 40% of EBIDTA. Of course, this is EBIDTA in a tax sense, so that it is based on adjusted taxable income, being taxable income:

- reduced by interest received, controlled foreign company (CFC) income, and recoveries or recoupments of depreciation allowances for tax purposes; and
- increased by interest paid and depreciation allowances claimed for tax purposes on capital assets.

These rules will apply only on a debt owed by a company to a creditor that is a connected person. If the creditor is not a connected person the debt will still be included if there is a back-to-back arrangement; e.g. the lender (such as a bank) obtained the funding from the connected person, or the loan was guaranteed by the connected person.

However, if the interest is subject to tax (which could be ordinary income tax or, when it is introduced, the withholding tax on interest paid to a non-resident) the section will not apply.

The allowable interest is calculated on 40% of (i) the adjusted taxable income (i.e. EBIDTA), plus (ii) the interest received, and then (iii) is reduced by interest incurred to other persons; i.e. in favour of creditors who are not governed by the section.

To the extent any amount is disallowed, the excess may be carried forward and treated as interest incurred in the following year. Provision is also made for an increase in the 40% ratio if the repo rate exceeds 10%.

An exemption is granted if the creditor funded the loan to the borrower by means of the creditor itself borrowing the funds from a foreign bank, and the interest does not exceed the official rate of interest as defined in the Seventh Schedule to the Act, plus 100 basis points. This concession is given where the loan creditor did not advance its own funds but had to borrow funds from a third party, so that the loan creditor essentially acted as a conduit. This could apply, for example, where a foreign holding company borrows money from a foreign bank to on-lend to its South African subsidiary. One must question, however, why this is permitted, but if the foreign bank had lent directly to the South African subsidiary, subject to a guarantee from the foreign holding company, the loan would have been caught by the section (see the notes on back-to-back arrangements above).

The section also does not apply to interest incurred on a linked unit where the creditor is a long-term insurer, or a pension or provident fund, which holds at least 20% of the linked units, had held them before 1 January 2013 and where 80% or more of the value of the underlying assets of the debtor comprised immovable property (and, again, this exemption will cease with effect from 1 January 2016).

The section comes into operation on 1 January 2015 and applies to interest incurred on or after that date.

This section serves a similar purpose to the thin capitalisation and transfer pricing rules contained in section 31 of the Act. It is not clear whether the SARS will agree not to apply section 31 when section 24M applies.

Reorganisation transactions

This section – section 23N of the Act – is essentially a replacement for section 23K, as described above. Its basis is very similar to section 23M, but will apply where shares in a company were acquired and either the interest is allowed to be claimed as a deduction under section 24O of the Act (where the purchaser ends up with at least 70% of the equity of the target company) or there has been a restructuring either by way of the target disposing of its business to another company by way of an intra-group transaction under section 45 of the Act, or by disposing of its business to the purchasing company by way of a liquidation distribution under section 47 of the Act.

The interest again is limited to 40% of adjusted taxable income (plus interest received less interest on other debts) and will be increased by a factor if the repo rate exceeds 10%.

Unlike under section 23M, however, any excess may not be carried forward and is for all time forfeited as a deduction. However, the section will apply effectively only for a maximum of the first six years of the debt, so that thereafter, the interest will become fully deductible.

This section applies to transactions entered into on or after 1 April 2014.

Substitutive share-for-share transactions

Amendments to the Act in 2012 saw the introduction of section 43, which provides for tax rollover treatment (such as no capital gains consequences) for transactions between a person and a company involving:

- a swap of equity shares for other equity shares;
- the subdivision and consolidation of a non-equity shares for other non-equity shares; and
- a swap of a property-linked unit (such as a dual linked share-debenture in a REIT or a controlled property company) for a share.

The section 43 roll-over relief provided in respect of share exchanges by way of subdivision or consolidation has been deleted. This is as a result of the fact that no disposal arises due to the bundle of rights attaching to such shares before and after the subdivision or consolidation remaining the same. There is in addition a consequential amendment to paragraph 11(2)(l) of the Eighth Schedule to the Act, which confirms that an exchange of shares by way of a subdivision or consolidation does not constitute a disposal (provided the bundle of rights attached to the shares held before and after the subdivision or consolidation is not changed).

The amendment to the definition of "substitutive share-for-share transaction" in section 43(1) is however perplexing. Where this definition used to provide for exchanges of equity (or non-equity) shares for equity (or non-equity) shares, as the case may be, the new definition only refers to the disposal of an equity share in the form of a linked unit in a company in exchange for an equity share other than a linked unit in that company, i.e. it allows for roll-over relief when the debenture is effectively capitalised.

The amendment significantly reduces the scope of the relief by applying solely to situations where linked units are held, and to make matters worse, the amendment is retrospective and applies to transactions entered into on or after 4 July 2013. This means that taxpayers who have, say, exchanged equity shares of one class for equity shares of another under the prior wording, but after that date, will not be afforded any relief, and will be subject to CGT if the new shares are worth more than the base cost of the old.

Refinements to the research and development (R&D) incentive

The R&D incentive not only provides for a 100% deduction of operating expenses incurred directly and solely for purposes of conducting R&D, but also for a 100% immediate write-off of qualifying capital expenses. In addition, qualifying expenses generate a further 50% deduction (effectively then a 150% deduction) if the R&D is approved by the Minister of Science and Technology.

This year's amendments, with an effective date of 1 January 2014, now seek to achieve the following:

- alignment of the 100% and 50% deductions and clarification that applications by taxpayers to the Minister of Science and Technology will be for the full 150% deduction;
- introducing a more robust definition of R&D with the overall intent of the definition to move more toward a scientific/technological bias with an added emphasis on innovation. The definition now focuses on two aspects; the first being creation and development, and the second improvements. An innovative requirement is inserted and improvements will also have to result from "systematic investigative or systematic experimental activities of which the result is uncertain". The definition now makes it clear that the R&D is intended for wider use than just internal business use and the resulting knowledge essential to the use of intellectual property has to be an integral part of the created intellectual property;
- clarification of excluded expenditures - capital allowance assets (and registration expenses associated with intangibles), other than prototypes and pilot plants created solely for the purposes of R&D, will be excluded from the immediate write-off; and
- simplification of the legislation and providing for the Minister of Finance, in consultation with the Minister of Science and Technology, to designate certain categories of R&D by way of regulations.

Tax incentives for special economic zones

An industrial Development Zone (IDZ) provides VAT and customs duty relief (within customs controlled areas in the IDZ) as well as income tax incentives for qualifying taxpayers (such as the additional allowance for industrial policy projects, available to certain manufacturing companies who will receive an extra point under the scoring mechanism for greenfield investments located in an IDZ).

With the Department of Trade and Industry reviewing the viability of IDZs and the introduction of the concept of a special economic zone (SEZ), with the intention that the existing IDZs will become SEZs, additional income tax incentives are to be introduced to encourage higher levels of investments in the SEZs.

The tax incentives include the following:

- a lower corporate tax rate (15% as opposed as to 28%) will be available for qualifying companies located within approved SEZs. A qualifying company must be formed or effectively managed within South Africa and generate 90% of its income from services or the sale of goods (i.e. trading stock) from activities attributable to a fixed place of business within one or more SEZ that has been approved by the Minister of Finance (in consultation with the Minister of Trade and Industry);
- a capital (depreciation) allowance, in lieu of normal allowances, of 10% per annum over 10 years for companies that erect or improve buildings and other fixed structures in the approved SEZ;

- employers within an approved SEZ will qualify for the benefits under the Employment Incentive Act, 2013; and

- similar VAT and customs relief as enjoyed under the IDZ dispensation.

The new provision will come into effect on 1 January 2014 and apply in respect of all years of assessment commencing on or after that date. The effectiveness of these incentives will be reviewed after a period of 10 years, in 2024, with an interim review after five years, in 2019.

Tenant construction of improvements on leased land

Various depreciation allowances for the erection or acquisition of certain movable and immovable assets (e.g. buildings and fixed structures) are available to the owners of these qualifying assets. Section 12N of the Act provides for depreciation allowances in respect of obligatory leasehold improvements undertaken on leased land or buildings owned by the government or certain exempt quasi-governmental entities. These depreciation allowances in respect of buildings and structures typically have a 10 to 20 year duration and tenants may claim the allowances as if the improvements were directly owned.

Section 12N of the Act will now apply to costs voluntarily incurred by a tenant undertaken in construction or improvements on leased premises. If this is the case the tenant will be deemed to be the owner for purposes of claiming allowances. In other words, where it was previously required that a tenant had to incur an obligation to effect improvements, the section now only requires that the tenant effects an improvement on the land or to the building, dropping the obligation requirement.

It should be noted that the new dispensation will still only be applicable in respect of construction of improvements in respect of public private partnerships and on government/quasi-government land.

The amendments apply from 4 July 2013 in respect of improvements completed on or after that date.

Deductible donations

Deductible donations are limited to 10% of a donor's taxable income during the year of assessment in which the donation is made, any excess being non-deductible.

The legislation is amended to encourage people to make donations to qualifying institutions. With effect from 1 March 2014, the excess will be available to be deducted in a following year of assessment, subject to the 10% limitation applying in that year. The excess can thus, in principle, be continuously rolled-over until it is absorbed by the donor's taxable income.

Also with effect from 1 March 2014, an enhanced deduction is given for a donation of immovable property. In addition to a deduction of an amount equal to the cost of the property, a deduction is given of the notional capital gain multiplied by 66.6% in the case of a natural person, and 33.3% in the case of others. The notional capital gain is the excess of (i) the lower of market value and municipal value over (ii) the base cost.

MATTERS AFFECTING MAINLY INDIVIDUALS

Removal of dividend exemption

Dividends from South African companies are exempt from income tax, but are subject to the 15% dividends tax. This exemption from income tax is, however, removed in certain limited cases.

With effect from 1 April 2014, the exemption from income tax will be removed (so that it will be fully subject to income tax at the maximum marginal rate of 40%, and will be exempt from the 15% dividends tax), if the dividend is related to shares acquired in respect of services rendered or to be rendered or by virtue of employment or the holding of any office, but the shares are not held by the employee himself or herself.

The purpose of this is to attack situations where a trust is established for employees, and the trust holds shares in the employer company, and dividends are then distributed to the employees in general. The Government considers this to be just another form of remuneration, and therefore the dividends should be fully taxable. An exception is where shares are restricted equity instruments under section 8C of the Act, because there will be income tax on the growth when the shares vest.

Unfortunately, the provision is not worded as narrowly as this and it goes much further. For example, assume that many years ago an employee paid full value for the shares that he or she acquired in the employer company and transferred the shares to a trust or family company, as part of an estate planning scheme, or even to a spouse. Because the shares are not held by the employee personally, the dividend is now fully taxable as ordinary income. Another example might be where a person acquired shares in the employer company and has since retired, but has retained the shares in a family trust. Because the shares were originally obtained by virtue of employment, from 1 April next year the dividend becomes fully taxable.

Similar rules apply where the shares held produce foreign dividends, which would normally be taxed at the effective rate of 15%.

We have little doubt that it was never intended that the legislation should go that far, but should be confined to trusts set up for the benefit of employees of an employer. Unfortunately, the drafting is so broad and imprecise that it is capturing situations which we believe were never intended to be encompassed.

Sickness policies

Individuals who have taken out income protection policies, e.g. to replace income while they are sick or temporarily disabled, were allowed to claim the premiums as deductions from their income (even from salary income) and were taxable on any amounts received under a claim.

With effect from 1 March 2015, any premium in respect of a policy relating to the death, disablement, severe illness or unemployment of a person will no longer be deductible, and the amount received in respect of a claim will no longer be taxable.

Bursaries and scholarships

The requirements for the exemptions for bona fide bursaries and scholarships granted by an employer to a relative of an employee, have been relaxed to allow for the exemption if the employee's remuneration in the preceding tax year did not exceed R250 000 (previously R100 000). The exemption available to relatives of employees for secondary education (i.e. until matric) remains the same, being R10 000. However, an additional exemption of R30 000 is now also available to bursaries to relatives of employees in respect of further studies (tertiary education) at a recognised educational or research institution.

The amendments will apply to years of assessments commencing on or after 1 March 2013.

Retirement funds: Contributions

A uniform tax regime for all types of retirement funds (pension funds, provident funds and retirement annuity funds) is introduced.

In terms of the unified regime, employees will be entitled to deduct membership contributions (in relation to all three retirement funds) at a flat rate of 27.5% of the greater of "remuneration" or "taxable income" (excluding retirement lump sums). The total deduction is, however, limited to R350 000 per annum. Contributions in excess of the annual limitation may be rolled-over to be deducted in a following year, subject to the prescribed limits applying in that year.

Contributions made by employers in respect of employees to any of the retirement funds will, generally, be deductible.

Contributions made by an employer to an approved retirement fund will trigger fringe benefit tax for the employees. The value of the fringe benefit in the case of a defined contribution fund will be the cash value of the employer's contribution, and the value of the fringe benefit in the case of a defined benefit fund will be determined in terms of a special formula.

Employer contributions which are treated as fringe benefits will be deemed to be made by the employee and thus be added to the contributions which qualify for tax deduction by the employee, subject to the percentage and monetary limitations referred to above.

INTERNATIONAL TAX ISSUES

Exit charge: indirectly owned immovable property

When a South African resident ceases to be a resident, a so-called exit charge is levied on all assets which will, post-cessation of residence, no longer form part of the South African tax net. Thus the excess of market value over the base cost of those assets is subject to CGT.

In principle, non-residents remain in the South African tax net in respect of immovable property situated in South Africa, including an interest in immovable property situated in South Africa held through a company or a (vesting) trust. On this basis, the exit charge did not apply to these interests.

Some of South Africa's tax treaties give sole taxing rights to gains derived from the disposal of such interests to immovable property to the country where the person is, at the time of disposal, a tax resident.

In this context, it was decided to make the exit charge applicable to indirect interests in (as opposed to direct holdings of) fixed property. As most of South Africa's treaties allocate taxing rights to South Africa in respect of indirect interests, the former resident will, upon actual disposal of the interest, also be subject to South African CGT on the appreciation in value of the interest from the date of exit to the date of disposal.

Domestic treasury management companies

Domestic treasury management companies, which are (i) incorporated in South Africa, (ii) have their place of effective management here, and (iii) registered with the South African Reserve Bank, and are thus not subject to exchange controls, are also not subject to the South African tax rules relating to currency gains and losses. Transactions in currencies other than the functional currency of the treasury company must be converted to the functional currency of the company, and then to the rand, at the annual average exchange rates.

Only companies listed on the JSE may nominate a (single) company in the group to be a domestic treasury management company.

Foreign dividend participation exemption

Foreign *in specie* dividends accrued/received on or after 1 March 2014, in respect of shares listed on a South African exchange, are exempt from the normal tax on foreign dividends.

The foreign dividend participation exemption (which applies where the South African resident holds at least 10% of the equity shares and voting rights in the foreign company) is, with effect from 1 April 2014, limited to foreign dividends on equity shares, so that, for example, preference share dividends will be taxed at the effective rate of 15%.

Foreign trade losses

Foreign trade losses will no longer be available for set-off against any South African source income, whether derived from a South African trade or otherwise.

Withholding tax: service fees

The withholding tax on service fees will apply at the rate of 15% on fees paid or becoming due and payable on or after 1 January 2016. This is a final tax.

The structure is similar to that of the other withholding taxes – the liability for the tax being that of the non-resident recipient of the fee, but subject to a withholding obligation on the payor of the fee.

The withholding tax is applicable in respect of fees for technical, managerial and consultancy services earned from a South African source.

Exempt are fees for services rendered:

- by a natural person who was physically present in South Africa for more than 183 days during a 12-month period preceding the date of payment of the service fee; or
- by any person through a permanent establishment in South Africa; or
  in terms of an employment relationship where PAYE would be payable,

any of which will thus be taxed in the ordinary way.

Beyond the scope of the tax are fees which relate to services incidental to the imparting of intellectual property.

There is no specific source rule to determine when service fees will be regarded as being from a South African source. The common law principles in this regard would apply. Generally speaking, service fees are regarded as being earned from a South African source if the services in respect of which they are earned are rendered in South Africa.

It remains to be seen how this process will be administered so that only fees from a South African source will be subject to the withholding, as opposed to all fees being so subject, with the foreign recipient having to claim a refund. Currently, only residents of countries with which South Africa has a double tax agreement that permits a lower rate (including zero) can claim the lower rate upfront.

Transfer pricing: equity loans

Exemption from the transfer pricing provisions has been granted in respect of loans from South African lenders to foreign borrowers who are connected persons if:

- the South African lender (or another company in the group to which the South African lender belongs) holds, directly or indirectly, 10% or more of the equity and voting rights of the foreign borrower; and
- the foreign lender is not obliged to redeem the debt in full within 30 years; and
- the redemption of the debt is conditional upon the market value of the assets of the foreign lender being equal to or in excess of the market value of its liabilities.
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Although the requirements are strict, the move towards recognising commercial reality is to be welcomed. It is hoped that in future the same logic could be applied to treat inbound financial assistance, in appropriate circumstances, as capital in the context of the thin capitalisation and transfer pricing rules.

Share issues for foreign shares: disposal for CGT

Generally speaking the issue of shares is specifically excluded from the definition of a disposal for capital gains tax purposes.

With effect from 1 April 2014, shares issued by a South African tax resident company in exchange for shares in a foreign company will constitute a disposal. Presumably the disposal proceeds will be the value of the foreign shares, which will equal the capital gain, as the newly-issued shares will not be regarded as having a base cost.

Withholding taxes on interest and royalties

The new withholding tax on interest at the rate of 15% will commence on 1 January 2015. On the same date, the withholding tax on royalties increases from 12% to 15%. In both cases these rates are subject to reduction (even to zero) under relevant double tax agreements.

VALUE-ADDED TAX PROVISIONS

General registration requirements

Two major changes to the value-added tax (VAT) legislation relate to the compulsory registration requirements, and registration requirements for e-commerce suppliers.

A person that makes taxable supplies in the course or furtherance of an enterprise is obliged to register as a vendor if the value of the taxable supplies exceed R1 million in the preceding 12-month period, or if reasonable grounds exist for believing that the total value of the taxable supplies is likely to exceed that threshold in the following 12 months.

The compulsory registration requirements are amended to create certainty for prospective vendors. With effect from 1 April 2014, a person will only be obliged to register for VAT if the taxable supplies have already exceeded the R1 million threshold in the preceding 12 months (i.e. this requirement remains unchanged), or if existing or future business is secured by a written contract, in terms of which a person will make taxable supplies in excess of the threshold in the following 12 months.

Registration requirements for e-commerce suppliers

In order to address the above uncertainty and to prevent foreign suppliers of e-commerce services from escaping the VAT net in South Africa, legislation is introduced in terms of which foreign suppliers will be obliged to register as vendors in respect of e-commerce supplies made to South African customers, during any month that the supplies exceed R50 000.

As the nature of e-commerce is such that the location of the customer is often unknown, these supplies will be monitored by means of a proxy for customer location; being either payment from a South African bank, or customer residence in South Africa.

These provisions will apply to foreign suppliers of e-commerce with effect from 1 April 2014. Before then, the Minister of Finance will publish regulations setting out which services are covered by these rules.

Conversion of a share block scheme to sectional title

A share block company is entitled to convert from a share block scheme to a sectional title scheme by special resolution. This conversion entitles a shareholder, who is a vendor, to a notional input tax deduction relating to the acquisition of immovable property.

It is now recognised that the ultimate owners of the immovable property merely convert their rights in such a conversion, and that there is, as such, no significant change in relation to the property. The shareholders will consequently, with effect from 1 April 2014, no longer be eligible for an input tax deduction on the conversion of a share block scheme to a sectional title.

The supply of services by home owners associations

The supplies made by home owners associations to any of its members will be treated as exempt supplies with effect from 1 April 2014. The purpose of this amendment is to align the VAT treatment relating to homeowners associations to that of sectional title body corporates. Home owner associations that will be required to deregister as vendors as a result of the above amendment, will be granted a concession to account for VAT on the deemed supplies of goods on hand in equal instalments over a period of six months.

Home owner associations could, however, apply to the SARS by way of written application for the provisions not to apply and the Commissioner may, having regard to the specific circumstances of each case, direct that the exemption does not apply to them.

TAX ADMINISTRATION ACT

Penalties

Under the Income Tax Act, prior to 1 October 2012 when the Tax Administration Act (the TAA) became effective, a person who understated income could be liable for additional tax (penalty) of up to 200% of the shortfall, i.e. this was the so-called treble tax. However, the SARS had discretion to reduce the penalty to zero (though if there was an intent to evade, the penalty could only be reduced if there were extenuating circumstances). There was also the 200% penalty under the Value-Added Tax Act (the VAT Act), but then it could only be imposed if inter alia there was an intent to evade tax.

The TAA introduced a completely different penalty regime whereby penalties are imposed in terms of a table depending upon the severity of the behaviour leading to the understatement, so that even in a standard case the penalty ranged from a minimum of 25% to a maximum of 150% (though the rates of certain of these penalties are now being reduced).

The SARS commenced imposing these penalties in all assessments raised after 1 October 2012, when the TAA came into effect, regardless of when the original assessments were raised in respect of income tax or other taxes, or when the returns were lodged. Tax advisors were unanimously of the view that this was not possible, and that the old rules should have continued to apply, for which the transitional provisions in the TAA made allowance. There are a number of reasons why it is believed that the new provisions could not apply. One example is that the minimum 25% penalty (to be reduced to 10%) could only be remitted if the taxpayer had a tax opinion from a tax practitioner supporting the treatment. Clearly a person submitting a tax return, say, in 2010, could never have known to get such an opinion.

The SARS' attitude was that they could not, logistically, keep two systems running at the same time.

Accordingly, the TAA has been amended to ensure that the new penalty regime will continue to apply to old matters, but two important concessions have been made:

- In the case of income tax, discretion is given to the SARS to reduce the penalty, even in full, if they are satisfied that there were extenuating circumstances.
- In the case of VAT, except if the understatement penalty under the TAA was imposed at the rate of 150% for intentional tax evasion, the SARS is obliged to remit all of the penalties.

Unfortunately the 10% late payment penalty under the VAT Act has not been addressed. Previously the penalty could be waived if it could be shown that there was no intent not to pay the tax or to postpone payment of the tax. Now the 10% penalty can only be waived if there are various criteria met; including that it is a first occurrence, that the problem has been remedied, and so on. Unfortunately the test for waiver is based on a standard which is now very different from the standard obtained when the original VAT return was submitted, and a taxpayer can be severely prejudiced by being judged on such a different standard.

Dividends tax returns

A new provision has been introduced which applies to companies in receipt of dividends from other South African companies; in terms of the former such companies will be obliged to submit returns of dividends earned by the last day of the month following the month in which the dividend is received. Previously, only companies distributing dividends were obliged to submit a return.

About Werksmans Tax practice

Our Tax practice is able to respond swiftly and efficiently on local and international tax matters. Team members have extensive experience in consulting to the commercial sector and are able to provide integrated advice and assistance on a wide range of tax issues.

Services range from consulting on the tax aspects of clients' commercial dealings to interacting on their behalf with the tax authorities and, where necessary, dealing with objections and disputes.

Special areas of expertise include the tax aspects of commercial activities such as mergers and acquisitions, private equity and black economic empowerment transactions, and corporate re-organisations.

Team members are also skilled in handling settlement negotiations, appeals in the Tax Court and High Court, and alternative dispute resolution processes.

In terms of international tax services, the team has a well-established track record in inward and outward investment matters and offshore structuring, taking into account the exchange control implications thereof.

Services include dealing with:

Domestic tax: income tax, withholding tax, capital gains tax, employees' tax, value-added tax and securities transfer tax

International tax: inward and outward investment

Exchange control advice

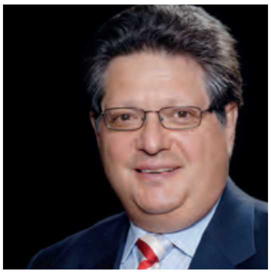
Estate planning

Tax rules relating to financial services and products: encompassing insurance, private equity, securitisations, hedge funds, structured and project finance, debt and derivative instruments

Tax structuring of transactions: including black economic empowerment transactions, mergers and acquisitions, unbundlings, reconstructions, management buyouts, distributions, funding, securities issues and buy-backs

Tax litigation and dispute resolution: from liaison with tax authorities and regulators on settlement negotiations, alternative dispute resolution, objections and Tax Court appeals.

Meet the Authors



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