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2019/2020 BUDGET PROPOSALS – TAX OVERVIEW

By the Werksmans Tax Team

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INTRODUCTION

When commentators and newspapers say that the taxpayers are bearing the cost of bailing out Eskom, SAA and other problematic State Owned Enterprises, not to mention paying for a bloated civil service, one merely has to observe that, for the first time in nearly two decades, there has been no adjustment to the tax tables to give relief for bracket creep in relation to individual taxes. Whereas last year there was no change to the top four brackets, but there were adjustments to the bottom three brackets. This year there was no change at all, so that even the lower to middle earning taxpayers will be paying tax purely on inflationary increases. The nominal increases in the rebates will serve to give some relief at the very bottom end, but virtually nothing for individuals earning R200 000 per annum and above. Despite the commitment to increase the medical tax credits annually when these were first introduced, there has been no increase in the current Budget.

From 2015/2016, year on year there have been upward adjustments to the various tax rates, from the increase in the personal income tax rate from 41% to 45%, an increase in the effective CGT rate across the board, the increase in dividends tax from 15% to 20%, and more recently the increase in the VAT rate from 14% to 15%, as well as the increase in the estate duty and donations tax rates from 20% to 25%. This is the first year in which no such obvious tax rate increases have been provided for despite an expected revenue shortfall of R42.8 billion compared to the 2018 Budget estimate.

The 2019 Budget, nevertheless, estimates that tax revenue will be raised by R15 billion through the bracket creep. It is also anticipated that a more efficient SARS will assist in raising revenue collections.

It is also noteworthy that no further changes to legislation were announced pursuant to recommendations made by The Davis Tax Committee (including their recommendation in their last report to reduce dividends tax from 20% back to 15%). Nevertheless, the documentation contains a raft of proposed amendments (principally of an anti-avoidance nature), but, unfortunately, the announcements are very short on detail, and it is therefore difficult to understand exactly what is intended to be done. This is particularly problematic where the effective date of the change is today, as in the case of the so-called dividend stripping rules linked to a sale of shares.

As in the past, we have confined ourselves to dealing with proposed amendments that we believe are more of widespread interest to individuals and companies, and have refrained from dealing with amendments that are either of a highly technical or esoteric nature.

INDIVIDUALS

PERSONAL INCOME TAX AND CGT

As was the case in 2018 and the year before that, individuals earning more than R1.5 million of taxable income per year will be taxed at 45%, with the top effective rate of CGT remaining at 18%. The first R40 000 of exempt capital gains also remains unchanged.

EMPLOYMENT TAX INCENTIVE

In 2018, government extended the employment tax incentive by 10 years. In addition, the eligible income bands will be adjusted upwards partially to cater for inflation. From 1 March 2019, employers will be able to claim the maximum value of R1 000 per month for employees earning up to R4 500 monthly, up from R4 000 previously. The incentive value will taper to zero at the maximum monthly income of R6 500.

EXPATRIATES

From 1 March 2020, South African tax residents who spend more than 183 days in employment outside South Africa will be subject to South African tax on foreign employment income exceeding R1 million. It is proposed that South African employers be allowed to reduce their monthly PAYE withholding by the amount of foreign taxes withheld. A consultation process with respect to administrative concerns will be held.

RETIREMENT REFORMS

When a member of a retirement fund retires and receives an annuity, any contributions to the retirement fund that were not deducted from the member's taxable income are tax-exempt. This exemption does not, however, apply to annuities received from a provident or provident preservation fund. It is proposed that this exemption be extended to provident and provident preservation fund members who receive annuities. If enacted, the exemption will apply to contributions made after 1 March 2016.

Members of a pension fund can deduct retirement fund contributions from their taxable income. Upon the death of a member, their surviving spouse may be entitled to receive a spousal pension from the fund, which payment is subject to PAYE. If the surviving spouse also receives other income, the aggregation of income can push them into a higher tax bracket. It is proposed that the monthly spousal pension be subject to PAYE withholding at a flat rate and tax rebates should not be taken into account in the calculation of the spousal pension.

COMPANIES

FURTHER CHANGES TO THE ANTI-AVOIDANCE RULES DEALING WITH DIVIDEND STRIPPING TRANSACTIONS

Changes to the Income Tax Act, 1962 (the Act), in 2017 and 2018 brought a number of changes to tax treatment of share buy-backs and so-called dividend stripping transactions. These changes were, in the main, aimed at preventing subscription and buy-back arrangements, under which CGT was avoided by a company shareholder. These rules in their current form only apply if the recipient of the exempt dividend disposes of the shares either as part of the dividend (i.e. a share buy-back) or within a period of 18 months of receipt of the dividend. It is proposed that these rules be expanded to deal with scenarios where a company declares a substantial dividend to a company shareholder followed by the issue of shares in the declaring company to a third-party investor. The effect of such a transaction is that the original company shareholder dilutes its shareholding in the company and receives an exempt dividend without a disposal of the shares. The legislation that is to deal with this position is only expected to be issued in draft in the second half of the year, although it will be effective retroactively to 20 February 2019. This brings tax uncertainty to companies wishing to restructure their capital as corporate shareholders may be penalised on a retroactive basis.

DEDUCTIBLE INTEREST ON DEBT FUNDED SHARE PURCHASES

The Act provides for a special interest deduction on debt used to fund the purchase of a controlling interest (70%+) in an operating company. It is envisaged that the requirement for the purchaser of the controlling shares to evaluate whether they qualify for the deduction set out under current provisions, be reconsidered in the event that the purchaser continues to be a controlling shareholder of the particular company (whether directly or indirectly) following the implementation of a restructure transaction.

Further, it is anticipated that amendments will be affected so as to ensure that the special interest deduction is only granted pursuant to debt-funded transactions of controlling interests in companies that already generate income (i.e. not to newly established companies).

CORPORATE ROLL-OVER PROVISIONS

The purpose of the corporate roll-over provisions of the Act is to provide relief in respect of transactions between groups of companies and between founding shareholders and their companies, where the group or the shareholder retains a substantial interest in the assets being transferred. The policy rationale surrounding the corporate roll-over provisions is to permit the tax-neutral transfer of assets in such circumstances in order to allow the assets to be transferred to the entity in which they can be employed in the most efficient manner.

These rules, in their current form, do not specifically address the interaction between the corporate roll-over provisions and tax rules dealing with foreign exchange items and other financial instruments. In this regard, questions arise as to whether foreign exchange differences and adjusted gains and losses should be taken into account in the transferee's hands if financial instruments of this nature are transferred in terms of the corporate roll-over provisions.

It is proposed that the corporate roll-over rules will be amended to exclude roll-over treatment for instruments of this nature. Accordingly, exchange items and interest-bearing instruments and their unrealised values will be crystallised in the hands of the selling party.

REFINEMENTS TO THE ANTI-AVOIDANCE PROVISIONS IN RESPECT OF INTRA-GROUP TRANSACTIONS

Section 45 of the Act provides for the tax neutral transfer of assets between companies that form part of the same group of companies by way of intra-group transactions. Often this involves a sale of an asset on loan account.

The intra-group rules contain a so-called "de-grouping" charge, which unwinds the tax neutral treatment of an intra-group transaction in the hands of the transferee. This de-grouping charge is imposed if the de-grouping occurs (i.e. either the transferor or the transferee exits the group) within 6 years of the intra-group transaction. In the case of such a de-grouping, the transferee triggers a deemed capital gain and/or recoupment of depreciation.

The penal effect of a de-grouping does not stop here because in addition to this, the consideration paid to the company disposing of the asset, the loan account in the above example, has a nil base cost.

If the loan is repaid after a de-grouping, a gain also arises for the creditor company being repaid. Accordingly, in a de-grouping scenario, economically speaking, both companies are subject to tax on the same asset. This will be addressed in the 2019 legislative cycle.

Some of the corporate roll-over provisions require the disposing company to take certain steps to liquidate, wind-up or de-register within 36 months of the date of the relevant transaction for the relief to find application. The rules dealing with the steps to liquidate a company do not deal with a de-registration by operation of law, such as where there is an amalgamation or merger under the Companies Act, 2008, and will be amended accordingly.

REAL ESTATE INVESTMENT TRUSTS (REITS)

The tax rules applicable to REITS only apply if the REIT is listed on a South African exchange. It is anticipated that Treasury will assess the treatment of unlisted REITS.

NATURE OF AMOUNTS RECEIVED BY PORTFOLIOS OF COLLECTIVE INVESTMENT SCHEMES (CISs)

Treasury expressed concern in 2018 that many CISs were deriving trading profits on shares, which should be taxable – only capital gains are exempt in the hands of a CIS.

Consequently, amendments to the Act were proposed to treat any amount received by CIS from the disposal of a financial instrument within 12 months of its acquisition as income.

The above proposal was, however, withdrawn pursuant to the public consultation process on the premise that it would be renewed in 2019. In this regard, it is proposed that a study be conducted with relevant stakeholders during the 2019 legislative cycle to find solutions that would not negatively affect the relevant groups.

INTERNATIONAL

CONTROLLED FOREIGN COMPANIES (CFC)

Currently, the controlled foreign company ("CFC") rules provide for a so-called "high tax exemption", in terms of which a CFC's income is not attributed to its South African shareholders if the CFC pays tax at a certain threshold in its country of residence (75% of the tax it would have paid in South Africa).

The 75% threshold was benchmarked against the UK corporate tax rate as it was in 2010.

In light of the UK tax rate decreasing to 19% and the US tax rate from 35% to 21%, it was announced in the 2018 Budget that Treasury will review the high-tax exemption to determine whether a reduction in the 75% threshold is warranted. No such review was performed in 2018, however, this appears to be a matter that will be considered during 2019.

MISCELLANEOUS

In 2013, the Minister of Finance announced the establishment of a treasury management holding company regime as part of the Budget proposals. In the main, a company can establish one subsidiary to manage the group treasury functions free from exchange control despite that subsidiary's domestic incorporation, and free from taxation on unrealised rand currency movements. However, the definition of a "domestic treasury management company" in the Act is different to that of the Reserve Bank's definition of the term. The definition in the Act will be amended to align the definitions, specifically that the company is to be incorporated in South Africa, which the tax law definition does not currently require.

The criteria used to validate foreign stock exchanges are expected to be revised as they have remained unchanged since 2001.

VAT

CLARIFICATION OF THE VAT TREATMENT OF SALE AND LEASEBACK TRANSACTIONS TAKING PLACE IN TERMS OF SECTIONS 42 AND 45 OF THE ACT

In the case of a supply of an enterprise in terms of an asset-for-share transaction as defined in section 42 of the Act or an intra-group transaction as defined in section 45 of the Act, section 8(25) of the VAT Act deems the supplier and recipient to be one and the same person, but only if the enterprise is supplied on a going concern basis. If they are not, VAT at 15% must be levied. Supplies under the other corporate roll-over rules do not have this requirement. Owner-occupied immovable property is typically transferred on a sale and leaseback basis and does not constitute a going concern on the date of its transfer. The result is that the supplier is required to levy output VAT on the supply of the property, even though the transaction qualifies for income tax or CGT relief under corporate roll-over provisions. The transferee of the property must then claim the VAT as an input VAT credit subsequent to the conclusion of the lease agreement with the transferor. Treasury has proposed that the VAT Act be amended in order to provide greater clarity on the supply of immovable property in the above cases.

TAX RATES AND THRESHOLDS

INDIVIDUALS AND SPECIAL TRUSTS

No adjustments are proposed to any of the personal income tax brackets as indicated below. Thus there is no relief even for inflation.

Personal income tax rate and bracket adjustments

2019/20		2018/19	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 195 850	18% of taxable income	0 – 195 850	18% of taxable income
195 851 – 305 850	R35 253 + 26% of taxable income above R195 850	195 851 – 305 850	R35 253 + 26% of taxable income above R195 850
305 851 – 423 300	R63 853 + 31% of taxable income above R305 850	305 851 – 423 300	R63 853 + 31% of taxable income above R305 850
423 301 – 555 600	R100 263 + 36% of taxable income above R423 300	423 301 – 555 600	R100 263 + 36% of taxable income above R423 300
555 601 – 708 310	R147 891 + 39% of taxable income above R555 600	555 601 – 708 310	R147 891 + 39% of taxable income above R555 600
708 311 – 1 500 000	R207 448 + 41% of taxable income above R708 310	708 311 – 1 500 000	R207 448 + 41% of taxable income above R708 310
1 500 001 and above	R532 041 + 45% of taxable income above R1 500 000	1 500 001 and above	R532 041 + 45% of taxable income above R1 500 000

Rebates

	2019/20	2018/19
	R	R
Primary	14 220	14 067
Secondary (Persons 65 and older)	7 794	7 713
Tertiary (Persons 75 and older)	2 601	2 574

Tax thresholds

	2019/20	2018/19
	R	R
Below age 65	79 000	78 150
Age 65 to below 75	122 300	121 000
Age 75 and over	136 750	135 300

Annual income tax payable and average tax payable comparison (taxpayers below 65):

TAXABLE INCOME	2018/19 RATES	2019/20 RATES	TAX CHANGE	CHANGE	AVERAGE TAX RATES	
R	R	R	R	%	NEW RATES	OLD RATES
85 000	1 233	1 080	-153	-12.41%	1.3%	1.5%
90 000	2 133	1 980	-153	-7.17%	2.2%	2.4%
100 000	3 933	3 780	-153	-3.89%	3.8%	3.9%
120 000	7 533	7 380	-153	-2.03%	6.2%	6.3%
150 000	12 933	12 780	-153	-1.18%	8.5%	8.6%
200 000	22 265	22 112	-153	-0.69%	11.1%	11.1%
250 000	35 265	35 112	-153	-0.43%	14.0%	14.1%
300 000	48 265	48 112	-153	-0.32%	16.0%	16.1%
400 000	78 972	78 819	-153	-0.19%	19.7%	19.7%
500 000	113 807	113 654	-153	-0.13%	22.7%	22.8%
750 000	210 473	210 320	-153	-0.07%	28.0%	28.1%
1 000 000	312 973	312 820	-153	-0.05%	31.3%	31.3%
1 500 000	517 973	517 820	-153	-0.03%	34.5%	34.5%
2 000 000	742 973	742 820	-153	-0.02%	37.1%	37.1%

Source: National Treasury

Retirement fund lump sum withdrawal benefits

2019/20		2018/19	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 25 000	0% of taxable income	0 – 25 000	0% of taxable income
25 001 – 660 000	18% of taxable income above R25 000	25 001 – 660 000	18% of taxable income above R25 000
660 001 – 990 000	R114 300 + 27% of taxable income above R660 000	660 001 – 990 000	R114 300 + 27% of taxable income above R660 000
990 001 and above	R203 400 + 36% of taxable income above R990 000	990 001 and above	R203 400 + 36% of taxable income above R990 000

Retirement fund lump sum benefits or severance benefits

2019/20		2018/19	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 500 000	0% of taxable income	0 – 500 000	0% of taxable income
500 001 – 700 000	18% of taxable income above R500 000	500 001 – 700 000	18% of taxable income above R500 000
700 001 – 1 050 000	R36 000 + 27% of taxable income above R700 000	700 001 – 1 050 000	R36 000 + 27% of taxable income above R700 000
1 050 001 and above	R130 500 + 36% of taxable income above R1 050 000	1 050 001 and above	R130 500 + 36% of taxable income above R1 050 000

CAPITAL GAINS TAX

Capital gains tax effective rate (%)

	2019/20	2018/19
	%	%
Individuals and special trusts	18	18
Companies	22.4	22.4
Trusts	36	36

Capital gains exemptions

DESCRIPTIONS	2019/20	2018/19
	R	R
Annual exclusion for individuals and special trusts	40 000	40 000
Exclusion on death	300 000	300 000
Exclusion in respect of disposal of primary residence (based on amount of capital gain or loss on disposal)	2 million	2 million
Maximum market value of all assets allowed within definition of small business on disposal when person over 55	10 million	10 million
Exclusion amount on disposal of small business when person over 55	1.8 million	1.8 million

CORPORATE INCOME TAX RATES

Income tax – companies

For the financial years ending on any date between 1 April 2019 and 31 March 2020, the following rates of tax will apply:

	2019/20	2018/19
TYPE	RATE OF TAX (%)	RATE OF TAX (%)
Companies (other than gold mining companies and long term insurers)	28	28
Personal service providers	28	28
Foreign resident companies earning income from a South African source	28	28
Dividends tax	20	20

Tax regime for small business corporations

2019/20		2018/19	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – R79 000	0% of taxable income	0 – R78 150	0% of taxable income
R79 001 – R365 000	7% of taxable income above R79 000	R78 151 – R365 000	7% of taxable income above R78 150
R365 001 – R550 000	R20 020 + 21% of taxable income above R365 000	R365 001 – R550 000	R20 080 + 21% of taxable income above R365 000
R550 001 and above	R58 870 + 28% of taxable income above R550 000	R550 001 and above	R58 930 + 28% of taxable income above R550 000

INCOME TAX RATES FOR TRUSTS

2019/20	2018/19
RATE OF TAX (%)	
45	45

TAX-FREE PORTION OF INTEREST

	2019/20	2018/19
	R	R
Under 65	23 800	23 800
Over 65	34 500	34 500

INTEREST WITHHOLDING TAX	RATE OF TAX
	%
Interest paid to non-resident creditors	15

TRANSFER DUTY

The transfer duty table affecting sales on or from 1 March 2018, and which applies to all types of purchasers, is as follows:

VALUE OF PROPERTY (R)	RATE
R	R
R0 – R900 000	0% of property value
R900 001 – R1 250 000	3% of property value above R900 000
R1 250 001 – R1 750 000	R10 500 + 6% of property value above R1 250 000
R1 750 001 – R2 250 000	R40 500 + 8% of property value above R1 750 000
R2 250 001 – R10 000 000	R80 500 + 11% of property value above R2 2500 000
R10 000 001 and above	R933 000 + 13% of property value above R10 000 000

MEDICAL TAX CREDITS

DESCRIPTION	2019/20	2018/19
	R	R
Medical scheme fees tax credit, in respect of benefits to the taxpayer	R310	R310
Medical scheme fees tax credit, in respect of benefits to the taxpayer and one dependent	R620	R620
Medical scheme fees tax credit, in respect of benefits to each additional dependant	R209	R209

ABOUT WERKSMANS TAX PRACTICE

The Werksmans Tax Practice is able to respond swiftly and effectively to South African and international tax matters. Team members have many years' experience in consulting to the commercial sector and are able to provide integrated advice and assistance on a wide range of local or international tax issues. Ongoing tax changes and the aggressive stance of the South African Revenue Service have elevated tax law in South Africa to a highly specialised area of practice.

The many changes in tax law since 2001 have resulted in a complex tax system, the complexity of which increases annually with comprehensive amendments. These cover multiple aspects such as ever-changing corporate restructuring rules, tax rules affecting financial instruments, rules affecting retirement and so on. The team's focus is on assisting corporates and high-net-worth individuals who seek comprehensive, up-to-date tax advice.

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

Special areas of expertise include the tax aspects of commercial activities such as mergers and acquisitions (M&A), private equity and black economic empowerment transactions, and corporate reconstructions.

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;

> Estate planning: domestic and international;

> Financial services and products: tax rules relating to insurance, private equity, securitisations, hedge funds, structured and project finance, debt and derivative instruments;

> Tax structuring of black economic empowerment transactions, M&A, unbundlings, reconstructions;

> Management buyouts, distributions, funding, securities issues and buybacks;

> Exchange control advice in relation to the above;

> Liaison and negotiation with tax authorities and regulators; and

> Tax litigation and dispute resolution: settlement negotiations, alternative dispute resolution, objections and Tax Court appeals.

MEET THE TAX TEAM

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ABOUT WERKSMANS ATTORNEYS

Established in the early 1900s, Werksmans Attorneys is a leading South African corporate and commercial law firm, serving multinationals, listed companies, financial institutions, entrepreneurs and government.

Operating in Gauteng and the Western Cape, the firm is connected to an extensive African legal alliance through LEX Africa.

LEX Africa was established in 1993 as the first and largest African legal alliance and offers huge potential for Werksmans' clients seeking to do business on the continent by providing a gateway to Africa.

With a formidable track record in mergers and acquisitions, banking and finance, and commercial litigation and dispute resolution, Werksmans is distinguished by the people, clients and work that it attracts and retains.

Werksmans' more than 200 lawyers are a powerful team of independent-minded individuals who share a common service ethos. The firm's success is built on a solid foundation of insightful and innovative deal structuring and legal advice, a keen ability to understand business and economic imperatives and a strong focus on achieving the best legal outcome for clients.