NORTON ROSE FULBRIGHT

2018

BUDGET HIGHLIGHTS

A measured budget, but tax base still under pressure

In line with the hopeful message delivered in the State of the Nation address by the President, the Minister of Finance delivered a measured budget which did not shy away from the difficult questions being asked of Treasury.

There is no doubt that the tax adjustments announced will hit South Africans in their pockets. However, Treasury failed to panic in the face of a slow economy and a growing deficit, and implemented some difficult changes which will hopefully make a material difference to the budget.

At the same time, statements regarding the realignment of tax incentives and the crack-down on illicit financial flows suggest that Treasury realises that increasing tax rates is not the only way to encourage economic activity and to bulk up the fiscus.

The Minister should be applauded for an honest medium term budget in October 2017, followed by an even better performance this year which can only strengthen the perception that Government is learning from its past mistakes and placing the country on a better course.

Main tax proposals

The main budget proposals for the 2018-19 fiscal year include:

- an increase in VAT from 14% to 15%;
- no rate adjustments to the top four income tax brackets, and below inflation adjustments to the bottom three brackets;
- an increase of 52c/litre for fuel, consisting of a 22c/litre increase in the general fuel levy and 30c/litre increase in the Road Accident Fund levy;
- higher *ad valorem* excise duties for luxury goods;
- increased estate duty to be levied at 25% for estates above ZAR30 million;
- increases in the plastic bag levy, the motor vehicle emissions tax and the levy on incandescent light bulbs to promote eco-friendly choices; and
- the sugar tax will be implemented from 1 April 2018.

Corporate Tax Proposals

Business (General)

Amendments to debt relief rules

In 2017, the Income Tax Act was amended to address the tax consequences of the reduction of certain debts and the artificial repayment of debts.

The rules as they stand are not sensible and impractical to apply. This has been appreciated and it appears these shortcomings will be addressed.

Share buybacks and dividend stripping

In 2017, measures were introduced to strengthen the anti-avoidance rules dealing with share buybacks and dividend stripping. These anti-avoidance rules override the corporate rollover relief rules, with the aim of preventing dividend stripping prior to corporate reorganisations.

Following concerns raised regarding the impact of these rules on legitimate transactions, government will review the interaction of these anti-avoidance rules and some of the corporate rollover relief rules.

The application of the anti-avoidance rules dealing with share buybacks and dividend stripping relating to preference share transactions will also be reassessed.

Refining rules for debt-funding in the acquisition of a controlling interest in an operating company

Historically, companies which used debt funding to acquire shares in an operating company were unable to deduct the interest incurred in connection with that debt funding.

In 2012 the Income Tax Act was amended to allow these companies to claim an interest deduction if they use debt funding to acquire a specified interest in an operating company and at least 80% of receipts and accruals of the operating company constitute income for tax purposes.

Amendments will be introduced to clarify when the test relating to the operating company's receipts and accruals should be applied.

Abuse of collateral lending arrangement provisions

Currently, the Income Tax Act allows for the transfer of listed shares and both local and foreign government bonds in collateral lending arrangements.

However, it appears that the provisions are allegedly being abused by some foreign shareholders using loan arrangements with a South African resident company, where the listed shares are provided as collateral, thereby reducing the dividends tax rate to zero.

The legislation regarding collateral lending arrangements will be amended to address this abuse.

Business (Banks and the Financial Sector)

Incorporating new stock exchanges

The Income Tax Act only makes reference to the JSE Limited. Government will review these provisions and incorporate a reference to the new stock exchanges in South Africa which have been recently been approved.

Portfolios of collective investment schemes (CIS)

Currently, where a CIS receives income which is not capital in nature and makes a distribution of that amount to its investors who have a participatory interest in the CIS within 12 months, the amount is taxed in the investor's hands.

Frequently, the CIS' treats all (or most) of its trades as being on capital account. Some clarification on the treatment of trading profits will be introduced.

Business (Incentives)

Refinement of the venture capital company regime

The venture capital company regime was introduced to promote investment in small and medium-sized enterprises.

Changes will include:

- the investment income threshold limitations for qualifying companies will be adjusted;
- when and how the controlled company test is to be applied will be clarified; and
- the application of the test for connected persons who are shareholders of the VCC will be amended.

Approval of six new special economic zones

The Minister of Finance will approve six additional special economic zones, namely: Coega, Dube Trade Port, East London, Maluti-a-Phofung, Richards Bay, and Saldanha Bay.

In these areas, qualifying firms will be entitled to a number of attractive incentives including a reduced corporate tax rate, and employment tax incentives for workers of all ages.

The applicable legislation will be reviewed to ensure that these incentives are provided without creating any opportunities for local companies to reduce their tax liability without due entitlement.

Review of all incentives and grants

The Department of Planning, Monitoring and Evaluation is conducting a review of all incentives and grants to ensure that they are aligned with inclusive growth objectives. In line with this, there are likely to be amendments of any incentives or grants which do not align with these objectives.

The research and development tax incentive which allows taxpayers to deduct 150% of expenditure incurred in relation to qualifying projects will be clarified and simplified.

International Tax

Taxation of short-term insurers

The Insurance Act, 2017 will permit foreign reinsurers to operate reinsurance businesses in South Africa through branches rather than subsidiaries.

The current tax legislation only applies to short-term insurers resident in South Africa.

The provisions of the tax legislation will therefore be extended to apply to non-residents operating short-term insurance business through branches in South Africa.

Extension of the application of controlled foreign company rules

Draft legislation released in 2017 provided that local distributions by discretionary foreign trusts or foreign foundations to individuals and local trusts will be taxable on revenue account in the hands of South African resident beneficiaries.

These proposals were not however implemented due to their perceived complexity and broad scope.

These proposals will be reconsidered during 2018.

Controlled Foreign Companies (CFC) – High tax exemption

Where a foreign company that is a CFC for South African tax purposes operates in a jurisdiction where tax is payable in that foreign jurisdiction at a rate greater than 75% of the tax that would be payable in South Africa, the CFC rules would not be applicable and the net income of the foreign company is deemed to be nil. Due to a global shift by countries to reduce the corporate tax rate, it is proposed that the 75% threshold must be revised.

Exchange control

Significant and strategic transactions

To support cross-border investment, and increase transparency, the National Treasury will publish a proposed policy framework for the review and approval of complex cross-border transactions.

Prudential limits

Due to recent events that suggest a need to increase investment in diverse asset classes by institutional investors, the offshore investment limit for funds under management by institutional investors will increase by 5%, including the African investment allowance.

Loop structures

The exemption regarding loop structures (which occur when South Africans invest in South Africa assets via an entity in a foreign jurisdiction) will be increased from a maximum shareholding of 20% to 40% for bona fide foreign direct investments by corporates.

The current minimum shareholding requirement of 10% for foreign direct investments by corporates is abolished. This applies to corporates and private equity funds, provided that the corporate or private equity fund is a tax resident in South Africa.

Holding company rules

The limit for transfers to group holding companies used as a treasury entity in foreign operations will be increased from ZAR2 billion to ZAR3 billion for listed companies, and from ZAR1 billion to ZAR2 billion for unlisted companies, subject to the applicable reporting requirements.

Inward listings

Treasury plans to release a comprehensive inward listings review paper this year to address various matters, including the standards for reporting and provided information , company track records, arm's-length arrangements, valuation of the acquiring company, management arrangements, funding arrangements, deployment of listing proceeds offshore, due diligence, audit history, stakeholder protection, better treatment of holders of securities, and confidence among market participants.

Personal Income Tax

Tax Rates

The new tax brackets are illustrated below (*red denotes change):

2017 / 2018		2018 / 2019	
Taxable income (ZAR)	Rates of tax (ZAR)	Taxable income (ZAR)	Rates of tax (ZAR)
0 - 189 880	18% of each R1	0 – 195 850	18% of each 1
189 881 – 296 540	34 178 + 26% of the amount above 189 880	195 851 – 305 850	35 253 + 26% of the amount above 195 850
296 541 – 410 460	61 910 + 31% of the amount above 296 540	305 851 – 423 300	63 853 + 31% of the amount above 305 850
410 461 – 555 600	97 225 + 36% of the amount above 410 460	423 301 – 555 600	100 263 + 36% of the amount above 423 300
555 601 – 708 310	149 475 + 39% of the amount above 555 600	555 601 – 708 310	147 891 + 39% of the amount above 555 600
708 311 – 1 500 000	209 032 + 41% of the amount above 708 310	708 311 – 1 500 000	207 448 + 41% of the amount above 708 310
1 500 001 and above	533 625 + 45% of the amount above 1 500 000	1 500 001 and above	532 041 + 45% of the amount above 1 500 000

Rebates	2017 / 2018 (ZAR)	Rebates	2018 / 2019 (ZAR)
Primary	13 635	Primary	14 067
Secondary	7 479	Secondary	7 713
Third	2 493	Third	2 574

Tax threshold	2017 / 2018 (ZAR)	Tax threshold	2018 / 2019 (ZAR)
Below age 65	75 750	Below age 65	78 150
Age 65 and over	117 300	Age 65 and over	121 000
Age 75 and over	131 150	Age 75 and over	135 300

Splitting of medical fees tax credits

The Income Tax Act provides a medical tax credit for individuals and it consists of two components: contributions to approved medical schemes; and additional out-of-pocket medical payments.

There is a concern that some taxpayers may be benefiting excessively from this rebate, specifically in instances where multiple taxpayers contribute toward the medical scheme or expenses of another person (for example, adult children jointly contributing to their elderly mother's medical scheme).

It is proposed that in instances where taxpayers carry a share of the medical scheme contribution or medical cost, the medical tax credit should also be apportioned between the various contributors.

Medical tax credit

In the next three years, below-inflation increases in the medical tax credits will assist Government in funding the implementation of national health insurance.

The medical tax credit will be increased as follows:

- for the first two beneficiaries from ZAR303 to ZAR310 per month; and
- for the remaining beneficiaries from ZAR204 to ZAR209 per month.

Retirement reforms

- *Tax treatment of contributions to retirement funds situated outside South Africa*: The Income Tax Act currently exempts from taxation all retirement benefits from a foreign source for employment rendered outside of South Africa. The current tax provisions will be reviewed taking into account the application of Double Taxation Agreements, to ensure that contributions will only be deductible in cases where benefits are taxable.
- *Align tax treatment of preservation funds upon emigration*: Upon formal emigration, an individual is able to withdraw the full value of their retirement annuity, after paying the applicable taxes. Government will consider aligning the tax treatment of other types of retirement fund withdrawals in similar circumstances.
- *Allowing transfers to pension and provident preservation funds after retirement*: In 2017, amendments expanded the choice of available retirement funds if an individual decided to postpone retirement. However, these rules excluded pension preservation and provident preservation funds due to the complexity of their administration. It is proposed that transfers to pension preservation and provident preservation funds will now be catered for in the legislation.
- *Rectifying tax anomalies on the transfer of retirement funds*: Retrospectively amendments will be introduced to correct unintended tax liabilities arising where a fund amount is transferred between, or within, retirement funds at the same employer.

Estate Duty

In line with the Davis Tax Committee's recommendation relating to wealth taxes, the estate duty on estates worth more than ZAR30 million is increasing from 20% to 25%.

In line with this amendment, and to prevent the staggering of donations to avoid estate duty, any donations above ZAR30 million in one tax year will also be taxed at 25%.

Special Voluntary Disclosure Program (SVDP)

The SVDP process came into effect on 1 October 2016.

The process afforded South African taxpayers the opportunity to regularise any undeclared foreign assets to SARS and the South African Reserve Bank (**SARB**) and pay a penalty as determined by the regulators.

The last date of submission for the SVDP was 31 August 2017.

The Minister of Finance has announced that over 2 000 applications were received. However, the review of these applications is still not finalised.

The Minister believes that ZAR3 billion will be collected from the SVDP process by the end of the 2017/2018 tax year (being 31 March 2018).

Environmental and health taxes

Carbon Tax

The second draft Carbon Tax Bill was released during December 2017 and it is intended that the Bill will be enacted by end of 2018 with an effective implementation date of 1 January 2019.

Acid mine drainage levy

Government is considering a new levy to environmental damages and to make polluters pay for the cost of fund the treatment of acid mine water.

Health promotion levy

Sugar tax has long been on the radar for Government. The implementation date for the levy has been set as 1 April 2018.

Tax administration

Official rate of interest

The Income Tax Act makes reference to the “official rate of interest”.

Currently the official rate of interest is 7.75%.

Given that the official rate of interest is currently lower than the prime rate of 10.25%, it is proposed that the official rate be adjusted to align it to the rates offered by commercial banks.

Electronic fiscal devices

In an effort to streamline its process, SARS proposes the utilisation of fiscal electronic devices which will assist the revenue authority with monitoring business transactions.

Other administrative measures to be taken by SARS include the enhancement of the custom and excise system, with a particular focus on the tobacco industry.

Financial technology and cryptocurrencies

Financial technology

The increase in financial technologies (FinTech) has brought about significant changes in financial and business models internationally.

The growth of FinTech brings many benefits but also creates a number of social issues such as increased retrenchments.

The National Treasury, SARB, the Financial Services Board, and the Financial Intelligence Centre have been operating an Intergovernmental Working Group on Financial Technology and Innovation since 2016 to address these developments.

Cryptocurrencies

The budget speech confirmed that existing provisions and general principles of the current tax legislation apply to transactions undertaken using cryptocurrencies. However, there are certain administrative difficulties which arise due to the nature of this technology.

The income tax and VAT rules will be amended to cater for these peculiarities and to provide guidance and certainty to those taxpayers transacting in cryptocurrencies.

In addition, SARB is set to release another position paper in relation to cryptocurrencies which will shed light on future regulation and recognition of these now popular digital assets.

Value-Added Tax

General 1% increase

Effective from 1 April 2018, there will be a 1% increase in the standard VAT rate from 14% to 15%. This is aimed at reducing the current deficit by bringing in an additional ZAR22.9 billion to the fiscus.

This will be the first increase of the VAT rate since 1993.

Though this increase will affect all households, the zero-rating of basic foodstuffs and paraffin will reduce the negative effect on the poor. Currently, 19 basic foodstuffs are zero-rated, including bread, for instance. However, there is a proposal that only brown bread and whole wheat brown bread will be zero-rated as rye and low GI breads are usually consumed by wealthier households and are to be excluded from the application of the zero-rate.

The government did consider a number of alternatives including: using multiple different VAT rates with higher rates applicable to more luxury items, increasing personal income tax rates, and increasing the corporate tax rate.

However, these were expressly rejected as there is considerable evidence to support the fact that such alternatives would not be as effective as the standard 1% increase across the board.

Writing-off irrecoverable debts

It appears that some vendors (such as collection agents) that buy irrecoverable debts from other vendors, for less than the amount owing and on a non-recourse basis, attempt to claim a VAT deduction if they write off all or part of this debt in future.

This results in a double deduction as the vendor selling the irrecoverable debt also claims a VAT tax deduction when it writes off the debt initially.

Government will include a definition of “face value of a debt transferred” in the Value-Added Tax Act to prevent this double deduction.

VAT on electronic services

In 2017 government announced that the regulations to the Value-Added Tax Act were being updated to broaden the scope of electronic services rendered to South African residents which are subject to VAT.

Electronic services will include cloud computing and services provided using online applications. The proposed regulations will be published for public comment.

Customs and Excise

Raising luxury *ad valorem* excise duties

Government will increase *ad valorem* excise duties which are already applied to some goods that are consumed mainly by wealthier households (such as cosmetics, electronics and golf balls).

Effective 1 April 2018, the maximum *ad valorem* excise duty for motor vehicles will be increased from 25% to 30%.

In addition, the *ad valorem* excise duty rates, now at 5% and 7%, will be increased to 7% and 9%.

Smart phones will expressly attract *ad valorem* excise duties and Government will consult on a proposal to have a progressive rate structure for cellphones based on the value of the phone.

Holistic reform of the diesel refund administration system and separation from the VAT system

The 2015 Budget Review announced the holistic reform of the diesel refund administration system.

Following publication of a discussion document for public comment in February 2017, extensive comments were received and processed.

In 2018, the National Treasury and SARS will engage with affected industries and other role players to inform the design of the new diesel refund administration system, which will be announced in Budget 2019.

The reform will also separate the diesel refund system from the VAT system. From the date at which the new diesel refund system commences, vendors will no longer be entitled to a VAT deduction in respect of the purchase and use of diesel in terms of a scheme for the development of small-scale farmers.

Changes in specific excise duties

Excise duties on:

- beer, cider and alcoholic fruit beverages will increase by R8.64/litre of absolute alcohol which translates to an increase of around 15c for an average 340ml can;
- spirits will increase by R14.89/litre of absolute alcohol which translates to an increase of around R4.80 for an average 750ml bottle;
- fortified wine will increase by 37c/litre;
- unfortified wine will increase by 30c/litre;
- sparkling wine will increase by 97c/litre;
- cigarettes will increase by R1.22/box of 20 cigarettes;
- cigarette tobacco will increase by R1.37/50g;
- pipe tobacco will increase by 76c/50g; and
- cigars will increase by R6.45/23g.

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