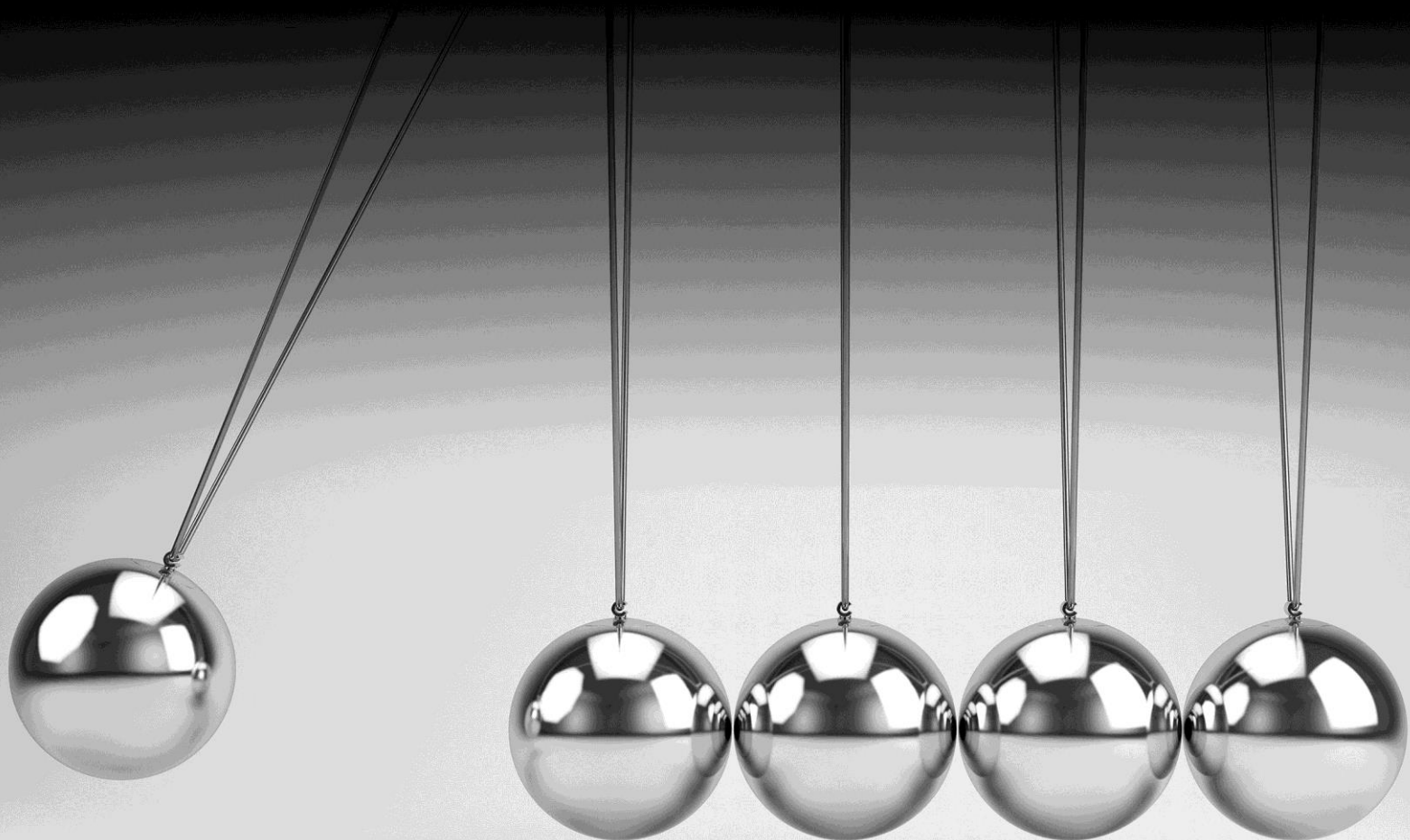


Financial institutions
Energy
Infrastructure, mining and commodities
Transport
Technology and innovation
Life sciences and healthcare

 NORTON ROSE FULBRIGHT

Budget 2017



Budget 2017

Introduction

The 2017 budget speech is an object lesson in balancing competing priorities: the need for increased revenue collection set against a number of sensitive political considerations, made more acute by the looming national election in 2019 and the watching brief by the rating agencies.

There has been a significant under-collection of tax in the 2017 financial year, and the resultant tax rate adjustments are to personal income tax (up a staggering 4% at the top end of the spectrum) and dividends tax (increased from 15% to 20%).

While a number of commentators are sceptical as to whether or not these increases will “fill the hole”, they certainly are more palatable to the electorate at large than an increase in Value-Added Tax.

On the positive side, no ambitious spending projects were hastily adopted which should help alleviate the deficit. The Minister stuck to his guns and continued on the course which has marked his tenure in office: presenting conservative but sensible budgets, many of which have been crafted amidst one or other calamity or controversy.

Main tax proposals

The main budget proposals for the 2017-18 fiscal year include are following –

- new top personal income tax of 45% for individuals with taxable incomes above R1.5 million;
- an increase in the marginal rate for trusts to 45% (from the current 41%);
- an increase in dividends withholding tax from 15% to 20%;
- the introduction of both the carbon tax and sugar tax in the near future; and
- the transfer duty-free threshold on purchases of residential property will increase from R750 000 to R900 000 on 1 March 2017.

Corporate Tax Proposals

Business (General)

Debt forgiveness

The taxation of debts which are forgiven or discharged for less than face value has been subject to complex rules for some time. The revenue authorities have grappled with different methods to be applied, particularly in an environment where a number of companies are failing.

The proposed changes include –

- aligning the tax treatment of debt forgiveness in mining companies with the rules applied in the ordinary course. This will result in mining companies reducing the base cost of the allowance assets funded with forgiven debt rather than recouping deductions claimed;
- new rules will be introduced relating to dormant group companies or group companies which are under business rescue to allow them to ignore debts waived by other group companies even where the funding was provided for expenditure which was deductible for tax purposes.

Anti-avoidance rules

- **Share buybacks**

In recent times, it has been popular for companies disinvesting from a company to exit by way of a share buyback by the investee company, rather than by selling their shares to the new investor. The tax effect of this has been a substantial capital gains tax saving for the selling party. This will be addressed.

- **The “*in duplum*” rule and tax debts**

The *in duplum* rule is a legal principle which provides that interest on a debt ceases to accrue where the total amount of the interest equals the outstanding principal debt. It has come to Government’s attention that taxpayers are avoiding tax by relying on this rule in a number of scenarios, usually involving an interest-free or low interest loan. It is proposed that amendments dealing with low-interest or interest-free loans will explicitly exclude the *in duplum* rule.

- **Dividend-stripping rules**

Dividend-stripping rules exist to prevent avoidance schemes involving excessive dividend distributions. In particular, they apply to situations where the buyer or a connected party to the buyer introduces loan funding to the target company, and the loan funding is distributed as a dividend shortly thereafter to the seller. Avoidance transactions have been identified where these rules are circumvented through the debt being introduced by a third party, such as a bank. These transactions will be addressed.

- **Contributed tax capital (CTC)**

Government has identified schemes whereby companies with a foreign parent increase their CTC and potentially avoid paying dividends tax when a distribution of return of capital is made to the foreign parent. These capital distributions are not subject to capital gains tax in the hands of the foreign parent company if the underlying investment is not immovable property in South Africa. Appropriate amendments will be made to the definition of CTC.

Corporate reorganisation rules

- **Assumption of contingent debt**

Currently, as part of the corporate reorganisation rules, the consideration in a corporate reorganisation transaction may include the buyer assuming certain of the seller's debts. With respect to debt, only unconditional obligations are currently catered for in the Income Tax Act in this situation. It is proposed that the assumption of future contingent liabilities will be considered acceptable consideration under the corporate reorganisation rules.

- **Real estate investment trusts (REITs)**

REITs are subject to a special tax dispensation that allows them to deduct their shareholder distributions against rental income as the shareholders bear the tax liability in terms of section 25BB of the Income Tax Act. Furthermore, a REIT is prohibited from claiming allowances on its assets, which means that an anomaly arises when a REIT is party to a reorganisation transaction, because its assets would not qualify as allowance assets. It is proposed that the legislation be amended to make provision for corporate reorganisation rules to apply to transactions involving REITs.

Third-party backed shares

The hybrid instruments rules have been in place for some time and seek to tax instruments on their substance rather than their form. The third party backed share rules apply to equities which are "secured" or de-risked by a third party (i.e. other than the issuer). These rules do not apply where the equity in question is issued for a "qualifying purpose", normally a direct or indirect investment in an operating company. It is suggested that the current qualifying purpose exemption is not broad enough and it will be expanded.

Business (Banks and the Financial Sector)

Changes to the tax treatment of financial institutions

The income tax treatment of financial assets and liabilities of banks and other financial institutions currently follows the accounting treatment contemplated in International Accounting Standard 39. With the impending replacement of IAS 39 with IFRS 9 in 2018, the tax treatment of the financial assets and liabilities of banks and other financial institutions is to be aligned with IFRS 9 (except for the treatment of impairments).

It has also been raised that the hybrid debt rules contained in section 8F of the Income Tax Act do not apply to certain banks and financial institutions. Rules will be introduced to make it clear that the hybrid debt rules will apply to a bank and financial institutions.

In certain circumstances it was argued that mismatches in the application of the debt reduction rules arise where debt is cancelled, waived, forgiven or discharged between a financial institution and another company that is part of the same group of companies as the financial institution. Rules will be introduced to prohibit any mismatches which may arise in these circumstances.

Business (Incentives)

Mining environmental funds

The income tax legislation currently allows for contributions made to mining rehabilitation trusts to be tax deductible, subject to conditions. New regulations have recently been introduced in the National Environmental Management Act, 1998 for the financial provisioning of the rehabilitation, management and effects of mine closures for mining companies. Amendments will be made to the

tax legislation to align with the proposals in the financial provisioning regulations. In addition, rules will be introduced to curb the abuse of tax-deductible contributions which are used for purposes other than mining rehabilitation.

Refinement of the venture capital company regime

The venture capital company (VCC) regime was introduced into the income tax legislation to promote investment in small and medium-sized enterprises. Further changes will be made to the regime to remove any perceived impediments to making VCC investments, which will hopefully encourage further participation in the regime.

Assisting micro businesses growing into small and medium-sized enterprises

Currently, qualifying micro businesses and small business corporations are eligible for preferential corporate income tax rates. There are however no measures which allow for the smooth transition for micro businesses that grow sufficiently to migrate to the small business corporation tax regime, which may result in the imposition of penalties in certain circumstances. Rules will be introduced to allow for the reduction of any administrative penalties which may arise from the transition of micro businesses to the small business corporation regime.

International Tax

Changes to the tax treatment of domestic treasury management companies

Domestic treasury companies are generally not subject to tax in respect of foreign currency gains and losses. However, the qualifying criteria for domestic treasury management companies are viewed as overly restrictive and will be reviewed.

Tax implications of acquisition of foreign intellectual property by South African multinationals

Relaxation of the rules regarding the payment of licence fees or royalties for so-called "tainted intellectual property" will be considered. It is proposed that the rules should be relaxed so that they do not affect legitimate commercial transactions or discourage the use of South African based group infrastructure to develop offshore intellectual property.

Tax implications of controlled foreign companies and offshore foreign trusts

Amendments to the controlled foreign company rules are proposed which will extend the application of these rules to foreign companies held by interposed trusts which have South African beneficiaries. This rule could have a significant impact on a number of offshore structures.

Personal Income Tax

Tax Rates

A new top personal income tax bracket of 45% for taxable incomes above R1.5 million per year has been introduced.

The primary, secondary and tertiary rebates and all the taxable income brackets will be increased by 1% from 1 March 2017. The new tax brackets are illustrated below:

2016 / 2017		2017 / 2018	
Taxable income (R)	Rates of tax	Taxable income (R)	Rates of tax
R0 - R188 000	18% of each R1	R0 - R189 880	18% of each R1
R188 001 – R293 600	R33 840 + 26% of the amount above R188 000	R189 881 – R296 540	R34 178 + 26% of the amount above R189 880
R293 601 – R406 400	R61 296 + 31% of the amount above R293 600	R296 541 – R410 460	R61 910 + 31% of the amount above R296 540
R406 401 – R550 100	R96 264 + 36% of the amount above R406 400	R410 461 – R555 600	R97 225 + 36% of the amount above R410 460
R550 101 – R701 300	R147 996 + 39% of the amount above R550 100	R555 601 – R708 310	R149 475 + 39% of the amount above R555 600
R701 301 and above	R206 964 + 41% of the amount above R701 300	R708 311 – R1 500 000	R209 032 + 41% of the amount above R708 310
		R1 500 001 and above	R533 625 + 45% of the amount above R1 500 000

Rebates :	2016/2017	Rebates :	2017/2018
Primary	R13 500	Primary	R13 635
Secondary	R7 407	Secondary	R7 479
Third	R2 466	Third	R2 493

Tax threshold :	2016/2017	Tax threshold :	2017/2018
Below age 65	R75 000	Below age 65	R75 750
Age 65 and over	R116 150	Age 65 and over	R117 300
Age 75 and over	R129 850	Age 75 and over	R131 150

Foreign employment income tax exemption for South African residents

The exemption on foreign employment income derived by a resident who works in a foreign country for more than 183 days will be amended so that foreign employment income will only be exempt from tax in South Africa if the employment income is subject to tax in the foreign country.

Trust and tax anti-avoidance measures

Section 7C of the Income Tax Act was introduced in 2016 as an anti-avoidance measure against the use of low-interest or interest-free loans to trusts. Currently, section 7C of the Income Tax Act applies to any loan, advance or credit that is provided to a trust by a connected person who is –

- a natural person; or
- a connected person in relation to a natural person.

It is proposed that the scope of this anti-avoidance measure be extended to cover avoidance schemes where the loan is advanced to companies owned by a trust. The anti-avoidance rule will not apply to trusts that are not used for estate planning, for example, employee share scheme trusts and some trading trusts.

Share incentive schemes

Section 8C of the Income Tax Act has been tweaked almost every year since its introduction. In 2016, new rules were introduced to regulate dividends paid to employees who participate in share-based incentive schemes. However, these rules did not elegantly tie into the capital gains tax provisions arising from the vesting or disposal of a restricted equity instrument. The interaction between these regimes will be clarified.

Employer-provided bursaries

In relation to bursaries, the following increases to the thresholds are proposed –

- income eligibility threshold for employees from R400 000 to R600 000;
- the monetary limits for bursaries from R15 000 to R20 000 for education below NQF level 7; and
- the monetary limits for bursaries from R40 000 to R60 000 for qualifications at NQF level 7 and above.

Medical tax credit

The medical tax credit will be increased–

- for the first two beneficiaries from R286 to R303 per month; and
- for the remaining beneficiaries from R192 to R204 per month.

Tax-free savings accounts

The tax-free savings accounts annual allowance of R30 000 will be increased to R33 000.

Withholding tax on dividend income

The dividends withholding tax, which is currently set at 15%, falls below the global standard set by the Organisation for Economic Co-operation and Development. It has thus been increased to 20% with effect from 22 February 2017. The exemption rates for inbound foreign dividends will accordingly be adjusted in line with this increase with effect from 1 March 2017.

Sugar Tax

The sugar tax, which was introduced by the budget speech 2016 will be effective as soon as the relevant legislation is approved by Parliament and signed into law by the President. At this stage, it is evident that the amount of tax payable will be based on the sugar content of the beverages at the proposed rate of 2.1c/gram of sugar content in excess of 4g/100ml. To ensure that both intrinsic and added sugar are included in this calculation, the legislation will follow definitions used by the World Health Organisation. This tax will also apply to concentrated beverages in line with the current health-promotion interventions proposed by Government.

Part of the revenue generated through this tax will be applied to Governmental health initiatives as a part of the strategy to fight non-communicable diseases.

Carbon Tax

A revised Carbon Tax Bill is to be tabled in Parliament and receive public comments by mid-2017. A revised regulation for the carbon offset allowance will be published alongside the Carbon Tax Bill and will enable corporate entities and firms to reduce their carbon tax liability. It was also noted that during the first phase of the tax, which will run until 2020, there will be no impact on the price of electricity as a result of the imposition of this tax.

Further clarity is needed on the alignment of the carbon tax and the carbon budget after 2020 which Government assures us will arrive by the end of the year.

Exchange control

Inward listings review

Parties interested in new inward listings and transactions involving loop structures and trusts which relate to such listings will have to consult with National Treasury. The intention is to discourage inversion transactions in terms of which legal domicile may be moved to a different jurisdiction despite the entity retaining significant South African assets.

Intellectual property

Government proposed removing restrictions on foreign exchange transactions involving intellectual property. It is also proposed that the restriction on loop structures be lifted in relation to transactions involving intellectual property, if they are entered into on an arm's length basis and at fair market-related prices.

Exchange traded funds referencing foreign assets

Government has proposed that local collective investment scheme management companies should be allowed to list exchange traded funds which hold foreign referenced assets on South African exchanges. These funds will not be subject to macro-prudential limits on the amounts that may be invested offshore. However, South African institutional investors and authorised dealers will have to treat investments in these funds as foreign assets which are subject to their portfolio allowances.

Transfer Duty

The duty-free threshold on purchases of residential property will increase from R750 000 to R900 000 from 1 March 2017.

2016 / 2017		2017 / 2018	
Property value (R)	Rate of tax	Property value (R)	
R0 - R750 000	0% of property value	R0 – R900 000	0% of property value
R750 001 - R1 250 000	3% of property value above R750 000	R900 001 - R1 250 000	3% of property value above R900 000
R1 250 001 - R1 750 000	R15 000 + 6% of property value above R1 250 000	R1 250 001 - R1 750 000	R10 500 + 6% of property value above R1 250 000
R1 750 001 - R2 250 000	R45 000 + 8% of property value above R1 750 000	R1 750 001 - R2 250 000	R40 500 + 8% of property value above R1 750 000
R2 250 001 – R10 000 000	R85 000 + 11% of property value above R2 250 000	R2 250 001 - R10 000 000	R80 500 + 11% of property value above R2 250 000
R10 000 001 and above	R937 500 + 13% of property value above R10 000 000	R10 000 001 and above	R933 000 + 13% of property value above R10 000 000

Value-added tax

Zero-rating of fuel

Government will consider removing the zero-rating on fuel, subject to consultation during 2018/2019. To mitigate the effect on transport costs, government will consider combining this with either a freeze or a decrease in the fuel levy.

VAT on electronic services

Regulations to the VAT Act are being updated to broaden the scope of electronic services rendered to South African residents which are subject to VAT. Specifically, electronic services will now include cloud computing and services using online application. The proposed regulatory changes will be published for comment this year.

Clarifying the VAT treatment on lease-holding improvements

Presently, the VAT Act does not provide clear rules on the timing and value of VAT applicable to improvements made by lessees on leasehold property. Amendments are proposed to clarify the VAT treatment of these improvements.

Amending the definition of “resident of the Republic” for VAT purposes

The definition of “resident of the Republic” will be amended to exclude foreign companies which are effectively managed in South Africa but fall below the threshold to register for VAT. This will enable other VAT vendors to zero rate their supplies to these foreign companies.

Movable property situated in an export country

There has been some suggestion that securities or shares in a foreign company listed on the JSE constitute movable property which is situated in the foreign country. The potential implication is that services supplied directly in connection with these securities or shares could be zero-rated. Amendments will be proposed to rectify this anomaly.

Customs and Excise

Marking, tracking and tracing of tobacco products

Amendments to the Tax Administration Act relating to the marking, tracking and tracing of locally manufactured and imported tobacco products will be considered as part of the annual budget review.

Review of the diesel refund administration system

The 2015 budget proposed a comprehensive review of the administration of the diesel refund to delink the diesel refund from the VAT system and create a standalone diesel refund administration system. A discussion paper outlining the options for the new administration system was published for comment on 15 February 2017. Legislative amendments will be developed following public consultation on the discussion paper.

Changes in specific excise duties

Excise duties on –

- beer, cider and alcoholic fruit beverages will increase by R7.13/litre of absolute alcohol which translates to an increase of around 12c for an average 340ml can;
- spirits will increase by R13.72/litre of absolute alcohol which translates to an increase of around R4.43 for an average 750ml bottle;
- fortified wine will increase by 35c/litre;

- unfortified wine will increase by 30c/litre;
- sparkling wine will increase by 93c/litre;
- cigarettes will increase by R1.06/box of 20 cigarettes;
- cigarette tobacco will increase by R1.19/50g;
- pipe tobacco will increase by 80c/50g; and
- cigars will increase by R6.58/23g.

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