NORTON ROSE FULBRIGHT

BUDGET 2016

Introduction

It was not clear what we expected from the 2016 budget speech which made it such a keenly anticipated event. The recent changes in personnel at the office of the Minister of Finance made it impossible to predict what Minister Gordhan's priorities would be since his tenure in office has been so short.

There was a sense that much of the focus would be on trying to avoid a sovereign debt downgrade and to talk up programmes to stimulate growth in a flagging economy. From a tax perspective, the outcome was not as bad as some had suggested, but for those at the top end of the scale, the changes will be felt.

This was a budget with a focused mission and whether or not it achieves its goals will be seen in days to come. Evidence will lie in movements of the Rand and noises from the rating agencies. However, it was a return to form for the Minister who always guided the economy with a conservative yet subtle hand on the tiller and the Minister's performance this year only reinforced how fortunate we were to have him back.

Main tax proposals

The main budget proposals for the 2016-17 fiscal year include the following –

- limited fiscal drag relief of R5.5bn has been extended to individuals through an adjustment to the tax rates, with the benefit mainly focused on lower and middle income earners.
- the effective capital gains tax rate for individuals increases from 13.7% to 16.4%, for corporates from 18.6% to 22.4% and for trusts from 27.3% to 32.8%. The annual exemption from capital gains for individuals increases from R30 000 to R40 000.
- the general fuel levy will increase by 30c/litre, raising R6.8bn for the fiscus.
- increases of between 6% and 8.5% in the duties on alcoholic beverages and tobacco products will be enacted, raising an additional R1.5bn and R767m respectively.
- an offer has been made to taxpayers who have undeclared offshore assets and income to participate in a six-month programme commencing from October 2016 to regularise their affairs.
- transfer duty on immovable property exceeding R10m will increase from 11% to 13% for properties acquired after 1 March 2016 which will yield and additional R100m for the fiscus.
- a new tax on sugar-sweetened beverages will be introduced from April 2017 in a bid to encourage and promote public health.
- a new tyre levy of R2.30/kg will take effect from 1 October 2016 to help finance recycling programmes.
- the taxes on incandescent globes, plastic bags and motor vehicle emissions will also be increased.

Corporate tax proposals

Business (general)

Hybrid debt instruments

Treasury has maintained its focus on eliminating base erosion and profit shifting, particularly in relation to hybrid debt instruments. With effect from 24 February 2016, the rules which reclassify interest payments on hybrid debt instruments as dividend payments for tax purposes will be amended to avoid an outright exemption where the issuer of the instrument is not a South African resident taxpayer.

A subordination of a debt can lead to an instrument being classified as a hybrid debt instrument. A concession will be introduced to exclude subordinated debt instruments from being regarded as hybrid debt instruments.

Taxation of trusts

The taxation of trusts has been on the radar screen in the recent past and measures have been mooted to prevent tax avoidance through the use of trusts. Government has proposed that the assets transferred through a loan to a trust are to be included in the estate of the founder at death. Furthermore, interest-free loans to trusts will be subject to donations tax. Lastly, measures will be introduced to limit the use of discretionary trusts for the purposes of income-splitting.

Share buy-backs

Historically a share subscription coupled with buy-back has been used in certain transactions to pay a tax exempt dividend to the seller and to minimise capital gains tax. The use of these arrangements will be reviewed to determine if counter-measures are required which may see these arrangements taxed on similar terms to a share sale.

Securities lending arrangements

The current income tax and securities transfer tax relief for the transfer of collateral in securities lending arrangements is limited to lending arrangements shorter than 12 months. Concerns that have been raised regarding this time limitation will be considered by Treasury. In addition, the tax treatment of securities-lending arrangements will be reviewed to take into account corporate actions during the term of the lending arrangements.

Refinement of third-party backed share provisions

Treasury will relax the anti-avoidance rules which recharacterise dividends received in respect of third-party backed shares as interest for transactions entered into before 2012.

It is also perceived that a number of schemes have been developed which circumvent these rules. New legislation will be introduced to curb these practices.

Business (financial sector)

Hedge funds

Additional amendments are proposed to provide extended roll-over relief for the migration of unregulated hedge funds to a new regulated regime, particularly in relation to trust structures.

Taxation of real estate investment trusts (REITs)

Amendments are proposed relating to the “qualifying distribution” criterion in section 25BB of the Income Tax Act to take account of factors such as building allowances claimed when determining whether a distribution is a “qualifying distribution”.

The current provisions of section 9C of the Income Tax Act which treat shares held for 3 years or more as capital assets are inappropriate for REITs because dividends received from REITs are included in taxable income. Proposals are made to prevent the recoupment of expenditure under section 9C(5) of the Income Tax Act where a taxpayer disposes of shares in a REIT.

Business (incentives)

- To further promote skills development, it is proposed that an increased incentive be provided to employers who provide bursaries to their employees. This incentive will take the form of an increase in the fringe benefit tax exemption thresholds for bursaries provided to employees or their relatives. The value of the qualifying bursaries will be increased to R15 000 for National Qualifications Framework levels 1 to 4, and to R40 000 for levels 5 to 10. Furthermore, the income eligibility threshold for employees to access this tax relief will be increased from R250 000 to R400 000, thereby allowing a broader range of employees and their relatives to access this benefit and further their skills.

- As regards public benefit organisations, consideration is also being given to expanding the list of public benefit education and training activities to accommodate industry-based training organisations, which would exempt them from tax.

- The rules regarding incentives for investments in venture capital companies are under review as there are concerns that certain other provisions in the Income Tax Act give rise to unintended tax consequences for investors.

- Treasury has proposed extending the urban development zone tax incentives to more municipalities, subject to a strict set of criteria, in order to stimulate investment in the construction and renovation of commercial and low cost residential buildings in the inner city.

Small business corporations in special economic zones

- Small business corporations in special economic zones will be taxed at the lower of the rates applicable to small business corporations or the special economic zone tax rate of 15%, subject to compliance with the applicable provisions.

- Currently mining companies can claim a deduction for expenditure incurred on building houses, hospitals, schools and recreational facilities if the expenditure directly relates to employees. It is proposed that the deduction be extended to community-related expenditure, thus expenses incurred for investing in the local community will be tax deductible.

Business (environmental taxation)

- Compliance with new fuel specifications will require an estimated R40 billion in capital expenditure by South African oil refineries. To facilitate the necessary upgrades, government proposes an accelerated depreciation allowance for a limited time. This would allow qualifying capital expenditure to be deducted over a three-year period instead of the normal five years.

- Capital expenditure that indirectly supports renewable electricity production, such as the construction of fences and roads, does not qualify for any special deductions. To encourage investment in renewable energy, government will consider enhancing existing provisions to include some necessary indirect infrastructure costs for additional allowances.

- Government will increase the general fuel levy by 30c/litre, effective 6 April 2016.

- The tyre levy, proposed in the 2015 budget to reduce waste, will be implemented at a rate of R2.30/kg of tyre, effective 1 October 2016. The levy will replace the current fee arrangements for tyres regulated by the Department of Environmental Affairs.

- An environmental levy on incandescent light bulbs, introduced in 2009, was last increased in 2013. The levy will be increased from R4 to R6 per globe from 1 April 2016.

- The plastic bag levy will be increased from 6 cents to 8 cents per bag, effective 1 April 2016.

- From 1 April 2016 the motor vehicle emissions tax will be increased, for passenger vehicles, from R90 to R100 for every gram of emissions/km above 120 gCO_2/km and, for double cabs, from R125 to R140 for every gram of emissions/km in excess of 175 gCO_2/km.

Business (energy)

- Government is preparing a major expansion of the independent power producer (IPP) initiative to contribute base-load energy capacity. Later this year, the Minister of Energy will announce preferred bidders for 1 000MW of coal projects. Private investment of about R45 billion is anticipated and a second round of coal projects is expected to add a further 1 500MW to the grid.

- A gas-to-power IPP programme is also under preparation, with a view to contributing 3 126MW of electricity generation through investment in liquefied natural gas facilities and power plants in the ports of Richards Bay, Coega and Saldanha Bay.

- Over the longer term, government has identified the need to expand production of nuclear power within South Africa's overall energy mix. Nuclear power involves substantial upfront costs, and government will only expand such capacity at a scale and pace that is affordable, after a thorough and transparent tender process.

- It was confirmed that the main aim of the carbon tax is to put a price on the environmental and economic damages caused by excessive emissions of greenhouse gases. A secondary aim is to change the behaviour of firms and consumers, encouraging them to use cleaner technology. In light of the current economic climate, government has confirmed that the carbon tax will be revenue neutral until 2020.

- The draft Carbon Tax Bill was published in November 2015, with 90 comments received to date. The draft bill will be revised, taking into account public comments and further consultation, including recommendations made by the Davis Tax Committee. No time-frame has been provided in the budget and we are therefore left to assume that it will be effective from 1 January 2017.

International tax

Withdrawal of withholding tax on service fees

Service fees paid to non-residents were intended to attract a withholding tax of 15% as from 1 January 2017. Treasury has identified certain anomalies particularly in the application of the withholding tax to tax treaties. It is thus proposed that the withholding tax on service fees be withdrawn from the Income Tax Act and dealt with under the reportable arrangement provisions.

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Bad debt deduction

An alignment of the tax treatment in relation to exchange differences that are included or deducted from taxable income when a foreign denominated loan is advanced by a taxpayer to another, and the loan subsequently goes bad will be introduced. The bad debt deduction provisions will be amended to specifically include any exchange difference for a debt that has been included in income.

Withholding tax on interest

When interest is paid to a foreign person by a South African resident, there is a withholding tax of 15% that must be withheld and paid to SARS by the resident. The current tax provisions do not cater for instances where interest withholding tax has already been paid but the interest is subsequently written off as irrecoverable. It is proposed that there will be a mechanism for a refund of interest withholding tax in these circumstances.

Personal income tax

Tax rates

The primary rebate and the bottom three income brackets will be adjusted by 1.8% and 3.4% respectively. The new tax brackets are illustrated below –

	2015/2016		2016/2017
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
R0 - R181 900	18% of each R1	R0 - R188 000	18% of each R1
R181 901 – R284 100	R32 742 +26% of the amount above R181 900	R188 001 – R293 600	R33 840 + 26% of the amount above R188 000
R284 101 – R393 200	R59 314 + 31% of the amount above R284 100	R293 601 – R406 400	R61 296 + 31% of the amount above R293 000
R393 201 – R550 100	R93 135 + 36% of the amount above R393 200	R406 401 – R550 100	R96 264 + 36% of the amount above R406 400
R550 101 – R701 300	R149 619 + 39% of the amount above R550 100	R550 101 – R701 300	R147 996 + 39% of the amount above R550 100
R701 301 and above	R208 587 + 41% of the amount above R701 300	R701 301 and above	R206 964 + 41% of the amount above R701 300

Rebates :	2015/2016	Rebates :	2016/2017
Primary	R13 257	Primary	R13 500
Secondary	R7 407	Secondary	R7 407
Third	R2 466	Third	R2 466

Tax threshold :	2015/2016	Tax threshold :	2016/2017
Below age 65	R73 650	Below age 65	R75 000
Age 65 and over	R114 800	Age 65 and over	R116 150
Age 75 and over	R128 500	Age 75 and over	R129 850

The medical scheme contribution credits increase from R270 to R286 per month for each of the first two beneficiaries and from R181 to R192 per month for each additional beneficiary.

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Capital gains tax

Tax rates

The table below illustrates the proposed increased inclusion rates –

	2015/2016	2016/2017
Individuals	33.3%	40%
Companies	66.6%	80%
Trusts	66.6%	80%
Individuals annual exclusion	R30 000	R40 000

The maximum effective capital gains tax rate for individuals has increased from 13.7% to 16.4%, and for companies from 18.6% to 22.4%. The effective capital gains tax rate relating to trusts increases from 27.3% to 32.8%.

The new rates will become effective for years of assessment beginning on or after 1 March 2016.

Retirement reforms

A number of fairly subtle amendments have been proposed in relation to the taxation rules governing pension and provident funds, as well as the rules around employee/employer contributions to such funds. These include –

- aligning the deductions available to employers for amounts contributed to retirement funds to ensure that they match the calculation of the fringe benefit tax raised against the employee;
- clarifying that taxpayers are entitled to deduct retirement annuity contributions made by them against passive or non-trading income earned by them, up to a certain limit so that these deductions are not only set off against non-passive income;
- introducing a roll-over mechanism to allow for the roll-over of excess contributions to retirement annuity funds and pension funds accumulated up until 29 February 2016;
- ensuring that the contributions made to certain retirement funds which are taxed as a fringe benefit are clearly specified, and that there is no ambiguity as to the quantum of the amount that falls within the scope of this section;
- the rules around pay-outs from retirement funds and compulsory acquisitions of annuities upon retirement have been controversial in recent times. Certain technical amendments will be made to clarify when the purchase of an annuity will or will not be required particularly with regard to a forced transfer from one fund to another.

Fringe benefits tax

A number of issues surrounding private travel and the calculation of fringe benefit tax have come up in recent times. This is particularly so with employers providing private travel to expatriate employees who are located in South Africa. What comprises “private travel” for the purposes of the Income Tax Act has different meanings in different parts of the act. This concept and the meaning of “private travel” is to be aligned to create clarity going forward.

Tax-free investments

The tax-free investments account was recently introduced to encourage savings amongst South Africans. As with other dispensations, a number of proposed changes have been suggested –

- certain structures have been identified which allow individuals to transfer proceeds of the tax-free investment account to a beneficiary of a long-term insurance policy with the result that no estate duty is payable.
- amendments are proposed to prevent the avoidance of estate duty;
- the implementation date allowing transfer as a tax-free investments between service providers has been postponed from 1 March 2016 to 1 November 2016 to ensure that the necessary processes are in place.

Share incentive schemes

The taxation of share incentive schemes is always controversial. A number of clarifications to the share incentive scheme have been proposed including –

- a technical amendment will be introduced clarifying that the taxation of share incentive schemes will be dealt with in terms of section 8C of the Act and not within the general definition of "taxable income" in section 1 of the Income Tax Act;
- SARS is constantly looking for structures which may circumvent the provisions of section 8C of the Income Tax Act. It is perceived that one such scheme relies on the dividend exemption which, in certain circumstances, results in a cash flow that is not taxed under the share scheme rules which is unintended and will be closed;
- certain dividends received in respect of employee share schemes are not exempt from normal tax. These dividends are to be brought within the PAYE regime to ensure pre-payment of the tax due;
- there are a number of circumstances in which employers must obtain a directive from the SARS as to the amounts to be withheld from lump-sums paid to employees. It does not cover all such payments and any exceptions to this rule are to be removed resulting in all such payments being subject to the employer obtaining a SARS directive.

Specific voluntary disclosure relief

The Minister of Finance has announced that a Special Voluntary Disclosure Programme will commence from 1 October 2016 to 31 March 2017, to give non-compliant taxpayers an opportunity to voluntarily disclose offshore assets and income from a tax and exchange control perspective.

With a new global standard for the automatic exchange of information between tax authorities providing SARS with additional information from 2017, time is now running out for taxpayers who still have undisclosed assets abroad.

Proposed tax relief

Only 50% of the total amount used to fund the acquisition of offshore assets (also known as "seed money") will be excluded from taxable income and subject to normal tax, where those funds did not comply with a tax act administered by SARS before 1 March 2015.

Investment returns in respect of those offshore assets received or accrued from 1 March 2010 onward will be included in taxable income in full and subject to normal tax. Therefore investment returns prior to 1 March 2010 will be exempt.

Interest on tax debts will only commence from 1 March 2010; and no understatement penalties will apply to the tax debt, if the application is successful.

SARS will not pursue any criminal prosecution under the Special Voluntary Disclosure Programme.

Exchange control relief

Applicants who are granted administrative relief in respect of unauthorised foreign assets or structures will only be required to pay reduced penalties of -

- 5% of the leviable amount if the regularised assets or the sale proceeds thereof are repatriated to South Africa;

- 10% of the leviable amount if the regularised assets are kept offshore,

on the current market value at 29 February 2016, rather than the 10% – 40% penalty that would be imposed in normal circumstances.

Sugar tax

The budget proposals recognise that obesity stemming from overconsumption of sugar has become a global concern and that fiscal interventions in the form of taxes are increasingly regarded as complementary tools throughout the world to assist in tackling this epidemic. Government therefore proposes to introduce a sugar tax from 1 April 2017 as a measure to assist the public in reducing their sugar intake.

Transfer duty

The transfer duty rates on property sales above R10 million increase from 11% to 13%. The new rate will become effective for property acquired after 1 March 2016.

	2015/2016		2016/2017
Property value (R)	Rates of tax	Property value (R)	
R0 - R750 000	0% of property value	R0 - R750 000	0% of property value
R750 001 - R1 250 000	3% of property value above R750 000	R750 001 - R1 250 000	3% of property value above R750 000
R1 250 001 - R1 750 000	R15 000 + 6% of property value above R1 250 000	R1 250 001 - R1 750 000	R15 000 + 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	R45 000 + 8% of property value above R1 750 000
R2 250 001+	R85 000 + 11% of property value above R2 250 000	R2 250 001 – R10 000 000	R85 000 + 11% of property value above R2 250 000
		R10 000 001 and above	R937 500 + 13% of property value above R10 000 000

The definitions of “date of acquisition” and “property” in the Transfer Duty Act will be reviewed to align them with other legislative provisions.

Value-added tax

- There is currently some uncertainty whether fees paid to a non-executive director may be subject to both employees tax (PAYE) as well as VAT. This anomaly will be investigated with a view to providing further clarity on how these fees are to be treated.

- The VAT implications of redeeming loyalty points as well as vouchers is to be further analysed and legislative amendments will be considered.

- The current methodology used for establishing the determined value of a company car for VAT purposes differs from the methodology prescribed for the purposes of calculating an employee's fringe benefit tax liability on the company car. These differences have resulted in employers having to maintain two sets of records. It has therefore been recognised that the VAT provisions and the fringe benefit provisions need to be aligned.

- It is proposed that the Value-Added Tax Act be amended to exempt goods proved to have been lost, destroyed or damaged through circumstances that the Commissioner deems exceptional from import VAT in certain circumstances (ie the goods are destroyed while entered for storage in a customs and excise warehouse).

- Businesses that are located in a customs-controlled area (CCA) enjoy VAT cash-flow benefits when importing goods into the CCA. The Customs and Excise Act has already been amended to align the CCA rules with the new rules relating to special economic zones. To further support the benefits of investing in special economic zones, an amendment is proposed to allow for the VAT-free movement of goods that are imported into special economic zones to a manufacturing duty rebate user, provided there is a sale subject to VAT.

Customs and excise

- Excise duties on –

    - alcoholic beverages will increase between 6.7% and 8.5%;

    - grain-fermented beverages (such as beverages made from maize) will increase from 2.5% to 9% by volume;

    - cigarettes, cigarette tobacco and pipe tobacco will be in line with inflation;

    - a fortified bottle of wine will increase by 6%;

    - an unfortified bottle of wine will increase by 8%;

    - sparkling wine will increase by 78c per bottle; and

    - a bottle of whisky will increase by R12.24.

- A general anti-avoidance rule will be introduced to customs and excise to enhance compliance with customs duties and excise taxation.