2015/16 BUDGET PROPOSALS - TAX OVERVIEW

By Head of Tax Practice, Ernest Mazansky, as well as Directors, Leon Rood and Michael Honiball.

LEGAL BRIEF
FEBRUARY 2015

INTRODUCTION

Following a trend which commenced in 2013, the number and scope of proposed changes to the various fiscal Acts (mainly the Income Tax Act and VAT Act) continue to fall. This, no doubt, reflects the depletion of skills at Treasury, and the failure to replace them.

Moreover, those changes that have been announced are mainly of a highly technical nature, and are probably more of interest to tax professionals than to business people in general, and even to legal and financial executives in those businesses.

Of course, the greatly feared spectre of wholesale tax increases did not materialise "only" with a 1% increase in the individual tax rates, also resulting in an increase in the maximum marginal rate from 40% to 41%, and with the matching increase in the tax rate applicable to trusts from 40% to 41%. As a consequence, the effective rate of CGT increases from 13.3% to 13.7% for individuals, and from 26.7% to 27.3% for trusts (and as there was no change to the company tax rate, the effective rate of CGT for companies remains unchanged at 18.7%). The major portion of the tax shortfall is to be made up by way of a large increase in the fuel levy.

Because, as mentioned, the bulk of the proposed amendments are so technical in nature, these will be mentioned in passing, and only those of more general interest will be explored in a little more detail.

On the positive side some good news was received in the form of further relaxations of exchange controls.

INDIVIDUALS

RETIREMENT FUNDS

Income and capital profits earned within a retirement fund are not subject to tax, and, upon death, the value of the fund is not subject to estate duty. By transferring further assets into such a fund and/or not withdrawing from the fund, one can defer income tax and even avoid estate duty.

To address these issues it is proposed that:

> a maximum age be proposed (as yet unspecified) at which withdrawals must be taken from a retirement fund, which will result in those amounts being taxable in the recipient's hands; and

> to the extent that amounts were contributed to a retirement fund in respect of which a tax deduction was not allowed (and therefore, upon receipt, no tax would be payable), an amount equal thereto will be added to the assets in the estate for the purposes of calculating the estate duty liability.

Expatriate employees who work in South Africa for a fixed term and who contribute to a retirement annuity fund here, will be entitled to withdraw the full amount upon returning to their home countries.

EMPLOYEE SHARE SCHEMES

The interrelationship between the taxation of share gains upon vesting, in terms of section 8C of the Income Tax Act, the treatment of the income tax exemption on dividends and PAYE on returns of capital, are to be reviewed in order to remove anomalies.

BUSINESS-RELATED ISSUES

DISPOSAL OF SHARES

Section 9C of the Income Tax Act generally deems proceeds on sale of shares held for at least three years to be of a capital nature, so that the profit will be subject to CGT. However if a shareholder receives a return of capital in excess of the holder's cost of the share, that excess is not also deemed to be of a capital nature under the section, ie the safe harbour protection granted to a person who holds shares for more than three years does not extend to a return of capital, and only applies to proceeds on an outright disposal.

This anomaly is to be remedied.

CANCELLATION OF A CONTRACT

If a contract involving the disposal of an asset is cancelled, it is expected that the parties would be restored to the status quo ante. It is argued that after the cancellation there is nevertheless a step-up in the base cost of the asset, even though no CGT has become payable. It is proposed that this anomaly be removed.

UNLISTED PROPERTY-OWNING COMPANIES

When REITs were introduced in 2012 Treasury undertook that a similar dispensation would be granted in the case of unlisted property-owning companies which distributed all of their net rentals to their shareholders. Treasury was prepared to do this only if these companies could be properly regulated. It is now proposed that a regulatory framework for unlisted property-owning companies be developed.

HEDGE FUNDS

It is proposed that hedge funds be categorised as collective investment schemes under the Collective Investment Schemes Control Act. This will require certain tax amendments.

SECURITIES LENDING ARRANGEMENTS

The current rules, particularly in relation to the provision of collateral, have not kept up with modern practice, and can result in securities transfer tax and CGT. The current tax treatment will be reviewed in this regard, but also to limit the use of collateral in possible tax avoidance arrangements.

INCENTIVES

The termination of the industrial policy project incentive is to be extended from the end of this year to 31 December 2017.

Other announcements include:

> possibly allowing the demarcation of two or more urban development zones per municipality for the purpose the UDZ incentive;

> introducing measures to ensure that taxpayers are not disadvantaged by the current undue delays by the adjudication committee which must grant approval for the R&D incentive; and

> reviewing the conditions of granting of the accelerated depreciation deduction for manufacturing assets under section 12C of the Income Tax Act as a result of "changes in the business models of some manufacturing activities", but unfortunately no detail was given in this regard.

INTERNATIONAL TAX

FOREIGN TAX CREDIT FOR SERVICE FEES

Normally a credit is given for foreign tax paid on service fees derived from a foreign source, which fees are taxed here because the recipient is a resident of South Africa. Contrary to accepted international principles and, even worse, contrary to double tax agreements, a number of foreign countries (particularly in Africa) insist on withholding taxes on fees paid to non-residents even where the fees were derived from a source in the non-resident's country (South Africa in this case). For this purpose South Africa nevertheless granted a credit under section 6quin of the Income Tax Act for the foreign tax (erroneously) deducted.

This concession is to be withdrawn.

CONTROLLED FOREIGN COMPANY RULES

Two changes are proposed:

> The first relates to the re-introduction of the so-called diversionary rules in terms of which profits earned by a controlled foreign company (CFC) on sales of goods to a connected person who is a South African resident, will be taxable in the South African shareholder's hands, and the latter will not benefit from the foreign business establishment exemption contained in the CFC rules insofar as this income is concerned. This is part of the efforts to address base erosion and profit shifting.

> Consideration will be given to extending the CFC rules to companies held by offshore trusts. This was attempted a few years ago and abandoned because of difficulty in drafting the rules. This will obviously affect a number of offshore structures established for the benefit of high net worth individuals.

CORPORATE MIGRATION

The general rule is that no capital gain arises merely because a company issues its own shares, because there is no disposal by the company of an asset. To prevent corporate migration of South African companies, which could occur if South African companies acquired shares in foreign companies and paid for them by issuing its shares, so that the control of the South African company shifted abroad, the South African company is now deemed to dispose of the shares it issued, thereby triggering a capital gain.

The problem is that this legislation introduced last year was not drafted in this precise manner and went far beyond that, and applies even where there is no change in control. Consideration will be given to relaxing the requirements "without losing sight of the initial policy intent".

WITHHOLDING TAX ON INTEREST

The withholding tax becomes effective on 1 March 2015. There remains a debate as to whether this tax applies to interest as defined in section 24J of the Income Tax Act or to interest as understood under the common law – the latter having a much narrower meaning. It is proposed that an appropriate definition will be given for withholding tax purposes.

VAT

A significant number of highly technical amendments have been proposed.

TRANSFER DUTY

The rates have been increased and a new bracket added, so that, whereas previously the maximum rate of 8% applied to a property value in excess of R1.5 million, now a maximum rate of 11% applies to a value in excess of R2.25 million.

TAX ADMINISTRATION

Amendments to the Income Tax Act are to be proposed to provide for the move to a self-assessment system for income tax. Taxpayers have de facto been subject to a self-assessment system for some years now, but without the required rules and protections. A more formalised system is to be welcomed.

EXCHANGE CONTROL

The exchange control rules and conditions will continue to be modernised and the process will be completed this year. The following changes take effect from 1 April 2015:

> The annual foreign investment allowance for individuals will increase from R4 million to R10 million per person. On emigration, the allowance increases from R8 million to R20 million per family unit.

> The various categories of the individual single discretionary allowance of R1 million are removed and now it may be used for any legal purpose abroad (including investment).

> Authorised dealers may currently approve foreign investments by corporates up to R500 million per applicant per annum, without the need to apply to the Reserve Bank. This threshold is to increase to R1 billion, while unused allowances may be carried forward.

> Credit cards may currently be used abroad only by individuals, but the dispensation will now be extended to corporates as well.

Further administrative details will be announced by the Reserve Bank.

TAX RATES AND THRESHOLDS

INDIVIDUALS

Personal income tax rate and bracket adjustments

2015/16		2014/15	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 181 900	18% of each R1	0 – 174 550	18% of each R1
181 901 – 284 100	32 742 + 26% of the amount above 181 900	174 551 – 272 700	31 419 + 25% of the amount above 174 550
284 101 – 393 200	59 314 + 31% of the amount above 284 100	272 701 – 377 450	55 957 + 30% of the amount above 272 700
393 201 – 550 100	93 135 + 36% of the amount above 393 200	377 451 – 528 000	87 382 + 35% of the amount above 377 450
550 101 – 701 300	149 619 + 39% of the amount above 550 100	528 001 – 673 100	140 074 + 38% of the amount above 528 000
701 301 and above	208 587 + 41% of the amount above 701 300	673 101 and above	195 212 + 40% of the amount above 673 100

Rebates

	2015/16	2014/15
	R	R
Primary	13 257	12 726
Secondary (65 and over)	7 407	7 110
Tertiary (75 and over)	2 466	2 367

Tax Thresholds

	2015/16	2014/15
	R	R
Below age 65	73 650	70 700
Age 65 and over	114 800	110 200
Age 75 and over	128 500	123 350

The limited relief, insofar as it applies to individuals younger than 65 years, is illustrated in the following comparative table:

TAXABLE INCOME	2014/15 RATES	2015/16 RATES	TAX CHANGE	% CHANGE
R	R	R	R	R
85 000	2 574	2 043	-531	-20.6%
90 000	3 474	2 943	-531	-15.3%
100 000	5 274	4 743	-531	-10.1%
120 000	8 874	8 343	-531	-6.0%
150 000	14 274	13 743	-531	-3.7%
200 000	25 056	24 191	-865	-3.5%
250 000	37 556	37 191	-365	-1.0%
300 000	51 421	50 986	-435	-0.8%
400 000	82 549	82 326	-223	-0.3%
500 000	117 549	118 326	778	0.7%
750 000	213 247	215 297	2 050	1.0%
1 000 000	313 247	317 797	4 550	1.5%

Retirement fund lump sum withdrawal benefits

2015/16		2014/15	
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 25 000	25 001 – 660 000	18% of taxable income above 25 000
660 001 – 990 000	114 300 + 27% of taxable income above 660 000	660 001 – 990 000	114 300 + 27% of taxable income above 660 000
990 001 and above	203 400 + 36% of taxable income above 990 000	990 001 and above	203 400 + 36% of taxable income above 990 000

Retirement fund lump sum benefits or severance benefits

2015/16		2014/15	
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 500 000	500 001 – 700 000	18% of taxable income above 500 000
700 001 – 1 050 000	36 000 + 27% of taxable income above 700 000	700 001 – 1 050 000	36 000 + 27% of taxable income above 700 000
1 050 001 and above	130 500 + 36% of taxable income above 1 050 000	1 050 001 and above	130 500 + 36% of taxable income above 1 050 000

CAPITAL GAINS TAX

Effective capital gains tax rates

	2015/16	2014/15
For individuals and special trusts	13.7%	13.3%
Companies	18.7%	18.7%
Trusts	27.3%	26.7%

Capital gains exemptions

DESCRIPTIONS	2015/16 R	2014/15 R
Annual exclusion for individuals and special trusts	30 000	30 000
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 and the following 31 March, the following rates of tax will apply:

TYPE	RATE OF TAX (%)	
	2015/16	2014/15
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	15	15

Tax regime for small business corporations

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

2015/16		2014/15	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – R73 650	0% of taxable income	0 – R70 700	0% of taxable income
R73 651 – R365 000	7% of taxable income above R73 650	R70 701 – R365 000	7% of taxable income above R70 700
R365 001 – R550 000	R20 395 + 21% of taxable income above R365 000	R365 001 – R550 000	R20 601 + 21% of taxable income above R365 000
R550 0001 and above	R59 245 + 28% of the amount above R550 000	R550 001 and above	R59 451 + 28% of taxable income above R550 000

INCOME TAX RATES FOR TRUSTS

RATE OF TAX %	
2015/16	2014/15
41%	40%

TAX FREE PORTION OF INTEREST

	2015/16	2014/15
	R	R
Interest - under 65	23 800	23 800
- over 65	34 500	34 500

TRANSFER DUTY

The transfer duty table, which applies to all types of purchasers, is as follows (applies to sales of property on or after 1 March 2015):

VALUE OF PROPERTY (R)	RATE
R0 – R750 000	0% of property value
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 750 001 - R2 250 000	R45 000 + 8% of property value above R1 750 000
R2 250 001 and above	R85 000 + 11% of property value above R2 250 000

MONTHLY MEDICAL TAX CREDIT

DESCRIPTION	2015/16	2014/15
Medical scheme fees tax credit, in respect of benefits to the taxpayer	R270	R257
Medical scheme fees tax credit, in respect of benefits to the taxpayer and one dependent	R540	R514
Medical scheme fees tax credit, in respect of benefits to each additional dependant	R181	R172

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 re-organisations.

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

ERNEST MAZANSKY

Title: Director, Werksmans Tax Pty Ltd, and head of Tax Practice
Office: Johannesburg
Direct line: +27 (0)11 535 8448
Email: emazansky@werksmans.com

MICHAEL HONIBALL

Title: Director and head of International Tax
Office: Johannesburg
Direct line: +27 (0)11 535 8136
Email: mhoniball@werksmans.com

DOELIE LESSING

Title: Director
Office: Stellenbosch
Direct line: +27 (0)21 809 6147
Email: dlessing@werksmans.com

LEON ROOD

Title: Director
Office: Johannesburg
Direct line: +27 (0)11 535 8187
Email: lrood@werksmans.com

DALEEN MALAN

Title: Senior Associate
Office: Stellenbosch
Direct line: +27 (0)21 809 6152
Email: dmalan@werksmans.com

YVONNE STEYN

Title: Associate
Office: Stellenbosch
Direct line: +27 (0)21 405 5221
Email: ysteyn@werksmans.com

> Keep us close

The Corporate & Commercial Law Firm
www.werksmans.com

A member of the LEX Africa legal network

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, and connected to an extensive African legal network through LEX Africa, the firm's reputation is built on the combined experience of Werksmans and Jan S. de Villiers, which merged in 2009.

LEX Africa was established in 1993 as the first and largest African legal network and offers huge potential for Werksmans' clients as it provides a gateway to Africa to companies seeking to do business on the continent. Each LEX Africa member firm specialises in corporate and commercial law and dispute resolution combined with intimate knowledge of the local customs, business practices, cultures and languages of each country.

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 180 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.