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ATTORNEYS

TAX

2016/2017 budget proposals – Tax overview

24 February 2016 *18 min read*

INTRODUCTION

The trend that began three years ago of a reduced number of substantive amendments announced in the Budget continued this year. Contrary to widespread expectations, there was no increase in the VAT rate. Wise as an increase might have been, it would have been politically difficult in an election year. The shocker was the significant increase in the rates of Capital Gains Tax (CGT). On the positive side, the relaxation of the voluntary disclosure rules for offshore income and assets, for both tax and exchange controls, are to be welcomed.

Though a large number of proposed amendments to the various fiscal Acts were announced, the majority of these are either of a highly technical nature or of a highly esoteric nature, and therefore we have limited ourselves to reporting on those which we believe are more of widespread interest to individuals and companies; and, of course, we have left space for the details on the Voluntary Disclosure Programme.

INDIVIDUALS AND TRUSTS

Capital Gains Tax

As stated, the effective rates of CGT have increased because now 40% of capital gains will be included in taxable income for individuals instead of 33.3%, and 80% of capital gains will be included for trusts instead of 66.6%. This results in the increase of the effective rate of CGT from 13.7% to 16.4% for individuals, and from 27.3% to 32.8% for trusts. (For companies the increase in the inclusion rate is the same as for trusts (80%) resulting in an increase in the effective rate from 18.65% to 22.4%). For individuals (but not trusts) the first R40 000 of capital gains will be exempt, an increase from R30 000. The new rates will be applicable from 1 March 2016.

Many countries have inflation adjusters so as to exclude the inflation effect from capital gains and only subject the real growth to tax. When CGT was first introduced in 2001, it was argued that the low inclusion rates at that time (25% for individuals and 50% for other taxpayers) were sufficiently low so as to make the need for an inflation adjustment unnecessary. That argument no longer holds, yet nothing has been said about including any such adjustment in the law.

Trusts and Estate Duty

Trusts have long been used as an estate planning mechanism, including (but not limited to) the avoidance of estate duty. Because a donation to a trust carries donations tax, assets are generally transferred to the trust by selling same on loan account, typically on an unsecured, interest-free basis.

It is proposed that, to limit taxpayers' ability to transfer wealth without being taxed, the assets transferred through a loan to a trust are to be included in the estate of the founder at death, and to categorise interest-free loans to trusts as donations. Further measures to limit the use of discretionary trusts for income-splitting and other tax benefits will also be considered.

It remains to be seen precisely how these objectives will be achieved and how the legislation will be drafted. At first blush, however, it does appear that treating the loan as a donation (presumably subject to donations tax) and then also including the trust's assets as assets of the founder's estate for estate duty purposes, would amount to double counting. One would also have to see what steps are being taken to avoid retroactivity.

Voluntary Disclosure Programme

Because of the multinational and worldwide disclosure of bank account and investment details under the Common Reporting Standards, there is pressure worldwide to disclose offshore investments and bank accounts and to "come clean". In South Africa there is a Voluntary Disclosure Programme (VDP) in the Tax Administration Act. This is useful but does have certain shortcomings, particularly in relation to offshore assets. A significant disadvantage is that there is no equivalent for exchange controls.

An additional VDP has now been announced to cover a six-month period commencing 1 October 2016, governing both tax and exchange controls. Further details are set out below.

As regards the "ordinary" VDP rules, one of the situations where it may not be applied for is if a potential applicant is aware of a pending audit or investigation. An amendment will clarify what is meant by "pending".

COMPANIES

Disposal of Shares

When companies sell shares in other companies, especially in subsidiaries, it has become widespread to structure the disposal by way of a subscription for new shares by the acquirer into the target company, followed by the target buying back its shares from the existing shareholder. This gives rise to a dividend in the existing shareholder's/seller's hands, which is tax free, rather than the seller having to pay CGT. This is not a so-called loophole as Treasury and SARS have been aware of this consequence since dividends tax was introduced in 2012, and took a policy decision to leave share buy-backs within the dividend regime, and not bring it within the CGT regime.

It has been announced that the widespread use of these arrangements "merits a review to determine if additional countermeasures are required." Thus it has not been formally announced that amendments will be introduced to bring this practice to a halt, though possibly enough has been said to allow amendments to be introduced later this year.

Restricted Equity Shares

Where restricted equity shares are granted to employees, the intention is that the excess of the market value over their cost will be taxed as income in the employees' hands when the shares vest, i.e. when the restrictions are removed or the shares are sold. Avoidance schemes have arisen where the value is paid out to the employees as a tax-exempt dividend prior to the shares vesting, so that the shares vest thereafter and at a time when they have no value, resulting in the employees escaping all tax other than dividends tax. It is proposed that the current rules be reviewed to deal with this.

Moreover, certain dividends received by employees do not qualify for the income tax exemption in relation to shares acquired by virtue of employment, and these dividends are taxable in their hands. It is left to each individual employee to disclose these receipts in his or her tax return. It is proposed to bring these dividends within the PAYE provisions.

Securities Lending Arrangements

The tax-free (including STT-free) status of scrip lending arrangements relies *inter alia* on restricting the period of lending to twelve months. Government understands that this period is too short and it is proposed that a gradual approach to address these concerns will be followed. Additionally the tax treatment of these arrangements will be reviewed to take into account corporate actions during the term of the lending arrangement.

Third-Party Backed Shares

Dividends received from preference shares which are secured by third parties are currently treated as "ordinary" income. This treatment arose from changes to the tax law in 2012. Government is to consider relaxing the application of the rules in relation to commercial arrangements which were already in existence prior to 2012. However, where these rules are circumvented via *inter alia* trust holding mechanisms, additional measures will be introduced.

Hybrid Debt Instruments

A hybrid debt instrument is one in respect of which any interest is deemed to be a dividend. Consequently the interest is not allowed as a deduction and the payment is subject to dividends tax.

One of the tests as to whether it is a hybrid is if the debt is subordinated until the issuer's assets exceed its liabilities. Problems could arise where an instrument becomes subject to a subordination because of the issuer's financial distress, and it is proposed that a concession be made in such circumstances.

There are also circumstances where hybrid debt instruments can result in avoidance of tax where the issuer is a non-resident. It could result in the foreign debtor deducting the interest with the South African creditor being deemed to receive a dividend. Amendments, effective 24 February 2016, will be passed to counter this practice.

Learnership Allowance and Employment Tax Incentive

Both of the above incentives expire at the end of this year. A review is under way and will be presented to Parliament by the third quarter of 2016. If there are delays in completing these reviews, Government may consider extending the incentives by one year.

Determined Value of Company Car

Currently the methods for determining the value of company cars for fringe benefits purposes and for VAT purposes are different. It is proposed to bring the VAT method into alignment with the fringe benefits tax method.

Employer-provided Bursaries

For bursaries not subject to fringe benefits tax, the income threshold will increase from R250 000 to R400 000, and the value of the qualifying bursaries will be increased from R10 000 to R15 000 for NQF levels 1 to 4, and from R30 000 to R40 000 for levels 5 to 10.

Service Fees paid to Non-residents

A few years ago a 15% withholding tax on service fees derived from a South African source was introduced into the law, but implementation was deferred. The legislation is now to be withdrawn in its entirety without being implemented. Instead, the issue will be dealt with by way of the mechanism of reportable arrangements under the Tax Administration Act. This will require local users of foreign suppliers of services to report fees paid above a threshold to foreign service providers, which will enable SARS to issue assessments on those foreign service providers where appropriate.

TAX ADMINISTRATION

Currently the period for lodging objection to an assessment is thirty business days from the date of the assessment. If a longer period is required it is necessary to seek an extension. As this period has been shown to be too short in practice, particularly in regard to complex matters, it is proposed that a longer period be considered.

TRANSFER DUTY

The table of transfer duty rates is set out elsewhere in this publication. The major change is an increase of 2%, to 13%, where the value of property acquired exceeds R10 million.

VOLUNTARY DISCLOSURE PROGRAMME

Under the current VDP all types of taxes may be disclosed, in respect of onshore and offshore income, VAT, etc. One cannot apply if one is aware of a pending audit or investigation, or there is an ongoing audit or investigation, in either case related to the default which one wishes to disclose. An application may also not be made if it involves a default which was similar to a default disclosed under the VDP within the previous five years.

Insofar as is relevant here, the basic principle is that one must disclose all of the undeclared income (whether local income evaded by illegally exporting funds or foreign investment income and capital gains not declared) as well as any foreign donations made, for example funds donated to an offshore trust, and pay the necessary tax plus interest thereon. Whereas normally there are five levels of understatement penalty applicable ranging from 10% to 150%, under the VDP there are three levels at 0% and the two highest levels are 5% and 10%. Immunity against criminal prosecution is provided.

The following are the main features of the additional VDP that has been announced:

- The application must be lodged during the period 1 October 2016 to 31 March 2017.
- Applicants must be South African residents on 29 February 2016 and may include an individual (including a deceased estate), a company and a CC holding a foreign asset on 29 February 2016, but not a trust.
- The applicant in relation to an offshore trust could be the donor or a beneficiary. As with the 2003 amnesty, applicants may elect the assets owned by the trusts to be theirs, in which case they will continue to be taxed on the trusts' assets until the assets are disposed of, in which case they will be deemed to dispose of the assets for market value.
- Because there is often great difficulty in being able to go back in history and determine the make-up of the funds and what is and what is not taxable, an assumption is made that 50% of the total amount used to fund the acquisition of unauthorised assets acquired before 1 March 2010 comprised untaxed income. This amount will be included in the 2011 assessment and taxed at ordinary income tax rates. There is no mechanism to prove that this total amount was built up using after tax income. The remaining 50% is specifically made exempt from tax.
- All dividends, foreign dividends, interest, rental or other investment income received before 1 March 2010 on those assets are specifically exempt from tax. Strangely, nothing is said about capital gains. Also, no mention is made of donations tax.
- Interest on the tax will continue to be payable, but all penalties will be waived.

In addition, exchange control relief will be given in that an application may concurrently be made to the Financial Surveillance Department of the South African Reserve Bank. The basis will be as follows:

- Persons who are the subject of any current or pending investigation will not qualify for relief.
- A levy will be payable based on the current market value of the assets at 29 February 2016.
- The levy will be at the rate of 5% if the funds are repatriated to South Africa, or 10% if they are kept offshore.
- The levy must be paid from foreign funds. If there are insufficient liquid foreign assets, and the levy (or portion thereof) must be payable locally, an additional 2% will be added on the amount paid locally.
- Individuals will not be allowed to deduct their R10 million foreign capital allowance or any portion thereof from any leviable amount, and the levy may not be reduced by any fees or commissions.

TAX RATES AND THRESHOLDS

INDIVIDUALS

Limited relief will be granted by adjustments to the personal income tax table as follows:

Personal income tax rate and bracket adjustments

2016/17		2015/16	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 188 000	18% of each R1	0 – 181 900	18% of each R1
188 001 – 293 600	R33 840 + 26% of the amount above R188 000	181 901 – 284 100	R32 742 + 26% of the amount above R181 900

293 601 – 406 400	61 296 + 31% of the amount above 293 600	284 101 – 393 200	R59 314 + 31% of the amount above R284 100
406 401 – 550 100	96 264 + 36% of the amount above 406 400	393 201 – 550 100	R93 135 + 36% of the amount above R393 200
550 101 – 701 300	147 966 + 39% of the amount above 550 100	550 101 – 701 300	R149 619 + 39% of the amount above R550 100
701 301 and above	206 964 + 41% of the amount above 701 300	701 301 and above	R208 587 + 41% of the amount above R701 300

Rebates

	2016/17	2015/16
	R	R
Primary	13 500	13 257
Secondary	7 407	7 407
Tertiary rebate	2 466	2 466

Tax Thresholds

	2016/17	2015/16
	R	R
Below age 65	75 000	73 650
Age 65 and over	116 150	114 800
Age 75 and over	129 850	128 500

The personal income tax proposals and relief for individuals is illustrated in the following comparative table:

TAXABLE INCOME	2015/16 RATES	Proposed 2016/17 RATES	TAX CHANGE	% CHANGE
R	R	R	R	%
85 000	2 043	1 800	-243	-11.9
90 000	2 943	2 700	-243	-8.3
100 000	4 743	4 500	-243	-5.1
120 000	8 343	8 100	-243	-2.9
150 000	13 743	13 500	-243	-1.8
200 000	24 191	23 460	-731	-3
250 000	37 191	36 460	-731	-2
300 000	50 986	49 780	-1 206	-2.4
400 000	82 326	80 780	-1 546	-1.9
500 000	118 326	116 460	-1 866	-1.6

750 000	215 297	213 431	-1 866	-0.9
1 000 000	317 797	315 931	-1 866	-0.6

Retirement fund lump sum withdrawal benefits

2016/17	
TAXABLE INCOME (R)	RATES OF TAX
0 – 25 000	0% of taxable income
25 001 – 660 000	18% of taxable income above R25 000
660 001 – 990 000	R114 300 + 27% of taxable income above R660 000
990 001 +	R203 400 + 36% of taxable income above R990 000

Retirement fund lump sum benefits or severance benefits

2016/17	
TAXABLE INCOME (R)	RATES OF TAX
0 – 500 000	0% of taxable income
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
1 050 001 +	R130 500 + 36% of taxable income above R1 050 000

CAPITAL GAINS TAX

Effective capital gains tax rates (%)

	2016/17	2015/16
Individuals and special trusts	16.4	13.65
Companies	22.4	18.65
Trusts	32.8	27.31

Capital gains exemptions

DESCRIPTION	2016/17	2015/16
	R	R
Annual exclusion for individuals and special trusts	40 000	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 (%)	
	2016/17	2015/16
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 the following 31 March, the following rates of tax will apply:

2016/17		2015/16	
TAXABLE INCOME (R)	RATE	TAXABLE INCOME (R)	RATE
0 – 75 000	0% of taxable income	0 – 73 650	0% of taxable income
75 001 – 365 000	7% of taxable income above R75 000	73 651 – 365 000	7% of taxable income above R73 650
365 001 – 550 000	R20 300 + 21% of taxable income above R365 000	365 001 – 550 000	R20 395 + 21% of taxable income above R365 000
550 001 and above	R59 150 + 28% of taxable income above R550 000	550 0001 and above	R59 245 + 28% of the amount above R550 000

INCOME TAX RATES FOR TRUSTS

RATE OF TAX (%)	
2016/17	2015/16
41	41

TAX FREE PORTION OF INTEREST

	2016/17	2015/16
	R	R
Interest – 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 2016, and which applies to all types of purchasers, is as follows:

VALUE OF PROPERTY (R)	RATE
0 – 750 000	0% of property value
750 001 – 1 250 000	3% of property value above R750 000
1 250 001 – 1 750 000	R15 000 + 6% of property value above R1 250 000
1 750 001 – 2 250 000	R45 000 + 8% of property value above R1 750 000
2 250 001 – 10 000 000	R85 000 + 11% of property value above R2 250 000
10 000 001 and above	R937 500 + 13% of property value above R10 000 000

MONTHLY MEDICAL TAX CREDITS

Description	2016/17	2015/16
	R	R
Medical scheme fees tax credit, in respect of benefits to the taxpayer	286	270
Medical scheme fees tax credit, in respect of benefits to the taxpayer and one dependent	572	540
Medical scheme fees tax credit, in respect of benefits to each additional dependent	192	181

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