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TAX

2017/2018 budget proposals – Tax overview

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INTRODUCTION

While the increase in the maximum marginal rate for individuals to 45% was widely forecast, with trusts being taxable at the same flat rate, the increase in the rate of dividends tax from 15% to 20% (and concomitantly, the same increase in the effective tax rate of foreign dividends) came like a bolt out of the blue. This increase is clearly aimed only at domestic shareholders because most non-resident shareholders will be protected by double tax agreements, and, tellingly, the withholding tax rates on interest and royalties remained unchanged at 15%. The new top bracket, starting at R1.5 million will, so the Minister of Finance contends, only affect approximately 100,000 taxpayers, but these taxpayers will now be responsible for 26.3% of the total tax collected from the personal income tax system.

A consequence of the increase in the maximum marginal rate is that it increases the maximum effective rate of capital gains tax (CGT) for individuals from 16.4% to 18%, and for trusts from 32.8% to 36%. We must be thankful for small mercies that the CGT inclusion rate itself was not also increased. Also of note is an absence of any changes to the estate duty regime or the taxation of local trusts, both as recommended by The Davis Tax Committee, which was another set of "reforms" widely expected to be announced.

In addition to the tax changes, the Budget documentation sets out a significant number of proposed amendments to the various fiscal Acts. Many of these are either of a highly technical or esoteric nature, and therefore we have limited ourselves to reporting on those which we believe are more of widespread interest to individuals and companies.

INDIVIDUALS

Personal income tax and CGT

As stated, individuals earning more than R1.5 million of taxable income per year will be taxed at a new maximum marginal rate of 45%, with the result that the top effective rate of CGT increases to 18% from 16.4%. The first R40 000 of exempt capital gains remains unchanged.

Foreign-employment income tax exemption

Due to the residence-basis of taxation employed in South Africa, (in general) income earned by a natural person who is a resident of South Africa, even from employment outside of South Africa, is subject to tax locally. However, an exemption from income tax exists for remuneration earned by any person for services rendered outside South Africa provided the individual spends a sufficient amount of (statutorily defined) time outside the country. A potential result of this exemption is that, depending on the domestic laws of certain jurisdictions, the income earned in that foreign jurisdiction may profit from double non-taxation. The proposed amendment is to exempt the foreign-earned income in South Africa only if it is subject to tax in the foreign country in which it is earned. It is as yet unclear whether the rate of tax payable in the foreign jurisdiction will have any bearing on the exemption in South Africa, or whether even the payment of a relatively low rate of tax in the foreign jurisdiction will suffice.

TRUSTS

Refining measures to prevent tax avoidance through the use of trusts

Following the 2016 Budget Speech, section 7C was introduced into the Income Tax Act to curb the tax-free transfer of wealth to trusts, both onshore and offshore. This section comes into effect on 1 March 2017 and effectively deems a donation where there is either no interest charged on a loan to a trust or where the rate of interest charged is lower than the "official rate of interest", on which there will consequently be donations tax chargeable at 20% every year the loan is in place. Since the announcement of the provision, there has been some planning undertaken to circumvent the application of this section by instead making interest-free or low-interest loans to companies owned by trusts. The proposed amendment will now broaden the scope of section 7C by making loans to companies owned by trusts subject to the same rules as those for loans to trusts. This anti-avoidance measure will not extend to trusts that are not used for (perceived) estate-planning, for example, certain trading trusts or to employee share scheme trusts.

COMPANIES

Corporate tax and dividends tax

The corporate tax rate has remained unchanged at 28%, however with the increase of the withholding tax on dividends to 20%, this means the effective rate of tax paid by a shareholder who is a natural person or trust, now stands at 42.4%.

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 company 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 if a company, rather than the seller having to pay CGT. It was announced in the 2016 Budget Speech that these arrangements "merits a review to determine if additional countermeasures are required". No countermeasures were, however, introduced. It has, nontheless, again been announced that specific countermeasures will be introduced "to curb the use of share buyback schemes", although no details have again been provided as to when and how this will be addressed. In fact, even as far back as 2008, when the dividends tax legislation was first enacted, Treasury was made fully aware that share buy-backs could be used to avoid CGT by keeping the proceeds within the dividends regime, where they had historically been under STC, instead of bringing them within the CGT regime. And Treasury took a deliberate decision to retain the status quo. And they even caused some anti-avoidance rules to be included which recategorised a dividend as proceeds for CGT purposes, but the rules were so narrow that they barely applied to any of the transactions.

Contributed tax capital

The contributed tax capital (CTC) of a company is a notional amount which is effectively equal to the share capital created less any amounts that have been returned to shareholders. It is accordingly reduced by any capital that is subsequently distributed by the company to its shareholders. This does not constitute a dividend and is therefore not subject to dividends tax. It is noted that a mechanism has been identified in terms of which subsidiaries with foreign shareholders increase their CTC and thereby avoid payment of dividends tax through capital distributions to its foreign shareholders. It is proposed that amendments be made to prevent the situation where these capital distributions are not subject to CGT in the hands of the foreign shareholder, i.e. where the underlying investment is not immovable property and therefore not within the SA CGT net.

Corporate reorganisation rules

The corporate reorganisation rules, contained in sections 41 to 47 of the Income Tax Act, provide for the tax-free transfer of assets for corporate restructuring purposes. These rules are, however, subject to certain limitations on how the transfer is funded. Currently, as for example in terms of a section 44 amalgamation transaction, the only acceptable means of funding the transfer of assets is by either obtaining shares in the buyer of assets or the buyer assuming the debts of the seller. Cash or other assets are not acceptable and, with respect to debt, only unconditional obligations are catered for. It is proposed that the assumption of future contingent liabilities be considered as acceptable consideration where the parties agree that the buyer will assume some of the future contingent liabilities of the seller, because there is a real economic effect on the sale as the seller will be freed from future cost relating to those liabilities.

Exemption for intra-group debt forgiveness extended to tax deductible expenses

The income tax implications for a borrower resulting from the waiver of a debt by a lender vary depending on the manner in which the borrower applied the debt. Thus a debtor may have CGT implications if for example the debt was applied for purposes of acquiring a capital asset. The CGT rules do, however, provide an exemption from the debt reduction provisions in the case where the debt is reduced between two companies forming part of the same domestic group of companies. Section 19 of the Income Tax Act dictates the income tax implications for the borrower if the debt was applied for purposes of funding tax deductible operating expenses or trading stock, but does not contain the same exemption for companies forming part of the same domestic group of companies. Under the status quo there is, accordingly, a disparity between the tax treatment of domestic intra-group debt relief where the borrower applied the loan capital to acquire capital assets as opposed to trading stock.

The 2017 Budget Review aims to remedy this disparity by specifically proposing the domestic intra-group debt relief exemption from the debt reduction provisions be extended to instances in which the loan capital was used to fund tax deductible expenses.

Concession for the conversion of debt into equity

Various methods have been applied in practice between parties in an effort to compromise debt. A common method includes the subscription for shares by a creditor, and the subscription price being set-off against the face value of the debt. In this regard, the 2017 Budget Review proposes a concession to allow for the conversion of debt into equity, specifically where a debtor settles a debt by the issuance of shares. Interest capitalised but previously claimed as a deduction will however result in a taxable recoupment.

Third party backed shares

Currently, section 8EA of the Income Tax Act provides that dividends received from (mainly) preference shares which are secured by third parties are treated as ordinary revenue, subject to “qualifying purpose” exemptions. Legitimate transactions may be inhibited by the narrow scope of the “qualifying purpose” exemptions. As a result, it is proposed that the current exemption on third-party backed shares with regard to asset-backed securities be further refined to cover all qualifying purposes.

INTERNATIONAL

Foreign Member Funds

Foreign member funds with a special tax dispensation will be established to enable local and foreign fund managers to establish and manage funds targeted for investments into Africa and the rest of the world. The specific relief mentioned is that foreign investors will be exempt from the interest withholding tax. Fees earned by local asset managers and CIS managers will be subject to tax in South Africa.

Domestic Treasury Management Companies

If a company qualifies as a domestic treasury management company, it benefits from tax relief in respect of foreign currency gains and losses as it is allowed to choose a foreign currency as its functional currency rather than ZAR. It is noted that the current qualifying criteria for domestic treasury management companies in relation to tax residence is very restrictive. The qualifying criteria are to be reviewed.

Acquisition of foreign IP by SA Multinationals

Current anti-avoidance measures discourage the use of SA-based infrastructure to develop offshore intellectual property because the Income Tax Act does not allow deductions for payments made to a foreign person in respect of the use of “tainted” intellectual property. While these measures were designed to prevent erosion of the tax base, they affect legitimate commercial transactions, and consideration will be given to relaxing them.

Foreign Companies held by Interposed Trusts

The proposals announced in the 2015 Budget Review in respect of the introduction of anti-abuse measures aimed at foreign companies held by interposed trusts is again on the agenda. Currently, foreign companies held by a discretionary trust are not

Controlled Foreign Companies. Specific countermeasures to curb this are to be introduced, but yet again no details have been provided.

VAT

Clarifying the VAT treatment on leasehold improvements

Currently no guidelines exist in respect of the value-added tax (VAT) treatment of leasehold improvements effected by the lessee to the leasehold property during the period of a lease agreement. It is now proposed that amendments be made to clarify the VAT treatment in respect of the time and value of supply of leasehold improvements on leasehold property.

Expansion of electronic services

Foreign electronic services provided to South African consumers have been included in the VAT system since 2014. These taxable services will now include cloud computing and services provided using online applications.

TAX ADMINISTRATION

Due to the possibility of interest payable by SARS accruing over a number of tax years, and in an attempt to avoid complications in then taxing that interest, or interest that is adjusted for previous tax years, it is proposed that interest payable by SARS should be deemed to accrue to the recipient on the date of payment thereof by SARS.

GENERAL

Also mentioned in the 2017 Budget Review:

- In line with the Organisation for Economic Co-operation and Development (OECD) led base erosion and profit shifting (BEPS) initiatives, SARS is updating the Transfer Pricing Practice Note in line with the OECD Transfer Pricing Guidelines to include new guidance on the arm's length principle and an agreed approach for pricing of intangibles that are difficult to value.
- The tax on sugary beverages will be implemented as soon as the necessary legislation is approved by Parliament and signed by the President. The proposed tax rate will be 2.1c/gram for sugar content in excess of 4g/100ml.

TAX RATES AND THRESHOLDS

INDIVIDUALS

Except for high income earners, limited relief will be granted by adjustments to the personal income tax table as follows:

Personal income tax rate and bracket adjustments

2017/18		2016/17	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 189 880	18% of each R1	0 – 188 000	18% of each R1
189 881 – 296 540	R34 178 + 26% of the amount above R189 880	188 001 – 293 600	33 840 + 26% of the amount above 188 000
296 541 – 410 460	R61 910 + 31% of the amount above R296 540	293 601 – 406 400	61 296 + 31% of the amount above 293 600
410 461 – 555 600	R97 225 + 36% of the amount above R410 460	406 401 – 550 100	96 264 + 36% of the amount above 406 400

555 601 – 708 310	R149 475 + 39% of the amount above R555 600	550 101 – 701 300	147 966 + 39% of the amount above 550 100
708 311 – 1 500 000	R209 032 + 41% of the amount above R708 310	701 301 and above	206 964 + 41% of the amount above 701 300
1 500 001 and above	R533 625 + 45% of the amount above R1 500 000		

Rebates

	2017/18	2016/17
	R	R
Primary	13 635	13 500
Secondary	7 479	7 407
Tertiary rebate	2 493	2 466

Tax Thresholds

	2017/18	2016/17
	R	R
Below age 65	75 750	75 000
Age 65 and over	117 300	116 150
Age 75 and over	131 150	129 850

The personal income tax proposals and effect on individuals is illustrated in the following comparative table (taxpayers below 65)

TAXABLE INCOME	Proposed 2017/18 RATES	2016/17 RATES	TAX CHANGE	% CHANGE	AVERAGE TAX RATES	
R	R	R	R	%	Old rates	New Rates
85 000	1 665	1 800	-135	-7.50%	2.10%	2.00%
90 000	2 565	2 700	-135	-5.00%	3.00%	2.90%
100 000	4 365	4 500	-135	-3.00%	4.50%	4.40%
120 000	7 965	8 100	-135	-1.70%	6.80%	6.60%
150 000	13 365	13 500	-135	-1.00%	9.00%	8.90%
200 000	23 174	23 460	-258	-1.20%	11.70%	11.60%
250 000	36 174	36 460	-285	-0.80%	14.60%	14.50%
300 000	49 347	49 780	-432	-0.90%	16.60%	16.40%
400 000	80 347	80 780	-432	-0.50%	20.20%	20.10%
500 000	115 824	116 460	-635	-0.50%	23.30%	23.20%
750 000	212 490	213 431	-941	-0.40%	28.50%	28.30%

1 000 000	314 990	315 931	-941	-0.30%	31.60%	31.50%
1 500 000	519 990	520 931	-941	-0.20%	34.70%	34.70%
2 000 000	744 990	725 931	19 059	2.60%	36.30%	37.20%

Retirement fund lump sum withdrawal benefits

2017/18	
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

2017/18	
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 (%)

	2017/18	2016/17
Individuals and special trusts	18	16.4
Companies	22.4	22.4
Trusts	36	32.8

DESCRIPTION	2017/18	2016/17
	R	R
Annual exclusion for individuals and special trusts	40 000	40 000
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 (%)	
	2017/18	2016/17
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	20	15

Tax regime for small business corporations

2017/18		2016/17	
TAXABLE INCOME (R)	RATE	TAXABLE INCOME (R)	RATE
0 – R75 750	0% of taxable income	0 – R75 000	0% of taxable income
R75 751 – R365 000	7% of taxable income above R75 750	R75 001 – R365 000	7% of taxable income above R75 0
R365 001 – R550 000	R20 248 + 21% of taxable income above R365 000	R365 001 – R550 000	R20 300 + 21% of taxable income above R365 000
R550 001 and above	R59 098 + 28% of taxable income above R550 000	R550 001 and above	R59 150 + 28% of taxable income above R550 000

INCOME TAX RATES FOR TRUSTS

RATE OF TAX (%)	
2017/18	2016/17
45	41

TAX FREE PORTION OF INTEREST

	2017/18	2016/17
	R	R
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 – 900 000	0% of property value
900 001 – 1 250 000	3% of property value above R900 000
1 250 001 – 1 750 000	R10 500 + 6% of property value above R1 250 000
1 750 001 – 2 250 000	R40 500 + 8% of property value above R1 750 000
2 250 001 – 10 000 000	R80 500 + 11% of property value above R2 2500 000
10 000 001 and above	R933 000 + 13% of property value above R10 000 000

Monthly Medical Tax Credits

Description	2017/18	2016/17
	R	R
Medical scheme fees tax credit, in respect of benefits to the taxpayer	R303	R286
Medical scheme fees tax credit, in respect of benefits to the taxpayer and one dependent	R606	R572
Medical scheme fees tax credit, in respect of benefits to each additional dependant	R204	R192

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