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TAX

2018/2019 budget proposals – Tax overview

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By: The Werksmans Tax Team

INTRODUCTION

Despite it being widely expected that this year's Budget would add to the ever-increasing burden of South African taxpayers, the Minister of Finance managed to deliver comparably less shocks than prior years. Short of the taxes mentioned below, no significant or unusual tax rate increases were announced, and this recognises the fact that the income tax rates are all close to the maximum that taxpayers can bear. Any further increases would certainly result in higher non-compliance, make South Africa unattractive for foreign investment, and influence the ratings agencies.

There has been a call for an increase in the VAT rate the last few years given the efficiency of collection and fact that it spreads the tax burden, but this point has been somewhat of a political hot potato. It does therefore come as a surprise that this rate has in fact been increased from 14% to 15% (not that there was any feasible alternative), a move which is expected to raise R22.9 billion in the next fiscal year.

Although personal income tax rates have not been increased, neither have the adjustments for inflation for the top four income tax brackets, and there were only limited adjustments to the bottom three brackets. Changes to the estate duty regime as recommended by the Davis Tax Committee, which were expected last year, have now seen the light in the form of a 25% estate duty rate for estates above R30 million, and the rate of donations tax increasing from 20% to 25% for donations exceeding R30 million per annum. Nothing was said, however, about limiting the exemptions on inter-spousal donations and bequests. Notably, the Minister of Finance indicated that further legislation arising from the Davis Tax Committee would be introduced this year, specifically dealing with the report on tax administration.

On the positive side, six special economic zones have been approved that will result in qualifying companies being subject to a reduced rate of corporate tax. Also, Government expects to have collected over R3 billion by 31 March 2018 from the over 2000 applications received under the Special Voluntary Disclosure Programme of last year.

In addition to the above, the Budget documentation discusses further proposed amendments to the various fiscal Acts, though quite a few of these are either of a highly technical or esoteric nature. We therefore 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 was the case last year, individuals earning more than R1.5 million of taxable income per year will be taxed at 45%, with the top effective rate of CGT remaining at 18%. The first R40 000 of exempt capital gains also remains unchanged.

Medical tax credits

The 2018 Budget Review announced that over the next three years there will be below-inflation increases to the medical tax credits, in order to assist Government to fund the rollout of national health insurance. The medical tax credit system will also be reviewed after the Davis Tax Committee presents its recommendations. The system currently consists of two components, being (a) the medical scheme fees tax credit

for approved medical scheme contributions, and (b) the additional tax credit for medical expenses. There is a concern that taxpayers may be excessively benefiting from this rebate, and specifically in instances were multiple taxpayers contribute toward the medical scheme or expenses of another person. The medical tax credit will therefore be apportioned where taxpayers carry a share of the medical scheme, contribution or cost.

Preferential interest rates to employees for housing

The Seventh Schedule to the Income Tax Act, 1962 (the Act) provides that an employee is deemed to have received a fringe benefit from his or her employer if he or she acquires any asset for less than the value of such asset. But there is an exception with regard to housing, i.e. there is effectively no fringe benefit subject to certain criteria being met.

As low-income earning employees generally require loans to fund the acquisition of housing, and as employers would generally provide the necessary loans with no or low interest payable, the exception will be extended to loans at preferential interest rates, which are solely for housing use, made to employees who satisfy the criteria.

The retirement reform proposals

Tax treatment of contributions to retirement funds situated outside of South Africa

The Act currently exempts a lump sum, pension or annuity received from retirement funds from a source outside of South Africa as consideration for past employment outside of South Africa. The intention is to remedy the disparity between this exemption and those in double taxation agreements and other provisions of the Act, to ensure that a deduction for contributions to such retirement funds is only allowed to the extent that the benefits are taxed.

Aligning tax treatment of retirement funds upon emigration

Currently, a member of a retirement annuity fund is allowed to withdraw the full fund value from his or her retirement annuity fund before his retirement date if he or she emigrates from South Africa. It is now intended to align the tax treatment of different types of retirement funds withdrawals in such circumstances.

Allowing transfer to pension and provident preservation funds after retirement

Last year, changes were proposed to allow employees to transfer their retirement benefits into a retirement annuity after retirement. Pension preservation and provident preservation funds were excluded, but now it is indicated that industry consultations clarified that pension preservation and provident preservation funds should also be catered for in the legislation.

COMPANIES

Clarification on the tax treatment of share profits derived by Collective Investment Schemes

Managers of Collective Investment Schemes (CIS) have to date advanced various arguments that the proceeds derived by CISs from the disposal of assets with which they are actively trading are of a capital nature and should, accordingly, be disregarded for capital gains tax purposes, as provided in the Eighth Schedule to the Act. If case law principles are followed, the proceeds derived from the disposal of such assets could be income in nature and would, accordingly, be subject to income tax in the hands of the CISs if they are not distributed to participatory interest holders within twelve months of their receipt or accrual. The Budget documentation states that the current rules will be clarified where proceeds of an income nature will effectively be taxed in the CIS's hands if not so distributed.

Refining of anti-avoidance rules dealing with share buybacks and dividend stripping

Last year, various changes were made to the anti-avoidance rules dealing with share buybacks and dividend stripping. These changes were, in the main, aimed at preventing subscription and buyback arrangements, under which CGT was avoided.

In order to strengthen these anti-avoidance provisions, the corporate restructuring rules in sections 41 to 47 of the Act specifically provide that they do not override these anti-avoidance rules, as they otherwise would do.

It follows that the dividend stripping and share buyback anti-avoidance rules could potentially adversely affect bona fide corporate restructuring transactions. In order to prevent such adverse tax implications, it was announced that the interaction between the two sets of rules will be reviewed. It was also announced that the anti-avoidance rules dealing with share buybacks and dividend stripping regarding preference shares would be clarified.

Amendments resulting from the application of debt relief rules

In 2017, the Act was amended to address the tax consequences of applying the debt relief rules. Concerns have been raised by stakeholders regarding unintended consequences that may arise from the application of these amendments. While no clarity is given as to how these concerns will be addressed, Government has noted the concerns and further amendments will be proposed.

Refining rules for debt-financed acquisitions of controlling interest in an operating company

Presently, companies that use debt funding to acquire a qualifying interest in an operating company can deduct the interest expenditure incurred on that debt. An operating company is defined as a company where at least 80% of its receipts and accruals constitute (taxable) income, and the income is derived from a business carried on continuously and in the course or furtherance of providing goods or rendering services for consideration. There is uncertainty as to when this test should be applied, and amendments will be introduced to provide clarity on this point. The legislation will also be reviewed to determine whether this test should be applied when an operating company transfers its business as a going concern to a company that forms part of the same group of companies.

Review of venture capital company rules

Venture Capital Company (VCC) legislation (section 12J of the Act) was enacted to encourage investment into small and medium enterprises by providing a tax deduction to an investor who subscribes for shares in the VCC.

The current rules limit a 'qualifying company', into which the VCC invests, in the amount it can derive as investment income, i.e. it may not exceed 20% of the gross income of the company. Investment income refers, insofar as relevant, to income such as dividends, foreign dividends, royalties and interest. The proposal is to amend the rules relating to the investment income threshold limitations in this test, but whether or not the threshold is to be increased or decreased is as yet unclear.

The rules currently limits the number of equity shares a VCC can hold in any one qualifying company to less than 70%, so as to avoid the qualifying company becoming a controlled group company. This, as the law stands, applies at the time of subscription for shares in the qualifying company by the VCC. One of the proposals put forward is to re-assess when this test must be applied. There is no further indication as to how this will change.

A further proposal relating to VCCs is in respect of the rules relating to the connected persons test, and the consequences thereof. The current provision allows for persons to be connected until the expiration of a period of 36 months from the date of first issue of a VCC share. After this period, there must be an appropriate spread of investors, such that no one person is a connected person in relation to the VCC. If the connected persons test is failed and corrective steps are not taken, SARS may withdraw the VCC status of the company with retroactive effect, and levy a penalty. Although a 'review' of this provision has been proposed, there is no clarity as to how this will be undertaken.

One thing is for certain, the VCC legislation is going to be tightened to reduce the scope for tax structuring. The only question that remains is how this will be done.

Taxation of short-term insurers

Until the implementation of the Insurance Act, 2017 (the Insurance Act), only short-term insurers who are resident in South Africa are subject to the provisions regulating the taxation of short-term insurance. Now that the Insurance Act permits foreign reinsurers to operate reinsurance businesses in South Africa through branches instead of subsidiaries, the proposal is to extend the short-term insurance taxing provisions to such branches.

INTERNATIONAL

Transfer pricing rules

Where additional taxable income arises from the application of the transfer pricing rules, the (corporate) taxpayer is also deemed to distribute a dividend subject to dividends tax. There appears to be a lack of clarity as to the precise ambit of the deemed dividend provision in the transfer pricing rules. Amendments are proposed to remove any anomalies.

Extension of the application of CFC rules to foreign companies held by foreign trusts and foundations

National Treasury remains intent on finding a way of extending the Controlled Foreign Company rules to foreign companies held by offshore trusts or foundations with South African resident beneficiaries. This was on the agenda for last year's tax amendments, but due to the

complexity of the application of the rules, they were withdrawn from the legislation. An attempt will again be made this year to introduce these rules.

Review of the CFC high-tax exemption

Under the CFC rules, if a foreign company is subject to high tax in the country of its residency, imputation under the CFC rules is required for the South African shareholder. To be viewed as high-taxed, the "net income" of the CFC as an aggregate must be subject to a global level of foreign tax of at least 75% of the amount of tax that would have been imposed had the CFC been fully taxed in South Africa.

The 75% threshold was benchmarked against the UK corporate tax rate as it was in 2010.

In light of the UK tax rate decreasing to 19% and the US tax rate from 35% to 21%, Government will review the high-tax exemption to determine whether a reduction in the 75% threshold is warranted.

Interest paid to a non-resident beneficiary of a trust

Interest that is paid to a non-resident attracts Interest Withholding Tax (IWT) at the rate of 15% (assuming no exemptions apply). In instances where a local trust earns interest on an investment and vests that interest in a non-resident beneficiary, the question is who has the responsibility to withhold IWT on that interest payment – is it the borrower paying the interest to the trust, or is it the trust after the trustees exercise their discretion to pay the interest? A rule will be considered to address this issue.

VAT

Insertion of definition: "face value of a debt transferred"

The Value-Added Tax Act, 1991 (the VAT Act), a VAT vendor is permitted to claim a deduction for VAT on irrecoverable debts written off. It has come to light that certain vendors, such as a bank or collection agent, who buys the book debt that has been written off, on a non-recourse basis, for an amount that is less than the amount owing, and who claim input tax on the purchase, attempt to claim a further VAT deduction on the same amount if they write-off all or part of the debt in future. This results in a double VAT deduction. To prevent this double deduction, a definition of "face value of a debt transferred" is proposed to be inserted into the VAT Act.

Re-issuance of VAT invoices

It is proposed that clarity be provided that in a situation where a vendor issues a tax invoice that includes incorrect information, together with correct VAT and other information, they be allowed to cancel the initial document and re-issue a correct one without it being regarded as an offence. This will also assist with the recipient being allowed to use the corrected invoice to deduct input tax, where currently the recipient is not permitted to do so. A proper audit trail of all incorrect and cancelled invoices, together with the re-issued invoices, will need to be kept.

TAX ADMINISTRATION

Adjustment to the "official rate of interest"

The "official rate of interest" must be used for purposes of quantifying the fringe benefit of low interest rate loans provided by employers to employees, the amount of a donation for low interest/interest free loans to trusts by connected persons, and for deemed dividends arising from interest-free loans by companies to non-corporate shareholders. The official rate of interest is the current Reserve Bank repurchase rate plus 100 basis points for loans denominated in ZAR (currently thus 7.75%). It is proposed that the official rate of interest be increased to a level closer to the prime rate of interest (currently 10.25%).

Tax treatment of cryptocurrencies

While no indication is given of what amendments are to come, it is proposed that the Act be amended to address the volatility and uncertain sustainability of cryptocurrencies and their resultant risk to the income tax system. Amendments to the VAT Act will also be considered, particularly in respect of the administrative difficulties posed by cryptocurrencies.

EXCHANGE CONTROLS

Reforming loop structures

Loop structures are created when South African exchange control residents indirectly invest back in South Africa via a foreign entity. Even if set-up for legitimate business reasons, such structures are not allowed, except for limited exclusions.

One such exclusion, which applies to companies, including private equity funds, allows such investments of between 10% and 20% in a foreign company. It is now proposed that this provision be increased to a maximum of 40% for bona fide business investment, growth and expansion transactions. The current minimum requirement of 10% is abolished.

Loop structures above the prescribed 40% threshold will require Reserve Bank approval with due consideration to transparency, tax, equivalent audit standards and governance.

Treasury companies (Holdcos)

The current maximum transfer to a Holdco (of foreign subsidiaries and for treasury management purposes) of R2 billion per annum (for deployment freely abroad) is to be increased to R3 billion where it is a subsidiary of a listed company, and from R1 billion to R2 billion if a subsidiary of an unlisted company.

GENERAL

Also mentioned in the 2018 Budget Review:

- The tax on sugary beverages will be implemented from 1 April 2018.
- Numerous amendments were effected in 2015 in anticipation of moving income tax to a self-assessment system. One such change was to remove the SARS's discretion in determining the percentage doubtful debt allowance in terms of section 11(j) and rather to replace such discretion with objective criteria outlined in a public notice. To date, the said criteria have not been published. In an attempt to increase certainty, it is proposed that such criteria be developed and incorporated into the Act.
- It is proposed that the requirement for a person who receives a tax-exempt dividend to submit a dividends tax return, be repealed.
- The President will establish a commission of inquiry into the functioning and governance of SARS.
- Updated VAT Regulations will be issued to cover foreign businesses selling electronic services to South African consumers.
- To promote eco-friendly choices the plastic bag levy, the motor vehicle emissions tax and the levy on incandescent light bulbs will be increased.

TAX RATES AND THRESHOLDS

INDIVIDUALS

No adjustments are proposed to the top four personal income tax brackets, and only limited relief to the bottom three brackets, as indicated below:

Personal income tax rate and bracket adjustments

2018/19		**2017/18**	
TAXABLE INCOME (R)	RATES OF TAX	TAXABLE INCOME (R)	RATES OF TAX
0 – 195 850	18% of taxable income	0 – 189 880	18% of taxable income
195 851 – 305 850	R35 253 + 26% of taxable income above R195 850	189 881 – 296 540	R34 178 + 26% of taxable income above R189 880
305 851 – 423 300	R63 853 + 31% of taxable income above R305 850	296 541 – 410 460	R61 910 + 31% of taxable income above R296 540
423 301 – 555 600	R100 263 + 36% of taxable income above R423 300	410 461 – 555 600	R97 225 + 36% of taxable income above R410 460

555 601 – 708 310	R147 891 + 39% of taxable income above R555 600	555 601 – 708 310	R149 475 + 39% of taxable income above R555 600
708 311 – 1 500 000	R207 448 + 41% of taxable income above R708 310	708 311 – 1 500 000	R209 032 + 41% of taxable income above R708 310
1 500 001 and above	R532 041 + 45% of taxable income above R1 500 000	1 500 001 and above	R533 625 + 45% of taxable income above R1 500 000

Rebates

	2018/19	**2017/18**
	R	R
Primary	14 067	13 635
Secondary	7 713	7 479
Tertiary	2 574	2 493

Tax thresholds

	2018/19	**2017/18**
	R	R
Below age 65	78 150	75 750
Age 65 and over	121 000	117 300
Age 75 and over	135 300	131 150

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	2018/19 RATES	TAX CHANGE	% CHANGE	AVERAGE TAX RATES	
R	R	R	R	%	Old rates	New Rates
85 000	1 665	1 233	-432	-25.9%	2.0%	1.5%
90 000	2 565	2 133	-432	-16.8%	2.9%	2.4%
100 000	4 365	3 933	-432	-9.9%	4.4%	3.9%
120 000	7 965	7 533	-432	-5.4%	6.6%	6.3%
150 000	13 365	12 933	-432	-3.2%	8.9%	9.6%
200 000	23 174	22 265	-910	-3.9%	11.6%	11.1%
250 000	36 174	35 265	-910	-2.5%	14.5%	14.1%
300 000	49 347	48 265	-1,083	-2.2%	16.4%	16.1%
400 000	80 347	78 972	-1,375	-1.7%	20.1%	19.7%
500 000	115 824	113 807	-2,017	-1.7%	23.2%	22.8%
750 000	212 490	210 473	-2,017	-0.9%	28.3%	28.1%

1 000 000	314 990	312 873	-2,017	-0.6%	31.5%	31.3%
1 500 000	519 990	517 973	-2,017	-0.4%	34.7%	34.5%
2 000 000	744 990	742 973	-2,017	-0.3%	37.2%	37.1%

Retirement fund lump sum withdrawal benefits

2018/19		2017/18	
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 R25 000	25 001 – 660 000	18% of taxable income above R25 000
660 001 – 990 000	R114 300 + 27% of taxable income above R660 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	990 001+	R203 400 + 36% of taxable income above R990 000

Retirement fund lump sum benefits or severance benefits

2018/19		2017/18	
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 R500 000	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	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	1 050 001 +	R130 500 + 36% of taxable income above R1 050 000

CAPITAL GAINS TAX

Effective capital gains tax rates (%)

	2018/19	2017/18
Individuals and special trusts	18	18
Companies	22.4	22.4
Trusts	36	36

Capital gains exemptions

DESCRIPTION	2018/19	2017/18
	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:



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TYPE	RATE OF TAX (%)	
	2018/19	2017/18