

TAX

Tax Amendments 2023

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On 1 November 2023, when the Minister of Finance presented his Medium Term Budget Policy Statement to Parliament, he also tabled various fiscal Bills. We will mainly discuss only two of them in this publication, being the Taxation Laws Amendment Bill, 2023 and the Tax Administration Laws Amendment Bill, 2023.

As has been the trend in recent years the number of significant amendments each year has been reduced, and the majority in number of the amendments are of a highly technical or esoteric nature, many of which are more of interest to tax professionals than to the business community in general.

Accordingly we limit our discussion to those amendments which are likely to be of interest in the general business environment.

INDIVIDUAL TAXPAYERS

Both of the amendments of interest this year have had wide publicity.

Solar Energy Tax Credit

This credit is in reality a rebate, so that it is a deduction from the calculated tax liability. Despite significant lobbying to broaden the scope of the equipment covered by the credit, Treasury has stood firm.

The essential elements of the rebate, which are contained in section 6C of the Income Tax Act, 1962 (the Act) are as follows:

- The rebate is available in respect of a cost incurred only by a natural person (so that, for example, if the home is owned by a trust or company and the owner incurs the expenditure, the rebate is not available, but it will be available if the occupier incurs the cost).
- The cost must be incurred on the acquisition of new and unused solar photovoltaic panels that have a generation capacity of at least 275W each.
- The panels must be brought into use for the first time on or after 1 March 2023 and before 1 March 2024 (which means that, as of the date of this publication, there are only about three and a half months left to instal and bring the panels into use).
- The rebate is an amount equal to 25% of the cost of the panels, with a maximum rebate of R 15 000.
- The panels must be installed and mounted on or affixed to a residence mainly used for domestic purposes by the person incurring the cost.
- In addition, the installation must be connected to the distribution board of the residence and an electrical certificate of compliance in respect of the installation must be obtained.
- In the event that an individual is claiming the enhanced deduction under section 12BA of the Act (see below) then this rebate may not be claimed as well.

Two-Pot Retirement System

Under the so-called Two-Pot Retirement System a minimum of two-thirds of the value of any retirement fund must be retained for retirement purposes, and a maximum of one-third may be drawn down at appropriate times prior to retirement.

Although the legislation will be enacted this year it takes effect to only from 1 March 2025 to allow the various retirement fund administrators time to update their systems.

CORPORATE AND BUSINESS

Interest Deduction

Technically, interest incurred in the production of income may only be claimed as a deduction if the interest was incurred in the course of a taxpayer's trade. Recognising the practical difficulty that often taxpayers in a non-trading scenario nevertheless incur interest in order to earn interest, in 1994 SARS issued Practice Note 31 (PN 31) that, in short, allowed an interest deduction incurred to earn interest income up to a maximum amount of the interest income, ie a loss could not be created.

In 2022 SARS announced that it would withdraw PN 31 with effect from 1 March 2023. Following a number of submissions it was agreed that they would defer withdrawal until 1 March 2024 and, in the meanwhile, legislation would be introduced to substitute for PN 31.

The original draft was very limited in scope and most unsatisfactory, but a far improved version of the new section 11G of the Act is now proposed.

What will now be deductible in any taxpayer's hands will be interest incurred in the production of interest that is included in (taxable) income, where that person is not carrying on a trade. The deduction will, however, be limited to the interest income earned in that year.

The following should be noted:

- Because section 11G applies only to the extent the person is not carrying on a trade it means that any taxpayer that is carrying on a trade will be able to claim the full deduction in the normal way, and there will be no cap based on the interest earned.
- The section comes into operation on 1 January 2025 and applies for tax years commencing on or after that date. Presumably SARS will postpone withdrawal of PN 31 to correspond to the effective date of the legislation.

Enhanced Deduction for Solar etc.

Historically, capital allowances for renewable energy (wind power, photovoltaic solar energy, concentrated solar energy, hydropower to produce electricity or biomass comprising organic wastes, landfill gas or plant material), has been deducted under section 12B of the Act on the basis of the amortisation being claimed over three years as to 50:30:20 (with installations producing a maximum of 1 megawatt qualifying for 100% deduction in the first year).

The new section 12BA provides an enhanced allowance of 125% of cost, but it applies only to the relevant new and unused equipment brought into use on or after 1 March 2023 and before 1 March 2025 (so that if the period is not extended, the historic allowance under section 12B will again apply from 1 March 2025).

Whereas section 12B allows the deduction only where the owner of the plant is generating and selling electricity, the new provision also grants the allowance to a lessor if the lessee is using the equipment in the generation of electricity in South Africa.

The following, however, should be noted:

- If the equipment is sold before 1 March 2026 then, in addition to the normal recoupment of the allowance based on the actual cost (ie the 100%) the additional 25% will also be recouped.
- In the case where the taxpayer is letting the asset to the user of the equipment there are a number of limitations in the Act which might mean that the full 125% cannot be claimed in the first year. These include, for example, section 23A where allowances claimed are limited to the lease income; section 23G, where there is a sale and leaseback and the lessee is a tax-exempt body; and section 24F, governing limited partnerships, where the total expenses and allowances claimed in any year is limited to the partners' contributions, plus income, plus any amount that the partners are liable to creditors of the partnership.

Third-Party Backed Preference Shares

Section 8EA of the Act treats dividends which arise in respect of a third-party backed share to be taxable income for the shareholder (ie the exemption is removed). A 'third-party backed share', in essence, is a preference share guaranteed by a third party with regard to the specified dividend yield or return attached to the preference share.

Section 8EA does not apply where the funds derived from the preference shares are applied for a "qualifying purpose", which is to acquire, directly or indirectly, equity shares in an operating company (including a holding company of an operating company).

It is now proposed to amend section 8EA to remove the above exception where the shares in the operating company cease to be held, ie the dividends will thereafter be fully taxable.

There are certain exceptions to this amendment as follows:

- First is where the funds derived from the disposal of the equity shares are used to redeem the preference shares within 90 days of deriving the funds (but a sale of shares solely to pay a dividend on the preference shares will still result in the new rule applying).
- The second is where the share in the operating company is a listed share which is substituted for another listed share pursuant to a corporate action as contemplated in the JSE's (or other South African exchange's) listings rules.

The amendment applies to tax years commencing on or after 1 January 2024. As most South African banks have financial years ending on 31 December, it effectively means that the amendment will apply from the beginning of next year.

Bearing in mind that the terms of the preference shares invariably have a gross-up clause, so that if the dividend becomes taxable the cost will be passed onto the issuer, there will not be much time to take the necessary steps to avoid any adverse consequence of this amendment.

Urban Development Zone Allowance

This allowance is granted under section 13quat of the Act and is given where there are redevelopment and regeneration projects in urban areas.

The allowance was due to expire on 31 March 2023 but now is extended so that it will no longer apply to assets brought into use after 31 March 2025.

INTERNATIONAL

Distributions from South African Trusts

One of the more controversial amendments is the intention to limit the flow-through principle applicable to trusts where the distribution is made to a beneficiary who is not a resident of South Africa. The intended effect will be that, despite the distribution to the foreign beneficiary, the trust itself will be taxable on the income.

This principle already purportedly applies where a trust distributes a capital gain, ie SARS is of the view that any distribution by a South African trust to a non-resident beneficiary of a capital gain is taxable in the trust's hands.

Following representations the amendment to section 25B was retained, but exemptions from the withholding tax on royalties and the withholding tax on interest are granted in respect of relevant amounts received by or accrued to a resident trust that are then paid to a beneficiary of the trust as a distribution.

The intention is to ensure that the trust is not subject both to income tax and the withholding tax.

Very concerning is the fact that foreign beneficiaries could be taxable in their home countries without being able to claim the tax paid by the trust as a credit against their tax.

The amendment itself is also problematic in that, while it is intended to apply to South African trusts, section 25B itself applies to both local and foreign trusts, and there is no reason why the provisions of this section should be limited to apply only to distributions made by a foreign trust to a South African beneficiary.

CGT Exemption

Paragraph 64B of the Eighth Schedule to the Act contains the so-called participation exemption, whereby a sale by a South African resident of shares in a foreign company is exempt from CGT if the resident holds at least 10% of the equity shares and voting rights in the foreign company, and certain other requirements are fulfilled.

Two main changes have been made in this regard:

- First, the exempt capital gain could arise in two circumstances, being, (a) where the resident sold the shares to a third party, or (b) where a capital gain arose out of a return of capital by the foreign company. One of these other requirements for the sale in (a) is that the seller had to have held the shares for at least eighteen months prior to the sale, but there was no minimum holding period in regard to (b). That minimum holding period of eighteen months has now been introduced. The amendment applies in respect of any foreign return of capital received or accrued on or after 1 January 2024.
- Secondly, additional requirements have been introduced in the case of a sale of shares to a third party, ie as in (a) above. Currently one of the other requirements is that the third party must be a non-resident that is not also a controlled foreign company in relation to any South African resident, nor a connected person in relation to the seller. In addition, now, the purchaser must not be either (i) a non-resident company that formed part of the same group of companies (for tax purposes) as the seller during a period of eighteen months prior to the sale, or (ii) a non-resident company, the shareholders of which immediately after the disposal are substantially the same as the shareholders of any company in the group of companies that disposed of the shares. This amendment is deemed to come into operation on 1 November 2023, being the date that the Taxation Laws Amendment Bill, 2023 was tabled in Parliament, and applies to any disposals on or after that date.

PAYE and Foreign Employers

It was announced in the 2023 Budget that an amendment would be made to require foreign employers paying salaries to employees in South Africa to register as employers for PAYE purposes and to withhold PAYE, under the Fourth Schedule to the Act.

Following submissions, Treasury accepted the impracticality of this and now the amendment requires that the foreign employer must register and withhold PAYE if it conducts business through a permanent establishment in South Africa.

While this will certainly narrow the scope of the foreign employers required to register and withhold, it should be noted that it is possible that the presence of an employee in South Africa could be sufficient to create such a permanent establishment in South Africa.

Controlled Foreign Companies

As is well known, profits of a controlled foreign company (CFC) are effectively attributed to and taxed in the hands of the South African-resident shareholders. One of the exemptions is where the company carries on business through a qualifying "foreign business establishment" (FBE).

It has been widely reported that the Supreme Court of Appeal (the SCA) in the *Coronation* case supported SARS's (more restrictive) interpretation of the extent to which a company could rely on the FBE exemption.

Despite this, draft legislation was circulated earlier this year to amend the FBE rules effectively to state what the SCA had already stated in the *Coronation* judgment.

Following submissions on the appropriateness or otherwise of the proposed amendment, and bearing in mind that the Constitutional Court has agreed to hear the appeal against the SCA decision, Treasury and SARS have agreed to postpone any amendment, pending the outcome of the Constitutional Court hearing.

Foreign Dividends

Section 10B of the Act allows for a total or partial exemption from tax on dividends from foreign companies. The exemption is total where the South African shareholder holds at least 10% of the equity shares and voting rights in the foreign company, and where the holding is less, the exemption is partial so that the shareholder pays tax at the effective rate of 20%.

There is an anti-avoidance provision contained in section 10B that effectively removes the exemption (so that the foreign dividend becomes fully taxable at ordinary income tax rates) where the foreign dividend earned is determined directly or

indirectly with reference to, or arises directly or indirectly from, any amount paid or payable by one party to another, and the former party claimed the payment as a deduction for income tax purposes.

Currently there is an exclusion which states that this rule will not apply if the deductible payment is in respect of the acquisition of trading stock.

This exclusion has been expanded to cover a foreign dividend declared from profits where less than 20% of the profits were generated from transactions with persons that claimed the payments as deductions for tax purposes.

So, for example, if the profits of the foreign company amounted to USD100 and that included an amount paid to it of USD5 by a South African taxpayer which claimed the payment as a deduction, 100% of any dividend received by any South African shareholder was taxable at the full rate of tax (28% or 45%).

After this amendment the dividend received will either be tax-free or taxable at 20%, depending on the size of the shareholding.

This is a practical and welcome amendment.

Advanced Pricing Agreements

As is well-known, it is possible to obtain binding rulings from SARS on the interpretation of provisions of the various tax Acts.

However, the legislation specifically excludes obtaining rulings on transfer pricing arrangements between South African residents and non-residents that are connected persons, or who are otherwise within the ambit of the transfer pricing rules in section 31 of the Act.

Many countries have a facility whereby taxpayers and the tax authority can agree on a transfer pricing methodology to be used, in which case the tax authority is obliged to accept the transfer prices used by the local company.

New legislation to facilitate such agreements has now been introduced into the Act. However, given its complexity, the need to amend systems and the need to staff up with the necessary skills, the new arrangements will only be introduced at some point in the future, to be advised by SARS.



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