

Tax Newsflash - Budget 2010 Crystal clear

In This Issue

The Minister of Finance, Mr Pravin Gordhan delivered his first budget speech to Parliament on 17 February 2010.

In this Tax Newsflash we highlight certain economic data tabled as part of the Budget Review and the tax proposals included in the Budget Review.

Income Tax

Individuals

Personal Tax Rates and Rebates

Individuals are to receive personal income tax relief amounting to R6.5 billion which presents the majority of the net tax relief offered. The tax savings for individuals are however not as favourable as that obtained in previous years.

Although tax rates have once again remained unchanged, increases to the tax brackets provide a reduction in the individual tax burden at all income levels. Most of the tax relief is however provided to taxpayers in the lower-income brackets. Bear in mind however, that the relief is aimed at partial compensation for the effects of inflation.

An illustration of this relief across a spectrum of incomes is shown in table 2.

The monthly saving (before adjustment for fiscal drag) for individuals in the top tax bracket is approximately R250 (compared to R419 in 2009/2010).

The primary rebate for all natural persons increases from R9 756 to R10 260, and the additional rebate for persons 65 years and older increases from R5 400 to R5 675.

Tax Thresholds

The annual income level at which an individual starts paying tax, after taking into account the individual rebates, has increased as follows:

	2009/2010	2010/2011
Under 65 years	R54 200	R57 000
65 years and older	R84 200	R88 528

Table 1: Income Tax Rates for the Year of Assessment commencing on 1 March 2010

Taxable income as exceeds R	But does not exceed R	Tax payable R
0	140 000	18%
140 000	221 000	R25 200 + 25%
221 000	305 000	R45 450 + 30%
305 000	431 000	R706 50 + 35%
431 000	552 000	R114 750 + 38%
552 000 +		R160 730 + 40%

**Table 2: Comparison of Annual Tax Payable (not inflation adjusted)
(Natural Persons under 65)**

Taxable Income R	2009/10 Tax Payable R	2010/2011 Tax Payable R	Reduction in Tax Payable R	Percentage Reduction %
57 000	504	0	504	100,0
60 000	1 044	540	504	48,3
65 000	1 944	1 440	504	25,9
70 000	2 844	2 340	504	17,7
75 000	3 744	3 240	504	13,5
80 000	4 644	4 140	504	10,9
85 000	5 544	5 045	504	9,1
90 000	6 444	5 940	504	7,8
100 000	8 244	7 740	504	6,1
120 000	11 844	11 340	504	4,3
150 000	18 504	17 440	1 064	5,8
200 000	31 004	29 940	1 064	3,4
250 000	45 504	43 890	1 614	3,5
300 000	61 004	58 890	2 114	3,5
400 000	96 004	93 640	2 364	2,5
500 000	133 704	130 710	2 994	2,2
750 000	233 204	229 670	3 534	1,5
1 000 000	333 204	329 670	3 534	1,1

Retrenchment Package Merger

The so-called R30 000 exemption from income tax which applies to retrenchment packages has not been reviewed for many years. In view of the high number of retrenchments, it was announced last year that a similar exemption to that relating to retirement lump sums is to be introduced for retrenchment packages. As a result, in future all retirement and retrenchment lump sum payments will be treated the same for tax purposes.

Comment

The fact that fiscal drag has been adjusted for individual taxpayers is noteworthy in the light of the large fiscal deficit. It is unclear whether the R300 000 aggregation will apply to both retrenchment and retirement lump sums.

Interest and Foreign Dividend Exemption

The 2010/11 increase in the interest and foreign dividend exemption is 6,2% (2009/10 – 10,5%) for persons under the age of 65 (from R21 000 to R22 300), and a 6,7% (2009/10 – 9,1%) increase for persons aged 65 years and older (from R30 000 to R32 000).

Of these total exemption amounts, the maximum exemption for foreign interest and foreign dividends increases from R3 500 to R3 700 per year.

The exemptions will also now be limited to widely available interest-bearing instruments such as bank deposits, government retail bonds and collective investment money market funds.

Comment

As one of Government's stated objectives is to support the creation of a culture of saving, the small increases in the exemptions seems counterproductive in the creation of such a culture.

Post-Retirement Conversion of Annuities into Lump Sums

Retirement savings lump sums benefit from a special rates table that provides a R300 000 "tax exemption". This table predominantly applies when a lump sum payout occurs upon a person's retirement or death. However, lump sum payouts may occur after retirement if a post-retirement annuity is subsequently converted into a lump sum. It is proposed that this post-retirement conversion receive the same treatment under the special rates table and that it accordingly also qualifies for the R300 000 tax exemption. In addition, these conversions will also be subject to the rule that all exemptions should be aggregated so that a taxpayer will only be able to enjoy the R300 000 exemption over his lifetime.

Retirement Savings Payouts to Third Parties

In some circumstances, the Pension Funds Act allows fund administrators to use a member's retirement benefits to make payments to third parties such as compensation to lenders for unpaid housing loans guaranteed by the fund. These payments will now be treated like other lump sum benefits for the benefit of the member, thereby triggering the special rates table.

Comment

It would seem that all the amendments relating to retirement issues are aimed at simplifying the tax rules. This move is welcomed.

Corporate Tax**Share-for-Share Reorganisations of Listed Companies**

"Share-for-share" reorganisations qualify for tax relief if certain conditions are met. These reorganisations would generally involve shares in the acquiring company being issued to the holder of shares in the target company whose shares are being acquired. In order for the tax relief to apply, it is necessary for the acquiring company to know certain tax information about the target company's shareholders, such as whether the target company's shareholder holds the target shares as a capital asset or as trading stock. This level of knowledge is impractical where the target company is listed, given the number of shareholders involved and the relatively small size of a typical holding.

It is consequently proposed that conditions of this nature will be waived in the case of "listed share for share relief, to the extent that this waiver does not create opportunities for tax avoidance."

Comment

This proposal is to be welcomed in that it will make share-for-share reorganisations practical in a listed context.

Default Elections Involving Intra-Group Rollovers

Transfers of assets between group companies, (i.e. transfers within a 70% owned group of companies), can be affected free of tax by way of rollover relief granted. This rollover relief applies automatically, if certain objective conditions are satisfied unless the parties involved in the transaction elect for it not to apply.

Where group companies regularly dispose of trading stock to one another the automatic application of the rollover relief can give rise to problems. Consequently, in order to simplify compliance, it is proposed that a “different methodology be provided for this class of intra-group transfers”.

Comment

It is unclear at this stage what form the “different methodology” will take. Either such transactions could be excluded completely from the rollover provisions or, alternatively, such transactions could be excluded from the rollover relief unless the parties elect for it to apply.

Reorganisations and Bad Debts

The intra-group reorganisation rules are designed for the acquiring group company to generally “step into the shoes” of the group company transferring qualifying assets. This concept does not apply in the case of bad debts due to a technicality. This means that a creditor can often not claim a bad debt deduction for debts acquired in a re-organisation where the debtor subsequently defaults.

It is proposed to amend the reorganisation rules to ensure that bad debt deductions can be claimed in these circumstances as long as it does not give rise to a double deduction.

Financial Instruments held as Trading Stock

The income tax rules for trading stock generally allow stock to be valued at the lower of cost or market value. An exception to this rule is where the trading stock consists of shares held by a company, in which case the stock must be valued at cost.

It is proposed that in future all financial instruments, held as trading stock, be required to be held at cost for tax purposes “because modern financial reporting distinguishes financial instruments from other inventory”.

Comment

The proposal will not allow a taxpayer, holding financial instruments as trading stock, to value these below cost, even if the market value of the instrument has fallen. It is unclear whether this proposal will affect all taxpayers holding financial instruments as trading stock, or merely be applicable to companies, which are currently the only taxpayers precluded from writing down shares held as trading stock.

The logic of treating financial instruments held as trading stock differently from other forms of trading stock is unclear. For example, why should one trader, holding fixed property as trading stock, be entitled to value such stock at the lower of cost or market value while another trader, holding shares in a property owning company as trading stock, be required to hold these at cost? The stated reason given, being that financial reporting distinguishes between financial instruments and other inventory, appears to lack substance.

Revised Taxation of Short-Term Insurers

A special concession is made for short-term insurers in terms of which a deduction for a certain level of reserves is allowed. In terms of an amendment passed in 2007, the level of reserves allowed as a deduction is determined in accordance with the minimum reserve requirements of the FSB, excluding contingency reserves. Prior to this, the deduction allowed in respect of short-term insurance reserves was determined solely at the discretion of the Commissioner and in practice was determined with reference to premiums earned in a particular year.

Given the recent economic downturn and the proposals to reserve on a more conservative basis to protect policyholders in future, a tax deduction may now be granted for potentially inflated reserves despite these being determined within the parameters set by the FSB. Furthermore, the level of reserves of short-term insurers are typically not related to premiums earned in any particular year as they relate more closely to the history of claims experience.

It has now been proposed that the taxation of short-term insurers be reviewed to address these issues to ensure that an element of matching is achieved between the level of reserves allowed as a deduction and premiums earned.

Residential Property Entities

In 2009 government announced a three-year window to allow certain companies and trusts, which own residential properties, to transfer these to their shareholders or beneficiaries free of transfer duty and other negative tax consequences. The relief was only granted in a limited number of circumstances and certainly did not apply to all entities owning residential property.

It has now been determined that “this window is insufficient” and consequently a “new, more flexible window period is proposed.

Comment

It is unclear what exactly is envisaged by this proposal. On first reading, it would appear that it merely envisages an extension of the period within which the residential property can be extracted from the relevant entity. It is however difficult to see why a three-year window period should be insufficient, particularly this early on in the period.

What is hopefully envisaged is that the relief given by the proposal is extended to more entities owning residential properties and that the previously enacted requirements to benefit from the relief are relaxed. This could result in the relief being extended to, for example, residential properties held for rental purposes or as holiday homes, which are currently excluded from the relief.

Sundry

Various other amendments are proposed to deal with, amongst other things, plantations involved in company formations, refinements to the proposed dividends tax, changes necessitated by company law reform and refinements to the presumptive turnover tax.

International Tax

Promoting South Africa as a Gateway into Africa

With its excellent business infrastructure, South Africa is ideally located to act as an investment gateway into Africa. Government has therefore signalled its intention to investigate ways to enhance South Africa's attractiveness as a location from which multinationals can invest into Africa. According to the Budget Review, relief from exchange control and taxation for various types of headquarter companies will therefore be considered. Under current rules, foreign funds cannot be channelled through South Africa to other foreign locations without exchange control approval. Furthermore, from a tax point of view, an international headquarter company tax resident in South Africa is subject to South Africa's tax laws like any other resident as a consequence of which its ability to compete with some of the more tax-friendly African holding jurisdictions is

restricted. For example, no relief from the secondary tax on companies (STC) is provided in respect of foreign dividends received by a resident which are on-declared to non-resident shareholders.

Comment

We welcome the proposal which, if correctly implemented, could significantly enhance South Africa's competitiveness as a tax-friendly holding jurisdiction. National Treasury will no doubt be careful to ensure that any proposed regime is in accord with South Africa's double tax treaty rules and does not constitute harmful tax practice.

Application of Thin Capitalisation Rules to South African Branches

The thin capitalisation rules in the Income Tax Act restrict the amount of interest-bearing borrowings by South African residents from foreign connected persons, typically by a South African subsidiary from its foreign parent. Any excessive financial assistance will result in interest expenditure on the borrowings being disallowed and treated as a deemed dividend distribution subject to STC. These rules only apply to residents, though, and therefore not to the South African branch of a non-resident (the branch is not a separate person from its head office). The fear is therefore expressed that this permits excessive gearing of such a South African branch with no restriction on stripping interest out of South Africa in a tax-deductible manner. Consequently, it is proposed to extend the ambit of the thin capitalisation rules to also apply to non-residents.

Comment

It is to be noted that the fear of tax stripping is probably overstated as it relates to the application of South Africa's tax laws to foreigners who are resident in a country with which South Africa has concluded a double tax agreement. Under a double tax agreement, the profits of the branch must be determined with reference to the arm's length principle. The proper application of this principle should restrict interest that can be charged to the branch. However, this is obviously more difficult for SARS to administer than a clearly defined rule.

Broadening of Tax Base

Closure of Sophisticated Tax Loopholes

The comment is made in the Budget Review that international competition puts pressure on South Africa to lower marginal tax rates, especially the headline corporate income tax rate. Government has over the past decade achieved lower rates by broadening the tax base, but its efforts in this regard are being undermined through the use of sophisticated anti-avoidance tax schemes. Accordingly, much effort goes into the identification of such schemes and considering appropriate measures to close these schemes.

Schemes that have been identified for closure in the Budget Review deal with cross-border mismatches, protected cell companies, cross-border insurance payments, participation preference and guaranteed shares, restricting the cross-border interest exemption, interest cost allocation for finance operations and transfer pricing. Of particular interest are protected cell companies, the proposal to restrict the cross-border interest exemption and transfer pricing.

Statutory Cell Companies

According to the Budget Review, a statutory cell company effectively operates as a multiple limited liability entity, with each cell protected against the other. The investor has full control over the cell, but not over the company. If the company is established as a foreign company, it may be possible to avoid it being a controlled foreign company (CFC) on the basis that South African residents do not hold more than 50% of the participation rights or voting rights in it. As a result, the income of the protected cell does not have to be imputed to the South African resident although the resident in effect holds more than 50% of the participation rights or voting rights of that cell. To close this loophole, it is proposed that each cell be treated as a separate company, and, hence, as a CFC.

Cross Border Interest Exemption

As regards the proposal to restrict the cross-border interest exemption, the Income Tax Act exempts foreign legal persons from South African tax on local interest, unless the interest is paid to a local branch of that foreign person. The purpose of the exemption is to attract foreign investment, but it is considered that it is overly broad and needs to be narrowed. However, it is not anticipated that any changes will affect foreign investment in South African bonds, unit trusts, bank deposits or the like.

Interest Cost to Produce Exempt Income

Interest costs on debt that finances “income” generating assets are generally deductible for tax purposes while interest costs on debt that finances “non-income” generating assets, such as shares, are not. “Income” in this context refers to income which is taxable as opposed to exempt income.

The Budget Review states that financial institutions are “deducting interest expenditure beyond what they should be allowed according to tax principles”. It accordingly states that it is proposed to introduce measures to ensure that interest expenses are allocated proportionately among various financial assets based on a “taxable income/gross receipts and accruals” formula.

Comment

The statement that financial institutions are deducting interest beyond what they should be allowed according to tax principles is strange. If the deductions claimed are in excess of what they are entitled to then one would expect SARS to apply tax principles to restrict them to what is allowed. What is more likely therefore is that there is a perception that applying normal tax principles, as determined by the courts over many years, gives financial institutions too large a deduction for interest paid where they earn substantial dividend income.

Presumably the intention is to allow interest income to be deducted in proportion to the gross taxable income generated by the institution relative to its gross total income. The review talks about “gross receipts and accruals”. This would include capital receipts, but it is unlikely that it is intended that capital receipts will come into the formula.

Transfer Pricing

On transfer pricing, it is proposed to provide a uniform set of transfer pricing rules to deal with artificial pricing or the misallocation of prices within the various components of a single transaction. It is stated that the rules will align the treatment of both onshore and offshore transactions. The transfer pricing rules apply in a cross-border context to transactions between related parties. In essence, SARS is empowered to adjust any

consideration in respect of such a transaction to reflect an arm's length price. This is to protect the tax base from erosion due to the manipulation of prices between related parties.

Comment

The proposed changes to stamp out sophisticated tax avoidance schemes are congruent with Government's attempts to broaden and protect the South African tax base.

Employees' Tax and Fringe Benefits

Discontinuation of SITE System

The standard income tax on employees (SITE) system was introduced in the late 1980s to limit the number of personal income tax returns filed annually. Administrative modernisation, and the fact that the personal income tax threshold for taxpayers younger than 65 years is approaching the SITE ceiling of R60 000, have eliminated the need for this system. SITE will be repealed with effect from 1 March 2011.

Comment

This change has long been anticipated given the larger drive to simplify the tax administration system. All allowances paid to an employee (except subsistence allowances and travel allowances) will now be subject to employees' tax in full or according to a formula (e.g. residential accommodation). The effect is that all taxpayers above the tax threshold will now need to register as taxpayers.

Modification of Company Car Benefits

Based on the continued drive to limiting salary structuring opportunities of employees, it has been announced that company car fringe benefit rules will be tightened. It is stated that the intention is to increase the "deemed monthly value", but it is unclear whether this would refer to the percentage (currently 2,5%) or to the actual determined value of the motor vehicle.

Medical Scheme Contributions and Medical Expenses

Effective from 1 March 2010, the caps for deductible medical contributions will increase to:

- R670 from R625 for the first two beneficiaries; and
- R410 from R380 for each additional beneficiary.

The proposed conversion of the deduction into a tax credit of 30% of allowable medical aid contributions and expenses, announced in last year's budget will be postponed to 1 March 2012.

Employer Payment of Professional Fees on Behalf of Employees

No taxable fringe benefit arises in the hands of an employee where the employer pays the subscription fees of a professional body on behalf of the employee if membership of that body is a condition of employment. Other fees paid on behalf of an employee that mainly benefit the employer will now enjoy the same tax treatment and the fringe benefit relief will be extended to cover these related-employer payments.

Comment

It is unclear at this stage what type of fees would qualify for this relief.

Administrative Issues

Voluntary Disclosure Programme

A voluntary disclosure programme was proposed. This programme will enable defaulting taxpayers to disclose unreported revenues and pay the associated tax with a reduced interest charge and without incurring penalties.

This concession will be available subject to the following conditions:

- The disclosure is complete
- SARS was not already aware of the default
- A penalty or additional tax would have been imposed had SARS discovered the default in the normal course of events.

The Minister also announced that alignment of exchange control violation penalties with this disclosure programme is being considered. In consequence of this programme, it is proposed that SARS's will no longer have a discretion to waive interest on unpaid provisional tax. The voluntary disclosure programme will apply from 1 November 2010 to 31 October 2011.

Comment

The tax associated with undisclosed revenue will still be payable as will an interest charge for late payment. The interest charge will however be reduced. Clarity on the extent of this reduction is outstanding.

The interest charge benefit under the programme would appear to be linked to SARS' prior knowledge of the default and to an inherent exposure of the taxpayer to a penalty as a result of the default.

PAYE Assessments

As a result of a recent court judgment legislative amendments are proposed to ensure that assessments for employees' tax can be raised against employers who have made an incorrect determination of the PAYE that is payable on a fringe benefit.

Additional amendments are also being considered to deal with situations where payment of this assessed PAYE could lead to a further fringe benefit.

Exemption from Provisional Tax Registration

Amendments are proposed to clarify that persons who are exempt from the payment of provisional tax will not be required to register as provisional taxpayers.

It was also announced that this proposal may be extended to cover taxpayers with little or no provisional tax to pay.

Process Improvements

The following process improvement initiatives were announced:

- Improved processes for call centres, office operations and payments.
- Further modernisation of personal income tax, PAYE, corporate tax, VAT and customs systems.
- Increased system infrastructure for processing of administrative penalties.
- Enhancement of systems to facilitate self-service and voluntary disclosure.

Other Administration Proposals

The following administration proposals were also announced:

- A greater focus on large taxpayers and high net worth individuals.
- Restricting advance tax rulings to only those taxpayers who have no outstanding returns and taxes.
- Greater information sharing among regulatory and enforcement agencies operating under the umbrella of the Ministry of Finance. Information sharing is currently restricted by secrecy provisions of the various agencies. It is proposed that these secrecy provisions be revised to facilitate this information sharing.
- Electronic filing of transfer duty returns and electronic payment of transfer duty.

Tax Incentives

Enterprise development

- Government has allocated R 3,8 billion towards incentive schemes in terms of the Enterprise Development programme, the largest programme in the Department of Trade & Industry (DTI);
- There is a major policy change in that production incentives will be increasingly grant based, reducing reliance on tax incentives.
- An additional R3.6 billion is allocated to the DTI for industrial policy interventions consistent with government's new Industrial Policy Action Plan. In particular, these funds go to support investment and production:
 - ▶ in the automotive components;
 - ▶ Clothing; and textile industries.
 (These key strategic sectors have been earmarked for the development of new support packages by the DTI. The aim of these new support packages is to boost manufacturing capacity and support job creation.)
- The automotive production and development programme was approved by Cabinet in October 2008 and replaced the motor industry development programme. The scheme will focus on increasing plant volumes and achieving better economies of scale, and provides for a taxable cash grant based on the amount of the investment.
- Provisions have been made for transfers and subsidies to the Industrial Development Corporation (IDC) for services rendered for the clothing and textiles programme to provide a production allowance for firms under certain conditions. This programme is still under development and guidelines will be published when findings is provided in 2010/2011.
- The IDC was tasked to develop an upgrading programme for the foundry and tooling industries.

➔ Specific incentive allocation:

Medium Term Expenditure Estimates			
	2010/2011	2011/2012	2012/2013
Enterprise Investment Programme	R346,7 mil	R524,5 mil	R603,9 mil
Critical Infrastructure Programme	R115,7 mil	R118,5 mil	R181,7 mil
Business Process Outsourcing & Offshoring	R223,1 mil	R233,1 mil	R224,0 mil
Film Incentive	R245,9 mil	R270,3 mil	R286,6 mil
Automotive Investment Scheme	R747 mil	R916,8 mil	R1 025,4 mil

Existing incentives will be effective immediately, while the implementation date for proposed automotive incentives is not certain.

The details of the proposed clothing and textile schemes will be announced in the course of 2010.

Comment

We welcome the continued spending on enterprise development and note specifically the increased spending on Business Process Outsourcing & Offshoring, Film industry & industrial policy projects. It is, however, disappointing to note that there is almost virtually no increased spend on critical infrastructure development. There was also no indication of the support for projects involved in co-generation /self-generation of electricity. It is also strange to note a policy shift, away from tax incentives to a grant based approach.






Climate Change

Climate change and concerns over global energy supply present both challenges and opportunities for South Africa. Industries must be helped to manage scarce resources more efficiently and to reduce greenhouse gas emissions through appropriate pricing of energy. This is necessary to enable investment in sustainable technologies. Green economy initiatives will create new opportunities for enterprise development, job creation and the renewal of commercial and residential environments. This must play a part in our new growth path.

Comment

The Minister referred in his budget speech to further measures of environmental taxes to be implemented. Our view is that this refers to the Climate Change Adaptation and Mitigation Policy & Incentives Green Paper, which the Government has indicated will be distributed for consultation by mid-year 2010. This paper is expected to propose measures to implement carbon pricing in the form of either a carbon tax on emissions or a cap and trade system of carbon emission reductions. These measures will be designed to reduce South Africa's national carbon emissions in line with President Zuma's announcement of a 34% cut in carbon emissions by 2020 and a 42% cut in emissions by 2025.

Other environmental taxes and levies that will also be investigated include:

-  A wastewater discharge levy in terms of the Water Act
-  Air pollution levies in terms of the new Air Quality Act
-  Levies on waste streams
-  A landfill tax
-  Traffic congestion charges

Employment Incentive

Under consideration is a cash reimbursement to employers for a two-year period, operating through the SARS payroll tax platform, and subject to minimum labour standards. It will be available to tax-compliant businesses, non-governmental organisations and municipalities. Our preliminary estimate is that about 800 000 people will qualify. The aim is to raise employment of young school-leavers by a further 500 000 by 2013. The expected effective date is early 2011.

Comment

We welcome any initiative that supports job creation and measures that assist business, NGO's and municipalities in the creation in such opportunities should similarity be supported.

Value -Added Tax

Enterprise Development

Not only has the VAT rate been left unchanged despite the fact that the VAT collections are R22bn behind the estimates, the bulk of the VAT proposals tabled by the Minister favour the taxpayer.

Residential Properties

It is now proposed that the full claw-back of VAT input tax on residential properties which are temporary leased before being sold by developers, be revisited with a view to reducing the value of the adjustment.

In general terms a residential property developer would be obliged to charge VAT on the sale of the units and would be entitled to claim the VAT incurred on the development costs. In some instances however, the developer may be unable to sell the units and instead of leaving the units vacant whilst trying to find a buyer, temporarily leases the properties to tenants.

In VATNEWS 14 (issued during March 2000) SARS ruled that in such case there had been a change of use and that because the property was being used to make exempt supplies (the letting of residential property) the developer was obliged to declare output tax on the market value of the property.

Comment

Not only was this ruling draconian, it is questionable whether it was correct in that the change in use adjustment in question applies where the property is used "wholly for a purpose" otherwise than making taxable supplies. It is our view that the temporary letting of a property prior to sale does not constitute the property being wholly used for the purposes of making exempt supplies.

Although the proposal only refers to adjusting the value of the adjustment it would be preferable for SARS to review the basis of its ruling and withdraw it in its entirety. The proposal only refers to residential property developers but financial institutions which rent out repossessed properties pending the sale of such properties would also be affected.

It is proposed to relax the rules relating to intra-group supplies on loan account.

Period for Outstanding Debts

In terms of current legislation where a vendor acquires goods or services and has not paid the full price for such goods or services within a 12 month period, the vendor is obliged to account for VAT on the unpaid portion of the price. This represents a claw back of the VAT which the vendor claimed when he acquired the goods or services in the first place.

This provision was primarily aimed at outstanding debts which had been written off by the seller who could then claim an input tax adjustment leaving SARS out of the pocket to the extent that the defaulting purchaser had also claimed input tax on acquiring the goods or services from the seller.

Anomalies are however created where these provisions are applied to supplies between companies in the same group and such loans (as is often the case) are not cleared within 12 months. In such case the group is prejudiced as the company supplying the goods or services would not have written off the debt as being irrecoverable and would not accordingly, have claimed an adjustment.

It is thus proposed that the 12 month rule in respect of intra group transactions will be relaxed.

Comment

It is hoped that such transactions will be excluded from the ambit of the provision altogether, but it is more likely that the 12 month period will simply be extended.

Other

Other proposals seeking to assist vendors include:

- The extension of pooling arrangements from farming and rental arrangements to other industries such as betting, trucking and shipping industries
- Providing vendors with the option to return VAT on imported services in their normal VAT201 returns instead of the prescribed VAT215 form which requires separate payment within 30 days of the date of importation. This means that vendors in a refund position can avoid having to make a separate payment to SARS.

Compliance

The remaining proposals relate to compliance issues:

- It is intended to include provisions requiring proof of payment in order to substantiate the notional input tax on second hand goods.
- Although a vendor does not require a tax invoice to claim input tax where the transaction does not exceed R50 it is proposed that some form of proof (such as a till slip) will be required.
- It is intended to review the definition of commercial accommodation within the context that “certain entities that supply exempt residential accommodation have (as a result of definitional technicalities) crossed over into supplying commercial accommodation”. One of the key exclusions from the definition of commercial accommodation is any dwelling which is supplied in terms of a lease agreement. It would appear that entities supplying students with furnished lodgings where there is no such lease agreement have in fact been supplying “commercial accommodation” on which VAT is leviable and that such result was unintended and will be reviewed.

Customs and Excise

Introduction

The following changes to the current customs and excise legislation were proposed.

Specific Excise Duties (“Sin Taxes”)

The annual changes to the sin taxes were expected with an increase in the rates of excise duties payable on tobacco products and alcoholic beverages in line with annual trends and benchmark target ranges of 23, 33, 43 and 52 per cent of the average retail price for wine, beer, spirits and tobacco, respectively. As these benchmarks were set a while ago in 2002, these will be reviewed during 2010.

The excise duty on malt beer increases by 8.2% from R46.41 to R50.20 per litre of absolute alcohol which equates to an average increase of 6.5c per 340ml can to a total of 85.34c per 340ml can.

For the fifth year, we see no changes to the excise duty on traditional beer and traditional beer powder, which remain at 7.82c per litre and 34.7c per kg respectively.

Wine incurred increases in excise duty of 8.1% unfortified, 8.3% fortified and sparkling wine 8.3%. This has resulted in the rates per litre on these products equaling R2.14 per litre unfortified, R4.03 per litre fortified and R6.67 per litre sparkling.

Ciders and alcoholic fruit beverages received an increase in excise duty of 8.2% on unfortified and fortified.

Spirits and liquors also saw an increase of 8.9% from R 25.05 to R27.27 per 750ml bottle.

Smokers will also face increased prices as a result of increases in the excise duties on cigarettes 16.1%, cigarette tobacco 6.3%, pipe tobacco 8.0% and cigars 6.2%.

These duty amendments to the specific excise duties above are effective from 17 February 2010.

Fuel Taxes

Fuel levy has increased by 10c per litre for both petrol and diesel. An additional 7.5c per litre increase on petrol and diesel is proposed to support the new multi-product petroleum pipeline between Durban and Gauteng. The diesel fuel tax refund and biodiesel fuel tax rebate concessions will adjust automatically to maintain relative benefits to qualifying beneficiaries.

We also see an increase in the Road Accident Fund (“RAF”) levy on both petrol and diesel by 8c per litre from R64.0c to R72.0c per litre. This increase is intended to strengthen the RAF’s financial position and effectiveness.

The above proposals will become effective from 7 April 2010.

Advalorem Excise Duties

No abolishment of ad valorem duties on luxury items has been provided for.

General Customs and Excise Matters

- **Carbon Emissions Tax:** The carbon dioxide vehicle emissions tax, a specific tax on new passenger vehicles, will be implemented from 1 September 2010. New passenger cars will be taxed based on their certified carbon dioxide emissions at R75 per g/km for each g/km above 120g/km. This emissions tax will be in addition to the current ad valorem luxury tax on new vehicles;
- **Environmental Levy Taxes:** Additional environmental levy taxes will be explored to raise revenue and meet South Africa's environmental objectives;
- **Third Party Information Reporting for Customs:** To bring the Customs and Excise Act in line with the Income Tax Act, amendments will be considered to provide for reporting of information by third parties for purposes of verifying information submitted to SARS;
- **Electronic Communication for Customs:** Amendments to the Customs and Excise Act will be considered to provide for more flexible alternative measures to secure user identification and access;
- **Tax Administration Improvements in the next three years:**
 - ▶ Customs modernisation (work continuing to modernise Customs);
 - ▶ Call centres, office operations and payment processes;
 - ▶ Increased system infrastructure to process administrative penalties;

Selected Economic Data

Table 1: Budget Revenue Collections				
	2009/2010	2010/2011	2011/2012	2012/2013
Taxes on income and profits ¹	352 800	377 716	428 132	489 416
<i>of which</i>				
Personal income tax	203 500	224 676	264 646	312 123
Corporate income tax	130 500	133 650	143 065	159 759
Taxes on payroll and workforce	7 750	8 424	9 149	9 606
Taxes on property	9 000	9 960	10 980	12 460
Domestic taxes on goods and services	201 995	230 880	250 335	280 980
<i>of which</i>				
Value-added tax	146 500	164 000	179 250	203 820
Taxes on international trade and transactions	18 830	20 850	22 861	25 806
State miscellaneous revenue and fees ²	50	20	20	30
Tax revenue	590 425	647 850	721 477	818 298
Non-tax revenue ³	8 938	10 380	11 483	12 379
<i>of which</i>				
Mineral and petroleum royalties	-	3 540	4 800	5 500
Less: SACU payments	-27 915	-14 991	-11 211	-22 781
National budget revenue	571 492	643 239	721 749	807 896
Provinces, social security funds and selected public entities	86 060	95 165	105 993	114 382
Budget revenue	657 552	738 404	827 742	922 278

¹ Also includes secondary tax on companies, interest on overdue income tax and small business tax amnesty levy.

² Includes stamp duties and revenue received that could not be allocated to a specific tax instrument.

³ Includes mineral and petroleum royalties, mining leases and departmental revenue.

Table 2: Economic classification of consolidated government expenditure

	2009/10	2010/11	2011/12	2012/13
	Revised estimate	Medium-term estimates		
	R million	R million	R million	R million
Current payments	480 408	527 892	580 140	623 715
Compensation of employees	270 859	294 432	315 773	332 283
<i>Percentage of GDP</i>	<i>11.10%</i>	<i>10.90%</i>	<i>10.60%</i>	<i>10.10%</i>
Goods and services	149 181	155 789	168 533	178 804
Interest	62 368	77 671	95 834	112 628
<i>Percentage of GDP</i>	<i>2.50%</i>	<i>2.90%</i>	<i>3.20%</i>	<i>3.40%</i>
Transfers and subsidies	268 580	284 016	315 049	337 335
<i>Percentage of GDP</i>	<i>11.00%</i>	<i>10.50%</i>	<i>10.60%</i>	<i>10.20%</i>
Payment for capital assets	53 530	68 168	69 418	73 567
<i>Percentage of GDP</i>	<i>2.20%</i>	<i>2.50%</i>	<i>2.30%</i>	<i>2.20%</i>
Payment for financial assets	32 806	20 893	754	5
Contingency reserve	-	6 000	12 000	24 000
Total payments	835 324	906 964	977 361	1 058 622
<i>Percentage of GDP</i>	<i>34.10%</i>	<i>33.60%</i>	<i>32.90%</i>	<i>32.10%</i>
<i>Gross domestic product</i>	<i>2 449 858</i>	<i>2 699 888</i>	<i>2 967 560</i>	<i>3 295 749</i>

Table 3: Revised Medium Term Macroeconomic Fiscal Framework

	2009/2010	2010/2011	2011/2012	2012/2013
GDP	2,449.90	2,699.90	2,967.60	3,295.70
GDP real growth rate	-1.5	2.9	3.4	3.6
Headline CPI inflation	6.7	5.7	6.2	5.9
Consolidated Budget Expenditure	835.3	907	977.4	1058.6
Consolidated Budget Revenue	657.6	738.4	827.7	922.3
Consolidated Budget Balance	-177.8	-168.6	-149.6	-136.3
% of GDP	-7.30%	-6.20%	-5.00%	-4.10%

For further information, please contact:

Business Unit Leader – Tax & Legal

Dave Kennedy

+27 (0)11 806-5340

www.deloitte.co.za



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