IAPA Johannesburg
Chartered Accountants (SA)

2020 BUDGET NEWSLETTER

The budget presented on the 26th of February 2020 has had no major surprises for taxpayers.

TAX PROPOSALS

- Above-inflation increase in the personal income tax brackets and rebates.
- Limit corporate interest deductions to combat base erosion and profit shifting as well as restricting the ability of companies to fully offset assessed losses from previous years against taxable income.
- Increase of 25c per litre to the fuel levy, which consists of a 16c per litre increase in the general fuel and 9c per litre increase in the RAF levy.
- Increase in the annual contribution limit to tax-free savings accounts by R3 000 from 1 March 2020 from R33,000 to R36,000 per annum.
- Increase in excise duties on alcohol and tobacco between 4.4 and 7.5 per cent. Also, government will be introducing a new excise duty on heated tobacco products, to be taxed at a rate of 75 per cent of the cigarette excise rate with immediate effect.
- Government will increase the cap on the exemption of foreign remuneration earned by South Africa tax residents to R1, 25 million per year from 1 March 2020.
- Over the next three years, the 2020 budget proposes total reductions of R261 billion, which includes a R160.2 billion reduction to the wage bill of national and provincial departments and national public entities.
- Reallocations and additional total of R111.1 billion over the medium term, of which R60 billion is set aside for Eskom and South African Airways.
- These measures narrow the consolidated deficit from 6.8 per cent of GDP in 2020/21 to 5.7 per cent in 2022/23, with debt rising to 71.6 per cent of GDP over the same period.
- Along with faster economic growth, fiscal sustainability will require targeted reduction of specific programmes, and firm decisions to rein in extra-budgetary pressures, including reform of state-owned companies and the Road Accident Fund (RAF).

CORPORATE INCOME TAX

To promote economic growth, government intends to restructure the corporate income tax system over the medium term by broadening the base and reducing the rate. Broadening the base will involve minimising tax incentives and introducing new interest deduction and assessed loss limitations. Rate reductions will be implemented in a revenue-neutral manner.

PERSONAL INCOME TAX

The personal income tax brackets and the primary, secondary and tertiary rebates will increase by 5.2 per cent for 2020/21, which is above expected inflation of 4.4 per cent. This adjustment provides R2 billion in tax relief. The change in the primary rebate increases the tax-free threshold from R79 000 to R83 100.

MEDICAL TAX CREDITS

Government proposes an increase in the value of medical tax credits in 2020/21 from R310 to R319 per month for the first two beneficiaries and from R209 to R215 per month for the remaining beneficiaries. This increases the value of the tax credit by 2.8 per cent. It is in line with the announcement in the 2018 Budget Review that the credit would be adjusted by less than inflation to help fund the roll out of national health insurance over the medium term.

TAX-FREE SAVINGS ACCOUNTS

The annual limit on contributions to tax-free savings accounts will be increased from R33 000 to R36 000 from 1 March 2020

CURTAILING EXCESSIVE CORPORATE INTEREST DEDUCTIONS

Government proposes to restrict net interest expense deductions to 30 per cent of earnings for years of assessment commencing on or after 1 January 2021. This measure will address a typical form of base erosion and profit shifting by multinational corporations. This practice involves artificially inflating company debt and /or the interest rate on that debt to a related party in another jurisdiction with a lower corporate income tax rate. The resulting interest payments are deducted in South Africa, reducing the domestic tax base and effectively shifting profits to be taxed at a lower rate offshore.

LIMITING THE USE OF ASSESSED LOSSES TO REDUCE TAXABLE INCOME

When a company`s tax-deductible expenses exceed its income, it records an assessed loss. Often, the loss is carried forward to the next year and is offset against taxable income in that year. Over the past few years, there has been an international trend to restrict this practice.

Government proposes broadening the corporate income tax base by restricting the offset of assessed losses carried forward to 80 per cent of taxable income, for years of assessment commencing on or after 1 January 2021. This is viewed as a reasonable approach that affects all businesses equally, rather than restricting the number of years for carrying forward assessed losses, which would disproportionately hurt businesses with large initial investments or long lead times to profitability.

TRANSFER DUTIES

The brackets to calculate transfer duties on the sale of property, last adjusted in 2017, will be adjusted for inflation from 1 March 2020. No transfer duty will be liable on the purchase of property with a value below R1 million.

FOREIGN REMUNERATION EXEMPTION

Government will increase the cap on the exemption of foreign remuneration earned by South African tax residents to R1.25 million per year from 1 March 2020.

TRUSTS

Taxpayers are undermining the adjusted rules by subscribing for **preference shares** in companies owned by trusts that are connected to the individuals. To curb this new form of abuse, it is proposed that the rules preventing tax avoidance using trusts be amended.

RESTRICTING THE ARTIFICIAL REDUCTION OF DIVIDENDS AND CAPITAL GAINS TAX

The current exchange control provisions restrict the use of loop structures, in part to protect the tax base. Tax legislation is a more appropriate tool to combat tax avoidance. For example, if a resident individual or trust holds at least 10 per cent of the total equity shares and voting rights in a foreign company, they qualify for a participation exemption and all foreign dividends received are exempt from tax. If the resident shareholding is more than 50 per cent, the foreign company is a controlled foreign company and all of the controlled foreign company's dividend income is exempt from tax. If loop structures are no longer restricted, it would be possible to set up a structure where the controlled foreign company owns a South African company, and any dividends flowing from the resident company to the resident individual or trust through the controlled foreign company are exempt for the individual or trust. This would enable the resident individual or trust to reduce their dividend tax liability in respect of dividends declared by a resident company from 20 per cent to, in some instances, zero.

A further loop structure risk exists if a resident dispose of shares in a controlled foreign company that owns South African assets. The unrealised gains attributable to the South African assets may not be taxed if the resident qualifies for the participation exemption for capital gains. Government proposes that the controlled foreign company legislation be amended to limit the dividend exemption available to a resident individual or trust relating to the accrual or receipt of dividends from a resident company to a controlled foreign company.

As a result, such dividends would be taxed at an effective rate of 20 per cent, in line with cases where resident individuals receive dividends from resident companies.

In addition, it is proposed that the participation exemption for capital gains on the disposal of shares in controlled foreign companies by residents should not apply to the extent that the value of those shares is derived from South African assets.

WITHDRAWING RETIREMENT FUNDS UPON EMIGRATION

Individuals are currently able to withdraw funds from their pension preservation fund, provident preservation fund and retirement annuity fund upon emigrating for exchange control purposes through the Reserve Bank. As a result of the exchange control announcements in Annexure E, the concept of emigration as recognised by the Reserve Bank will be phased out. It is proposed that the trigger for individuals to withdraw these funds be reviewed. Any resulting amendments will come into effect on 1 March 2021.

PUBLIC BENEFIT ORGANISATIONS

Public Organisations approved to receive tax-deductible donations will have to submit audit certificates If a public benefit organisation fails to comply with specific requirements for receiving tax-deductible donations, SARS may regard these donations as taxable income for the organisation. If the failure is not addressed within a reasonable period, the receipts issued by the organisation will no longer be valid for claiming tax deductions.
The sanctions do not apply to the requirement that an organisation conducting mixed activities, some of which qualify for the issue of receipts and some of which do not, obtain an audit certificate for the use of the funds for which receipts have been issued. It is proposed that this be corrected.

SIMPLIFYING CROSS-BORDER TRADE AND FINANCIAL FLOWS

In 2019, South Africa was one of 54 countries that signed up to an African free-trade area encompassing 1.2 billion people and more than US$ trillion in output. African countries have agreed to cut tariffs to zero on 90 per cent of goods, which alongside other trade-facilitating measures, is expected to increase intra-continental commerce by more than 50 per cent over four years, according to the United Nations Economic Commission for Africa. The free trade area presents an opportunity to speed up development on the continent and represents potentially large market for South Africa goods and services.

In this context, the National Treasury proposes modernising the foreign-exchange system. Since 1933 South Africa has operated a "*negative list*" system. By default, foreign-currency transactions are prohibited, except for those listed in the *Currency and Exchanges Manual*. As a result, even small individual transactions-such as for travel-require onerous approval processes. This regime constrains trade and cross-border flows, particularly in relation to fast-growing African economies.

REFINING THE CORPORATE REORGANISATION RULES

The interaction between anti-avoidance rules for de-grouping after the conclusion of certain intra-group transactions and rules for the transfer of assets and the assumption of related debt may result in double taxation. Furthermore, unbundling transactions are subject to an anti-avoidance rule that excludes the shareholders and unbundling company from benefitting from the rollover relief if 20% or more of the shares in the unbundled company are held by non-residents-either alone or together with individuals connected to those non-residents-after the transaction. This rule aim to limit the extent to which taxpayers can distribute tax free shares in resident companies to non-residents. The current rule creates a loophole; it is proposed that the legislation be amended to address these concerns.

REVIEWING THE VENTURE CAPITAL COMPANY TAX INCENTIVE REGIME

The venture capital company tax incentive regime has a sunset clause of 30 June 2021. The Government will review the effectiveness, impact and role of this regime to ascertain whether the incentive should be discontinued.

REVISING THE DEFINITION OF "TELECOMMINICATION SERVICES" FOR THE ELECTRONIC SERVICES REGULATIONS

With effect from April 2019, the regulations prescribing electronic services were changed to broaden the scope of electronic services that are subject to South African value-added tax. However, the definition of "telecommunication services" in the regulations currently contains an incorrect reference that creates unintended consequences. It is proposed that further changes be made to the regulations to address these consequences.

TAX AND EXCHANGE CONTROL TREATMENT OF INDIVIDUALS

Following reforms to the income tax treatment of South African tax residents who receive remuneration outside the country, government proposes to remove the exchange control treatment for individuals, while strengthening the tax treatment. The intention is to allow individuals who work abroad more flexibility, provided funds are legitimately sourced and the individual is in good standing with the South African Revenue Service.

Individuals who transfer more than R10 million offshore will be subjected to a more stringent verification process. Such transfers will also trigger a risk management test that will include certification of tax status and the source of funds, and assurance that the individual complies with anti-money laundering and countering terror financing requirements prescribed in the Financial Intelligence Centre Act (2001). This will be phased in by 1 March 2021.

Under the new system, natural person emigrants and natural person residents will be treated identically. Additional restrictions on emigrants – such as the restrictions on emigrants being allowed to invest, and the requirement to only operate blocked accounts, have bank accounts and borrow in South Africa – have been repealed.

The concept of emigration as recognised by the Reserve Bank will be phased out, to be replaced by a verification process based on the requirements above. Tax residency for individuals will continue to be determined by the ordinarily resident and physically present tests as set out in the Income Tax Act (1962). Under existing international standards, South Africa participates in the automatic sharing of information between tax authorities on individuals' financial accounts and investments. These cooperative practices will remain in place to ensure that South African tax residents who have offshore income and investments pay the appropriate level of tax.

IAPA NEWS

We have some exciting news to report, we had two successful candidates in the latest SAICA Board Exams. We want to congratulate Levi Segal and Nonhlanhla Kunene for passing their final qualification exams and both becoming CA (SA). Well done to them.

GREAT BUSINESS QUOTES

- There's no shortage of remarkable ideas, what`s missing is the will to execute them." Seth Godin
- Forget past mistakes. Forget failures. Forget everything except what you`re going to do now and do it."-William Durant
- "There are no secrets to success. It is the result of preparation, hard work and learning from failure."-Colin Powell
- "Success is not the key to happiness. Happiness is the key to success. If you love what you are doing, you will be successful."- Albert Schweitzer
- "Success is often achieved by those who don't know that failure is inevitable. - Coco Chanel
- "Many of life's failures are people who did not realize how close they were to success when they gave up."-Thomas Edison
- "I never dreamed about success. I worked for it."-Estee Lauder
- "Yesterday`s home runs don't win today's games."-Babe Ruth

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While every care has been taken in the compilation of this Newsletter, no responsibility of any nature whatsoever shall be accepted for any inaccuracies, errors or omissions.