

Important News

South African National Budget 2010/11

In brief

In this Maitland publication we highlight the direct tax proposals contained in the South African National Budget, as presented by the Minister of Finance on the 17th of February 2010.

The VAT, Customs and Excise proposals are not covered.

In view of the limited focus of this publication, no action (or inaction) should be based solely on it.

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Income Tax

Individuals

The changes relating to individuals, as discussed below, will be effective from **1 March 2010** unless indicated otherwise.

Rate, bracket and cap changes

The comparative tax tables, rebates, thresholds, exemptions and other tax rates for the 2009/10 and 2010/11 tax years are set out in more detail in the Appendix on page 5.

Notwithstanding the tough current economic climate, income tax relief was again granted to all individual taxpayers. The bottom bracket will extend to all individuals with a taxable income up to **R140 000**, while the top rate of tax of 40% will only kick in for taxable income in excess of **R552 000**.

Inflationary adjustments will be made to income tax rebates and thresholds applicable to individuals, as a result of which the income tax threshold for individuals **under 65** will be increased to **R57 000** and for individuals **over 65** to **R88 528**.

The interest exemption will be increased to **R22 300** for people **under 65** and to **R32 000** for people **over 65**. Foreign dividends and interest of up to **R3 700** will be **exempt**, but this amount will need to be set off against the interest exemption, if utilised.

The tax-free or deductible portion of contributions to medical aids will be increased to **R670** (currently R625) for each of the first two members and to **R410** (currently R380) for each additional member.

The annual capital gains tax (CGT) exclusion applicable to disposals during a person's lifetime remains unchanged at **R17 500**. The exclusion granted to individuals during the year of death also remains **unchanged at R120 000**.

As the income tax threshold for taxpayers under 65 is approaching R60 000 (the current SITE ceiling), it is proposed that SITE be repealed from 1 March 2011, but with possible transitional administrative relief measures for low-income taxpayers with multiple sources of income.

Retrenchment package merger

Retrenchment packages are tax exempt up to **R30 000**. It is proposed that all retrenchment- and retirement lump sums be treated according to the same table.

Company car fringe benefit

Following the announcement in last year's budget speech effectively putting an end to the deemed kilometres travel allowance, it is proposed that the company car fringe benefits be reviewed by increasing the deemed monthly taxable values of company cars.

Employee deferred compensation and insurance schemes

Steps will be taken in relation to so-called "key person" insurance policies. In short, these insurance arrangements are entered into to protect companies from revenue losses upon the departure of key employees. National Treasury is concerned about a mismatch between the employer's deduction and the benefit enjoyed by employees upon retirement or termination of employment. Steps will be taken to ensure matching and it is proposed that such insurance will be taxed as a fringe benefit.

Individual and savings issues

A reform of the fiscal framework applying to retirement funding has been mooted for a number of years and it now seems that hard proposals are beginning to filter through. So, for example, it is proposed that the post retirement conversion of annuities into lump sums receive the same treatment and special rates that apply to retirement lump sums. A similar extension of the special rates table to cover secondary successions of retirement savings is proposed.

There is currently a non-taxable benefit where employers pay professional body subscription fees on behalf of employees where membership of such body is a condition of employment. It is proposed that fringe benefit relief be extended in circumstances where such fees largely benefit the employer.

It is proposed that the current regime dealing with employee share schemes be refined to cover unintended consequences. Specific attention will be given to shares held in employer trusts (where double taxation may arise) and share swaps as such swaps are considered by the National Treasury to undermine the legislation in certain circumstances.

Corporates & Other Tax Payers

Tax avoidance

In order to combat tax avoidance and to increase revenue collection, a number of measures are proposed to combat specific tax avoidance schemes, such as measures to:

- combat cross-border mismatches, which might involve double-dip tax structures in two or more tax jurisdictions or entity reclassifications between two or more tax jurisdictions;
- re-allocate interest cost allocations for finance operations, to ensure that interest expenses are allocated proportionately among various financial assets according to a formula;
- combat the use of protected cell companies, by deeming that each cell of a protected cell company is a separate company and applying the ownership requirements for a controlled foreign company to each cell;
- discourage cross-border insurance payments, where the insurance payment is more akin to a capital investment as opposed to a risk related insurance premium;
- restrict participation preference and guaranteed shares, by denying the application of the participation exemption from substantially held foreign subsidiaries from preference share dividends, guaranteed dividends and dividends derived directly or indirectly from South Africa;

- restrict the cross-border interest exemption applicable to non-residents investing in South African debt, other than South African bonds, unit trusts, bank deposits and other like instruments; and
- tighten-up on the transfer pricing rules.

Introduction of an international holding company regime

With the view of promoting South Africa as the gateway into Africa, a review will be undertaken of the tax and exchange control rules which currently stand in the way of a South African company being used to channel funds received from foreign locations to other foreign locations.

It will be interesting to see the form the review takes and ultimately what type of regime is introduced. Hopefully the mistakes made when the previous "international headquarter company" regime was introduced in 2000, which regime was subsequently terminated on 1 June 2004, are not repeated.

For the new regime to work, it is suggested that the international holding company must qualify as a resident for South African income tax purposes in order to be in a position to avail of the double taxation agreements that South Africa has concluded.

Review of the South African tax system to accommodate Islamic compliant financial arrangements

Given the international growth in the use of Islamic compliant financial instruments, the review in the next two years of the South African tax system to accommodate this type of financing is welcomed.

Share-for-share reorganisations of listed companies

The recognition of the practical difficulties experienced by the shareholders of an acquiring company engaging in a share-for-share transaction, as to whether the target shareholders hold their respective shares as capital assets or trading stock and the proposed removal of this onerous requirement is a positive development.

Intra-group transfers of trading stock

It is proposed that a different set of rules will be introduced which govern the transfer of trading stock between group companies so that unless an election is made, the intra-group rollover relief provisions would not apply. The reason given for this change is to simplify tax compliance.

Update on the transition from the STC regime to a final dividend withholding tax regime

It was announced that most of the issues surrounding the implementation of the dividend withholding tax have been finalised and that only a "number of small issues" still need to be resolved. These essentially relate to (i) the current and proposed definition of a dividend, the adding of a new definition of what constitutes a foreign dividend and certain defects with the definitions applying to STC, (ii) dealing with transitional issues between the current and proposed regimes, (iii) dealing with practical problems in relation to in specie dividends and (iv) introducing further refinements to the proposed dividend withholding tax system.

It is interesting to note that in budget speech 2009/10 it was announced that the basic legislative framework for the introduction of the dividend tax regime was in place and that once the double tax treaty ratification process was completed the dividend tax would come into operation. We were further told that all the applicable tax treaties had already been renegotiated and that it was anticipated that the dividend tax would be implemented during the second half of 2010.

On the one hand, delaying the implementation of the legislation until it is correctly formulated is a positive development but it is suggested that by providing taxpayers with an indication as to when it is anticipated that the "small issues" are expected to be resolved and whether the switch to the dividend tax during the second half of 2010 is still on track would have been helpful.



Review of the thin capitalisation rules

The thin capitalisation rules will be reviewed to cover foreign owned South African branches. As part of the review, the application of the non-discrimination provisions in the double taxation agreement that South Africa has concluded would also be considered.

The impact of the change would be to limit the amount of interest that can be deducted by the South African branch of a foreign company in determining its South African taxable income.

Country change of currency

The conversion of one currency into another is a taxable event. Countries may occasionally convert their entire currency into another currency. This type of currency change would technically trigger a potential currency gain or loss, even though the conversion is wholly outside the taxpayer's control. In order to mitigate this tax charge in these unique circumstances, legislative provisions will be introduced.

Administration & Compliance

Voluntary disclosure

Despite the reported success of the Tax and Exchange Control Amnesty of 2004 there has been a growing lobby for a second amnesty. In line with many international jurisdictions, a "voluntary disclosure programme" is proposed to commence on **1 November 2010 to 31 October 2011**. Although the details are sparse it seems that, whilst the full amount of tax due will need to be paid, a reduced interest charge will apply without penalties. Further consideration will be given to align the exchange control regime with this opportunity.

General administration

Mention is made of the proposed sharing of information amongst Ministry of Finance-related agencies. Whilst such sharing of information has long been a feature of the relationship between the South African Revenue Service and the South African Reserve Bank, its broader extension is noteworthy.

Special Relief Measures

Special relief measures are proposed to accommodate:

- professional sports bodies, who have until 31 December 2012 to amalgamate their professional and amateur divisions;
- the termination of certain non-public benefit organisations, such as chambers of commerce, trade unions and fidelity funds, which will give rise to recoupments; and
- the extension of deductible donations that may be made to the Peace Park Foundation, so that there is no time limit on making deductible donations to the Peace Park Foundation.

Other Taxes

Mineral and Petroleum Resources Royalty Act

The implementation of the mining royalty will become effective on 1 March 2010.

Environmental taxes and incentives

A fixed tax will be charged on the sale of new motor vehicles calculated with reference to CO2 emissions. This duty will be charged on new motor vehicle sales after 1 September 2010.

Sin taxes

As usual, the sin taxes were increased.

Road Accident Fund levy

There will be an increase in this levy – from 64c per litre to 72c per litre to provide funding to the Road Accident Fund.

General Fuel levy

The general fuel levy on petrol and diesel is increased by 10c per litre and a further 7.5c per litre in order to fund a new petroleum pipeline between Durban and Gauteng.

Signs of Things to Come

The following will be considered for possible inclusion in later budget tax proposals:

- abolition of estate duty;
- taxation of financial instruments;
- environmental taxes and the pricing of carbon; and
- exchange control reforms.

Appendix

Income Tax for Individuals: Tax Rates, Rebates and Thresholds

2009/10		2010/11	
Taxable Income	Rates of Tax	Taxable Income	Rates of Tax
R0 – R132 000	18% of each R1	R0 – R140 000	18% of each R1
R132 001 – R210 000	R23 760 + 25% of the amount above R132 000	R140 001 – R221 000	R25 200 + 25% of the amount above R140 000
R210 001 – R290 000	R43 260 + 30% of the amount above R210 000	R221 001 – R305 000	R45 450 + 30% of the amount above R221 000
R290 001 – R410 000	R67 260 + 35% of the amount above R290 000	R305 001 – R431 000	R70 650 + 35% of the amount above R305 000
R410 001 – R525 000	R109 260 + 38% of the amount above R410 000	R431 001 – R552 000	R114 750 + 38% of the amount above R431 000
R525 001 and above	R152 960 + 40% of the amount above R525 000	R552 001 and above	R160 730 + 40% of the amount above R552 000
Rebates		Rebates	
Primary	R9 756	Primary	R10 260
Secondary (for persons over 65)	R5 400	Secondary (for persons over 65)	R5 675
Tax Threshold		Tax Threshold	
Below 65	R54 200	Below age 65	R57 000
Age 65 and over	R84 200	Age 65 and over	R88 528

Local Interest Exemption and Foreign Interest and Dividend Exemption

Below 65	R21 000	Below 65	R22 300
Age 65 and over	R30 000	Age 65 and over	R32 000
Foreign interest and dividends	R 3 500	Foreign Interest and dividends	R 3 700

Capital Gains Tax

Annual Exemption	R17 500	Annual Exemption	R17 500
Primary Residence Exemption	Where the sale proceeds do not exceed R2m, completely exempt Where the sale proceeds do exceed R2m, the first R1.5m is exempt	Primary Residence Exemption	Where the sale proceeds do not exceed R2m, completely exempt Where the sale proceeds do exceed R2m, the first R1.5m is exempt
Year-of-death exemption	R120 000	Year-of-death exemption	R120 000

Estate Duty

Rate	20%	Rate	20%
Exemption	R3.5m per person or R7m per 2 spouses	Exemption	R3.5m per person or R7m per 2 spouses

Donations Tax

Rate	20%	Rate	20%
Annual Exemption	R100 000	Annual Exemption	R100 000