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BUDGET SPEECH 2020 AIMS TO WIN BACK INVESTOR CONFIDENCE

Minister Tito Mboweni walked the tightrope in delivering his Budget Speech 26 February 2020. In an effort to preserve the last remaining investment grade status he had to demonstrate to the ratings agencies that South Africa was applying appropriate measures of fiscal discipline in cutting expenditure and limiting the amounts allocated to underperforming SOEs, whilst not overburdening South Africans with taxes.

Personal income taxpayers received a measure of welcome relief when the Minister announced that the personal income tax brackets and the rebates (primary secondary and tertiary) would increase by 5.2% for the 2020/21 tax year. The bulk of this relief accrues to taxpayers earning up to R750 000.

Although there had been much speculation ahead of the Budget, no VAT increase materialised. This is welcomed, given the need to stimulate the economy and promote growth.

Whilst the SA corporate tax rate remains unchanged at 28%, the Budget Review acknowledged that South Africa's relative competitiveness internationally has lagged over the last several years due to rates in other countries such as UK, India and USA falling. Accordingly, in an effort to promote economic growth, government intends, over the medium term, to restructure the corporate income tax system by broadening the base and reducing the rate.

The base broadening proposals will involve minimising tax incentives, and introducing new interest deduction and assessed loss limitations.

The intention is to implement rate reductions in a revenue-neutral manner:

- Effective years of assessment commencing on or after 1 January 2021, the offset of assessed losses carried forward will be limited to 80% of taxable income.
- Government proposes to restrict net interest expense deductions to 30% of earnings for years of assessment commencing on or after 1 January 2021.

The benefit of tax incentives is under discussion. Sunset clauses for a number of incentives are to be introduced, while others will be under review.

Exchange controls are to undergo further reforms. Over the next 12 months, a new capital flow management system will be put in place. All foreign-currency transactions will be allowed, except for a risk-based list of capital flow measures.

This change will increase transparency, reduce burdensome and unnecessary administrative approvals, and promote certainty.

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The capital flow measures take account of the Organisation for Economic Co-operation and Development best-practice Code of Liberalisation of Capital Movements and are aligned with similar approaches in other developing countries.

The annual limit for contributions to tax-free savings account will be increased to R36 000 – a measure intended to increase savings. In an effort to help fund the rollout of national health insurance, the increases in medical tax credits continue to be implemented below the rate of inflation.

The annual limit for contributions to tax-free savings account will be increased to R36 000 – a measure intended to increase savings.

Some of the indirect tax changes include:

- Increasing the fuel levy by 25c/litre, consisting of a 16c/litre increase in the general fuel levy and a 9c/litre increase in the RAF levy.
- Increasing excise duties on alcohol and tobacco by between 4.4 and 7.5 per cent.
- Heated tobacco products will be subject to excise duties with immediate effect.
- Government intends to tax electronic cigarettes in 2021.

BERNARD SACKS: Tax Partner
bernard.sacks@mazars.co.za

2020 BUDGET IS THE BOLDEST IN RECENT YEARS

The 2020 Budget Speech, delivered on Wednesday 26 February by Minister of Finance, Tito Mboweni, contained several pieces of good news for taxpayers. At the same time, the Minister has taken a bold step in committing government to curtailing spending, which may have far-reaching consequences if it fails.

This is according to Mike Teuchert, National Head of Taxation at Mazars, who says that this year's Budget signals a fundamental shift in Governments approach. "By all accounts, this may be the most amount of positive developments to come out of the Budget Speech in at least five years."

A CONSUMER-FRIENDLY BUDGET

Teuchert notes that there was good news for personal income taxpayers in virtually all of the tax brackets. "In total, Treasury has given personal income taxpayers around an additional R2 billion in tax reductions through above-inflation bracket creep relief, which was quite unexpected."

> Treasury is going to make up the R2 billion additional relief from increases in the carbon tax and plastic bag levy.

With that said, there have been the normal increases in a number of consumer-aimed taxes, such as sin taxes and fuel levies. "Treasury is going to make up the R2 billion additional relief from increases in the carbon tax and plastic bag levy. All in all, the news is still very good for the consumer because it essentially amounts to no real increases in the taxes that directly affect them."

CORPORATE SECTOR RECEIVES MIXED NEWS

According to Graham Molyneux, Tax Partner at Mazars, one major positive development for the corporate sector is the indication that Treasury aims to lower the corporate income tax rate over the medium-term. "Government clearly recognises the importance of making South Africa a more attractive proposition to foreign investors."

In a move that accords with the recommendations of previous tax commissions, National Treasury is looking to cut back on tax incentives, particularly to businesses. "It seems that Treasury has arrived at a view that tax incentives in their own right, are not generally used for the purposes that are intended (i.e. stimulating growth and employment) but end up being abused by taxpayers."

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A further measure proposed by the Minister in the Budget is to limit the ability for businesses to offset assessed losses from prior periods against current year taxable profits. "This move will certainly have adverse cash-flow implications for quite a few local businesses (for example in the property development sector)."

TREASURY'S RISKY BET

Teuchert says that the 2020 Budget still has a few worrying points, the most notable of which is the growing national debt. "Currently, national debt stands at around 61% of GDP – this is expected to increase to 65% of GDP by the end of the year, and 71.3% by 2022. This could potentially be the debt spiral that South Africa won't be able to escape from."

At the same time, Minister Mboweni's plan to address the revenue shortfall is by drastically reducing government expenditure and ensuring that government institutions operate more efficiently.

"For instance, we see planned decreases in the wage bill as well as on SOE spending. While these intended changes are positive, the Minister's whole plan hinges on getting it right. If Government can't get its house in order, it will have a dramatic effect on the country's debt levels," Teuchert concludes.

MIKE TEUCHERT: National Head: Taxation
mike.teuchert@mazars.co.za

BERNARD SACKS: Tax Partner
bernard.sacks@mazars.co.za

ADRIAN PILLAY
ALLESHNI MOODLEY
ANISHA DATHARAM
ARSHAD SHABOODIEN
BIANCA VIVIERS
BRONWYN HOLT
CECILE STEMMET
CHONTELLE BARNARD
CRYSTAL THAMBIRAN
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On behalf of the Mazars family, we would like to congratulate our APC candidates on successfully completing their exam. Well done. Here's to a prosperous and exciting journey!

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NEW **EXCHANGE CONTROL**

AND SARS PROCEDURES FOR EMIGRANTS

Due to the change to the foreign employment exemption coming into effect on 1 March 2020, there has been a spurt of expats approaching both the South African Revenue Service (SARS) and the South African Reserve Bank (SARB) to formalise their permanent exit from South Africa, in order to not have to pay tax in South Africa on their foreign employment income.

Some advisors have been encouraging expats to financially emigrate through the SARB as a way to break tax residency. However, this is only one factor considered when determining whether a person has broken tax residency. Government wants to encourage all South Africans working abroad to maintain their ties to the country. Consequently, this concept of financial emigration will be phased out by 1 March 2021.

With effect from 1 March 2021, it is proposed that an emigrant and a resident will be treated identically for exchange control purposes.

South Africa signed the Multilateral Competent Authority Agreement on automatic exchange of financial information in September 2017, and is currently sharing financial information with 105 countries.

The tax rules governing tax residency will remain unchanged with the concept of being either ordinarily resident, or resident in terms of the physical presence test. SARS will rely on the co-operative practices of sharing of financial information between South Africa and other offshore jurisdictions.

SARS is going to become more stringent in their verification process when a person wishes to remit capital amounts of more than R 10 million per annum offshore. When making application to SARB, an individual will be subject to a vigorous verification process, triggering risk management practices to verify the source of the funds to be remitted and to confirm that all taxes have been paid to SARS, in line with any anti money laundering and counter terror financing requirements prescribed in the Financial Intelligence Centre Act (2001).

Restrictions imposed by the SARB on emigrants in relation to making investments, operating blocked accounts, and borrowing funds in South Africa will be abolished and the concept of emigration from an exchange control perspective will be phased out and replaced with this more stringent verification process.

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South Africa signed the Multilateral Competent Authority Agreement on automatic exchange of financial information in September 2017, and is currently sharing financial information with 105 countries (as of 25 April 2019).

These countries include Mauritius, Panama and the United Arab Emirates. As per this exchange of information agreement SARS will be provided with the financial account information of foreign accounts where the reportable person on record as a South African tax resident.

From a recent televised interview with the SARS Commissioner, Edward Kieswetter, SARS now have systems in place to start analysing this information and to start identifying those taxpayers who have been reported on and who have not disclosed similar information to SARS.

The proposed relaxation of the exchange control restrictions for emigrants is very welcome and we look forward to seeing the detailed changes to be published by SARB.

South African residents wishing to externalise large amounts of funds should ensure that their affairs are in order before commencing this process.

SHARON MACHUTCHON: Tax Consultant
sharon.machutchon@mazars.co.za

TAX-FREE **BURSARY SCHEMES LOOPHOLE** TO BE CLOSED

The ability for employers and employees to structure their remuneration package to include a tax-free bursary or scholarship is one of the few mechanisms left to increase an employee's take-home pay.

Employees have been able to use their tax savings resulting from the tax-free bursary or scholarship to contribute to their own or children's education and retirement savings.

> When implementing a bursary scheme employers must be aware that to qualify for the exemption various critical legal and administrative procedures must be followed to ensure that the benefit is exempt from normal tax.

Currently the tax legislation makes provision for bona fide scholarships or bursaries granted by employers to employees to enable or assist the employee to study at a recognisable educational institution to be exempt from normal tax.

Provided certain requirements are met, this exemption may apply in instances where an employer provides a scholarship or bursary to a relative of an employee.

"Relative" in this context means the spouse of the employee, or anybody related to the employee or the employee's spouse within the third degree of consanguinity.

The potential reach of the definition of "relative" is accordingly very wide – including the employee's grandchildren, brothers and sisters or nephew and nieces. In addition, adopted children are deemed to be the biological child of their adoptive parent for purposes of this definition.

In order for the above-mentioned exemption to apply to scholarships or bursaries awarded to relatives of employees, the following requirements are to be met:

1. The "remuneration proxy" of the employee should not exceed R600 000 in relation to a year of assessment.
2. The exemption will only apply to the extent that any scholarship or bursary awarded to an employee relative during the year of assessment does not exceed:
   - R20 000 (R30 000 per year for a disabled person) in respect of Grade R to 12 as contemplated in the definition of "school" in section 1 of the South African Schools Act No 84 of 1996;

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- R20 000 (R30 000 per year for a disabled person) in respect of a qualification to which an NQF level from 1 up to and including 4 has been allocated in accordance with applicable South African legislation;
- R60 000 (R90 000 per year for a disabled person) in respect of a qualification to which an NQF level from 5 up to and including 10 has been allocated in accordance with application South African legislation.

Where a bursary or scholarship does not fall within the ambit of the above exemption, it will be taxable in the employee's hands.

As a bursary scheme can be implemented with virtually no cost to the employer, it has been a very attractive way to offer a reward to employees.

However, when implementing a bursary scheme employers must be aware that to qualify for the exemption various critical legal and administrative procedures must be followed to ensure that the benefit is exempt from normal tax.

It has come to the attention of the government that a number of employer bursary schemes implemented in recent years seek to reclassify ordinary remuneration as a tax-exempt bursary.

In the 2020 Budget proposals it was announced that Government proposes to close the loophole and these amendments will take effect on 1 March 2020.

ELZAHNE HENN: Tax Director
elzahne.henn@mazars.co.za

TAX AND **DECEASED ESTATES**

The 2020 budget speech left some people with mixed emotions, but all in all, most people found it to be positive, perhaps the most positive budget speech in the past number of years.

I, personally, was quite grateful that estates as a whole was, mostly unaffected by the budget speech this year. Be that as it may, this time of the year always presents itself as a good opportunity to review the tax implications as it relates to deceased estates and general estate planning.

There are a few taxes that affect estate planning and deceased estates with the most important of those being, income tax, capital gains tax (CGT) and estate duty. A brief explanation of the effect of these taxes on a deceased estate is explained here below and these effects should also be considered when one attends to your estate planning prior to the drafting of your Will.

INCOME TAX

Up and until 1 March 2016 the Executor in a deceased estate was only responsible for the income tax (inclusive of CGT) submissions up to date of death and the submission of any CGT for post date of death sales at which point the executor's responsibility ended. The income tax flowing from income earned **after** date of death would be for the heirs in the estate to reflect in their own tax returns.

SARS, however, found over the years, that they were losing out on millions in income tax, due to many heirs not reflecting the income in their tax returns for whatever the reasons may be.

Due to the above, the position changed quite dramatically after 1 March 2016.

SARS amended legislation in 2016 which changed the position to the executor now receiving a lot more responsibility out of a tax point of view in that that they would now not only be responsible for the income tax (inclusive of CGT) to date of death, but would have to register the estate as a separate / new tax payer thereafter and complete and submit tax returns for all taxable income earned within the estate (with an annual R23,800.00 interest exemption being applicable). These returns would have to be submitted until the finalisation of the estate. The CGT that the executor would have previously have accounted for on post date of death sales would no longer have to be dealt with separately, but would now form a part of the applicable tax return for the year in which the asset was sold.

> The general estate administration process, which is already a lengthy and time consuming exercise, is delayed for an even longer period of time.

This change ensured that SARS was placed in a position where it could keep track of income earned as this had to be declared by the actual executor and simultaneously ensure that SARS was in a position to physically collect the tax due on this income prior to finalisation of the estate.

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Unfortunately this change in position has caused the general estate administration process, which is already a lengthy and time consuming exercise, to be delayed for an even longer period of time.

CAPITAL GAINS TAX

Capital Gains Tax would be applicable in any estate where the deceased held assets to which this tax applies – with the main assets being immovable property, shares and business interests (note that the above is not a complete list of assets subject to CGT).

Death itself is deemed as a CGT disposal of assets and thus in the deceased's final tax return this deemed disposal of CGT related assets would have to be reflected.

The exception to the rule in this particular instance is if the asset subject to CGT is bequeathed to a resident surviving spouse. Should this be the case then there is a rollover of the capital gain to the estate of the surviving spouse and thus the deemed disposal falls away, with the surviving spouse taking the asset over at the base cost at which the deceased obtained it (and not at the date of death value of the deceased). Note that this rollover does not apply to a non-resident surviving spouse and would also not be applicable if the CGT related asset bequeathed to the spouse is sold out of/by the estate (in which case the calculations related to both the deemed and actual disposals would have to be calculated and declared by the executor).

In the cases where the rollover to a surviving spouse is not applicable there could potentially be two separate CGT calculations involved, with the first being the deemed disposal of the asset as at date of death, and the second being an actual disposal of the asset in the event that it is sold by the estate.

As indicated under the income tax heading, the CGT calculation on an actual sale of asset by the estate is no longer attended to on its own, but now rather forms a part of the tax return in the year in which the sale occurred.

Note that there are exclusions that can be claimed for example for a primary residence there would be an exclusion of R2 million available as well as in the year of death where the normal exclusion available to an individual or natural person (in the amount of R40,000 per annum) is increased to R300,000 for that particular tax year. There are also other exclusions applicable not listed in this article.

ESTATE DUTY

Currently Estate Duty is levied at the rate of 20% on the net asset value in an estate that exceeds R3.5 million, with an estate where the said net asset value exceeds R30 million, being liable for 25% estate duty on the balance exceeding R30 million (applicable from 1 March 2018).

Net estate generally refers to the gross assets in the estate, plus all deemed assets, less liabilities and all other allowable deductions, with the dutiable estate being the net estate less the allowable Section 4A deduction, currently being R3,5 million per individual.

Subject to certain limitations or restrictions, where assets are bequeathed to a surviving spouse, a rollover (similar to the rollover applicable with regards to CGT **but** in this instance also applicable to a non-resident surviving spouse) would apply. This basically means that the value of assets bequeathed to a surviving spouse, for which deductions have not been claimed elsewhere, is deductible provided that the deduction allowable shall be reduced by the amount awarded to any individual or Trust other than the spouse.

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The benefit would also not be applicable in the event that assets are left to a Trust for the benefit of the spouse, but with discretion being awarded to the Trustees to allocate such asset or income therefrom to any person **other** than the surviving spouse. The terms of the Trust is therefore essential in establishing whether the bequest to the Trust is deductible or not.

As mentioned above, generally each individual has an estate duty rebate of R3.5 million available. Where the deceased was the spouse of one or more previously deceased persons, the amount that can be deducted from the net estate increases to R7 million less the amount deducted from the net value of the estate of any one of the previously deceased persons (spouses). It is important to note where the deceased is the surviving spouse of more than one marriage, then the amount that can be deducted is limited to one predeceased spouse with the choice of which spouse being that of the executor.

Note that there are many other estate duty deductions available and these are set out in Section 4 of The Estate Duty Act, one of these being assets awarded to charities (they have to be registered with SARS as a PBO to be recognised as a charity for this purposes).

It is important to review your Will on a regular basis to ensure tax efficiency.

CONCLUSION

Although there are other taxes, such as VAT that could potentially be applicable to a deceased estate, income tax, CGT and estate duty are the main and most important ones to consider. The emphasis on consideration in this instance being that during estate planning which is cardinal to the process of having a Will drafted, these taxes should already be considered and estimates calculated if possible at that time, to ensure that the administration of the estate one day runs as smoothly and efficiently as possible. Due to the tax position changing on a regular basis it is also important to review your Will on a regular basis to ensure tax efficiency.

ANICA UNGERER: Director: Estate and Trusts
anica.ungerer@mazars.co.za


upskill
Did you miss our post budget 2020 client event at a Mazars office near you?
Mazars partnered with Upskill and Mazars Tax expert Di Seccombe to create a highlights video of this year's National Treasury Budget.
This comprehensive video includes Di's analysis of the changes to expat tax and financial emigration.
Click here to register to watch

AT A LOSS: **TREASURY'S PROPOSAL**

TO LIMIT THE USE OF ASSESSED TAX LOSSES

In his recent Budget Speech, Minister Mboweni proposed tax legislative amendments affecting the use of assessed losses. This article explores the practical implications for taxpayers of these proposed amendments.

Where a South African taxpayer's tax-deductible expenses and allowances exceed their income, an assessed loss is created.

Our Income Tax Act allows for the off-setting of assessed losses against future taxable income. The carry-forward period of such an assessed loss is indefinite, provided that the taxpayer continues to conduct a trade in each subsequent year of assessment. This is a fairly generous regime when compared to other African jurisdictions, a number of which limit the carry-forward of assessed losses to a fixed number of years, e.g. 9 years in Kenya. Where a taxpayer is found not to be trading in a year of assessment, any assessed loss which that taxpayer may have created will permanently be lost.

In his Budget Speech, Minister Mboweni has proposed to limit the off-setting of such assessed losses carried forward to 80% of taxable income.

This change is intended to take effect for years of assessment commencing on or after 1 January 2021.

It is unclear from the proposal as to whether the disallowed portion of the assessed loss can be carried forward to subsequent years of assessment. One would expect this to be the case as, in our view, to impose a permanent disallowance of the portion of assessed loss equal to the remaining 20% of taxable income would be overly harsh, especially in South Africa's current economic climate.

The practical implication of this proposal is that a taxpayer with assessed losses (therefore likely operating under financial constraints), may still have to foot a tax bill, even where that taxpayer's taxable income is less than its cumulative assessed losses.

This is of particular relevance to industries which are very capital intensive in their first few years, for example, renewable energy. Given the nature of their business, these types of taxpayers generally create significant assessed losses in their first three to five years of existence, due to accelerated capital allowances, construction and funding costs. These losses are then utilised over a number of years, once the renewable assets begin producing electricity for sale.

As part of the project bidding process with the Department of Energy, renewable energy companies must prepare extremely detailed financial models, setting out the production capacity, income, expenditure, funding and returns over the lifetime of the project. Assessed losses affect the cashflows and anticipated returns within these models.

The current tax proposal has the potential to negatively impact these financial models and their returns, as well as an industry which may hold the key to South Africa's current energy woes.

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Practically, the example[1] below demonstrates the potential financial impact of this proposal.

	CURRENT TREATMENT	PROPOSED TREATMENT
YEAR 1		
Assessed loss of R150 000 created	(150 000)	(150 000)
YEAR 2		
Taxable income of R50 000	50 000	50 000
Assessed loss utilisation	(50 000)	(40 000)
Result for the year	0	10 000
Tax liability for the year	**0**	**(2 800)**
YEAR 3		
Taxable income of R90 000	90 000	90 000
Assessed loss utilisation	(90 000)	(72 000)
Result for the year	0	18 000
Tax liability for the year	**0**	**(5 040)**
YEAR 4		
Taxable income of R50 000	50 000	50 000
Assessed loss utilisation	(10 000)	(38 000)
Result for the year	40 000	12 000
Tax liability for the year	**(11 200)**	**(3 360)**
Total tax liability over 4 years	**(11 200)**	**(11 200)**

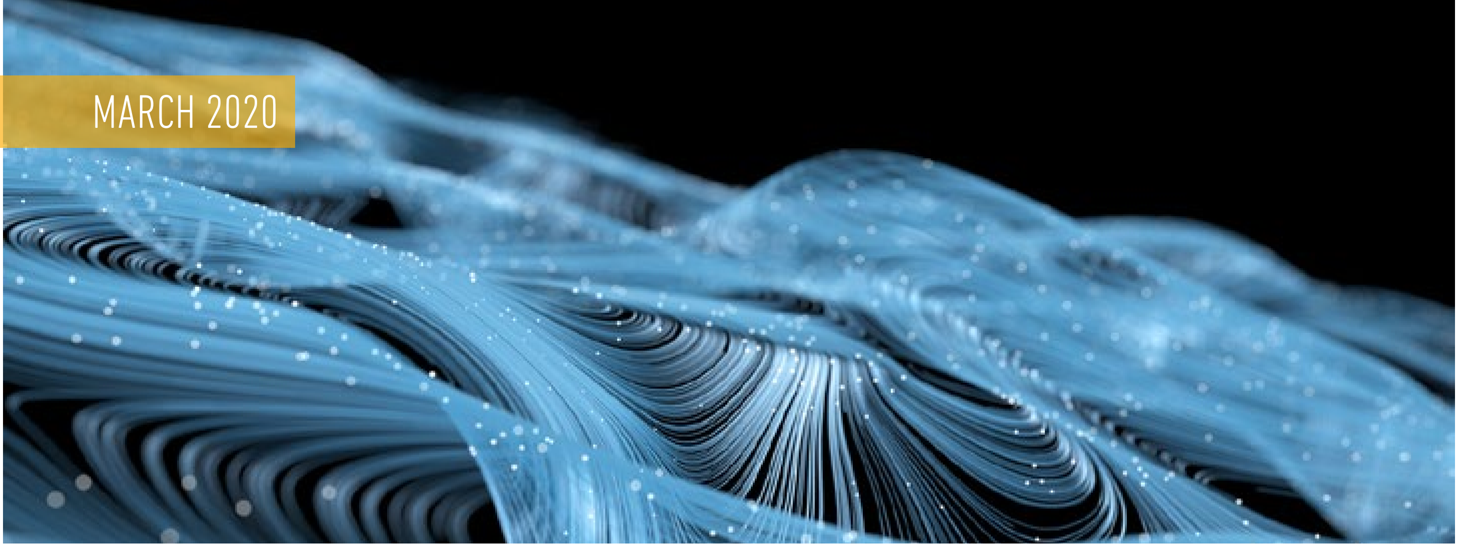
[1] Our example assumes that the disallowed portion of the assessed loss can be carried forward indefinitely.

While the total tax liability (in the fullness of time, and assuming that the disallowed portion of the loss can be carried forward indefinitely) is the same, it is the impact on cashflow in the early years that is critical here. In creating an assessed loss, the taxpayer will have incurred significant upfront expenditure, likely using interest-bearing debt. Further cash outflows in the form of tax liabilities in the immediately subsequent years only place more financial pressure on such taxpayers.

This proposal, in light of South Africa's current economic climate, may not be construed as supporting Government's desperate cries to the country for the creation of sustainable economic growth.

We anticipate taxpayers to be fairly vocal in opposing this proposal, once the draft legislation is published for public comment.

GREG BOY: Senior Manager: Tax Consulting
greg.boy@mazars.co.za



TAX TREATMENT OF **EXCESSIVE DEBT FINANCING** UNDER REVIEW

"Government proposes to restrict net interest expense deductions to 30 per cent of EBITDA."

Minister Mboweni's 2020 Budget Review has been received as a largely positive one by most South Africans, although aspects such as the country's increasing levels of debt, have left many worried. Ironically, one of the positives from the Budget is that Government has issued a discussion document detailing the proposed tax treatment of SA companies which are excessively financed by way of debt (the Discussion Document) – a topic which the previous Minister of Finance raised as a concern in 2018, and one which has been a source of great uncertainty for taxpayers.

The reason for this proposal lies in the fact that multinational enterprise groups (MNE groups) with operations in SA often choose to fund their SA entities by way of interest bearing debt (as opposed to equity), allowing the funded entities to deduct the related interest expenditure when determining their taxable income, provided the relevant requirements have been met. Debt funding can create opportunities for base erosion and profit shifting (BEPS), given that MNE groups can minimise their tax liabilities by placing the majority of interest bearing debt in countries with higher corporate tax rates relative to others, such as SA.

This is not a new issue for SA. Thin capitalisation rules, providing for a safe harbour of a 3:1 debt-to-equity ratio to determine excessive debt, were already introduced in 1995, in an attempt to curb the use of excessive debt in relation to equity.

There has, however, been heightened interest in the topic since the G20 Finance Ministers called on the Organisation for Economic Co-operation and Development (OECD) to find solutions to BEPS.

Apart from the thin capitalisation rules, SA has introduced several other tax policies over the past 25 years to prevent the erosion of its tax base by way of excessive interest deductions. These include amendments to the transfer pricing anti-avoidance legislation (section 31 of the Income Tax Act), Practice Note 2, a draft interpretation note in 2013, interest withholding tax and other legislation specifically aimed at limiting interest deductions such as sections 23N and 23M of the Income Tax Act.

Inbound interest bearing debt funding from associated enterprises currently falls within the ambit of the SA transfer pricing rules. Although there has been uncertainty as to whether the thin capitalisation rules continued to apply since the introduction of transfer pricing, the Discussion Document confirms that these rules have in fact been repealed, with only the consideration under section 31 of the Income Tax Act applying from 1 April 2012. This section, comes down to whether the terms and conditions of the funding, including the quantum of funding and interest charged, differ from that which independent parties dealing at arm's length would have agreed upon.

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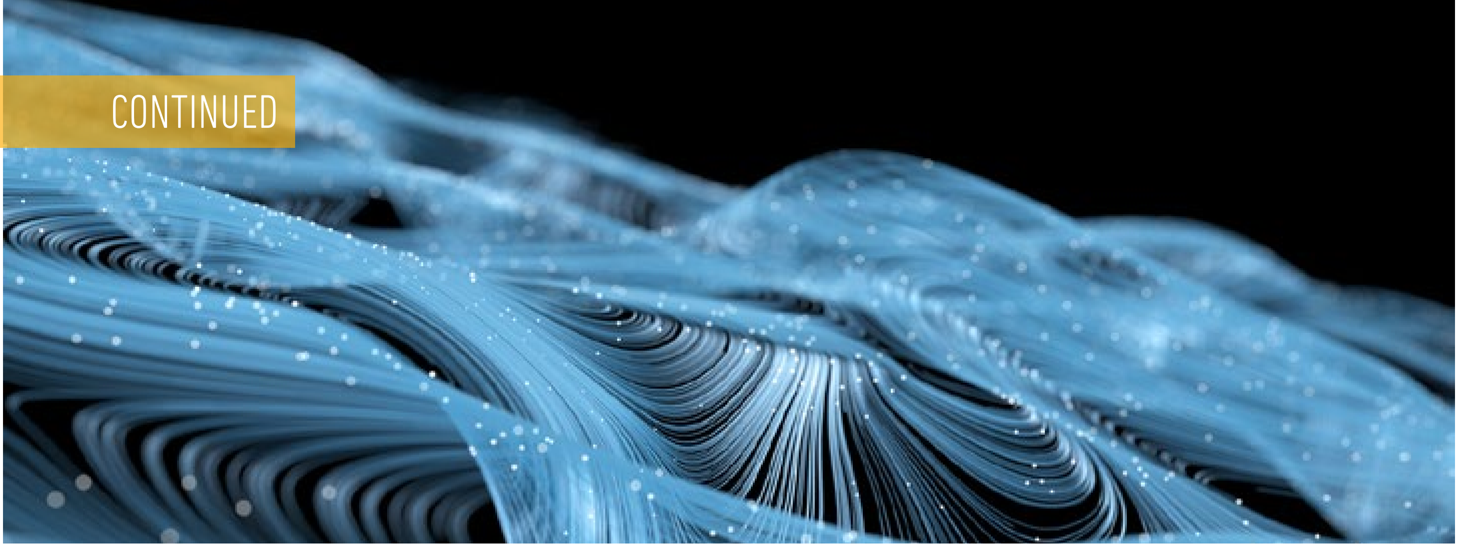

Where any such difference results or will result in a tax benefit for one of the parties, the necessary transfer pricing adjustment will have to be made.

Section 23M was introduced with effect from 1 January 2015 which serves to limit interest deductions by way of a prescribed formula in instances, including where the related interest is not subject to tax in South Africa, and the existence of a controlling relationship between the creditor and debtor exists.

The OECD/G20 BEPS Project considered the rules which countries have in place to limit excessive debt or interest deductions. It concluded that the best means of addressing tax base erosion is to limit net interest deductions to a fixed percentage of between 10 and 30 per cent of earnings before interest, tax, depreciation and amortisation (EBITDA) and to apply this rule to all entities within a MNE group as a minimum. Most European Union countries have implemented the OECD recommendations already, or are in the process of doing so.

From an African perspective, Botswana has led the way by implementing the OECD's recommendations through restricting net interest deductions by entities forming part of MNE groups to 30 per cent of EBITDA. Botswana allows interest expenses which cannot be deducted in a particular year to be carried forward for a period of 3 years in the case of general companies, and for a period of 10 years in the case of mining companies.

It is noted in the Discussion Document that SA's existing rules do have similar design features to the OECD's recommendations, although the SA rules are targeted at a smaller set of transactions which set the interest deduction limitation at a higher percentage of earnings (given the formula set out in section 23M).

Government consequently proposes to implement the OECD's recommendations by restricting net interest deductions to 30 per cent of EBITDA for years of assessment commencing on or after 1 January 2021.

In terms of the Discussion Document, it is proposed that the new rules apply to total (external and connected) net interest expenses and equivalent payments to all entities operating in SA that form part of a foreign or SA MNE group. The Discussion Document also proposes that taxpayers be allowed to carry forward disallowed interest deduction amounts for 5 years on an annual first-in-first-out basis. It also tentatively proposes that a de minimis rule be included to exempt entities with net interest expenses between ZAR 2 million and ZAR 5 million from applying the 30% rule.

As an example, a company with an EBITDA of ZAR 20 million and an interest expense of ZAR 10 million in one year, will only be allowed to deduct ZAR 6 million as a tax-deductible expense in that year (being 30% of EBITDA), with the disallowed portion of ZAR 4 million being carried forward to the next year. The ZAR 4 million would again be subject to the 30% rule in the following year. In terms of the proposed de minimus rule, a company with a net interest expense of ZAR 3 million in a particular year would be allowed to deduct the full expense in that year, and would not be subject to the 30% limitation.

The interplay between the existing and the proposed new rules will have to be considered in much more detail before the new rules are implemented, specifically given the proposal by Government that these rules should replace section 23M. The proposal furthermore makes it clear that the new rules will not be replacing the application of the transfer pricing rules in respect of inbound loans, and that the new interest limitation rules will have to be applied to those net interest expenses which have already passed the arm's length test.

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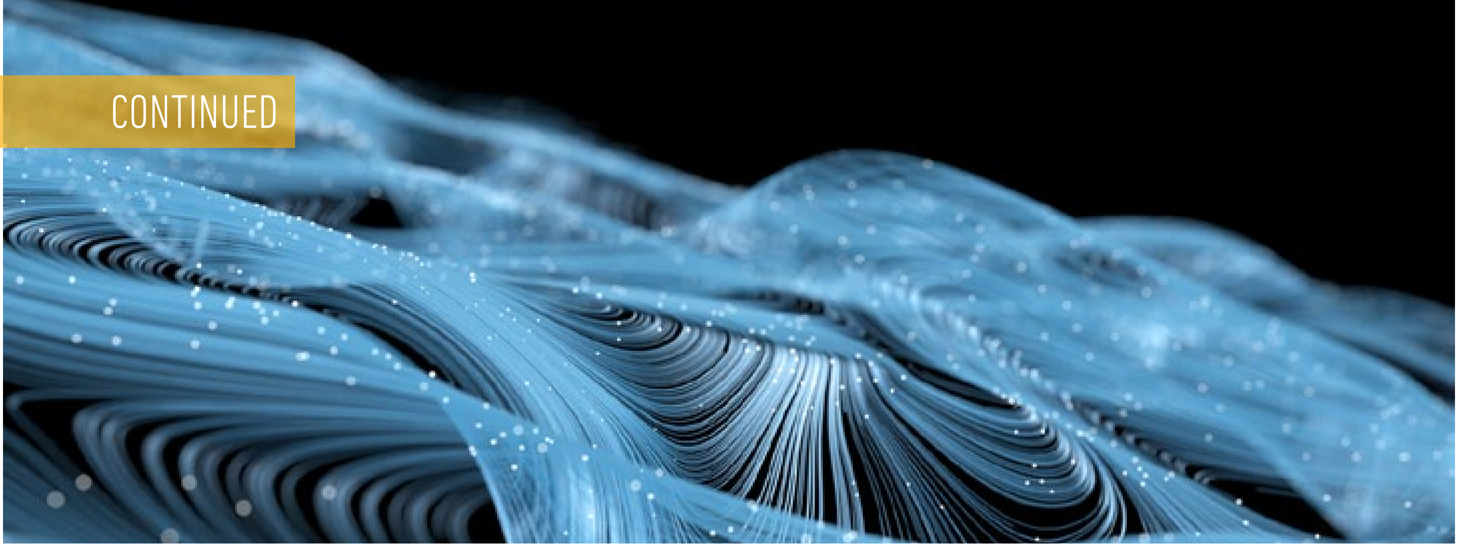

Government also recognises the uncertainty that prevailed regarding the application of previous safe harbour rules, and agrees that a safe harbour is needed to provide taxpayers with certainty in respect of whether the arm's length principle also has to be applied in respect of the quantum of finance provided.

Government concludes that replacing the existing rules (specifically section 23M) will provide a more uniform approach to all interest payments flowing out of the country, regardless of which country the loan emanates from, which may enhance the level of protection of SA's tax base. Although this seems to be a noble intention, and although any guidance in this regard is welcomed, the interplay between the new and existing rules, the transitional measures which are to be considered for existing third-party loans when doing away with section 23M and the appropriate safe harbour will have to be properly considered and addressed in order to avoid any further uncertainty on this topic going forward.

Government invites comments in respect of the proposed changes, including views on the appropriate safe harbour to apply in respect of transfer pricing, by 17 April 2020.

MALAN DU TOIT: Tax Consultant: Transfer Pricing
malan.dutoit@mazars.co.za

SARS TO INCREASE FOCUS ON CROSS-BORDER RELATED PARTY TRANSACTIONS AND THE ACTIVITY OF MULTINATIONAL ENTERPRISES

In the budget speech of 26 February 2020 Finance Minister Tito Mboweni highlighted transfer pricing and the activities of multinational enterprises (MNE's) as a major concern for South Africa. SARS views this in the light of some MNE Groups engaging in aggressive tax planning resulting in profits being recognised in low tax jurisdictions. Minister Mboweni specifically highlighted that a significant amount of revenue leaves South Africa each year in the form of amounts paid for intra-group services related to MNE Groups.

From a transfer pricing perspective the risk often arises as to whether the services being rendered is resulting in an actual benefit for the service recipient and whether a third party would have paid for a similar type of service. It was further highlighted that transfer pricing risk profiling is to remain a focal area for SARS to address non-compliance with South African transfer pricing legislation and regulations.

Over the last two years Mazars has seen an increase in requests for relevant material relating to intra-group transactions of South African taxpayers forming part of MNE Groups. Given the emphases placed on this by Minister Mboweni in the recent budget speech it would be advisable for South African entities forming part of MNE Groups or who are the ultimate parent entity of a MNE Group to evaluate their transfer pricing policies and documentation ensuring that they are able to comprehensively substantiate the arm's length nature of intra-group transactions.

CHARL HALL: Tax Consultant: Transfer Pricing Lead (Cape Town)
charl.hall@mazars.co.za

DANIEL BAINES: Tax Consultant: Transfer Pricing (Johannesburg)
daniel.baines@mazars.co.za

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- How will your income tax change?
  - Put your monthly taxable income into Fin24's Budget 2020 Income Tax Calculator to find out.
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- 30 MARCH Excise Duty payments
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- 31 MARCH CIT Provisional Tax Payments where applicable

CONTACTS

BLOEMFONTEIN
+27 51 400 0500
bfn@mazars.co.za

CAPE TOWN
+27 21 818 5000
cpt@mazars.co.za

DURBAN
+27 31 818 9000
dbn@mazars.co.za

GEORGE
+27 44 874 5022
grg@mazars.co.za

JOHANNESBURG
+27 11 547 4000
jhb@mazars.co.za

KATHU
+27 53 723 1772
kathu@mazars.co.za

KIMBERLEY
+27 53 831 5490
kim@mazars.co.za

PAARL
+27 21 871 1474
prl@mazars.co.za

PLETTENBERG BAY
+27 44 533 0510
plt@mazars.co.za

PORT ELIZABETH
+27 41 501 9700
plz@mazars.co.za

PRETORIA
+27 12 347 3820
pta@mazars.co.za

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