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31 August 2023

BUSINESS UNITY SOUTH AFRICA SUPPLEMENTARY COMMENTS ON THE DRAFT TAXATION LAWS AMENDMENT BILL, 2023 (DTLAB) AND THE DRAFT TAX ADMINISTRATION AMENDMENT BILL, 2023.

INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

SOLAR ENERGY TAX CREDIT

Proposed Amendment

With respect to the rooftop solar tax incentive, individuals will be entitled to a tax rebate to the value of 25 percent of the cost of any new and unused solar PV panels, up to a maximum of R15,000. The rooftop solar tax incentive will be available for a period of one year and will apply to new and unused solar PV panels that are acquired by the individual and brought into use for the first time on or after 1 March 2023 and before 1 March 2024.

Issues with the proposal

Period of the incentive

The period of the incentive is relatively short and may not provide a sufficient incentive to taxpayers to invest in solar solutions.

Focus of incentives/solar energy tax credit

Clarity is required regarding the interplay between the solar energy tax credit and the capital gains tax ('CGT') legislation where there is a sale of the solar panels which gives rise to CGT and the individual is also subject to additional tax arising on the reversal of the credit (arising from disposal) in terms of section 6C(5).

Installations by body corporate or homeowners association

Clarity is required on how the proposed incentives would apply where a body corporate installs solar panels/electricity generation on the building to assist owners. Would the members of the body corporate/owners qualify for the section 6C rebate only if a levy is charged by the body corporate or would the solar energy tax credit deem to apply at a member level regardless of whether a levy is charged or alternatively, would the body corporate qualify for the section 12BA (125% deduction (if other income is earned)).

Grammatical corrections

There are grammatical errors in the following clauses which need to be corrected:

(2)*(a)* The solar energy tax credit applies in respect of **the** cost actually incurred by the natural person.

Recommendations

It is recommended that National Treasury (NT):

- Consider aligning the period for which the incentive is available to a period of two years to apply to assets acquired on or after 1 March 2023 and before 1 March 2025 (or a similar period as provided for business incentives).
- Correct the grammatical errors.

APPORTIONING THE TAX-FREE INVESTMENT CONTRIBUTION LIMITATION WHEN AN INDIVIDUAL CEASES TO BE A TAX RESIDENT

Proposed Amendment

When a natural person ('taxpayer') ceases their South African tax residency they will effectively have two years of assessment within the same 12-month period. However, Tax Free Investment ('TFI') contributions are limited to R36,000 "per year of assessment". As a result, a taxpayer having two years of assessment in a single 12-month tax period can "double-up" on the TFI annual contribution limitation of R36 000. In order to ensure that taxpayers do not "double up" on the TFI annual contribution limit NT proposes that the TFI annual R36,000 contribution limit will be apportioned between the taxpayer's two years of assessment in the 12-month period from 1 March to 28 or 29 February.

Potential problem(s)

In the case of TFIs, NT proposes that the wording of subsection 12T(4) of the Income Tax Act of 1962 (the ITA) be amended to cater for the apportionment of the contribution limitation between the two years of assessment by inserting a proviso as follows:

"Provided that where any person's year of assessment is less than a period of 12 months, the amount that shall be allowed as contributions under this section shall be the amount that bears to the amount referred to in paragraph (a) the same ratio as the number of days in that year of assessment bears to 365 days".

Firstly, the proposed amendment seeks to apportion the taxpayer's 'annual' contribution limits. However, subsection 12T(4) refers to both 'annual' (section 12T(4)(a)) and 'lifetime' limits'(section 12T4(c)). Applying the proviso to subsection 12T(4) as a whole unintentionally limits the taxpayer's lifetime contribution limits.

Secondly, taxpayers may make contributions at any time during a year of assessment, provided they do not exceed the overall 'annual' contribution limits. The wording of the proposed proviso however seeks to apportion the contribution limit across the two years of assessment. It assumes that contributions will be made at the same rate across the relevant 12-month period and ignores when the contributions were actually made. If a taxpayer makes irregular contributions during the 12-month period, the proposed wording could cause the taxpayer to exceed the contribution limit for their period of assessment. This can be demonstrated as an example: A taxpayer contributes R36,000 on 1 March 2024. The taxpayer ceases his South African tax residency on 30 August 2024. If the proviso (in its current wording) is applied to the taxpayer, the contribution limit for the first year of assessment would be approximately R18,000 (i.e., 183/365). This taxpayer would be in contravention of the contribution limit since he contributed R36,000 in his first year of assessment.

Finally, the provision that imposes a penalty on contributions exceeding the 'annual' limits is subsection 12T (7). No amendment has been proposed to this subsection of 12T i.e., it still refers to the R36,000 contribution limit applying to a year of assessment. The fact that no amendment is proposed means that a taxpayer could still contribute R36,000 to each year of assessment and not be subjected to the penalty.

Suggested solutions

In order to ensure that the proviso only applies to section 12T(4)(a), it is suggested that any amendment to the subsection only be made to section 12T(4)(a) and not the subsection as a whole.

In order to ensure that taxpayers who contribute irregular amounts during a 12-month period (1 March to 28/29 February) are not unintentionally prejudiced by the proposed proviso (but will still be precluded from 'doubling up'), the following amendment to subsection 12T(4)(a) is proposed:

12T(4) Contributions in respect of tax free investments shall be-

(a) *Limited to an amount of R36 000 in aggregate during any* ***[year of assessment]*** ***<u>period of twelve months commencing on 1 March and ending on 28 or 29 February, as the case may be</u>****;*

In order to ensure that taxpayers who exceed the contribution limits during a 12 month period (1 March to 28/29 February) are subjected to the penalty, the following amendment to subsection 12T(7) is proposed:

12T(7)

(b) *(a) If during any* ***[year of assessment]*** ***<u>period of twelve months commencing on 1 March and ending on 28 or 29 February, as the case may be</u>*** *any person contributes in excess of the amount of R36 000 in respect of tax free investments, an amount equal to 40 per cent of that excess is deemed to be an amount of normal tax payable by the person contemplated in subsection (1) (b) in respect of that* ***[year of assessment]*** ***<u>period</u>****.*

(c) If any person contributes in excess of R500 000 in aggregate in respect of tax free investments, an amount equal to 40 per cent of so much of that excess as has not previously been taken into account in terms of this subsection shall be deemed to be an amount of normal tax payable by the person contemplated in subsection 1 (b) in respect of the ***[year of assessment]*** ***<u>period of twelve months commencing on 1 March and ending on 28 or 29 February, as the case may be</u>*** *in which the excess is contributed.*

LIMITING THE RETIREMENT FUNDS CONTRIBUTION DEDUCTION WHEN AN INDIVIDUAL CEASES TO BE A TAX RESIDENT

Proposed Amendment

When a natural person ('taxpayer') ceases their South African tax residency they will effectively have two years of assessment within the same 12-month period. However, retirement fund contributions are capped at R350,000 "per year of assessment". As a result, a taxpayer having two years of assessment in a single 12-month tax period can "double-up" on the utilisation of the R350,000 cap on their allowable retirement fund deductions.

To ensure that taxpayers do not "double up" their utilisation of the R350,000 cap, NT proposes that the R350,000 cap will now be apportioned between the taxpayer's two years of assessment in the 12-month period from 1 March to 28 or 29 February.

Issues with the proposal

In the case of section 11F, NT proposes that the wording of subsection 11F(2)(a) be amended to cater for the apportionment of the R350,000 cap, between the two years of assessment as follows:

": Provided that where any person's year of assessment is less than a period of 12 months, the amount that shall be allowed as a deduction under this paragraph shall be the amount that bears to the amount referred to in this paragraph the same ratio as the number of days in that year of assessment bears to 365 days;"

Currently taxpayers can make retirement fund contributions at any time during a year of assessment. As the R350,000 cap is intended to apply across all contributions made during the relevant 12-month period, the taxpayer can make irregular contributions at any time and still avail himself of the overall R350 000 cap. The wording of the proposed proviso, however, seeks to apportion the contribution limit across the two years of assessment. It assumes that retirement fund contributions will be made at the same rate across the relevant 12-month period and ignores when the contributions were made. If a taxpayer makes irregular contributions during the 12-month period, the proposed wording could cause the taxpayer to be limited to a deduction in one year of assessment. This can be demonstrated as an example: A taxpayer contributes R350,000 to his RA on 1 March 2024. The taxpayer earns taxable income of R1,750,000 up to 2 July 2024. The taxpayer ceases his SA tax residency on 30 August 2024. If the proviso (in its current wording) is applied to the taxpayer, the contribution limit for the first year of assessment would be approximately R175,000 (i.e., 183/365). This taxpayer's contribution of R350,000 made on 1 March 2024 would exceed the deduction limit of R175,000.

Recommendation

In order to ensure that taxpayers who contribute irregular retirement fund amounts during a 12 month period (1 March to 28/29 February) are not unintentionally prejudiced by the proposed proviso (but will still be precluded from 'doubling up'), it is recommended that the wording of the preamble to the deduction limits in subsection 11F(2) be amended to refer to twelve month period instead of a year of a assessment.

The following amendment to subsection 11F(2) is proposed:

> *(2) The total deduction allowed in terms of subsection (1) must not in* ***[a year of assessment]*** ***<u>a period of twelve months commencing on 1 March and ending on 28 or 29 February, as the case may be</u>*** *exceed the lesser of—*
>
> (a) R350 000

TRANSFER BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER

Proposed Amendments

To ensure parity amongst members of occupational retirement funds who have reached normal retirement age in terms of the fund rules but have not yet opted to retire from their respective fund, and are subject to an involuntary transfer, it is proposed that the following changes be made in the ITA from 1 March 2024:

- members of pension or provident funds who have reached normal retirement age as stipulated in the fund rules, but have not yet opted to retire from said fund, and are subject to an involuntary transfer, are able to have their retirement interest transferred from a less restrictive to a more restrictive retirement fund without incurring a tax liability; and
- the value of the retirement interest, including any growth thereon, will remain ring-fenced and preserved in the receiving pension or provident fund until the member elects to retire from that fund. This means that these members will not be entitled to the payment of a withdrawal benefit in respect of the amount transferred.

Issues with the proposal

The legislative changes to give effect to the proposed amendments are as follows, per the Draft TLAB:

1(1)(e) Definition of **"pension fund"**: by the addition in paragraph (ii) of the proviso to the definition of ''pension fund'' after subparagraph (ff) of the following subparagraph:

<u>"(gg) that a member who has transferred a retirement interest in terms of paragraphs 2(1)(c) and 6A(d) of the Second Schedule to this fund shall not be entitled to payment of a withdrawal benefit as contemplated in paragraph 2(1)(b)(ii) of the Second Schedule in respect of that transferred amount; and";</u>

1(1)(i) Definition of **"provident fund"**: by the addition in paragraph (ii) of the proviso to the definition of ''provident fund'' after subparagraph (ff) of the following subparagraph:

“(gg) that a member who has transferred a retirement interest in terms of paragraphs 2(1)(c) and 6A(d) of the Second Schedule to this fund shall not be entitled to payment of a withdrawal benefit as contemplated in paragraph 2(1)(b)(ii) of the Second Schedule in respect of that transferred amount; and”;

38. (1) Paragraph 6A of the Second Schedule: Paragraph 6A of the Second Schedule to the ITA, is hereby amended by the addition after subparagraph (c) of the following subparagraph:

‘‘(d) pension or provident fund into another pension or provident fund.’’

This submission deals with the following three issues:

A. The proposals in the draft TLAB which restrict the right to a withdrawal benefit when a retirement interest is transferred to a pension or provident fund.
B. Changes to the explanatory memorandum (TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER) to reflect the issue accurately for members of pension and provident funds.
C. Transfers between retirement annuity funds after normal retirement age.

A. The proposals in the draft TLAB which restrict the right to a withdrawal benefit when a retirement interest is transferred to a pension or provident fund

Currently, paragraph 2(1)(b)(iB) of the Second Schedule provides for an accrual of a transfer benefit from one retirement fund to another before retirement date. A deduction for the transfer is provided in paragraph 6 of the Second Schedule. All transfers are tax free. With the exception of a retirement annuity fund, the member is entitled to a withdrawal benefit in the transferee fund.

Currently paragraph 2(1)(c) of the Second Schedule provides for an accrual of an “amount transferred for the benefit of that person after normal retirement age, less any deductions permitted under the provisions of paragraph 6A”. This paragraph is intended to apply to members who have retired from employment but have deferred their retirement date and then elect to transfer their retirement interest to another fund or are subject to a bulk section 14 transfer to another fund. Paragraph 6A only makes provision for a transfer to a preservation fund or retirement annuity fund. Therefore, the proposal to include pension and provident funds in paragraph 6A was requested and is welcomed.

The proposed new paragraph (ii)(gg) of the proviso to the definition of "pension fund" and the proposed paragraph (ii)(gg) of the proviso to the definition of "provident fund", contemplate and apply to a "retirement interest" which is transferred to a pension or provident fund. When a retirement interest is transferred to a pension or provident fund, the member will not be entitled to a withdrawal benefit from the pension or provident fund and only a retirement benefit is available.

However, paragraph 2(1)(c) does not include the word "retirement interest". It only refers to "an amount". A member's benefit that is transferred to a pension or provident fund under paragraph 2(1)(c) does not qualify as a retirement interest and will not be subject to the proposed restriction in paragraph (ii)(gg) of the proviso to the definition of "pension fund" and paragraph (ii)(gg) of the proviso to the definition of "provident fund".

In addition, the definition of retirement interest states the following:

"retirement interest" *means a member's share of the value of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as determined in terms of the rules of the fund on the date on which he or she elects to retire or transfer to a pension preservation fund, provident preservation fund or retirement annuity fund;*

The definition does not include a transfer to a "pension fund" or "provident" fund. A retirement interest is only defined as a transfer to a pension preservation fund, a provident preservation fund and a retirement annuity fund. Therefore, a member may not transfer a retirement interest to a pension or provident fund.

The definitions of "pension fund" and "provident fund" in the ITA likewise currently only makes provision for the transfer of a retirement interest to a preservation fund or a retirement annuity fund. These definitions will have to be amended to also make provision for the transfer of a retirement interest to another pension fund or provident fund.

B. <u>Changes required to the explanatory memorandum (EM)</u>

The following matters are brought to the attention of NT:

1. The heading of the amendment in the EM refers to "TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO ARE 55 YEARS OR OLDER". The age threshold of 55 is only definitely applicable to retirement annuity funds. Occupational funds usually have a higher retirement age.
2. The EM states in the 'Reasons for change' section that the only impact is on "active" contributing members of provident / pension funds. This is not entirely accurate as the impact is wider than this. It impacts all members over normal retirement age who are transferred between pension / provident funds (i.e.: also, paid-up members).
3. The EM indicates in the 'Proposal' section, that the proposed amendment is only in respect of "involuntary" transfers. However, the DTLAB provides for all such transfers.

C. <u>The exclusion from paragraph 6A of the second schedule to the ITA of transfers post normal retirement age from a retirement annuity fund to a retirement annuity fund</u>

Finally, BUSA would like to remind NT of the request to consider including a deduction in paragraph 6A of the Second Schedule to the ITA for transfers post-retirement age (the age of 55) from one retirement annuity fund to another retirement annuity fund. Clarity is required on whether the proposed amendments purposely exclude transfers from one retirement annuity fund (RAF) to another retirement annuity fund.

Paragraph (e) of the definition of "gross income" in section 1 of the ITA includes retirement lump sum benefits, as referred to in paragraph 2(1)(c) of the Second Schedule i.e.:

"Any amount transferred for the benefit of that person on or after normal retirement age as defined in the rules of the fund, but before retirement date, less any deductions permitted under the provisions of paragraph 6A".

Paragraph 6A of the Second Schedule allows for deductions in respect of the following:

- Transfers from a pension fund into a pension preservation fund, provident preservation fund or a retirement annuity fund, or;
- Transfers from a provident fund into a pension preservation fund, a provident preservation fund or a retirement annuity fund, or;
- Transfers between preservation funds, or from a preservation fund to a retirement annuity fund, or;
- Transfers from a pension or provident fund into another pension or provident fund (to be inserted by Clause 38 of the Draft Taxation Laws *Amendment Bill, 2023, from 1 March 2024, in subparagraph (d) after subparagraph (c) of paragraph 6A).*

Therefore, currently these transfers are included in the gross income of a member in terms of paragraph 2(1)(c), but there is no corresponding deduction. This would mean that the transfer of the benefit of any member of a retirement annuity fund to another retirement annuity fund, where that member is older than the normal retirement age (i.e., 55 years or older, or when a member becomes permanently incapable of carrying on his or her occupation due to sickness, accident, injury or incapacity through infirmity of mind or body), before that member has elected to retire, will be taxable, based on the existing wording of paragraphs 2(1)(c) and 6A. This is because the transfer would be included in gross income in terms of paragraph 2(1)(c) of the Second Schedule but there would not be a reciprocal deduction available, because paragraph 6A does not provide for a deduction in respect of such transfers.

Recommendation

Amendments are required to the definition of “retirement interest”, paragraph 2(1)(c) of the Second Schedule as well as to the definitions of “pension fund” and “provident fund”, as follows:

retirement interest” *means a member’s share of the value of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund as determined in terms of the rules of the fund on the date on which he or she elects to retire or transfer to a <u>pension fund, provident fund,</u> pension preservation fund, provident preservation fund or retirement annuity fund;*

Paragraph 2(1)(c): ~~any amount~~ a member's retirement interest transferred for the benefit of that person after normal retirement age, less any deductions permitted under the provisions of paragraph 6A;

Paragraph (ii)(dd) of the proviso to the definition of ''pension fund':

"… where the employee elects to transfer the retirement interest to a pension fund, provident fund, pension preservation fund, provident preservation fund or a retirement annuity fund …"

Paragraph (ii)(dd) of the proviso to the definition of ''provident fund'':

"… where the employee elects to transfer the retirement interest to a pension fund, provident fund, pension preservation fund, provident preservation fund or a retirement annuity fund …"

These amendments, together with what is suggested below, will provide a very clear framework for the taxation of:

- pre-retirement withdrawals that are transferred to another fund (taxable under paragraph 2(1)(b)(iA) of the Second Schedule), read with paragraph 6); and
- transfers after the member is retired from employment but has not yet retired from the fund (falling within the ambit of paragraph 2(1)(c) of the Second Schedule, read with the proposed paragraph 6A(d), which will be subject to the proposed paragraph (ii)(gg) of the proviso to the definition of "pension fund" and paragraph (ii)(gg) of the proviso to the definition of "provident fund".

In addition, we recommend that:

1. The heading in the EM be changed to refer to '"TRANSFERS BETWEEN RETIREMENT FUNDS BY MEMBERS WHO REACHED NORMAL RETIREMENT AGE".
2. NT amend the explanation in the 'Reasons for change' section in the EM to reflect that all members over normal retirement age are impacted, not only active contributing members.
3. That NT updates the commentary in the 'Proposal' section in the EM to reflect that the proposed amendment would apply to all transfers of members who reached normal retirement age.

4. That NT update paragraph 6A of the Second Schedule to the ITA to add transfers from one Retirement Annuity Fund to another Retirement Annuity fund, by adding the following after the newly inserted subparagraph (d):

    ''(e) retirement annuity fund into another retirement annuity fund.''

INCOME TAX: BUSINESS (GENERAL)

REVIEWING THE PRINCIPLES OF PRACTICE NOTE 31 OF 1994

Proposed Amendment

NT has proposed that Practice Note 31 of 1994 ('PN31') be withdrawn and that legislative guidance be provided to the extent that deductions dealt with in terms of PN31 align with the currently prevailing policy.

The draft legislation proposes to introduce a new section 11G to allow for an income tax deduction for expenditure incurred by a company in the production of interest income accruing from another group company (as defined in section 1 of the ITA provided certain requirements are met.

Issues with the proposal

The proposed section 11G (intended to replace PN31) is significantly narrower than the provisions of PN31 and will significantly restrict the ability to deduct expenditure incurred in the production of interest income.

The proposal may significantly negatively impact legitimate business structures. Such structures include but are not limited to:

- Special purpose vehicles for debt securitisation or the issue of debt to third parties; and
- Back-to-back loan arrangements outside of a group of companies which have sound commercial rationale (for example an individual that is an investor in a company could borrow funds from a bank to on-lend to the company. Under this proposal the individual would be taxed on the interest income but would be denied a deduction in respect of the interest expense paid to the bank)
- Employee share schemes where the trust incurs expenditure in managing the scheme, but is not carrying on a trade, as required in terms of the ITA. The trust normally earns dividends on unallocated shares and interest on cash accumulating in the trust. In terms of PN31 the trust would have been allowed to apportion expenses between dividend and interest income and deduct the latter portion against interest income, limited to the amount of interest received.

It is further noted that the wording of the proposed section 11G differs from the requirements listed in the EM which accompanied the DTLAB. The EM requires the group company which obtains the funding from the taxpayer (also within the same group), to use the funding for ‘purposes of its trade to produce income’. To the extent that the intention of the EM is carried through and contained in the final wording of section 11G, this could result in tax leakage in tiered funding structures.

Recommendation

BUSA recommends that the proposed section 11G is amended so as not to limit the expenditure incurred to amounts owing for the purpose of providing a loan, advance or credit advanced only to group companies but **expanded to connected persons and third parties**. In addition, it is recommended that section 11G is extended to persons other than companies to cater for persons that borrow to on-lend as a means to prevent abuse, it is proposed that the expenditure is limited to amounts incurred where the corresponding income is included in the gross income of the related recipient. As an alternative, NT can consider introducing an approval process for legitimate business structures where clarity is required whether such structures constitute a ‘trade’, in which case section 11G would not apply.

Given that the withdrawal of PN31 will significantly restrict the deductibility of expenditure incurred to produce interest income, this would have a negative financial and commercial impact on Taxpayers. To provide such Taxpayers with a sufficient opportunity to prepare for the change in practice we would recommend that NT consider delaying the effective date to apply in respect of years of assessment commencing on or after 1 January 2025.

SECTION 23M CLARIFYING THE INTEREST LIMITATION RULES

Proposed Amendment

The proposal seeks to clarify the application of the interest limitation rules and align the legislation to its intended purpose.

Issues with the proposal

We refer to an extract of section 23M(3) below.

3) The amount of interest allowed to be deducted in respect of all debts owed as contemplated in subsection (2), in respect of any year of assessment must not exceed the sum of—

(*a*) the amount of interest received by or accrued to the debtor; and

(*b*) an amount determined by multiplying the adjusted taxable income of that debtor for that year of assessment by 0,3,

reduced by so much of *any amount of interest incurred by the debtor in respect of debts other than debts* contemplated in subsection (2) as exceeds any amount not allowed to be deducted in terms of section 23N.
(our emphasis in italics)

Whilst the need for clarity brought in respect of the proposed amendments is understood, further refinements are required to confirm that the deductible interest referred to in section 23M(3) should be reduced by so much of any amount of interest incurred that is allowed as a deduction by the debtor in respect of debts other than debts contemplated in subsection(2)….

The taxpayer could for example have borrowed funds from a third party to fund the acquisition of shares. The interest would not be deductible as it is not incurred in the production of income. If the amount of interest allowed as a deduction in section 23M(3) is then reduced by the non-deductible interest the taxpayer would be penalised twice in respect of this interest (since the interest is not deductible and the amount of other interest allowed as a deduction would be also be reduced). The reduction should therefore only reference an amount of interest incurred by the debtor that qualifies for a deduction.

Issue 2

In light of increase in interest rates consideration should be given to whether 0,3 of adjusted taxable income' referred to in section 23M(3) is reasonable or if this should be increased.

Issue 3

Unlisted Property Industry also relies on debt funding to grow and create asset pools that can be utilised by other industries (listed REITS) and are funded by regulated institutions like pension funds, retirement funds and insurers. This industry plays a crucial role in the SA economy particularly in undertaking new developments, resulting in it being a major employer. Stunting this element of the market, would consequently have a negative impact on job creation and growth. To limit the dire impact of the current interest limitation rules and create a more even playing field with the REIT sector we propose extending the exclusion in section 23M(6), section 8F(3)(d) and section 8FA(3)(d) to debt funding where these vehicles are owned and funded by regulated institutions such as pension funds, long-term insurers and short-term insurers.

Recommendations

Issue 1

We recommend that the word *"deductible*" be inserted in section 23M(3) to clarify the intention.

Issue 2

Consideration should be given to whether 0,3 of adjusted taxable income' referred to in section 23M(3) is reasonable or if this should be increased.

Issue 3

To create more parity between the legislation for listed and unlisted REITS, and limit the application of the current interest limitation rules; the exclusion in section 23M(6)(b), section 8F(3)(d) and section 8FA(3)(d) should not be confined:

- to “linked units” but should rather refer to “funding by creditors who are long-term insurers, pension funds and provident funds”; and
- to a specified date (i.e., linked units issued prior to 1 January 2013).

CLARIFYING ANTI-AVOIDANCE RULES DEALING WITH THIRD-PARTY BACKED SHARES

Proposed Amendment

Section 8EA of the ITA contains anti-avoidance rules that deem dividend yields of third-party backed shares to be income except where the funds derived from the issue of the third-party backed shares are used for a qualifying purpose. A qualifying purpose includes, inter alia, the direct or indirect acquisition of equity shares in an operating company.

The 2023 Draft TLAB seeks to specifically introduce an ownership requirement, of the equity shares in the targeted operational company by the person that acquired those equity shares, at the time of the receipt or accrual of any dividend or foreign dividend.

Issues with the proposal

The proposed amendments

- are deemed to have come into operation on 31 July 2023 and apply in respect of any dividend or foreign **dividend received or accrued during years of assessment** ending on or after the date. This would therefore have a retrospective impact and apply to dividends received prior to 31 July 2023, thus leaving it impossible for transactions that will now be affected to be restructured or unwound.
- Does not cater for the wind up of the preference share structure. Typically, in a preference share funding structure at the end of the preference share term the shares in the operating company (or part thereof) are sold to provide funding to settle the accumulated preference dividends and to redeem the preference shares. In terms of the proposed amendments any dividend paid in these circumstances would be deemed to be an amount of 'income'
- Does not consider instances where the shares in one operating company have been disposed of and replaced with shares in another operating company.

Further, the proposed amendments do not consider instances where the operating company has been disposed of through the application of the corporate re-organisation rules in PART III of the ITA. It is not uncommon for group of companies to effect internal restructures on a continuous basis in order to, inter alia, realise economies of scale, increase internal efficiency and/or to accommodate changing circumstances or new commercial opportunities. The proposed "ownership requirement" impedes on group re-organisations where the ownership of the shares in the operating company may be transferred to another group company within the same group of companies.

Finally, the definition of operating company in section 8EA of the ITA includes any company that is a listed company. A listed company is defined in section 1 of the ITA as meaning a company where its shares or depository receipts in respect of its shares are listed on an exchange as defined in section 1 of the Financial Markets Act 19 of 2012 and licensed under section 9 of that Act or a stock exchange in a country other than the Republic which has been recognised by the Minister as contemplated in paragraph (c) of the definition of "recognised exchange" in paragraph 1 of the Eighth Schedule to the ITA. The proposed "ownership requirement" disregards instances where ownership could change as a result of that listed share being substituted with another listed share in terms of a corporate action outside of the control of the person that acquired the share.

Recommendations

The proposed amendments introduce a new requirement for the exemption in section 8EA(3) to apply and has retrospective effect on commercial transactions implemented based on the existing requirements. As such, the proposed effective date is commercially untenable.

We recommend that the proposed amendments come into operation on a future date not earlier than 1 January 2024 and apply in respect of any year of assessment commencing on or after that date.

BUSA further recommends that:

- Where the shares in the operating company are disposed of and the proceeds are used within 6 months to either:
    - Acquire shares in a another operating company
    - To fund the payment of dividend in respect of the preference share
    - To fund the redemption of the preference share

The proviso should also not apply.

- The proposed amendments in respect of the “ownership requirement” should also allow for internal restructures within the same group of companies as well as involuntary corporate actions. Such exclusions should remain within the policy rationale.

TRANSLATING CONTRIBUTED TAX CAPITAL FROM FOREIGN CURRENCY TO RANDS

Proposed Amendment

Although the ITA contains specific rules dealing with the translation of amounts received by or accrued to, or expenditure or loss incurred by a person, denominated in foreign currency to Rands, these rules do not specifically cater for the translation of contributed tax capital (CTC) to Rands.

The 2023 Draft TLAB proposes to introduce Section 25E to the ITA to introduce rules on how to translate the elements that constitute CTC from a foreign currency to rands when a company changes its tax residency to South Africa, and its functional currency and share capital was denominated in a currency other than the Rand.

Issues with the proposal

The scope of the proposed amendments and translation rules are currently limited to foreign companies, that change their tax residency during a year of assessment. A company that is incorporated in a foreign jurisdiction but tax resident in South Africa by virtue of being effectively managed in South Africa is required to maintain CTC. Where the shares are issued from and maintained in the foreign company's share register in foreign functional currency, the ITA does not prescribe any rules of how the CTC should be translated in such instances.

Recommendation

Where companies have a functional currency other than South African Rand the CTC should be determined in that foreign currency. This section should therefore only apply where the functional currency changes to Rands.

INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)

REFINING THE PROVISIONS DEALING WITH THE IMPACT OF INTERNATIONAL FINANCIAL REPORTING STANDARD ('IFRS') 17 INSURANCE CONTRACTS ON THE TAXATION OF INSURERS

Proposed Amendment

In assessing the impact of IFRS 17 on cell captive insurers, it was noted that there are instances where reinsurance assets and liabilities are recognised for IFRS purposes in relation to cell profits due to or due from the cell owner. For tax purposes, these are not true commercial reinsurance arrangements, and these balances should be disregarded in determining a cell captive insurer's taxable income.

In addition, cell captive arrangements effected in terms of preference share arrangements may be accounted for under IFRS 17 or IFRS 9. Currently, insurance contract liabilities under IFRS17 and investment contract liabilities under IFRS 9 are both included in the "adjusted IFRS value" definition in section 29A of the ITA.

Moreover, where a separate liability is recognised in respect of profits due to the cell owner, it may be possible that such a liability may also be included in the "value of liabilities" definition in section 29A of the ITA, resulting in the double-counting of the liability because the current definition of "value of liabilities" in respect of a policyholder fund and a risk policy fund is the sum of "adjusted IFRS value" plus all other liabilities.

NT proposes that reinsurance contract assets and liabilities relating to a cell owner as contemplated in the definition of "cell structure" in section 1(1) of the Insurance Act, No.18 of 2017 be disregarded in symbol "L" of the "adjusted IFRS value" definition in section 29A of the ITA.

It is further proposed that this change be mirrored in section 28(3A) of the ITA to cater for foreign long-term insurers that conduct insurance business through a branch in South Africa and fall under the ambit of section 28 of the ITA.

In addition, it is proposed that a change be made to the definition of "value of liabilities" in section 29A of the ITA to exclude all other liabilities relating to a cell owner.

Long-term insurance tax treatment of cell captive arrangements (section 29A)

Issues with the proposal

The proposed changes currently only adjust third-party cells, it seems that first-party cells were inadvertently omitted from the proposed legislative amendments.

Recommendation

It is recommended that first party cells be included alongside third-party cells in the proposed amendments.

Short-term insurance tax treatment of cell captive arrangements (section 28)

Issues with the proposal

The proposal above, as far as short-term insurers are concerned, only deals with the value of liabilities as set out in section 28(3A). It is noted that section 28(3A) only deals with foreign reinsurers who conduct insurance business in South Africa through a branch. The proposed amendment therefore does not cater for reinsurance assets and liabilities that are recognised for IFRS purposes in relation to cell profits due to or due from the cell owner in the context of an ordinary short-term insurer.

Recommendation

To ensure that there is no uncertainty relating to the amounts which should be included in relation to third party cell arrangements, it is recommend that the following is considered in relation to section 28(2)(a)(i) (edits are included in bold and underlined):

(I) an amount equal to the sum of insurance revenue for insurance contracts ~~and net earned premiums for investment contracts~~, which are determined in accordance with IFRS as reported by the insurer to shareholders in the audited annual financial statements, **<u>provided that no regard should be had to</u>** any reinsurance due to an owner as contemplated in the definition of "cell structure" in section 1 of the Insurance Act, in respect of a third party risk as defined in that section of that Act **<u>which is taken into account in the determination</u>** of **<u>such</u>** insurance revenue in accordance with IFRS;

In addition to the above, it is noted that there are instances where the premiums relating to certain investment and insurance contracts are not recognised in insurance revenue or income. These are not limited to first party cell arrangements. To cater for these circumstances and to ensure that the provision will only be applicable to short-term business, it is recommended that the following is considered in relation to section 28(2)(a)(ii) (edits are included in bold and underlined), this subsection will then also cover investment contracts:

(II) Premium income earned during that year of assessment in relation to **<u>an investment contract or insurance contract entered into by a short-term insurer in the course of carrying on short-term insurance business</u>**, which do not form part of (i).

Further, it is noted that the proposed amendments do not cater for liabilities which relate to third party and first party cells arrangements that do not form part of the liabilities for incurred claims. It is recommended that the following is considered in relation to section 28(3) (edits are included in bold and underlined):

<u>(a)</u> the liabilities for incurred claims relating to short-term insurance business in respect of the policies of the insurer, net of amounts recognised in respect of reinsurance contracts for liabilities for incurred claims, which are determined in accordance with **<u>IFRS</u>** as annually reported by the insurer to shareholders in its audited financial statements."

The addition after subparagraph (a) of the following subparagraph:

<u>(b) Liability for claims in relation to an investment contract or insurance contract entered into by a short-term insurer in the course of carrying on short-term insurance business, which do not form part of (a).</u>

General

Annexure C of the 2023 Budget Review made provision for other technical corrections related to modifications following the implementation of the tax law. The items below are technical corrections which are required following the implementation of the tax amendments effective from 1 January 2023 to cater for the impact of the implementation IFRS 17 on insurers.

The implementation of IFRS 17 has been a complex process and is ongoing with the first of the short-term insurers starting to report on the new IFRS 17 basis during the 2023 financial year. In applying the amended tax legislation, a number of anomalies and unintended consequences have come to the fore. These have been set out below together with proposed recommendations to refine and clarify the legislation to address the uncertainties identified.

Given the materiality of the adjustments required due to the implementation of IFRS 17, the matters noted below are of **critical importance** to short-term insurers for the 2023 year of assessment, for **annual financial statement reporting and provisional tax purposes.**

Commentary provided below references the amendments to section 28 of the ITA as amended by the Taxation Laws Amendment Act No. 20 of 2022.

Calculation of phasing-in amount Legislation

'Section 28(3D)

(c) For purposes of paragraph (a), "phasing-in amount" means the amount by which the amount of the deduction under subsection (3) or (3A), for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, exceeds the amount of the deduction under subsection (3) or (3A) for the latest year of assessment commencing on or after 1 January 2022, ***but before 1 January 2023, had IFRS 17 and subsection (3) or (3A), as amended by the Taxation Laws Amendment Act, 2022, been applied at the end of that year of assessment****, reduced by the difference between—*

i) the amount of insurance premium debtors and reinsurance premium debtors; and

ii) the amount of reinsurance premiums payable,

at the end of the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 been applied, other than amounts forming part of the liability for incurred claims, and increased by the amount determined under subsection (3C) (a).

(d) For purposes of paragraph (b), "phasing-in amount" means the amount by which

the amount of the deduction under subsection (3) or (3A) for the latest year of assessment commencing on or after 1 January 2022, ***but before 1 January 2023, had IFRS 17 and subsection (3) or (3A), as amended by the Taxation Laws Amendment Act, 2022, been applied at the end of that year of assessment*** *exceeds the amount of the deduction under subsection (3) or (3A), for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, increased by the difference between—*

i) *the amount of insurance premium debtors and reinsurance premium debtors; and*
ii) *the amount of reinsurance premiums payable,*

at the end of the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 been applied, other than amounts forming part of the liability for incurred claims, and reduced by the amount determined under subsection (3C) (a).'

Issue

Under IFRS 4, a short-term insurer would in terms of section 28(3) of the ITA (before the recent amendments) have been allowed a deduction for all insurance liabilities (i.e., Unearned Premium Reserve ('UPR')/ Incurred but not reported ('IBNR')/ Outstanding claims reserve ('OCR') etc.) net of reinsurance.

Under IFRS 17, 'premium debtor' balances (amongst others) are specifically set off against the insurance contract liabilities relating to unearned premiums (referred to under IFRS 17 as Liability for Remaining Coverage ('LFRC')). This in effect reduces the deduction for unearned premiums and as a result, a portion of the unearned premiums would, prior to the latest amendments, be taxed.

To address the above, section 28(2)(a) of the ITA was amended so that a short-term insurer would be taxed on 'Insurance Revenue' (which includes only earned premiums net of reinsurance). As such, a separate deduction for an unearned premium reserve (i.e., LFRC under IFRS 17) is not required and the deduction for insurance liabilities as set out in the amended section 28(3) of the ITA is limited to the Liability for Incurred Claims ('LIC') net of reinsurance.

The phase-in provisions were introduced to defer and spread the tax impact as a result of the difference between the methodologies applied in valuing insurance liabilities between IFRS 4 and IFRS 17. Simplistically, the phasing-in amount should constitute the difference between the value of insurance liabilities under IFRS 4 and the value of insurance liabilities determined under IFRS 17.

The interaction between the amendments to section 28(2)(a) and section 28(3) of the ITA with the phasing-in provisions, however, creates complexity regarding the calculation of the 'phasing-in amount'. The current wording of the legislation may be interpreted to mean that the 'phasing-in amount' would be the difference between the deduction allowed under section 28(3) prior to amendment (i.e., LFRC plus LIC net of reinsurance which represents the **total** insurance liabilities) and the deduction under the amended section 28(3) (i.e., LIC net of reinsurance which represents **only a portion** of the total insurance liabilities). Simplistically, one would be comparing total insurance liabilities determined under IFRS 4 to only a portion of the liabilities determined under IFRS 17, resulting in an overstatement of the 'phasing-in amount'. Please see the example below as an illustration:

For transition from IFRS 4 to IFRS 17 it is assumed that there is no change in the technical valuation of UPR/ LFRC. It is further assumed that there is only a change in the valuation under IFRS 17 of IBNR/LIC from R30 to R50 and a corresponding movement in the reinsurance asset from R18 to R30 (net increase in IFRS 17 liability of R8).

The LFRC and Reinsurance LFRC balances under IFRS 17 will differ to the UPR and Reinsurance UPR balances under IFRS 4 only to the extent that the premium debtors and reinsurance premium debtor form part of LFRC under IFRS 17.

Statement of financial position under IFRS 4			**Statement of financial position under IFRS 17**		
UPR	100	Liability	LFRC	60	Liability (movement due to inclusion of premium

Statement of financial position under IFRS 4			Statement of financial position under IFRS 17		
					debtors as part of LFRC under IFRS 17)
Reinsurance UPR	(60)	Asset	Reinsurance LFRC	(36)	Asset (movement due to inclusion of reinsurance creditor under IFRS 17)
Premium Debtor	(40)	Asset	LIC	50	Liability (movement due to change in valuation of liability)
Reinsurance Premium Creditor	24	Liability	Reinsurance LIC	(30)	Asset (movement due to change in valuation of liability)
IBNR	30	Liability			
Reinsurance IBNR	(18)	Asset			

Phase–in calculation

Amended section 28(3D)(c)	
Deduction under subsection (3) or (3A), for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023	*52*
Deduction under subsection (3) or (3A) for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had ***IFRS 17 and subsection (3) or (3A), as amended by the Taxation Laws Amendment Act, 2022, been applied at the end of that year of assessment (i.e., only LIC net of reinsurance)***	*20*
Difference	*32*
Reduced by the difference between (i) the amount of insurance premium debtors and reinsurance premium debtors; and (ii) the amount of reinsurance premiums payable.	*(16)*
Phase-in	***16***

Doesn't reflect the true movement in insurance liabilities of R8 which is an increase in liabilities under IFRS 17

It is noted that per the SAIA submission in relation to the 2022 Draft Taxation Laws Amendment Bill, dated 29 August 2022 (Appendix 2), it was recommended that the 'phasing-in amount' definition should not reference the amended section 28(3) (which only refers to LIC), as this may result in unintended consequences.

Recommendation

As an alternative, we proposed the inclusion of LFRC net of reinsurance LFRC in the calculation of the phasing-in amount. We note that section 28(3C)(b) provides for a deduction of the LFRC calculated for the last year of assessment commencing on or after 1 January 2022 but before 1 January 2023, had IFRS 17 been applied at the end of that year of assessment. Reference to section (3C)(b) could therefore be included in the phasing-in calculation to ensure that both LIC and LFRC are correctly included in the determination of the amount which should be phased in.

Please see the example below to illustrate:

SAIA proposal	
Deduction under subsection (3) or (3A), for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023	*52*
Deduction under subsection (3) or (3A) ***and (3C)(b)*** *for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had* ***IFRS 17 and subsection (3) or (3A) and (3C)(b), as amended by the Taxation Laws Amendment Act, 2022,been applied at the end of that year of assessment***	*44*
Difference	*8*
Reduced by the difference between (i) the amount of insurance premium debtors and reinsurance premium debtors; (ii) the amount of reinsurance premiums payable.	*(16)*
Phase-in (NEGATIVE)	***(8)***
This correctly reflects the actual movement in the valuation of insurance liabilities of R8. The result is, however, negative. Considering that there has been an increase in	

LIC under IFRS 17, section 28(3D)(b) should apply and not section 28(3D)(a) as currently envisaged by section 28(3D)(c)

BUSA note that the result of the phase-in calculation example above is **negative** R8. This highlights that there may be circumstances where at face value it appears that the liabilities under IFRS 4 exceed the IFRS 17 liabilities which would result in the application of section 28(3D)(a) read together with section 28(3D)(c). The phase-in amount is however reduced by the difference between (i) the amount of insurance premium debtors and reinsurance premium debtors; and (ii) the amount of reinsurance premiums payable. Once this reduction is taken into account, a situation may occur where the movement in liabilities is actually an increase in liabilities under IFRS 17 which should result in the application of section 28(3D)(b). It is therefore proposed that a proviso be included in section 28(3D)(c) to address circumstances where the phase-in calculation yields a negative result.

BUSA note that no such proviso is required in section 28(3D)(d) which addresses the situation where liabilities under IFRS 17 relative to IFRS 4. This is because the section 28(3D)(d) phase-in amount is increased by the difference between (i) the amount of insurance premium debtors and reinsurance premium debtors; and (ii) the amount of reinsurance premiums payable. Therefore, the phase-in amount will always be calculated as a positive amount in terms of section 28(3D)(d).
Please see Annexure 2 for proposed legislative amendments for consideration.

Add back of deduction of liabilities in the subsequent year.

Legislation

"Section 28(3C) For the purpose of determining the taxable income derived by any short-term insurer from carrying on short-term insurance business, the short-term insurer must, in the first year of assessment commencing on or after 1 January 2023— … (b) deduct the liabilities for remaining coverage calculated for the last year of assessment commencing on or after 1 January 2022 but before 1 January 2023, had IFRS 17 been applied at the end of that year of assessment."

Issue

Under IFRS 4, a short-term insurer would in terms of section 28(3) have been allowed a deduction for all insurance liabilities (i.e. UPR/ IBNR/ OCR etc.) net of reinsurance. Section 28(4) of the ITA provides for the inclusion in taxable income of insurance liabilities deducted by a short-term insurer in the prior year of assessment, being the amounts deducted net of reinsurance.

The newly inserted section 28(3C)(b) of the ITA provides for a deduction of the Liability for Remaining Coverage*"* i.e. LFRC calculated for the last year of assessment commencing on or after 1 January 2022 but before 1 January 2023, had IFRS 17 been applied at the end of that year of assessment. Since the adjustments for insurance liabilities under IFRS 4 were made net of reinsurance, it follows that the deduction for the LFRC should also be net of reinsurance to avoid an over-deduction of the LFRC in the year of implementation.

Recommendation

To avoid unintended consequences, section 28(3C)(b) of the ITA requires amendment to refer to the deduction of the LFRC **net of reinsurance**.

Please see Annexure 2 for proposed legislative amendments for consideration.

Treatment of salvages

Legislation

"Section 28(3C) For the purpose of determining the taxable income derived by any short-term insurer from carrying on short-term insurance business, the short-term insurer must, in the first year of assessment commencing on or after 1 January 2023—

(a) include in its income an amount equal to the difference between amounts recoverable by that short term insurer in respect of claims incurred under a short-term policy issued by that short-term insurer at the end of the last year of assessment commencing on or after 1 January 2022, but before 1 January 2023 that has not been received by that short-term insurer by the end of that year of assessment".

Issue

Under IFRS 4, receivables for ‘salvages/ third-party recoveries’ are recognised separately on the balance sheet and are therefore easily identifiable. Some taxpayers (not all) specifically adjust for the amounts receivable in respect of salvages in their tax computations so that these amounts are only taxed on receipt in line with the ITA. Going forward, under IFRS 17, it will not be practically possible to tax these amounts on receipt (versus accrual). Since the ‘salvages/ third-party recoveries’ receivable immediately before transition to IFRS 17 would not have been taxed, these amounts would need to be included in the taxable income of the short-term insurer in the year of implementation.

To address this, section 28(3C) (a) was included in the legislation and requires a taxpayer to include in taxable income amounts recoverable by that short-term insurer in respect of claims, for instance in respect of salvages and third-party recoveries, that have not been received.

Recommendation

It is noted that some short-term insurers taxed amounts recoverable (such as salvages) on an accrual basis, even though these amounts were not received. In these instances, the amendment to section 28(3C) (a) will have unintended consequences on the basis that recoverable amounts that have already been taxed would be included in taxable income in the year of IFRS 17 implementation. We recommend that the legislation is amended to ensure that amounts recoverable in respect of claims previously taxed are excluded to prevent double taxation.

This was noted as part of the 2022 Annexure C process and SAIA made a submission to NT requesting refinement in this regard (Appendix 2).

Please see Annexure 2 for proposed legislative amendments for consideration.

References to the insurance and reinsurance receivable and payable balances

Issue

Amended sections 28(3C) and 28(3D) of the ITA refer to, “amounts of insurance premium debtors and reinsurance premium debtors” and “amounts of reinsurance premiums payable”.

It is submitted that the terms “amounts of insurance premium debtors and reinsurance premium debtors” and “amounts of reinsurance premiums payable” which are narrow terms and will not adequately address all the insurance and reinsurance receivable and payable balances included in the LFRC.

Insurance and reinsurance receivable and payable balances which are allocated to insurance liabilities under IFRS 17 can also include additional debtors and creditors balances relating to claims, fees, and commissions.

Recommendation

This was noted as part of the Annexure C process and SAIA has made a submission to NT requesting refinement in this regard (Appendix 2). To avoid any unintended consequences, we therefore request NT to consider expanding the phrase to include all insurance and reinsurance receivable and payable balances included in the liabilities for remaining coverage’.

Please see Annexure 2 for proposed legislative amendments for consideration.

Insurance debtors and creditors included in the liability for incurred claims.

Issue

Section 28(3) provides that a short-term insurer shall be allowed a deduction for Liabilities for Incurred Claims (‘LIC’), net of reinsurance contracts for LIC, which are determined in accordance with IFRS as reported by the insurer to shareholders in the audited annual financial statements.

It has been identified that there are instances where insurance related debtors / creditors can be allocated to LIC as opposed to LFRC. Amounts provided for in LFRC relate to future service whereas amounts provided for in LIC relate to past service. To the extent that a portion of insurance debtors / creditors relate to past services, the amount is reallocated from LFRC to LIC. The same is true for the reinsurance LFRC and LIC.

The tax deduction allowed for in terms of section 28(3), currently refers to the amount of LIC as determined in accordance with IFRS 17 net of reinsurance. The reallocation of insurance debtors / creditors from LFRC to LIC as highlighted above could either increase or reduce the tax deduction allowed to the extent that LIC is adjusted by any insurance related debtors / creditors balances.

Section 28 was amended to ensure that no tax liability is created where certain debtor/ creditor balances, previously disclosed as separate balances under IFRS 4, are reallocated and set off against LFRC under IFRS 17. Similarly, section 28(3) which provides for a deduction for LIC should be amended to exclude any debtor/ creditor balances which have been allocated to the LIC to ensure that a deduction is allowed for the full number of incurred claims for the relevant year of assessment.

Recommendation

We recommend that section 28(3) be amended to refer to LIC excluding any insurance related adjustment for debtors / creditors as this will ensure that the current tax regime is maintained and the impact on the remainder of section 28 is limited to an expansion of references to debtors / creditors.

It should be noted that because this portion of debtors / creditors must specifically be quantified to reallocate to LIC, it would be possible to adjust the LIC balance with this amount for tax purposes, which is different to the position which is applicable to LFRC.

Conclusion

The full impact of the implementation of IFRS 17 for short-term insurers is still being assessed and the matters which have been noted above are based on the information which is available for the 2022 year of assessment. Considering the IFRS 17 data which is available at present, the provisions of amended section 28 of the ITA as currently drafted result in uncertainty, which may in some cases have a significant impact both for the *fiscus* and for the respective short-term insurers which are impacted. We therefore respectfully request that NT carefully consider the matters raised above and seek to address these as part of the 2023 legislative amendment process.

While we have attempted to address all matters which have been identified to date, we note that due to the complexity of IFRS 17 and the continued implementation thereof, the proposed amendments as set out above may still in future require further refinement and additional amendments may be required.

INCOME TAX: BUSINESS (INCENTIVES)

ENHANCED DEDUCTION IN RESPECT OF CERTAIN MACHINERY, PLANT, IMPLEMENTS, UTENSILS AND ARTICLES USED IN THE PRODUCTION OF RENEWABLE ENERGY

Proposed Amendment

The current renewable energy tax incentive available in section 12B of the ITA, provides for a deduction to be claimed over a period of three years at a rate of 50:30:20 per cent (small-scale solar PV projects can obtain 100 per cent write-off in year one). To encourage rapid private investment to alleviate this energy crisis, NT has proposed to temporarily enhance the current renewable energy tax incentive available in section 12B through the insertion of section 12BA. Section 12BA allows for an upfront deduction of 125 percent of the cost incurred with reference to eligible assets.

Issues with the proposal

Clarity required on the items falling within the ambit of the incentive.

The proposed section 12BA as set out in the 2023 DTLAB provides an allowance for *"any new and unused machinery, plant, implement, utensil, or article … to be used by that taxpayer or the lessee of that taxpayer in the generation of electricity in the Republic from …"*. In addition, the proposed incentive makes provision for the foundation or supportive structure where the machinery, plant, implement, utensil, or article is mounted or affixed to such structure.

It appears that the allowance would only apply to capital assets owned by the taxpayer and used for the purpose of electricity generation, together with the supporting structure thereof. It is however not clear whether the additional assets which are required to store and convert the energy generated are included in the ambit of the proposed incentive.

This can be demonstrated by the following example: the only part of a Solar Photovoltaic System ('Solar PV System') that generates energy is the solar panel, however, the solar panel has no functionality without an inverter and the connecting cables. It is thus unclear whether only the solar panel or the solar panel, the inverter, battery, and the connecting cables will qualify for the incentive.

The storage and conversion of energy is a critical element which enables a user to consume the renewable energy which is produced. It is important to note that the same issue applies to the provisions of section 12B.

As the intention is to incentivise taxpayers to invest in renewable energy generation and assist in alleviating pressure on the national electricity grid, it is important that all elements which form part of the energy generation, consumption and storage process is considered.

Period for which the incentive applies.

The proposed section 12BA limits the period for which the enhanced incentive applies to two years from 1 March 2023 to 1 March 2025. In this regard it is important to note that the construction period and the time to obtain regulatory approval required for renewable energy systems can be lengthy and, in some cases, can take up to two years to complete. In such circumstances taxpayers may not be incentivised to accelerate investment in renewable energy generation as the proposed period for which the incentive applies would expire before the capital assets are brought into use.

This can be demonstrated by the following example: a solar plant of less than 100 megawatts can take up to twelve months to construct before being fully operational (after regulatory approval is obtained) whereas a wind plant of the same megawatts can take up to 24 months. The overall process of approval, construction and bringing into use may therefore easily exceed a period of two years.

It is therefore important for NT to carefully consider the time period for which the enhanced incentive is made available. This is important to ensure that the enhanced incentive will achieve the desired outcome of alleviating pressure on the national grid.

Limitation of enhanced renewable energy tax incentive in respect of assets granted an allowance in terms of section 12B of the Act.

To ensure that there is no duplication of tax incentives in respect of the enhanced renewable energy tax incentive, the EM states that draft legislation will clarify that taxpayers can deduct expenses incurred either in respect of section 12B or 12BA, but not both. We have noted that neither section 12B or section 12BA provide clarity in this regard.

Clarification regarding expenses incurred for the acquisition of qualifying assets by lessees.

From a legal perspective as soon as a lessee attaches any qualifying assets acquired to a leased building, the qualifying assets become part of the building and the lessee is deemed to have disposed of the assets. Effectively there would be an immediate recoupment, in terms of proposed section 8(4)(nA) of the enhanced renewable energy tax incentive.

Recommendation

Clarity required on the items falling within the ambit of the enhanced incentive.

We recommend that NT provide clarification as to the '*machinery, plant, implement, utensil, or article'* which will qualify for the incentive and consider the inclusion of all relevant equipment/ assets which enable the consumption and storage of the renewable energy generated. This is also applicable to the provisions of section 12B.

Extension of the period for which the incentive applies.

The enhanced deduction is intended to encourage private investment to alleviate the energy crisis, we recommend that NT consider the extension of the period for which the incentive is available or consider the inclusion of renewable energy systems where construction commences within the period after 01 March 2023 and before 01 March 2025.

To the extent that NT seeks to implement a sunset clause on the incentive, we recommend that the incentive period be amended to cater for the variations in construction periods based on the nature of the renewable energy system (i.e., solar/ wind etc) and the megawatts to be transmitted.

Clarification regarding expenses incurred for the acquisition of qualifying assets by lessees.

While we note that section 12N of the ITA, deems a lessee to be the owner of certain improvements to leasehold property which are affected by such lessee, section 12N of the ITA is narrow. Section 12N only comes into play where a lessee holds a right of use or occupation of land or buildings and incurs an obligation to effect improvements thereto in terms of:

- A Public- Private Partnership.
- a qualifying agreement, namely, an agreement in terms of which the right of use or occupation is granted, and the land or buildings are owned by the South African government in the national, provincial or local sphere or an entity of which the receipts and accruals are exempt from tax in terms of section 10(1)(cA) or

- the Independent Power Producer Procurement Programme administered by the Department of Energy.

Further, section 12N does not apply to lessees who carry on any banking, financial services, or insurance business.

To encourage corporate taxpayers to invest in alternative energy solutions who currently lease premises, we recommend that NT include a deeming provision that the qualifying assets are owned by the lessee in circumstances where the lessee incurred the cost for the qualifying assets in section 12BA.

CLARIFYING THE FOREIGN BUSINESS ESTABLISHMENT EXEMPTION FOR CONTROLLED FOREIGN COMPANIES (CFC)

Proposed Amendment

The definition of Foreign Business Establishment (FBE) is proposed to be clarified by replacing the following wording in the definition: "*conduct/conducting the primary operations of that business*" to "*perform/performing all the important functions of that business for which the controlled foreign company is compensated*." The intention is to prevent outsourcing of key or important business activities while retaining only management activities in relation to the underlying operations.

Issue with the proposal

The proposal is vague and does not provide clarity as both a "primary operation" or "important function" have no definition or technical meaning and are subject to the rules of interpretation. The move to important function widens the ambiguity.
The meaning of "important function" is extremely vague in the context of business as any function will have a degree of importance for various reasons (I.e., back-office functions may be important in order for an operation to comply with governance or regulatory requirements but may not be as important as the ability to weld a widget in a widget manufacturer).

The linking of "important functions" to the phrase "for which the CFC is compensated" may exclude operations that have supply chains across multiple jurisdictions that contribute to a final product or service that is purchased from the CFC. The amendment introduces more uncertainty than clarity.

The proposal limits the scope of the FBE exemption by potentially excluding operations that have economic substance and active income but have sub-contracted various functions that contribute to the final product. This is contrary to the purpose of CFC legislation which is to tax mobile and passive income where economic substance is lacking. For example, take a CFC that owns an office block that sub-contracts various functions (leasing, collections, property management maintenance, facilities management, cleaning). Whilst the CFC does have management on the ground that manages and oversees the various sub-contracted functions, signs contracts, oversees the finances of the CFC (including making payments to subcontractors and other suppliers). In these circumstances it is not clear whether the activities of the management would constitute performing all the important functions of that business for which the controlled foreign company is compensated.

Recommendation

It is recommended that the proposal is withdrawn in its current form in order for the following steps to take place:

1. A comparative review of CFC legislation is undertaken to align South Africa's CFC legislation to best practice, including considering the recommendations of the OECD's BEPS action plan 3, the impact of the pending OECD Pillar 2 Global Minimum tax, and the extent that the current legislation is administratively burdensome for most taxpayers.
2. A new amendment is crafted based on consultation with stakeholders that will ensure clarity.

EXTENDING THE ANTI-AVOIDANCE PROVISION TO COVER FOREIGN DIVIDENDS FROM SHARES LISTED IN SOUTH AFRICA

Proposed Amendment

It is proposed that the round-tripping anti-avoidance provision for foreign dividends be extended to foreign dividends received or accrued from shares listed on a South African stock exchange if the foreign dividends are directly or indirectly funded by amounts that were deductible in South Africa. In order to limit the impact of the round tripping anti-avoidance measures on legitimate transactions, it is proposed that the round tripping anti-avoidance rule in section 10B(4) of the Act only applies in respect of foreign dividends that are declared from profits provided that at least 20 per cent of the profits were generated from transactions with persons that deducted the amounts paid or payable from income.

Issues with the Proposal

An investor would not have knowledge in respect of where the profits from which the dividend are declared; are sourced. Such an investor would only be party to this information if they have, for example, a greater than fifty (50) percent holding in the declaring company along with sufficient insight into what is occurring in it or unless a listed company supplies the appropriate information. We thus believe that the proposal would be impractical to apply.

Additionally, investors holding less than 10% of the shares in a JSE dual listed foreign company do not influence the decisions of the foreign company.
Furthermore, this change will also require system changes for tax reporting of foreign dividends which will be costly to unit trust managers and create a compliance burden for investors.

Recommendation

We recommend that investors holding less than 10% shares in such JSE listed foreign company be excluded from the application of this anti-avoidance provision. Furthermore, that any portfolio of collective investment schemes as defined in section 1 of the ITA also be excluded from the application of this anti-avoidance provision.

INTERACTION BETWEEN THE ANTI-AVOIDANCE RULE AND EXEMPTION APPLYING TO FOREIGN DIVIDENDS

Proposed Amendment

The current denial of exemption for foreign dividends that are directly or indirectly sourced from tax-deductible payments is proposed to be extended to the partial exemption that currently results in an effective tax rate of 20 per cent, thereby ensuring that those dividends will be taxed at 20 per cent where the anti-avoidance rule is applicable.

Issue with the proposal

Investors holding less than 10% of the shares in a JSE dual listed foreign company do not influence the decisions of the foreign company. Furthermore, this change will also require system changes for tax reporting of foreign dividends which will be costly for regulated intermediaries to implement and create a compliance burden for investors.

Recommendation

We recommend that:

- portfolio investors holding less than 10% shares in such JSE listed foreign company be excluded from the application of this anti-avoidance and
- the portfolio of collective investment schemes as defined in section 1 of the ITA be also excluded from the application of this anti-avoidance provision.

Annexure 2 - Proposed legislative amendment wording.

Proposed amendments are underlined in bold.

Proposed amendments to section 28(3D)

'Section 28(3D) …

(c) For purposes of paragraph (a), "phasing-in amount" means the amount by which the amount of the deduction under subsection (3) or (3A), for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, exceeds the amount of the deduction under subsection (3) or (3A) **<u>and subsection (3C)(b)</u>** for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 and subsection (3) or (3A) **<u>and subsection (3C)(b)</u>**, as amended by the Taxation Laws Amendment Act, 2022, been applied at the end of that year of assessment.

<u>Provided that this amount is —</u>

- **(i) <u>reduced by the difference between:</u>**
  - **(a) <u>the amount of insurance and reinsurance receivable balances; and</u>**
  - **(b) <u>the amount of insurance and reinsurance payable balances</u>**

  <u>at the end of the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 been applied, other than amounts forming part of the liability for incurred claims, and</u>
- **(ii) <u>increased by the amount determined under subsection (3C) (a).</u>**

<u>Provided that where this amount is less than zero, the equivalent positive amount shall be deemed to be the phasing-in amount determined in terms of paragraph(d).</u>

(d) For purposes of paragraph (b), "phasing-in amount" means the amount by which the amount of the deduction under subsection (3) or (3A) **<u>and (3C)(b)</u>** for the latest year of assessment commencing on or after 1 January 2022, **but before 1 January 2023, had IFRS 17 and subsection (3) or (3A), as amended by the Taxation Laws Amendment Act, 2022, been applied at the end of that year of assessment** exceeds the amount of the deduction under subsection (3) or (3A) **<u>and (3C)(b)</u>** , for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023.

Provided that this amount is-

(i) **<u>increased by the difference between:</u>**

(a) **<u>the amount of insurance and reinsurance receivable balances; and</u>**

(b) **<u>the amount of insurance and reinsurance payable balances</u>**

<u>at the end of the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 been applied, other than amounts forming part of the liability for incurred claims; and</u>

(ii) **<u>reduced by the amount determined under</u> subsection (3C) (a)<u>.</u>**

Proposed amendments to section 28(3)

Subject to subsection (3A) and notwithstanding section 23(e), for the purpose of determining the taxable income derived during any year of assessment by any short-term insurer from carrying on short-term insurance business, there shall be allowed as a deduction from the income of that short-term insurer an amount equal to the sum of liabilities for incurred claims relating to short-term insurance business in respect of the policies of the insurer, net of amounts recognised in respect of reinsurance contracts for liabilities for incurred claims, which are determined in accordance with IFRS as reported by the insurer to shareholders in the audited annual financial statements. Provided that liabilities for incurred claims shall be:
(i) increased by the amount of insurance and reinsurance receivable balances; and
(ii) reduced by the amount of insurance and reinsurance payable balances which are taken into account the determination of the liabilities for incurred claims in accordance with IFRS as reported by the insurer to shareholders in the audited annual financial statements.

<u>It is further provided that</u> no regard should be had to **any reinsurance due to an owner as contemplated in the definition of "cell structure" in section 1 of the Insurance Act, which is taken into account in the determination of such liabilities in accordance with IFRS;**

Proposed amendments to section 28(3C)

(3C) For the purpose of determining the taxable income derived by any short-term insurer from carrying on short-term insurance business, the short-term insurer must, in the first year of assessment commencing on or after 1 January 2023—

a. include in its income an amount equal to the difference between –

   i) **amounts recoverable, other than by way of reinsurance arrangement, by that short-term insurer, and**

   ii) **amounts recoverable, other than by way of reinsurance arrangement, which have been included in the taxable income of that short-term insurer, in respect of claims incurred under a short-term policy issued by that short-term insurer at the end of the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023.**

b. deduct the liabilities for remaining coverage calculated for the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 been applied at the end of that year of assessment, **net of related reinsurance contract assets and reinsurance contact liabilities**; and

c. deduct the **net amount of insurance and reinsurance receivable and payable balances, at the end of the latest year of assessment commencing on or after 1 January 2022, but before 1 January 2023, had IFRS 17 been applied, other than amounts forming part of the liability for incurred claims.**

BUSA's submission around various amendments and considerations related to the Carbon Tax Act and its implementation:

Issue with the proposal

- Extension of Carbon Tax Phase and Clarity (S65(1)):

The initial carbon tax phase's extension of three years, from December 31, 2022, to December 31, 2025, is acknowledged, but there is a requirement for clarity regarding the extension specifically the applicability of allowances in the extension phase.

Issue with the proposal

- Alignment of Greenhouse Gas Guidelines and Units Correction (S66(1)(a)):

The intention to align greenhouse gas guidelines with the Carbon Tax Act is supported. However, there are concerns about incorrect units displayed for "Default Net Calorific Value".

In addition, it has been noted that the emission factor for saw dust and waste tyre have been adopted from the national methodological guidelines for quantification of greenhouse gas emissions in terms of NEMAQA (Act 39 of 2004) GN 688 dated 7 October 2022, however, the research undertaken to inform these numbers did not take into account the biogenic content due to challenges with laboratory access.

Recommendation

BUSA's recommendation includes specifying units for each net calorific value and revising values in line with the Department of Forestry, Fisheries and the Environment's guidelines.

BUSA suggests that there be a revision of emission factors related to biomass and waste tires to consider biogenic emissions. The argument is that biogenic sources shouldn't be accounted for at the company level, as international protocols don't include them in the carbon tax regimes. Biogenic emissions' inclusion is seen as counterproductive to moving away from fossil fuels.

Issue with the proposal

- Fugitive Emission Factors Correction (Schedule 1, Table 2):
  Proposed changes in fugitive emission factors for coal mining need clarification. While the intent to correct errors is appreciated, the method proposed to divide factors by 1000 creates factual inaccuracies and confusion between the Carbon Tax Act and DFFE's guidelines.

Recommendation

BUSA recommends that the system be corrected without introducing new errors.

Issue with the proposal

DRAFT AMENDMENTS TO THE CARBON OFFSET REGULATIONS PRESCRIBING CARBON OFFSETTING IN TERMS OF SECTION 19(C) OF THE CARBON TAX ACT

- Carbon Offsets Regulations Extension (Regulation 2(2)):

The formalization of the extension is welcomed, but a need is recognized to align carbon tax payments and eligible carbon credit retirement, requiring an update to the utilization period.

BUSA recommends amending the regulation to reflect this necessary alignment by allowing eligible carbon credits to be utilized for the purpose of regulations on or before July 31, 2026, pertaining to the first phase of the carbon tax ending on December 31, 2025.

Recommendation

The regulation should therefore be amended to indicate that eligible carbon credits can be 'utilised for the purpose of these regulations on or before **31 July 2026**', in relation to the 1st phase of the carbon tax ending on 31 December 2025.

Renewable energy tax incentive and adjusting the minimum royalty rate for oil and gas

BUSA is expressing concern regarding the timeframes allotted for project implementation in relation to the renewable energy tax incentive, specifically under section 12BA of the Act. BUSA recommends an extension of at least two years to adequately account for the necessary time for project completion.

Concerning the proposed amendment to adjust the minimum royalty rate for oil and gas, as outlined in section 52(1) of the Act, this change follows the issuance of the National Treasury's Tax policy discussion document on December 15, 2021. Furthermore, BUSA requests that the National Treasury take into consideration the feedback received during the public consultation on the tax policy discussion document, which occurred on April 13, 2022.

BUSA underscores the importance of a holistic approach when evaluating the modification of the royalty rate for Oil and Gas Companies. BUSA proposes that this alteration should be considered in conjunction with the proposed amendment to the Upstream Petroleum Resource Development Act (UPRDA), which introduces a 20% State Participation in the overall project economics (Net Present Value) and has implications for the investment decisions made by Oil and Gas Rights holders.

The proposed change, outlined in section 52(1A), would result in an increase of the minimum royalty rate from the current 0.5% (applicable when the oil and gas mine operates at a loss) to 2% of gross sales. The business acknowledges the retention of the formula used to determine the royalty rate, which is appreciated for its ability to account for variations in cost structures depending on factors such as deep water versus shallow water, onshore versus offshore operations, and the distinct infrastructure requirements for the commercialization of gas versus oil.

Issue with the proposal: 12BA. Enhanced deduction in respect of certain machinery, plant, implements, utensils and articles used in production of renewable energy.

Business is of the view that the timeframes are quite limited considering the time required for project implementation, it is recommended that an extension of least two years be taken into account.

Issue with the proposal: Amendment of section 3 of Act 28 of 2008 as amended by section 92 of Act 15 of 2016

This amendment follows National Treasury – Tax policy discussion document issued 15 Dec 2021 and NT feedback on public consultation on the tax policy discussion document as held on 13 April 2022.

National Treasury must take into account that the change in the royalty rate for Oil and Gas Companies should be considered wholistically in conjunction with the proposed change in the UPRDA for the introduction of State Participation at 20% on the overall project economics (NPV) and decision to invest by Oil and Gas Rights holders.

Issue with the proposal: *(b)* by the insertion after subsection (1) of the following subsection: ‘‘(1A) The royalty mentioned in section 2 in respect of the transfer of a refined mineral resource, that is oil and gas, is determined by multiplying the gross sales of the extractor in respect of that mineral resource during the year of assessment by the percentage determined in accordance with the formula in section 4(1A).".

Impact of the proposed change is to increase the min royalty rate from the current 0.5% (where oil and gas mine is in a loss position) to 2% of gross sales.

It is welcomed that the formula for determination of the royalty rate is retained to accommodate recognition of cost structure differences for deep vs shallow water, onshore vs offshore, together with the difference in infrastructure requirements for the commercialisation of gas vs oil.

Yours faithfully

Cas Coovadia
CHIEF EXECUTIVE OFFICER