KPMG

Budget Summary:

South Africa: a new tax reality

KPMG South Africa's 2021/22 Budget Summary

Finance Minister, Tito Mboweni, delivered the National Budget address on 24 February 2021

Key highlights

Noted below are some of the key proposals outlined in the Speech that would be of relevance to you and your organisation.

Tax Policy

- The corporate tax rate is reduced to 27% for years of assessment commencing on or **after 1 April 2022**. While this proposal is most welcome, we note that from a tax policy perspective the reduction will come at the cost of less tax incentives, limitation on interest deductions, and assessed loss offsets in future.

Individuals and employment tax

- The personal income tax brackets, primary, secondary and tertiary rebates have been adjusted for inflation. The tax-free threshold increases to R87 300 per year, and medical tax credits will be adjusted to a limited extent.
- The minimum value for paid-up retirement annuities will increase from R7 000 to R15 000 **from 1 March 2021**.
- The ceiling for contributions to the Unemployment Insurance Fund (**UIF**) will be increased to R17 711.58 per month **from 1 March 2021**. Therefore, the maximum contribution for employees who earn more than R17 711.58 per month, will be R177.12 per month.
- Tax provisions for travel and home office allowances will be reviewed considering the large-scale migration to working at home over the past year. In recognition of the potential effect on salary structuring, this will be a multi-year project, starting with consultations during 2021/22.
- The nature of long-service awards for fringe benefit purposes will be reviewed to consider a variety of forms of awards that could be considered non-cash benefits.
- In an attempt to curb the abuse of the employment tax incentive in cases where training institutions are used to claim the employment tax incentive (**ETI**) for students, it is proposed that the definition of an "employee" be changed in the Employment Tax Incentive Act (2013) to specify that work must be performed in terms of an employment contract that adheres to record-keeping provisions in accordance with the Basic Conditions of Employment Act (1997).
- Annuitisation for provident funds will be effective **from 1 March 2021**.
- On retirement, a member of a retirement fund may receive an annuity but they are currently prohibited from using their retirement interest to acquire these annuities. Government proposes expanding the amount of retirement interest that may be used to acquire annuities.
- Through the application of Double Tax Treaty (**DTT**) provisions, South Africa may lose its right to tax retirement funds withdrawals when individuals ceased to be South African tax residents in a year prior to withdrawing or retiring from the fund. To address this anomaly, it is proposed that the retirement fund interest forms part of the assets that are subject to retirement fund withdrawal tax. The individual will be deemed to have withdrawn from the fund on the day before he/she ceases to be a South African tax resident. A tax credit will be provided for this deemed withdrawal tax to reduce the tax due on retirement from the fund. This proposal would need to be reviewed in detail to consider the impact where a change in South African tax residency is triggered through the tie breaker clauses of a DTT and the individual is still ordinarily tax resident in South Africa (i.e. intends to return to South Africa after his/her assignment).
- It is proposed that transfers into more or similarly restrictive funds be tax-free in cases of early retirement.
- It is proposed that self-insured risk benefits be classified as a defined contribution component to ensure that retirement funds that provide both defined contribution component retirement benefits and self-insured risk benefits can provide the fringe benefit value based on the actual contribution.

Trusts and deceased estates

- Following the implementation (in 2016) of the anti-avoidance provisions to curb the transfer of growth assets to trusts/companies owned by trusts on low interest/interest-free loans, and the recent amendment in 2020 to provide for preference share funding structures with characteristics similar to the low interest/interest-free loan structures, some taxpayers seem to still be undermining the anti-avoidance provisions by transferring the affected loans between trusts, where the founder of one trust is related to one or more beneficiaries of the other trust. Further changes are being proposed to curb these transactions.
- Schemes have been identified in which assets are ceded to a trust in exchange for services rendered by an employee or independent contractor so as to reduce or eliminate the liability for tax. It is proposed to amend the 'gross income' and donations tax provisions of the Income Tax Act to address these schemes.
- To alleviate the uncertainty as to when assets are transferred from a deceased estate to the heirs/beneficiaries, it is proposed that the tax legislation be amended to align the date of the disposal with the date that the liquidation and distribution account becomes final.

Corporate income tax

- The definition of contributed tax capital (**CTC**) will be clarified to curb perceived abuse and to clarify that shareholders within the same class of shares should share equally in the allocation of CTC.
- The legislation contains provisions which trigger tax consequences upon waiver, cancellation reduction or discharge of a debt – these are commonly referred to as the debt reduction or debt relief rules. Amounts of interest that are waived, cancelled, extinguished or converted to shares are however excluded from these provisions as it was anticipated that interest would be recouped in terms of the general recoupment provisions contained in the legislation. It is proposed that a definition of "interest" be included in the debt reduction rules to clarify this exclusion.
- The hybrid debt anti-avoidance rules will be amended to address the potential for economic double taxation of returns paid on such hybrid debt instruments.
- The following technical amendments are proposed to be made to the corporate reorganisation rules to address certain anomalies:
  - Refining the interaction between the value-shifting rules and the corporate reorganisation rules;
  - Clarifying the rules that trigger additional consideration in asset-for-share transactions where debt was assumed;
  - Clarifying the "early disposal" anti-avoidance rules and its interaction with the "de-grouping" and "nil base cost" anti-avoidance rules;
- Refining the rules applicable to unbundling transactions.

Financial sector

- The tax treatment of the transfer of a policy or insurance book of business between short-term insurers will be clarified as the application of the general tax provisions appear to result in inequitable tax treatment for the parties to the transaction specifically as it relates to the transfer of liabilities.
- A revised expense deduction formula for the taxable policyholders of a long term insurer is being proposed to include the aggregation of unrealised gains and losses.
- Tax legislation governing the tax consequences of a deposit insurance scheme will be introduced once the legislation governing the deposit insurance scheme is passed by Parliament.
- Regulated companies within the financial sector may soon be required to pay a financial sector levy. The revenue generated from this levy will fund the Prudential Authority, Financial Sector Conduct Authority and other entities and activities outlined in the Financial Sector Regulation Act.
- Collateral arrangements permit the transfer of certain financial assets between parties in a tax neutral manner. It is proposed that the legislation be clarified where collateral is used in subsequent collateral arrangement transactions to provide the parties with more certainty on the potential tax consequences if certain requirements are not met.

Cross border tax

- The controlled foreign company anti-diversionary rules will be amended to curb circumvention of these rules by taxpayers.
  The interaction between the provisions dealing with a CFC ceasing to be a CFC and the participation exemption will also be clarified.
- South Africa is part of the group of countries attempting to develop a multilateral framework to address income tax challenges associated with the taxation of digital services providers, which was expected by the end of 2020.
  While the pandemic has resulted in a delay, South Africa will consider a unilateral approach if consensus is not reached in respect of the multilateral proposal.

Value-Added Tax (VAT)

- Proposed inclusion of super fine maize meal in the list of grades of maize meal that qualify for zero rating.
- A domestic reverse charge mechanism is proposed to address schemes and malpractice to claim undue VAT refunds relating to gold exports.
- The VAT Act will be amended to align with the New Insurance Act (2017), making specific provision for the VAT treatment of micro-insurance.
- The VAT treatment of the temporary letting of residential property by developers unable to sell the property will be clarified to allow developers to account for the required output tax adjustment in an equitable manner.

Tax compliance and administration

- Where an employer is non-compliant with respect to submission of the bi-annual and year-end employees' tax returns, it is proposed that SARS be enabled to raise the non-compliance penalty on a basis that for example allows the estimation of the employees' tax due with an adjustment once the actual employees' tax is known.
- When the duration of a taxpayer's year of assessment does not exceed six months whether by reason of death, ceasing to be a tax resident, a company being incorporated during a year or a change of a company's financial year, it is proposed that a first provisional tax payment and return not be required.
- It is proposed that the information required by SARS when claiming donations be extended by taxpayers and third parties.
- Dividends tax will only be refunded if the refund is claimed within 3 years of the date of payment of such dividend. It is proposed that this be extended to dividends *in specie.*
- The provisions relating to VDP's will be reviewed during the 2021 year to align with SARS' strategic objectives.
- It is proposed that the period within which farmers are allowed to reopen previous assessments be aligned with the document retention rules.

Carbon tax and incentives

- In line with the stated aim to reduce incentives, the end dates for the following incentives will not be extended:
  - Sections 12DA (Rolling stock), 12F (Airport and port assets) and 13sept (Low cost housing on loan account): **28 February 2022.**
  - Section 12O (Films): **1 January 2022**.
- The venture capital company tax incentive will cease on **30 June 2021**.
- The Urban Development Zone and Learnership tax incentives will be extended, with the revised end dates of **31 March 2023 and 31 March 2024** respectively.
- Industrial policy projects approved in terms of the section 12I manufacturing tax incentive are required to meet certain compliance criteria within a specified timeframe. The COVID-19 pandemic has hindered compliance. An amendment of the time period within which assets must be brought into use and the compliance period, will be considered.
- For the 2021 calendar year, the carbon tax rate will increase by 5.26% (CPI of 3.26% plus 2%), resulting in an increase in the carbon tax rate from R127 per tonne of carbon dioxide equivalent (for the 2020 calendar year) to R134 per tonne of carbon dioxide equivalent.
- The Department of Environment, Forestry and Fisheries (**DEFF**) proposes to regulate greenhouse gas emissions under the carbon budgeting system by imposing caps on companies for a five-year period. Once legislation on carbon budgets is enacted, the carbon budget allowance of 5%, as provided in the Carbon Tax Act, will be phased out.
- In the first phase of the carbon tax, which **ends 31 December 2022**, renewable electricity purchases can be offset against the carbon tax liability of electricity generators. It is proposed that section 6(2)(c) of the Carbon Tax Act be amended to clarify that only entities that conduct electricity generation activities and purchase additional primary renewable energy, directly under the Renewable Energy Independent Power Procurement Programme, or from private independent power producers with a power purchase agreement, are eligible to claim the tax deduction for their renewable energy purchases. The amendment will take effect from 1 January 2021.
- To ensure alignment between the activities covered under the Carbon Tax Act and the amended National Greenhouse Gas Emission Reporting Regulations, gazetted by the DEFF in September 2020, the following changes are proposed in Schedule 2 of the Carbon Tax Act, effective from 1 January 2021:
  - Threshold change for activity 1A2m brick manufacturing from 4 million to 1 million bricks/month
  - Emissions from the following activities now reportable:
  - *2A4a ce*ramics, 2A4b soda ash, and 2A4d other (production capacity ≥ 50 tonnes/month)
  - 2B10 chemicals industry other (production capacity ≥ 20 tonnes/month)
  - 2C7 metal industry other (production capacity ≥ 50 tonnes/month)
  - 2G1B electrical equip*ment* (production capacity ≥ 50 kilograms/year)

- Inclusion of activity 1A2n manufacture of ceramic products by firing, in particular roofing tiles, tiles, stoneware or porcelain (production capacity ≥ 5 tonnes/day)
- Exempted activities now reportable:
- *3A2 manure management* (threshold: 40 000 places for poultry)
- *3C1a biomass burning in forest lands, 3C4 direct nitrous oxide emissions from managed soils,* and *3C5 indirect nitrous oxide emissions from managed soils* (owning ≥ 100 hectares of plantation)
- *3D1 harvest wood products* (harvest wood products produced from timber harvested from forest owner registered for reporting.

Customs and Excise Duty proposals

- Customs and excise rate increases:
  - ***Specific excise duties:*** With effect from 24 February 2021, specific customs and excise duties are increased. Alcoholic beverages increased by between 8%, (excluding traditional African beer and beer powder which remain unchanged). The rate of duty on cigarettes, cigarette tobacco, pipe tobacco and cigars increased by 8%.
  - ***General Fuel Levy & Road Accident Fund Levy:*** The General Fuel Levy for 2021/2020 is increased by 15c/li to 385c/li and 370c/li respectively for petrol and diesel. The Road Accident Fund Levy will increase by 11c/li to 218c/li. These increases will take effect on 7 April 2021.
  - ***Heated tobacco products:*** The duty on heated tobacco products will remain unchanged at a rate of 75 per cent of the rate applicable to a pack of cigarettes.
  - ***Carbon tax on fuel:*** For the 2021 calendar year, the carbon tax rate will increase by 5.2% to R134 per tonne of carbon dioxide equivalent. The levy for 2021 will increase by 1c to 8c/litre for petrol and 9c/litre for diesel from 7 April 2021.
- Legislative amendment proposals:
  - ***New excise proposals:*** Following public consultation, National Treasury proposes to tax electronic nicotine and non-nicotine delivery systems.
  - ***Bio based placed plastic bags:*** Government proposes to introduce a reduced levy of 12.5c/bag for bio-based plastic bags.
  - ***Export taxes on scrap metal:*** Government proposes that the effective date of the export tax on scrap metals be postponed to 1 August 2021.
- ***Air cargo exports:*** Government proposes to amend section 6(1)(hC) to allow for the consolidation of air cargo at de-grouping depots for export.
- ***Accreditation:*** Government seeks to amend the current accreditation system to align with the requirements of the SAFE Framework of Standards issued by the World Customs Organisation.
- ***Minimum threshold for payment of refunds and underpayment of duties:*** Government proposes to adjust the minimum thresholds for payment of refunds to taxpayers and underpayments of customs duties by taxpayers.
- ***Less serious offenses:*** Government proposes to include the unlawful use or possession of a customs uniform as an offence in terms of section 79(1)(e).
- ***Diesel refund administration:*** On 9 February 2021, government published draft legislation for the diesel refund system for public comment and will take guidance from industry-specific consultations throughout 2021.

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