3 June 2010

Via e-mail: nomfanelo.mpotulo@treasury.gov.za

Ms Nomfanelo Mpotulo
National Treasury

And to

Via e-mail: acollins@sars.gov.za

Ms Adele Collins
South African Revenue Services

Dear Madam

DRAFT TAXATION LAWS AMENDMENT BILL, 2010

The Law Society of South Africa submits it comments herewith.

Please confirm receipt.

Yours faithfully

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<u>Representations on the Taxation Laws Amendment Bill, 2010</u> ("the Bill")

1. **Reversal of dividend exemption for shares falling within section 8C of the Income Tax Act No. 58 of 1962 ("the Act")** - applicable provisions are section 8C, section 10(1)(k)(1) and section 64B(5) of the Act.

   1.1. The proposal is set out in the Explanatory Memorandum to the Bill as follows:

   '*The treatment of capital distributions and dividends in respect of restricted shares will be aligned to one another. Both events will generally trigger ordinary revenue (and no Secondary Tax on Companies) in recognition of this partial cash-out. However if the capital distribution or dividend consists of another restricted equity instrument, the capital distribution or dividend will be treated as a non-event. The restricted equity instrument will then be taxed like any other restricted equity instrument falling under section 8C.'*

   1.2. The problems with the proposed amendments are as follows:

   1.2.1. Shares acquired in terms of section 8C are fully taxed as income on vesting.

   1.2.2. The value of the share necessarily takes into account future income in the form of dividends.

   1.2.3. Other taxpayers are exempt from tax on dividends.

   1.2.4. Profits are already taxed in the company by way of Company Tax, and by Secondary Tax on Companies when distributed and are not deductible; therefore the proposal gives rise to effective double taxation.

   1.2.5. This creates a disincentive for transferring equity to employees because there will be a worse tax treatment than short term remuneration or bonuses which are tax deductible by the employer and taxable to the employee.

   1.2.6. There seems to be an error in the legislation in that there is taxation of dividends on all equity instruments irrespective of whether they are restricted or unrestricted or acquired by virtue of employment or otherwise. It must be so that this proposed change is only in respect of restricted equity instruments.

2. **Narrowing the interest threshold exemption** – applicable provision is section 10(1)(i)(xv) of the Act.

   2.1. The proposal is set out in the Explanatory Memorandum to the Bill as follows:

   'The interest exemption should only be applicable to savings that flow into the general economy and all other forms of interest are to be taxable at marginal rates.'

2.2. A restriction is therefore imposed on the interest exemption for loans made to companies.

2.3. This disadvantages company loan schemes which encourage employee savings. This is unfair and prejudicial to such saving schemes whereby employees are and should be encouraged to save. Such saving schemes promote savings by middle and lower income groups.

2.4. The alleged anti-avoidance or perceived abuse arising where shareholders fund their own companies by way of loans is misplaced. It is unavoidable in commercial practice for shareholders of companies to be required to provide funding to companies as

2.4.1. this is a commercial necessity; and

2.4.2. financial institutions usually insist on shareholder funding as a condition to providing bank finance.