SUMMARY: DRAFT TAXATION LAWS AMENDMENT BILL, 2013

The Draft Taxation Laws Amendment Bill, 2013 was published for public comment on 4 July 2013. A number of changes are proposed which, if implemented, will be relevant to our clients and will impact on the advice we give. The most relevant proposals include:

1. INCOME PROTECTION/LUMP SUM DISABILITY POLICIES

It is proposed that premiums paid by natural persons in respect of life, disability and severe illness policies will no longer be deductible. However, all proceeds on life, disability and severe illness policies will be tax-free, irrespective of whether the proceeds take the form of a lump sum or an annuity.

There will be no transitional period for current policy holders. Going forward, premiums will no longer be eligible for deduction even if the plans are pre-existing. On the other hand, all policy proceeds will be tax-free even if the policy previously generated deductible premiums. Where cover under income protection policies were previously "inflated" to provide for income tax on the proceeds thereof, cover should, going forward, be adjusted to ensure that clients are not over-insured.

The proposed amendments are **effective as from 1 March 2014** and will be applicable in respect of premiums paid as well as receipts and accruals in respect of years of assessment commencing on that date.

2. CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS

2.1. *Member contributions*

It is proposed that individual members making a contribution will receive a uniform deduction for these contributions regardless of whether the contribution is to a pension, provident or retirement annuity fund. Contributions will be deductible subject to certain limits:

Percentage limit: Deductions in respect of member contributions will be up to 27.5% on the greater of "remuneration" or "taxable income" (excluding annuities and retirement lump sums). The potential reliance on "taxable income" means that self-employed individuals can make deductible contributions or that formally employed individuals can make individual contributions based on amounts above remuneration if earning income from other sources.

Monetary limit: The "percentage deduction limit" is subject to the monetary deduction limit of R 350 000 per annum.

Contributions in excess of above limits may be rolled over to future years where the amounts will again be deductible together with contributions made in that year, but subject to the limits applicable in that year. However, any contributions that have not been deducted as at retirement (the aggregate non-deductible contributions) will be set off against any lump sum income.

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2.2. *Employer contributions*

a. Employer deduction

Employer contributions to all approved South African retirement funds will be deductible against income. The deduction will be unlimited.

b. Employee fringe benefit

Any contributions made by an employer to an approved South African retirement fund for the benefit of an employee will be taxed as a fringe benefit in the hands of the employee. The value of the fringe benefit for tax purposes will depend on whether the contributions are made to a defined benefit fund or a defined contribution fund:

a. If the contributions are made to a defined contribution fund, the cash value of the contributions will be included as a taxable fringe benefit for that employee.
b. If the contributions are made to a defined benefit fund, the value of the fringe benefit will be determined through a special formula.

Any contributions made by an employer for the benefit of an employee will be deemed to have been made by the employee, thereby being potentially deductible by the employee. The deductibility of these amounts will fall within the percentage - and monetary limits above.

The proposed amendments will be effective in respect of contributions made **on or after 1 March 2015.**

3. PROVIDENT FUND POST-RETIREMENT COMPULSORY ANNUITISATION

3.1. *Basic annuitisation rule*

It is proposed that the same mandatory annuitisation requirements currently applicable to pension funds and RAs be applied to provident funds. As from 1 March 2015, any person retiring from a provident fund or provident preservation fund won't be able to receive a lump sum of more than one-third of their retirement interests. A mandatory compulsory annuity will now be required for the remaining two-thirds of their retirement interests (pre-retirement interests remain free from any mandatory compulsory annuitisation). However, this basic rule will be subject to the following:

3.2. Protection of historic vested rights within a provident fund

The following measures will be introduced to segregate historically vested rights within provident funds from the new rights mentioned above:

a. Balances in provident funds as at 1 March 2015 (and any subsequent growth thereon) need not be annuitised; and

b. If a provident fund member is older than 55 years of age as at 1 March 2015, the mandatory requirements will not apply to contributions made (and any growth thereon) if the member remains in the same provident fund until retirement.

Due to the alignment of the mandatory annuitisation requirements between all retirement and preservation funds, a more flexible system of free portability can now be allowed. The transfer of retirement savings to provident and provident preservation funds from other funds (to the extent that a transfer is allowed) will henceforth be free from tax in all instances (e.g. pension funds can now be transferred to provident funds).

The proposed amendments will be **effective as from 1 March 2015.**

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4. SIMPLIFICATION OF TAX REGIME FOR NON-PROPERTY CISs

In non-property CISs, disposals of capital assets by the CIS are tax-exempt. Amounts other than of a capital nature are tax-free to the scheme as long as the scheme itself distributes these amounts within a 12-month period. Non-capital amounts retained beyond this 12-month period are treated as ordinary revenue in the hands of the CIS.

The current capital versus ordinary revenue distinction adds unnecessary complications with certain schemes being potentially exposed to ordinary revenue treatment if these schemes unwittingly treat ordinary revenue items as capital. It is therefore proposed that non-property CISs be wholly exempt from tax at scheme level, regardless of whether the income is of ordinary revenue nature or of capital in nature.

Distributions by non-property CISs will, however, be treated as ordinary revenue in the hands of unit holders subject to the following exceptions:

Unit scheme repurchases; and

Dividends (Dividends received by a CIS will retain their nature as dividends in the hands of unit holders as long as the scheme distributes those dividends to unit holders within 12 months after the scheme receives those dividends.)

The proposed amendments are effective for CIS years of assessment commencing **from 1 January 2014.**

5. DEEMED ORDINARY REVENUE TREATMENT IN CASE OF CERTAIN DISPOSALS OF UNITS IN CISs

Whether a gain or loss upon disposal of a unit in a CIS is of revenue or capital nature, is currently largely determined with reference to case law. A deeming provision does, however, exist in respect of a CIS in securities; if a unit in this type of CIS is held for at least 3 years, any gain or loss upon disposal is deemed to be of a capital nature and subject to CGT. This deeming provision does not currently apply to other categories of CISs.

The following is proposed in respect of the disposal of units in various categories of CISs:

a. Amounts received or accrued by the unit holder on the disposal of units in a restricted hedge fund will always be deemed to be of an ordinary revenue nature and subject to income tax.
b. Disposals of units in a retail CIS hedge fund will now be subject to the same regime as disposal of units in CISs in securities. Section 9C will apply which will result in amounts received or accrued on the disposal of these units after a 3-year holding period, automatically being treated as profits of a capital nature and subject to CGT. If these units were disposed of within a 3-year period, case law will determine whether the proceeds are of revenue or capital nature.
c. Insofar as the disposal of units in CISs in participation bonds are concerned, the nature of unit disposals will be determined with reference to case law.

The proposed amendment will apply in respect of disposals on or after **1 January 2014**.

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6. TAXATION OF TRUSTS

   Although the Minister of Finance made it clear during the most recent Budget Speech that the taxation of trusts would be reviewed to eliminate the abuse of trusts to avoid tax, the Draft Taxation Laws Amendment Bill sheds no light on the details of this review, its proposed application or its proposed effective date. As a matter of fact, the Draft Bill is completely silent on the issue. We can therefore only assume that the review will not be implemented any time soon.

For more information, the Draft Bill together with Treasury's Explanatory Memorandum can be downloaded from http://www.treasury.gov.za/legislation/draft_bills/default.aspx

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