SNG Grant Thornton

TaxFocus

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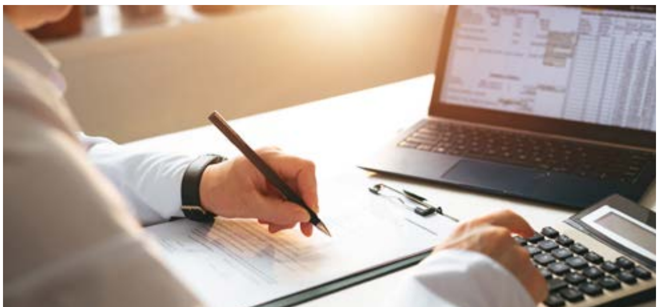
Welcome back to all of you! January has come and gone and we are well on our way into 2022!

February represents our first issue for the year. February is also traditionally the month in South Africa we get to hear the Finance Minister Budget Speech. We will be hosting a post budget event on the 24th of February 15:00-17:00 with ABASA with the key focus being policy developments. In this issue we cover some of the policy matters we expect to engage further on during the event like the discussion paper on Oil and Gas tax regime, Research and Development tax incentive, introduction of a sin tax on Electronic nicotine & Non-nicotine delivery systems (otherwise known by some as Vapers). We also take a look at some international tax developments.

We're on a roll!

Inside Jan/Feb



Inside February

Reviewing South Africa's Research and Development ("R&D') tax incentive Scheme

Tax Manager
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A report published in 2018 on business incentives in South Africa made a number of key observations some particularly related to the Research and Development tax incentive. These have been supported by studies commissioned by the World Bank and the Department of Science and Technology. The main observation that of particular interest given the structure and state of our economy is that large businesses in particular in the manufacturing sector are the largest beneficiaries of the R&D tax incentive.

What is the tax incentive?

The incentive is a tax deduction from income of 150% of the expenditure incurred in relation to eligible R&D activities. The term R&D is defined in the Income Tax Act and any activity that meets the definition of R&D is eligible in terms of the R&D tax incentive.

Who qualifies?

A company that is a tax resident in South Africa that carries out eligible R&D activities qualifies for the tax incentive. Foreign companies may qualify if they meet the definition of permanent establishment.

A company whose R&D activities have been approved is required to submit annual progress reports to the DSI.

How do you apply for it?

To apply for the R&D tax incentive, a company must complete and submit the application form to the Department of Science and Innovation ("DSI") via email. Once the application is assessed by the DSI, the DSI will make a recommendation to the Minister of Science and Technology who will make the final decision on whether the application is approved or declined.

Will the R&D tax incentive be extended beyond September 2022?

The National Advisory Council on Innovation recommended that the DSI not relinquish the R&D tax incentive, but rather to work much harder to improve the impact of the incentive over the next period. We believe that the R&D tax incentive will be extended beyond October 2022.

How does the Discussion Paper propose to address poor uptake of the incentive by Smaller Companies?

The discussion paper notes that globally smaller companies are more responsive to R&D incentive which is in contrast with the South African data as indicated in the introduction above. It is also noted that the R&D incentive in the said global economies does offer preferential treatment to smaller companies. The paper makes no tangible recommendations to address this anomaly. It considers use of refundable tax credits which are rejected.

We are of the view that research looking at the best policy position to ensure that SMEs invest in R&D covering all various areas from funding, reporting, monitoring and overall environment required from ideation to registration of an IP should be commissioned by government. The current discussion paper does not deny the importance of R&D to drive growth in new and existing industries in young companies. It is therefore not enough to only note challenges faced by young companies implementable solutions should be sought and implemented.

Administrative proposals regarding the pre-approval system and review process

The DSI intends to invest in a fully functional online application system and improve on the current evaluation and monitoring processes. The DSI is also working on improving supporting documentation, providing better reasons where applications are declined and ensuring good communication with applicants. The Discussion Paper and all other relevant documentation is available on www.treasury.gov.za

Discussion Paper: Proposed tax regime in respect of Oil and Gas

Senior Manager - Tax Advisory
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On 17 December 2021 National treasury issued a tax policy discussion paper (discussion paper) on "what is the most appropriate tax regime for the oil and gas industry?". Government wishes to evaluate whether the tax regime for the upstream petroleum industry (within the wider fiscal policy context) is suitably designed to create a balance between attracting investment and generating an appropriate level of government revenue, while simultaneously enabling South Africa to achieve its commitments in respect of climate change. Below are key proposals made in the discussion paper together with our brief comments where relevant.

State participation

At the heart of the Upstream Petroleum Resources Development Bill, is the State's participation, regulation of the upstream oil and gas industry as well as the intention to replace certain parts of the current Mineral and Petroleum Resources Development Act 28 of 2008 (MPRDA). Once promulgated, the bills will grant the State a 20% "carried interest" in the production/revenue of an oil and gas project reduced by the State's proportionate share of exploration and production costs. Cost recovery for investors is 50 and 100 per cent in respect of the State's proportionate share of exploration and production costs, respectively. As explained in the discussion paper, the notion of "carried interest" essentially a means for the State to benefit from the proceeds of an oil and gas project without making any upfront cash investment. The carried interest means that the State will only start receiving its share of production / revenue after production commences. Under this model, it is the investors who bear all the risk should there be no commercial discovery made.

The discussion paper propose that the share of the state participation will come through National Revenue Fund thus the South African Revenue Service (SARS) and not to any state-owned entity or another government department. This consideration is welcome given that SARS has extensive knowledge and experience in the sector and the fact that recent development in the country, particularly on the state capture cast a significant doubt on the channeling of the funds to any state-owned entities or government departments. Of interesting to note is that the state will, however, not be passive and only collect its share of revenue, the discussion paper provides that the state through the department of Mineral Resources and Energy (DMRE) will be involved in the strategic and operations management of the of oil and gas projects. We are yet to see how the intertwine between SARS and DMRE will pay out.

Flat rate of Royalty

Another key proposal is a flat-rate royalty of 5 per cent (as defined in section 6 of the MPRDA, 2008) to be levied on gross sales of oil and gas companies. The current royalty regime imposes a royalty on variable rates depending on the profitability of the company. The current regime requires an adjustment for a number of input factors in a complex formula which result in the rate fluctuating between the minimum of 0.5% to 5%. The discussion paper seems to advocate that a flat royalty would make the determination of the royalty simple and easier for both revenue authority and companies to administer.

Fiscal stability agreement

Another key consideration is whether or not government should continue with the issuance of new Fiscal stability agreement (FSA), what these agreements should include if there is a continuation. Fiscal stability agreements are currently provided for in the Tenth Schedule to Income Tax Act and the MPRDA. Investing in exploration, development and production of oil and gas resources is an expensive exercise with long time horizons. From this perspective, it is understandable that investors want certainty in this regard. For the past 7 years, government has not approved any FSA. The discussion paper does not provide reasons why there was no approval of the FSA. Whether is because no applications were received or applications were declined. However, if the State acknowledge that the industry is characterized by significant cost and investors faces the risk of partnering with the state on the proportionate share, then one will expect that these companies should instead be given as much certainty as possible regarding the State's share of taxes. In light of some of the commercial, geological, and political risks which causes investment anxiety within oil and gas as indicated above there is a strong need for continuity of FSAs to encourage investors to commit to long-term projects within the oil and gas industry. Lack of fiscal stability agreements may hamper growth and development within oil and gas industry in South Africa.

Discussion Paper: Taxation of Electronic Nicotine and Non-Nicotine Delivery Systems

Customs & Excise Tax
Zwelibanzi Makhubo

National Treasury has issued a discussion paper on the "Taxation of Electronic Nicotine and Non-Nicotine Delivery Systems". Electronic nicotine delivery systems (ENDS) and non-nicotine delivery systems (ENNDS) also known as e-cigarettes. E-cigarette devices broadly consist of a mouthpiece, battery, vaporizing chamber (with or without a heating coil) and a cartridge that contains a liquid solution, flavorings and other chemicals (e.g., nicotine). The battery-powered device vaporises the liquid solution to create an aerosol which is inhaled and exhaled by users to simulate the act of smoking commonly referred to as vaping.

The discussion paper proposes the introduction of a specific excise tax on of nicotine and non-nicotine solution in 2022. The proposed excise tax will be levied, collected and administered under the Customs and Excise Act 91 of 1964 (the Act).

Background

The South African Government has introduced various measures aimed at reducing the consumption of tobacco products. There are now new generation products (NGPs) available in the market. NGPs are harm reduction or reduced risk products. These products include e-cigarettes and heated tobacco products (HTPs) which are more popular with younger people.

Governments around the world have started regulating and imposing a tax on. However, the country is in the process of changing the status qou. Back in 2018, the Draft Control of Tobacco Products and Electronic Delivery Systems Bill was published to repeal the current Tobacco Products Control Act 83 of 1993. Recently, the Minister of Finance announced South Africa's intention to publish a discussion paper on a proposal to tax e-cigarettes. We discuss the key considerations for importers and manufactures of e-cigarettes in South Africa and provide a view on the possible implications.

Key considerations in the implementation of the tax

The discussion paper considers the following issues in the appropriate design and instrument to be used in implementing the tax on e-cigarettes:

- The type of instrument – National Treasury is of the view that a specific excise regime is appropriate for the taxation of e-cigarettes. Unlike ad valorem excise duties which is based on the value of the excisable product, a specific excise regime is based on volume/weight much easier to administer.

- The coverage and base – Given the nature of e-cigarettes, luxury or non-essential products, the government should consider an ad valorem duty on e-cigarettes with a focus on both the liquid solutions base (non-nicotine) and nicotine content. Excise tax will be levied on the volume of the non-nicotine measured in milliliters (ml) and the nicotine content solution measured in milligrams (mg).

- The excise structure – For purposes of minimizing the administrative costs on the tax system and to reduce the compliance burden on taxpayers, a flat rate is recommended as opposed to a progressive or tiered rate structure. Liable manufactures will be required to obtain and retain nicotine content certification or a South African National Accreditation System (SANAS) or International Laboratory Accreditation Cooperation (ILAC) test report to be produced on request or at the time of import, as may be applicable.

- The excise duty rates – National Treasury has looked at several options regarding the applicable excise rates for e-cigarettes. The options considered include: (a) The 40% benchmark – the excise duty equivalent to 40% of the price of the most popular brand in each tobacco category; (b) Cigarette equivalence- using the number of cigarette equivalence for the determination of the excise rate; (c) Introductory rate – 60 cents per milliliter on the volume of the liquid solution plus 30 cents per milligram for the nicotine.

Conclusion

Globally, several countries impose a tax on e-cigarettes. The issuing of this discussion paper indicates intention to introduce excise tax to be levied, collected and administered under the Customs and Excise Act 91 of 1964. In view of the above discussion.

Discussion Paper: Taxation of Electronic Nicotine and Non-Nicotine Delivery Systems (cont.)

Customs & Excise Tax
Zwelibanzi Makhubo

- A requirement for manufactures of e-cigarettes to register as excise clients and license a customs and excise manufacturing warehouse with the Customs division of the South African Revenue Services (SARS). Registration with SARS is once off. However, licensing may be subject to renewal on or before 31 December of each year. Other than the obligation to register as importer, no additional registration and/or licensing requirements on importers.

- Where a specific excise tax is implemented, manufactures may be required to prepare and submit monthly or quarterly returns via the SARS eFiling platform and make payment if due. Additionally, should a corresponding ad valorem excise duty apply, importers will be required to pay the applicable excise duties at the time of import.

- The ILAC or SANAS test report requirements for both local manufactures and importers will add additional costs, over and above the excise duties, to the selling price of e-cigarettes in South Africa.

In our view, National Treasury has the unenviable task of implementing atax regime that is both administratively feasible for SARS and for the taxpayer. The more complex the administration, the higher the cost of compliance on the taxpayer. A complex tax regime may have the unintended consequence of discouraging compliance.

Moreover, South Africa is following the rest of the global community in imposing taxes on e-cigarettes. All indications point to the tax being implemented on or before the end of 2022 . Taxpayers should keep a close eye on developments in this area and should factor ongoing discussions in their strategic outlook going forward.

Pillar Two: OECD releases Model Rules for domestic implementation of global minimum tax

International Tax
Raeesa Haneef

In December last year, the Organisation for Economic Co-operation and Development (OECD) released the Pillar Two Model Rules as approved by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The Model Rules, referred to collectively as the “GloBE rules”, include the Income Inclusion Rule (IIR) and the Under Taxed Payments Rule (UTPR).

The OECD also released a summary of the rules (The Pillar Two Model Rules in a Nutshell), an overview of the key operating provisions of the GloBE rules (Fact Sheets) and a Frequently Asked Questions document.

The rules define the scope and set out the mechanism for the GloBE rules under Pillar Two, which will introduce a global minimum corporate tax rate set at 15%. The minimum tax will apply to MNEs with revenue above EUR 750 million and is estimated to generate around USD 150 billion in additional global tax revenues annually.

The GloBE rules provide for a co-ordinated system of taxation intended to ensure large MNE groups pay this minimum level of tax on income arising in each of the jurisdictions in which they operate. The rules create a “top-up tax” to be applied on profits in any jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum 15% rate.

It is anticipated that the Pillar Two rules should be brought into domestic law this year, 2022, to be effective in 2023, with the exception of the UTPR which is to enter into effect in 2024. The GloBE rules are designed as a common approach, which means that Inclusive Framework members are not required to adopt the GloBE rules but if they choose to do so, they should implement and administer the rules in a way that is consistent with the Model Rules. Inclusive Framework members are also required to accept the application of the GloBE rules by other Inclusive Framework members.

SNG Grant Thornton is committed to keeping you informed staying abreast of these changes, which will undoubtedly impact the tax landscape globally.

Introduction of a federal Corporate Tax (“CT”) on business profits under a prospective CT regime in the UAE

International Tax
Raeesa Haneef

On 31 January 2022, the UAE’s Ministry of Finance (“MoF”) announced the much anticipated introduction of a federal Corporate Tax (“CT”) on business profits under a prospective CT regime in the UAE.

The relevant legislation for the CT regime (UAE CT Law) is currently being finalised and will be subsequently promulgated. Once promulgated, the UAE CT Law will provide more details and guidance on several critical aspects.

The UAE CT regime will become effective for fiscal years starting on or after 1 June 2023 and is expected to be a federal level corporate taxation. Thus, all UAE businesses, corporations and entities engaged in and licensed to undertaken commercial activities shall be subject to the UAE CT. Businesses engaged in the extraction of natural resources will be exempt from the UAE CT and shall continue to be subject to Emirate level taxation. In general, the UAE CT Law shall be levied at a standard statutory tax rate of 9% of taxable income above AED 375,000. Additional provisions include:

- The application of 0% rate on taxable income up to AED 375,000; and
- A different tax rate for large multinationals that meet specific criteria set with reference to Global Minimum Tax rate under the “Pillar Two” of the Organisation for Economic Cooperation and Development (OECD) Inclusive Framework on Base Erosion and Profit Shifting (“BEPS IF”).

SNG Grant Thornton is ready and able to assist new and existing clients with operation in the UAE to adapt to these proposed changes especially where these clients have commercial transaction structures, inter-company transactions or investment / holding structures in the UAE.

Careers

Please visit our website www.grantthornton.co.za for available positions within the Tax Division.

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