



# Legal Counsel

## Simplified Overview of Special Economic Zones Tax and Customs Incentives



*South African Revenue Service*

## **Disclaimer**

This document is not meant to delve into the precise technical and legal detail that is associated with the relevant tax and customs legislation. It should, therefore, not be used as a legal reference.

## **Introduction**

In advancing its efforts towards promoting economic growth and industrial development, the South African government, via the Department of Trade and Industry, has established various special economic zones (SEZs) within designated areas in South Africa. SEZs are geographically designated areas of a country set aside for specifically targeted economic activities, supported through special arrangements and systems that are often different from those that apply in the rest of the country. These SEZs are supported by means of government-provided infrastructure, business support services and streamlined approval processes. A number of targeted tax incentives are provided by Government to ensure SEZs' growth, revenue generation, creation of jobs, attraction of foreign direct investment and international competitiveness, which include income tax, value-added tax (VAT) and customs-related incentives.

By way of history, SEZs were preceded by so-called industrial development zones (IDZs) which were established in 2001 and were less ambitious in scope than SEZs. IDZs were mainly distinguished from SEZs in that they were relatively export driven and provided only VAT and customs incentives as opposed to SEZs, which in addition to VAT and customs incentives, also provide income tax incentives. Effective 2016, all existing IDZs automatically become SEZs whilst further new SEZs remain to be established on successful application.

## **Income tax incentives**

### **Corporate income tax incentives**

Most South African companies are subject to an annual income tax charge of 28% on their taxable income. In simplified terms, the taxable income of a company consists of a company's annual earned income excluding certain exempt income and less permissible expenses and allowances.

In February 2016, two types of special income tax incentives came into operation for qualifying companies carrying on business within an SEZ:

- a) Companies carrying on business within an SEZ are subject to an annual income tax rate of 15%. This lower income tax rate is very attractive as it is almost half of the normal corporate income tax rate. Only a qualifying company doing business within an SEZ approved by the Minister of Finance may benefit from this lower tax rate. Further mechanisms exist to limit non arm's length transfer of profits between companies located within the SEZ and companies located outside the geographical area of the SEZ.

The Income Tax Act, 1962, currently provides preferential tax treatment for small business corporations (SBCs), that is, certain companies with an annual gross income of less than R20 million. In addition to accelerated allowances these taxpayers also have a graduated tax rate which increases depending on the taxable income of the SBC for the year (this marginal rate works out at less than the normal flat rate of 28% applicable to most corporate taxpayers). Previously no legislative clarity was provided regarding the tax treatment of SBCs located within an SEZ,

however, the 2016 National Treasury Budget Review has proposed that the legislation be amended to make it clear that SBCs in SEZs be subject to corporate income tax at either the applicable graduated rate or 15%, whichever is lower. This proposal has since found expression as part of a bill of parliament, which is expected to be enacted by early 2017.

- b) Qualifying companies are able to reduce their taxable income by means of a special allowance which is related to expenditure incurred on the cost of any new or unused building or improvement to such building. This allowance may be claimed at a rate of 10% per annum on the cost of such building or improvement.

### **How to access these benefits**

Qualifying taxpayers may access these incentives by claiming them in the appropriate fields of their annual corporate income tax return.

### **Employment tax incentive**

The employment tax incentive (ETI) is an existing tax incentive designed to encourage the employment of young persons. It allows employers hiring people 18 to 29 years old to reduce the amount of employees' tax paid on behalf of their employees whilst leaving the wage received by the employee unaffected. Effectively this creates a cost-sharing mechanism between employers and Government in respect of employee wages.

The ETI is made more attractive for employers operating their businesses within an SEZ, as there is no hiring age limitation applicable; that is, the ETI applies regardless of the age of the relevant employee. Whilst the current legislation excludes employers located within an SEZ from this age limitation, only employers, approved by the Minister of Finance in the *Government Gazette*, located within an SEZ can avail themselves of the age exemption. The Minister of Finance is still to publish such a *Gazette*.

### **How to access these benefits**

Qualifying employers may claim this incentive on a monthly basis by claiming it on the monthly employer declaration form which is available from SARS.

### **Customs and excise incentive**

Goods imported into a customs controlled area (CCA) situated in an SEZ are relieved from applicable import customs, excise duties and economic restrictions whilst stored and undergoing manufacturing (which includes processing, cleaning and repair) within the CCA. Goods manufactured in the CCA and subsequently supplied to the local domestic market are subject to the payment of the import customs and excise duties that were relieved at time of importation on the imported goods (raw materials). The liability for customs and excise duties, which enjoyed relief on imported goods used in manufacturing in the CCA, cease upon subsequent export.

Only enterprises located within a CCA of an SEZ are eligible for the relief from import customs and excise duties on goods imported into the CCA. The relief amounts to a full rebate of import customs and excise duties on all goods imported into a CCA by a CCA enterprise.

This means that the payment of customs and excise duties on any goods imported into a CCA in an SEZ would be suspended, translating to a significant cash flow benefit for any

enterprise located there. This has been accomplished by the creation of a specific rebate provision in the customs and excise legislation, that is, rebate item 498.01.

### **How to access these benefits**

A CCA enterprise that intends to import and export goods must register with SARS as an importer and exporter. A CCA enterprise that intends to utilise rebate item 498.01 must also register with SARS as a rebate user. Application for the registration as a rebate user may be done simultaneously with the application for registration as an importer or exporter.

Application for registration must be made on Form DA 185 and its relevant annexures. Particular note must be taken of the supporting documents and information that must be submitted to SARS as specified in the application form. This form and further information can be found on the SARS website ([www.sars.gov.za](http://www.sars.gov.za)).

### **Value-added tax incentives**

The value-added tax (VAT) regime was amended to allow for goods and services that are acquired from the domestic market to be charged with VAT at the 0% and to allow the import of goods to be exempt from VAT.

These incentives are available to a business that is situated in a CCA of an SEZ or the operator of the SEZ operator for purposes of developing the CCA within the SEZ. Importantly, the VAT incentive applies only in the CCA of the SEZ and not to other areas within the SEZ.

Consequently, the SEZ operator must obtain approval from SARS: Customs and Excise as discussed above for an area to be designated as a CCA and any business that intends operating in the CCA must also obtain approval from SARS: Customs and Excise to be designated as a customs controlled area enterprise (CCAEE). Further, the CCAEE must also be registered as an importer for customs purpose, under the applicable rebate item. Once registration is obtained, then only will the CCAEE be able to access the VAT incentive.

The VAT incentives include –

- goods and services supplied by a VAT-registered vendor into the CCA, for the CCAEE or the SEZ operator, will carry a zero VAT charge, instead of a 14% VAT charge;
- goods imported into the CCA, by the CCAEE for purposes of the CCA, will carry no VAT charge (being an exemption from VAT upon importation), instead of carrying a VAT charge of 14%. However goods sold by the CCAEE into the domestic market will carry a VAT charge of 14%; and
- if the import is from a non Botswana, Namibia, Lesotho and Swaziland country, the upliftment of 10% on the value of the import, is also not applicable.

For a detailed explanation of how the VAT incentive operates, please consult VAT Interpretation Note 40 (Issue 3), available via the link: **Interpretation Note 40 (Issue 3)**.

### **How to access these benefits**

In order for SARS to properly manage the VAT incentive, the CCAEE, and the VAT-registered vendor making the supply into the CCA are required to obtain, complete and retain a VAT267 form.