AN ANALYSIS OF TAX INCENTIVES OFFERED FOR INVESTMENTS BY INDIVIDUALS IN SOUTH AFRICA AND THE UNITED KINGDOM

A mini thesis submitted in partial fulfilment of the requirements for the degree of

MASTER OF COMMERCE (TAXATION)

of

RHODES UNIVERSITY

By

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22 January 2024

DECLARATION

Certificate

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ABSTRACT

This research analysed the tax incentives available for investments by individuals in South Africa and compared them to investments in the United Kingdom. It answered the question whether, based on incentives provided in the United Kingdom, recommendations can be made for investment incentives to be implemented in South Africa. The type of investments described were venture capital schemes, tax-free investments, retirement savings, endowment policies, purchased annuities, workplace investment schemes, and fixed interest bonds. These classes of investments were discussed together with the tax incentives offered for them in South Africa and the United Kingdom.

An interpretative paradigm was adopted for this research, together with a doctrinal methodology and a qualitative method. This research analysed the legislative provisions in South Africa and the United Kingdom. Information was also collected from secondary sources such as textbooks and articles written on investments and taxes. There were no ethical considerations in this research as the data that was used are publicly available.

The tax incentive provisions in South Africa have not proven to be effective in increasing household savings, which remain low. The comparison of the taxes and incentives in South Africa and the United Kingdom indicated that there are some similarities on how certain investments are taxed, but for most types of investments, the United Kingdom provided more favourable tax incentives than South Africa.

Recommendations were made for the venture capital company incentive previously applying to be reinstated, or to introduce some form of income tax and capital gains tax relief for direct investment into venture capital companies. The removal of the penalty for tax-free investments in excess of the maximum permitted was recommended, and to charge income tax according to the tax tables on contributions exceeding the limit. With regard to purchased annuities, it was recommended that no income tax should apply to annuities received in the case of disability, sickness, and similar circumstances. For the section 8B Broad-Based Share Incentive Scheme recommendations were made to not levy dividends tax on cash dividends retained for reinvestment into the scheme, and for employees not to be liable for income tax when shares are disposed of, where they are no longer in the relevant employment due to circumstances beyond their control. A recommendation was also made to consider introducing workplace savings schemes similar to the savings schemes applying in the United Kingdom. An education campaign by the South African Revenue Service was recommended, to inform the public of investment incentives.

Keywords: South African and United Kingdom investment incentives for individuals, venture capital schemes, tax-free investments, retirement investments, endowment policies, purchased annuities, workplace investments and fixed interest securities.

ACKNOWLEDGEMENTS

I would like to thank God for giving me the opportunity to do my master’s degree.

I would also like to thank my supervisor, Professor Elizabeth Stack for her advice, patience, support, timeous responses and ensuring that I produce a good standard of work.

I would also like to thank my mother for her prayers and encouragement, and my oldest sister for her support throughout my studies.

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LIST OF ABBREVIATIONS AND ACRONYMS

TERM	ABBREVIATION/ACRONYM
Chief Executive Officer	CEO
Income Tax Act, 58 of 1962, as amended	The Income Tax Act
Individual Savings Accounts	ISAs
Pay As You Earn	PAYE
Save As You Earn	SAYE
Share Incentive Plans	SIP
Small and medium enterprises	SMEs
South African Institute of Taxation	SAIT
South African Revenue Service	SARS
Workplace Individual Savings Accounts	Workplace ISAs
United Kingdom Companies Act, 46 of 2006	2006 United Kingdom Companies Act
United Kingdom Finance Act, 12 of 2004	2004 United Kingdom Finance Act
United Kingdom Finance Act, 14 of 2012	2012 United Kingdom Finance Act
United Kingdom Finance Act, 21 of 1942	1942 United Kingdom Finance Act,
United Kingdom Finance Act, 26 of 2021	2021 United Kingdom Finance Act
United Kingdom Income and Corporation Taxes Act, 1 of 1988	1988 United Kingdom Income and Corporation Taxes Act”
United Kingdom Income Tax Act, 3 of 2007	2007 United Kingdom Income Tax Act

United Kingdom Income Tax (Earnings and Pensions) Act, 1 of 2003	2003 United Kingdom Income Tax (Earnings and Pensions) Act
United Kingdom Income Tax (Trading and Other Income) Act, 5 of 2005	2005 United Kingdom Income Tax (Trading and Other Income) Act
United Kingdom Individual Savings Account (Amendment) Regulations, 2020	2020 United Kingdom Individual Savings Account (Amendment) Regulations”
United Kingdom Individual Savings Account Regulations, 1870 of 1998,	1998 United Kingdom Individual Savings Account Regulations
United Kingdom Savings (Government Contributions) Act, 2 of 2017	2017 United Kingdom Savings (Government Contributions) Act
United Kingdom Social Investments (Accreditation of Social Impact Contractor) Regulations, 3066 of 2014	2014 United Kingdom Social Investments (Accreditation of Social Impact Contractor) Regulations
United Kingdom Taxation of Chargeable Gains Act, 12 of 1992	1992 United Kingdom Taxation of Chargeable Gains Act

CHAPTER ONE: INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The household (private) savings rate is extremely low in South Africa (South African Reserve Bank: 2022). There was a decline in household net wealth in the second quarter of 2022 as liabilities increased while assets decreased. Exposure to credit increased and there was a further increase in household debt (South African Reserve Bank: 2022). Due to the poor savings culture, most individuals do not retire comfortably (Alexander Forbes: 2019). When making decisions to invest, taxes may have a significant impact on the after-tax returns. The government needs to encourage private investment, as an increase in private investments will stimulate demand and supply and lead to the growth of the economy (Fallon and Pereira Da Silva: 1994). To achieve this, a healthy climate for private investment is therefore essential (Fallon and Pereira Da Silva: 1994). Tax incentives are provided by the government of South Africa with the expectation of generating investment (Calitz, Wallace and Burrows: 2013).

This research investigates income tax incentives for investments by individuals in South Africa and in the United Kingdom. The United Kingdom is selected as both countries have a similar legal system, and similarities in their tax regimes. South Africa has a mixed legal system, which includes civil law inherited from the Dutch, common law from the British, and customary law (Van der Merwe: 2012). The household savings rate in the United Kingdom peaked at 23.9% in the second quarter of 2020, which was the highest recorded throughout the period (De Querol Cumbrera: 2023). The proportion of adults in the UK that had adequate retirement savings increased in 2020 as adults over thirty years old were either saving a minimum of 12% of their income or had a defined benefit scheme to cover their main retirement income (De Querol Cumbrera: 2023). Therefore, the comparison of the two counties' tax systems is justified. This research describes the laws of the two countries in ways that enable the reader to understand how the two countries have resolved their tax design issues and what South Africa can adopt from the United Kingdom, which is an important objective in comparative tax law (Brooks: 2020).

Investments in qualifying venture capital companies enjoyed a tax deduction in terms of section 12J of the South African Income Tax Act, 58 of 1962, as amended (referred to as the "the Income Tax Act"). This investment was used increasingly over the years (Visser: 2018) The scheme was, however, in terms of the 2021 to 2022 Budget Review (National Treasury: 2021b), subject to a “sunset clause” that ended on 30 June 2021, and was not renewed. The scheme had been introduced to encourage investment in start-ups, small and medium enterprises (referred to as SMEs), and riskier investments that would help create jobs and stimulate economic growth, but the scheme was said not to have sufficiently achieved its objective and had rather provided significant tax deductions for wealthy taxpayers (National Treasury: 2021a). The United Kingdom offers relief to individuals investing in small businesses in the form of the Enterprise Investment Scheme, Seed Enterprise Investment Scheme, Social Investment Tax Relief and Venture Capital Trusts (Schedule 7 of the United Kingdom Finance Act, 14 of 2012, referred to as the “2012 United Kingdom Finance Act”). Investors can claim income tax relief on subscriptions of up to £200 000 for the Seed Enterprise Investment Scheme and Venture Capital Trusts, and up to £1 million for the Enterprise Investment Scheme and Social Investment Tax Relief (but not on new investments made on or after 6 April 2023). An additional relief is also applicable for the Enterprise Investment Scheme where investors can claim up to £2 million income tax relief if at least £1 million of that is invested in knowledge intensive companies. Capital gains tax relief is also applicable on 100% of the investment in the Enterprise Investment Scheme and the Social Investment Tax Relief and 50% of the investment in the Seed Enterprise Investment Scheme. For Venture Capital Trusts, the relief is only applicable when shares are sold.

In South Africa, individuals can invest in a savings account or a tax-free savings account. For a savings account, individuals under the age of 65 are granted an interest exemption of up to R23 800 per year of assessment, and those 65 years and older are granted a R34 500 interest exemption (section 10(1)(i) of the Income Tax Act). Amounts received in respect of financial instruments or long term insurance policies in terms of section 29A of the Income Tax Act, as provided in section 12T of the Income Tax Act, are exempt for investments of up to R36 000 per annum (previously R33 000), and up to a R500 000 lifetime limit. Penalties at the rate of 40% apply on excess contributions made by the investor (section 12T(7) of the Income Tax Act). In the United Kingdom, individuals may have a normal savings account using the individual savings account (referred to as “ISA”) allowance of up to £20 000 per year (HM Revenue and Customs: 2018). There is also a personal savings allowance (section 12B of the United Kingdom Income Tax Act, 3 of 2007, referred to as the “2007 United Kingdom Income Tax Act”). For individuals with taxable income of up to £17 570, interest is tax free up to £5 000, but the higher the taxable income of the taxpayer, the more the allowance is reduced (section 12(3) of the 2007 United Kingdom Income Tax Act). For every extra £1 earned by the taxpayer, the savings allowance is reduced by £1 so that the low income taxpayers benefit more from the allowance (section 12 of the 2007 United Kingdom Income Tax Act).

In South Africa, endowment policies are investment policies issued by long-term insurance companies in terms of the Long Term Insurance Act, 52 of 1998, where investors commit to a minimum investment period, after which the proceeds are tax free (PPS Investments: 2020)**.** In South Africa, no deduction can be claimed in respect of endowment policy contributions (section 23(r) of the Income Tax Act), and the proceeds are exempt from tax (section 10(1)(gH) of the Income Tax Act). In the United Kingdom, qualifying endowment policies are not subject to income tax, but under section 1(1) of the United Kingdom Taxation of Chargeable Gains Act, 12 of 1992, referred to as the "1992 United Kingdom Taxation of Chargeable Gains Act", the benefit paid out upon death, maturity, or sale or surrender, gives rise to capital gains tax at the applicable rate. The rate charged when the investor disposes of the endowment policy is 10% (section 1H of the 1992 United Kingdom Taxation of Chargeable Gains Act). For non-qualifying endowment policies, the proceeds are subject to income tax at the marginal rate for the high-rate taxpayers, and for basic rate taxpayers the proceeds are tax-free.

In South Africa, individuals can invest in retirement annuity funds, pension funds, and provident funds, and contributions to all retirement funds are deductible from taxable income, subject to limitations (section 11F of the Income Tax Act). One-third of the capital can be withdrawn on retirement and the lump sum is taxed at a beneficial rate. Any withdrawals from the retirement funds prior to the normal retirement age are taxed at a higher rate than would have applied if the withdrawal had been made at retirement age (Schedule 1 of the Rates and Monetary Amounts and Amendment of Revenue Laws Act, 22 of 2020). In the United Kingdom, pensions are tax free for withdrawals up to a maximum of 25%, thereafter the normal income tax rates apply (paragraphs 1 to 3A of Schedule 29 to the United Kingdom Finance Act, 12 of 2004 referred to as the "2004 United Kingdom Finance Act"). Individuals pay tax when their income amounts to more than their personal allowance. The standard personal allowance is £12 570 (section 35(1) of the United Kingdom Income Tax Act, 3 of 2007). Tax relief may be claimed by private pension contributors of up to 100% of their contributions to the fund (sections 188 and 190 of the 2004 United Kingdom Finance Act). Taxpayers get automatic relief for contributions if their employers deduct their pension contributions from their remuneration before deducting income tax, and if their income tax rate is 20%, the pension provider claims it from the Government as tax relief, and adds it to the taxpayer's pension savings, which is known as relief at source (section 192 of the 2004 United Kingdom Finance Act).

Section 10A of the South African Income Tax Act sets out the manner in which purchased annuities are taxed. The determination of the capital element of each annuity payment is prescribed by a formula which, in simple terms, spreads the annuity purchase price over the expectation of life of the annuitant using prescribed mortality tables. An exemption is provided for any annuity amount payable to a purchaser or his spouse or surviving spouse, or to the deceased or insolvent estate of such spouse or surviving spouse, as is determined in accordance with subsection (3) to represent the capital element of such amount (section 10A(2) of the Income Tax Act). In the United Kingdom, tax is charged on the annuity payments arising in the tax year, taking into account any tax deductions applicable to the taxpayer. No tax is charged under the scheme on the exempt capital element of the annuity (HM Revenue and Customs: 2021a).

In South Africa, shares issued by the employer to employees are usually taxed in terms of sections 8B and 8C of the Income Tax Act. Section 8B provides for a "broad-based employee share plan", where employees can participate in the scheme without tax consequences, except that any gain made from disposal of a qualifying equity share, or any right or interest in a qualifying equity share, that is disposed of by an individual within five years from the date of grant of the share is taxed as "remuneration" and included in the "gross income" of the individual for that year of assessment, unless the disposal is in exchange for another qualifying share, or on the death or insolvency of the employee. Section 8C provides for the taxation of shares issued to employees and directors by virtue of their employment. When the ownership of the shares vests immediately (ownership is unrestricted), or the ownership of the shares becomes unrestricted, any gains (the difference between the market value of the shares on the date of vesting and any consideration given for the shares) is deemed to be remuneration and taxed as income. Capital gains tax is levied on disposal of the shares, provided they are held for three years or more; shares held for speculative motives that are disposed of within three years after their acquisition are subject to normal income tax. In terms of paragraph 3(a) of the Eighth Schedule to the Income Tax Act, the capital gain is determined by the calculation of the difference between the proceeds of the sale or disposal (paragraph 35 of the Eighth Schedule to the Income Tax Act) and the base cost (paragraph 20 of the Eighth Schedule to the Income

Tax Act) of the shares disposed of. The capital gain, after the deduction of the annual exclusion of R40 000 in terms of paragraph 5 of the Eighth Schedule to the Income Tax Act (R300 000 in the case of death), is included in taxable income (in terms of section 26A of the Income Tax Act) at the rate of 40% (paragraph 10 of the Eighth Schedule to the Income Tax Act). The maximum effective tax rate for individuals on the capital gain is therefore 18%.

In the United Kingdom, there are workplace investment schemes known as Save As You Earn (referred to as "SAYE"), Share Incentive Plans (referred to as "SIP"), and workplace Individual Savings Accounts (referred to as "workplace ISAs") (Schedule 2 to the United Kingdom Income Tax (Earnings and Pensions) Act, 1 of 2003, referred to as the "2003 United Kingdom Income Tax (Earnings and Pensions) Act"). For SAYE schemes, bonuses are tax free, no income tax is charged on dividends on any shares owned by an employee and, unless invested in an ISA, the gains from selling shares are taxed (Schedule 3 to the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). SIP schemes exempt the employee from income tax if the shares stay in the scheme for more than 5 years (Schedule 2 to the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). ISAs exempt the employee from any tax on income or dividends on the shares they gain in the scheme.

In the United Kingdom, fixed interest securities (gilts and corporate bonds) are issued by the government or large corporations and are aimed at large insurance companies or retirees (Part I of Schedule 11 to the United Kingdom Finance Act, 21 of 1942, referred to as "the 1942 United Kingdom Finance Act"). The growth of the bond is tied to the current interest rate issued by the Bank of England. Fixed interest securities with redemption date on or after 1 January 1992, are exempt from capital gains tax under section 115 of the 1992 United Kingdom Taxation of Chargeable Gains Act. In South Africa, interest on retail savings bonds is subject to the annual interest exemption of R23 800 for individuals below the age of 65 and R34 500 for individuals aged 65 years and above (section 10(1)(i) of the Income Tax Act), while the capital repayment is tax free.

In the United Kingdom, community shares refer to the withdrawable share capital of co-operative and community benefit societies (Part 3 of the United Kingdom Social Investments (Accreditation of Social Impact Contractor) Regulations, 3066 of 2014, referred to as the "2014 United Kingdom Social Investments (Accreditation of Social Impact Contractor) Regulations"). Tax relief of up to 25% of the invested amount is provided for United Kingdom based taxpayers who invest in community shares. This is spread over 5 years, where individuals are allowed to claim 5% tax relief for each tax year for 5 years from the date of investment. All shareholders can apply formally for tax relief under the Seed Enterprise Investment Scheme, which will enable them to claim relief against their income tax and capital gains tax (Part 3 of the 2014 United Kingdom Social Investments (Accreditation of Social Impact Contractor) Regulations). There is no similar investment incentive in South Africa.

This study seeks to answer the following question: Are there any investment incentive measures for individuals in United Kingdom tax legislation that could provide recommendations to be incorporated into South African tax legislation to encourage investment?

1.2 LITERATURE REVIEW

Calitz *et al* (2013) published a paper on the application of tax incentives to stimulate investment in South Africa. The purpose of the paper was to provide a potential framework and methodology for analysing the effect of tax incentives in South Africa. The authors reported that in some countries, tax incentives have been introduced the adverse tax effects on investments, and in others, they are implemented to keep up with the competition for international investments. They argued that the impact of a tax incentive on the output of a targeted industry will depend on the production function, supply of and demand for factors of production, demand for the output, and the reduction in the cost of the capital from the incentive. They explained that tax incentives lower the cost of the capital and as a result, lower the price of the output, but the accuracy of this depends on the industry in which the incentive is provided. They suggested that an alternative approach to analysing the effect of tax incentives is the general equilibrium model that focuses on changes in tax rates to affect consumption and production, considering assumed resource constraints. They also suggested a corporate tax deduction as an alternative to tax incentives, as a decrease in corporate tax may reduce the cost of capital.

Fallon and Pereira Da Silva (1994) carried out research on aspects of South African economy, which was published by the World Bank as part of its informal series of discussion papers on the South African economy. The research examined the challenge of promoting equity and sustainable growth of the economy using an econometric model developed by the World Bank staff. A broad conclusion was made that there needs to be "greater complementarity between a revival of public and private investment to place the economy on a sustainable growth path" (Fallon and Pereira Da Silva, 1994: 116). An increase in private investments will stimulate demand and supply and lead to growth of the economy. A healthy climate for private investment is essential (Fallon and Pereira Da Silva: 1994). The authors claim that South Africa's considerable economic potential can be achieved only if the right policy mix is conceptualised. Therefore, there is a need for tax incentives to be adopted to encourage both domestic and foreign investment in the country.

Jeffrey (2016) published an article on South Africa's need to attract domestic and foreign investment for economic growth. The article examined concerns regarding declining investment, particularly foreign direct investment, and the changes required to reverse these trends. It is important to attract foreign direct investment because without improved economic growth, the government will not achieve its objectives of reducing inequality, poverty, and unemployment. Jeffrey explained that the population of the country is growing, while the level of unemployment is also growing. To increase the country's growth potential, investment has to be primarily generated internally. Jeffrey listed a number of changes or improvements necessary to build and sustain the economy, *inter alia,* as follows:

- restrictive legislation that leads to inefficiencies and low productivity must be withdrawn;
- legislation promoting both domestic and foreign investment must be encouraged rather than discouraged;
- the country's infrastructure must be enhanced to support growth; and
- South Africa's goods-producing, mining, manufacturing, agricultural and agricultural processing industries, and its primary and downstream industries must be developed.

Thus promoting investment and the growth of small and medium enterprises by providing incentives to invest in these enterprises, is essential. Jeffrey (2016) concluded that a number of policies may be well intended but defeat the essence of future growth of the economy and development of the country, and that the recommendations listed above are necessary to achieve growth and development. Jeffrey cited high economic growth as the fastest way to resolve the economic and social problems in the country, as it is the best and most effective way of reducing inequality and unemployment, while raising the standard of living in a sustainable way. Jeffrey confirmed that, therefore, tax incentives are some of the policy changes that could contribute to the growth of the economy. He also emphasised that the government, businesses and individuals should recognise their obligations and work towards the economic goal.

Elmerraji (2019), in an article, explained how savings are "saving" the United States economy. He stated that maintaining solid savings at both a personal and national level is also important to avoid economic distress, debts and the collapse of the economy. Elmerraji also pointed out that individuals need to invest in order to take responsibility for their income after retirement. With regard to individual savings, Elmerraji expressed the opinion that having a higher portion of income allocated to savings means that living expenses will be lower and this increases the ability to cope with financial hardships, and in times of need, the individuals will still manage to pay for things such as utility bills, mortgage bonds and their daily living expenses, which relieves the government from having to provide for them.

In an article by Visser (2018), he discussed whether tax implications should influence investment decisions. Visser explained that venture capital companies are a marketing vehicle to attract investors who qualify to invest in these companies, and also bring together investment expertise in favour of the small business sector. Visser pointed out that the easiest way for first time savers to save is through a savings account, nevertheless the tax-free investments are still underutilised by individuals who are not of high net worth, and only a small percentage of the population of South Africa utilises the tax-free incentives available. Visser claimed that the lack of sufficient tax incentives is often used as an excuse by South Africans who are not willing to save. Visser continued that implementing additional tax incentives will make a positive contribution towards the discipline of individuals to save. Visser concluded that the tax-free thresholds offered in South Africa are not that attractive to individuals of high net worth, even though they may seem attractive and generous to the average man on the street.

The personal savings rate in South Africa averaged at 4,58% from 1960 to 2021 (Trading Economics: 2022). The highest it has been, was 23,8% in the second quarter of 1972, and the lowest was -2,5% in the fourth quarter of 2013. The Chief Executive Officer (referred to as the CEO) of the South African Savings Institute stated that savings are low due to a lack of sufficient tax incentives, and that he is convinced that if more tax breaks and allowances were offered to the public to save, the savings rate would increase (Visser: 2018). However, Visser reported that the CEO of the South African Institute of Taxation (referred to as SAIT) claimed that the incentive instruments for savings were not the problem, and he referred to capital gains tax as being too high, considering that the inflation rate is around 5%, while capital gains tax for individuals is 18%. Visser concluded that the impact of inflation on savings is seldom considered, and also noted that the venture capital company investments had been increasingly used over the years the incentive was applicable.

Rossouw (2018), in explaining how to earn higher investment returns and pay less tax, stated that tax has a significant impact on investment returns, and therefore it is important to understand the tax advantages of different types of investment. Rossouw described retirement funds as a "winner" on the tax front, in view of their excellent tax benefits.

The research referred to in this limited literature review confirms the need to encourage investment and promote policies with this aim.

1.3 GOALS OF THE RESEARCH

The main goal of this research is to determine whether there are any tax incentives for individuals offered in the United Kingdom that can be adopted in South Africa to encourage investments. The sub-goals of the research are as follows:

- Discuss the selected investments offered in South Africa, how the investments are taxed, and tax incentives provided to encourage investment.
- Discuss investments offered in the United Kingdom, how they are taxed, and tax incentives provided to encourage investment.
- Identify any incentive measures adopted in the United Kingdom that could be used in South Africa to encourage investment.
- Recommend investment incentive measures that could be adopted in South Africa.

1.4 METHODS, PROCEDURES, TECHNIQUES AND ETHICAL CONSIDERATIONS

An interpretative paradigm was adopted for this research. Interpretivism is inductive and subjective, and sees reality as a construct of the human mind created through shared cultural and social practices and a shared belief system (Collis and Hussey: 2014). An interpretative approach is resourceful in understanding and describing data (Babbie and Mouton, 2008). An interpretive research strategy is therefore qualitative. A doctrinal research methodology was adopted for the research. This research methodology provides a comprehensive analysis of rules governing a particular legal category, and the relationship among the rules (Botha: 2005). The method is a form of statutory interpretation that goes beyond an analysis of the literal text that has been used to construct legislation, and considers the wider context within which statutory provisions exist (Du Plessis: 2002). Comparative law, which compares the legal systems of different countries, and possibly also a comparative analysis of the law over time, falls into this research methodology (Botha: 2005). This thesis analyses the legislative provisions in South Africa and the United Kingdom relating to tax incentives to promote investment by individuals. Information is also obtained from secondary sources such as textbooks and articles written on investments and taxes.

As a doctrinal research methodology is applied, together with a qualitative methodology, the credibility of the research is promoted by:

- placing evidential weight on legislation and the writings of acknowledged experts in the field;
- discussing opposing viewpoints and concluding, based on credible evidence; and
- the rigour of the arguments.

As the documents to be used for the research are all publicly available, no ethical considerations arise in relation to their use. No application for ethical clearance has therefore been submitted using the Rhodes University Ethical Review Application System.

1.5 CHAPTER OVERVIEW

Chapter two of this research discusses the investments that are offered in South Africa in more detail, how these investments are taxed, and the tax incentives available.

Chapter three discusses investments that are offered in the United Kingdom, how these investments are taxed, and the tax incentives available, in order to identify investment incentive measures that could provide recommendations to be incorporated into South African tax legislation.

Chapter four compares the tax rates and incentives offered in South Africa and the United Kingdom.

In the final chapter the goals of the research are linked to the discussion in each chapter. The comparison between the tax incentives in South Africa and the United Kingdom is briefly presented. Policy recommendations are made for measures that could be adopted in South Africa. Limitations of the study are identified and a suggestion is made for further research.

CHAPTER TWO: INVESTMENTS AND TAX INCENTIVES OFFERED IN SOUTH AFRICA

2.1 INTRODUCTION

This chapter focuses on the first goal of the research, which is to discuss the selected investments offered in South Africa, how the investments are taxed, and tax incentives provided to encourage investment by individuals. This discussion includes the venture capital scheme, tax-free investments, retirement investments, endowment policies, purchased annuities, workplace investments and retail savings bonds. Each type of investment is defined and briefly discussed, and the tax incentives available to encourage investment by individuals are highlighted.

2.2 VENTURE CAPITAL COMPANY INVESTMENTS

The government introduced the incentive for venture capital companies to assist with the growth of small to medium sized businesses and junior mining companies by providing equity finance (Visser: 2018). Venture capital companies attracted investments. In the 2020 to 2021 financial years, R11,5 billion had been invested in venture capital companies, which was tax deductible for the investors (National Treasury: 2021b). Venture capital companies also bring together investment in favour of the small business sector. However, the venture capital company regime was subject to a “sunset” clause that ended on 30 June 2021, but no measures were taken to extend it, and it lapsed (National Treasury: 2021b). The lack of access to equity finance is the main challenge faced by small and medium sized businesses and junior mining companies, and the provisions of section 12J of the Income Tax Act therefore offered a tax advantage for investors that helped to generate equity finance for these companies.

A venture capital company was a company approved by the Commissioner for the South African Revenue Service (referred to as SARS) in terms of section 12J(5) of the Income Tax Act, and in respect of which approval had not been withdrawn in terms of section 12J(6) or (6A) of the Income Tax Act. Venture capital companies look for businesses with high growth potential and buy shares in the business with the expectation of receiving high returns on their investments (Visser: 2018). Venture capital shares are equity shares held by taxpayers in a venture capital company issued to the taxpayer by the venture capital company (section 38(1)(g) of the Taxation Laws Amendment Act, 24 of 2011). Hybrid equity instruments and third party backed shares are not eligible (section 12J(1) of the Income Tax Act). Section 8E(1) of the income Tax Act defines a hybrid instrument as follows:

> (a) any redeemable preference share which the relevant company is obliged to redeem in whole or in part within a period of three years from the date of issue thereof, or which may at the option of the holder be redeemed in whole or in part within the said period, or in respect of which the holder has a right of disposal which may be exercised within the said period.

Individuals who invested in qualifying venture capital companies from 1 January 2009 could claim a full tax deduction for amounts invested (section 12J(2) of the Income Tax Act). For example, if an individual earned R2 million taxable income in the 2021 year of assessment, the tax on the taxable income would be R749 679 ([R2 000 000 – R1 577 300] x 45% + R559 464). If the individual invested R1 million in a venture capital company, that amount would be subtracted from the R2 million taxable income, according to section 12J of the Income Tax Act. In that case the tax would only be calculated on the remaining R1 million and at 2021 tax rates, the tax would be R322 771 ([R1 000 000 – R744 800] + R218 139 x 41%]. This represents a substantial tax saving. However, there is no capital gains tax relief on the disposal of the venture capital shares, or capital gains reinvestment relief when reinvesting proceeds of any venture capital shares sold, or capital loss relief against income (SARS:2020). Dividends paid to investors by the venture capital companies are subject to dividends tax (SARS:2020).

From 21 July 2019, investments made by natural persons and trusts could only be deducted up to a maximum of R2,5 million, and for companies, a maximum of R5 million was allowed (section 12J(3C) of the Income Tax Act). If the venture capital company shares were held for longer than five years, the deduction would not be subject to recoupment (section 12J(9) of the Income Tax Act).

In terms of sub paragraph (g) of the definition of the definition of "qualifying company" in section 12J(1) of the Income Tax Act, for a company to qualify as a venture capital company, "no person who holds a share in a venture capital company to whom that company has issued any share holds, directly or indirectly and whether alone or together with any connected person in relation to that person, more than 50 per cent of the participation rights, as defined in section 9D(1), or of the voting rights in that company."

Investments made after 30 June 2021 did not qualify for the incentive (section 12J(11) of the Income Tax Act). Since the expiry of the section 12J incentive, share investments in venture capital companies are now being treated as an expenditure of a capital nature as they were before the introduction of the incentive (National Treasury: 2008). As such, these investments are not deductible from income by the shareholder.

2.3 TAX-FREE INVESTMENTS

As household savings have been declining steadily in South Africa since the 1980s and continue to be low, tax-free savings were implemented as an incentive to increase the household savings rate (National Treasury: 2014). Tax-free investments are financial instruments or policies as defined in section 12T(1) of the Income Tax Act, administered by a person or entity designated by the Minister in the *Gazette*, owned by a natural person or deceased or insolvent estate of a natural person (deemed to be the same person as the natural person in respect of the contributions made), in compliance with the Regulations given by the Minister. According to the Regulations (Notice 308 of 2017 issued by the Minister of Finance) in terms of section 12T of the Income Tax Act, in respect of *Persons or Entities that may Administer Financial Instruments or Policies as Tax-Free Investments*, a bank, mutual bank, co-operative bank, long term insurer, manager of a collective investment scheme, the government, an authorised user as defined in the Financial Markets Act, and an administrative service provider, may administer financial instruments or policies as a tax-free investment for the purpose of section 12T of the Income Tax Act.

In terms of section 12T(2), amounts received by or accrued to a natural person, or the deceased or insolvent estate of a natural person, on the tax-free investment are exempt from normal tax. Further, when calculating the aggregate capital gain or loss of the investor, gains and losses from the disposal of tax-free investments are disregarded (section 12T(3) of the Income Tax Act). A dividend withholding tax at the rate of 20% is deducted by companies paying dividends to investors (section 64E(1)(a) of the Income Tax Act). Section 64F(1)(o), however, exempts dividends paid in respect of tax-free investments as contemplated in section 12T(1), from the withholding tax.

There is a penalty for contributions exceeding the limits (section 12T(4) of the Income Tax Act). If an investor contributes an amount in excess, presently, of R36 000 towards tax-free investments during any year of assessment, 40% of the excess contribution will be deemed to be an amount of normal tax payable by the investor in respect of that year of assessment (section 12T(7)(a) of the Income Tax Act). If an investor contributes in excess of the amount of R500 000 towards tax-free investments in aggregate, 40% of the excess contribution, which has not previously been taken into account in respect of the penalty, will be the amount of normal tax payable by the investor in respect of the year of assessment in which the excess contribution was made (section 12T(7)(b) of the Income Tax Act). Transfers of amounts in respect of tax-free investments to other tax-free investments of the same person, or amounts received by or accrued from a tax-free investment, are not considered in determining whether the investor contributed in excess of the R36 000 per annum or R500 000 in aggregate to the tax-free investment (section 12T(6) of the Income Tax Act).

Regulation 309 (2017) in terms of section 12T(8) of the Income Tax Act on the *Requirements for Tax-Free Investments*, provides further requirements regarding the composition of tax-free investments and it reads as follows:

> A derivative instrument in respect of the tax-free investment may be used as an asset underlying the tax-free investment to reduce risk of loss or reduce cost but without increasing the risk of loss (regulation 14 of the Regulations in terms of section 12T(8) of the Income Tax Act). Tax-free investments cannot be used as accounts where debit orders, stop orders, payments, withdrawals may be made (regulation 15 of the Regulations in terms of section 12T(8) of the Income Tax Act). Policies in respect of which tax-free savings investment are comprised may not provide for any cover against the occurrence of unforeseen events such as disability, illness, or death (regulation 15 of the Regulations in terms of section 12T(8) of the Income Tax Act).

The actual interest exemption provided for in section 12T can be criticised on the basis that it does not provide a real incentive. For example, if it is assumed that interest on the tax-free investment will amount to 7% per year, on an investment of R36 000, this will amount to only

R2 520. Only once the interest on the annually invested amounts of R36 000 by a person under the age of 65, is more than R23 800 (the interest exemption in terms of section 10(1)(i) of the Income Tax Act – see below), is the tax-free investment an incentive. To achieve the threshold of R23 800 would require a total investment of R340 000 (R23 800/0,07), thus annual investments of R36 000 for almost ten years).

The dividend exemption, however, provides an exemption of 20% that would not be available on dividends declared on other shares. Similarly, the exclusion from capital gains tax on the disposal of tax-free investments would not be available for other investments.

2.4 OTHER INTEREST-BEARING INVESTMENTS

Section 10(1)(i) exempts interest amounting to R23 800 a year on other interest-bearing investments, such as fixed deposits or savings accounts, for individuals who are not 65 years and older, and for those over the age of 65, up to R34 500. Tax is payable according to the tax table, on the taxable income, after deduction of the interest exemption. The incentive existed before the introduction of section 12T and was retained at current nominal levels, to be eroded in value by inflation over time (National Treasury: 2014).

From 2000, tax-free interest income thresholds were actively used as a tax measure to encourage investment (National Treasury: 2014). Tax-free interest thresholds were implemented as an incentive to increase the household savings rate, but the household savings rate continues to be low. The interest exemption has not been a highly visible feature of the tax system, limiting its effectiveness as an incentive (National Treasury: 2014). Given the expenditure incurred in offering incentives to the public, government must consistently assess the effectiveness of such policies in achieving the intended objectives and adjust these incentives if more effective options are available (National Treasury: 2014).

2.5 RETIREMENT FUND INVESTMENTS

In South Africa, individuals can invest in various retirement funds, comprising retirement annuities, pension funds and provident funds. The tax incentives for retirement funds were introduced to encourage South Africans to save for retirement to reduce vulnerability in old age (National Treasury: 2013). These tax incentives aim to encourage individuals to save towards achieving an adequate level of retirement income (National Treasury: 2013).

Contributions to all retirement funds, limited as provided for in section 11F(2), are deductible from the investor's taxable income (section 11F of the Income Tax Act). Notwithstanding the provisions of section 23(g) of the Income Tax Act (which provides that deductions are not allowed in the determination of taxable income, to the extent that the expenses are not incurred in the production of income from carrying on a trade), contributions made to the investor's pension fund, provident fund or retirement annuity in terms of the rules of that fund are deducted from the investor's pre-tax income, which lowers the tax payable (section 11F(1) of the Income Tax Act). Section 11F(2) of the Income Tax Act provides that the total deduction allowed for each year of assessment must not exceed:

(a) R350 000;

(b) 27,5% of the higher of the person's

- (i) remuneration (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as defined in paragraph 1 of the Fourth Schedule; or
- (ii) taxable income (other than in respect of any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and severance benefit) as determined before any deduction under this section and section 6*quat* (1C) and 18A; or

(c) the taxable income (other than in respect of any retirement fund lump sum benefit and severance benefit) of that person before

- (i) allowing any deduction under this section and sections 6*quat*(1C) and 18A; and
- (ii) the inclusion of any taxable capital gain.

Paragraph 1 of the Fourth Schedule to the Income Tax Act defines remuneration as "any amount of income that is paid or is payable to any person by way of salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, pension, superannuation allowance, retiring allowance or stipend, whether in cash or otherwise, and whether or not in respect of services rendered."

In terms of section 11F(3) of the Income Tax Act, amounts contributed to pension funds, provident funds or retirement annuity funds that have been disallowed as a deduction in the previous year of assessment solely by reason of being in excess of the allowed amount, are deemed to be amounts contributed in the current tax year for deduction purposes, unless the amount:

- has been allowed as a deduction in another year of assessment;
- was accounted for under paragraph 5(1)(a) of the Second Schedule (which deals with the deduction from the lump sum received from a pension fund, pension preservation fund, provident fund, provident preservation fund, or retirement fund upon death or termination of employment, where the investor was previously a member the funds of amounts equal to the contributions to pension funds, provident funds and retirement annuity funds that did not rank for deduction in terms of section 11F);
- was accounted for under 6(1)(b)(i) of the Second Schedule (which deals with the deduction to be allowed from the lump sum received for amounts equal to retirement contributions that did not rank for deduction in terms of section 11F where there was a termination of employment, or the amount was assigned in terms of a divorce order granted after 13 September 2007, and where the investor was previously a member of the pension fund, pension preservation fund, provident fund, provident preservation fund, or retirement annuity fund); or
- was taken into account in determining the amounts exempt under section 10C (which deals with the exemption in respect of qualifying annuities of the non-deductible portion of contributions to the funds).

The section 11F deduction is available for contributions made to retirement funds, notwithstanding section 23(g), which prohibits the deduction of amounts to the extent that they were not laid out for the purpose of trade. The amounts must have been contributed to pension funds, provident funds or retirement annuity in terms of the rules of the fund (section 11F of the Income Tax Act).

Paragraph (i) of the definition of "gross income" in section 1 of the Income Tax Act includes in "gross income" the cash equivalent of the value of any benefit or advantage granted in respect of employment or to the holder of any office, as determined in terms of the Seventh Schedule to the Income Tax Act. Paragraph 2 of the Seventh Schedule to the Income Tax Act provides as follows:

> For the purposes of this Schedule and of paragraph (*i*) of the definition of "gross income" in section 1 of this Act, a taxable benefit shall be deemed to have been granted by an employer to his employee in respect of the employee's employment with the employer, if as a benefit or advantage of or by virtue of such employment or as a reward for services rendered or to be rendered by the employee to the employer.

Paragraph 2(l) of the of the Seventh Schedule to the Income Tax Act provides that contributions made for the benefit of the employee to any pension fund or provident fund shall be included in the gross income of the employee. Paragraph 13(1) of the Seventh Schedule to the Income Tax Act provides that the cash equivalent of the value of the taxable benefit derived by reason of payment of an amount by the employer releasing the employee from the obligation to pay such amount shall be the amount added to the employee's gross income. The amount contributed on behalf of the employee, is deductible from the employee's taxable income in terms of section 11F of the Income Tax Act, which provides for the deduction of all contributions made to retirement funds.

The special tax rates applying to retirement fund lump sums from 1 March 2023 to 29 February 2024 provide for a tax-free lifetime amount of R550 000, and a maximum tax rate of 36% on lump sums in excess of R1 089 000 (Schedule 9 to the Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2023). All lump sum benefits received by persons retiring from a retirement fund, or as a consequence of death, or as a "severance benefit", are taxed on a cumulative basis (Schedule 9 to the Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2023). This special tax table also applies to "severance benefits" received from an employer. As these are not a form of investment they are not relevant in this study.

The incentive provided by the tax table applying to lump-sum benefits from retirement funds is as shown in the following example:

If a sixty-five-year-old taxpayer earns taxable income amounting to R600 000 in the form of a salary for the 2023 year of assessment, the normal tax that will be levied will be:
R152 867 [R121 475 + (R600 000 – 512 800) x 36%], less the primary and secondary rebates (section 6) of R26 679 = R126 188.

By contrast, the tax on a retirement lump sum benefit of R600 000 paid by a retirement annuity fund is R50 000 (R600 000, less the tax-free amount of R550 000) x 18% = R9 000.

This tax saving of R117 188 as a result of the favourable tax rate incentive, is considerable.

In addition to the benefit of reducing a taxpayer's taxable income by contributing to a retirement fund, a retirement fund is not a "person" as defined in section 1 of the Income Tax Act, and tax is only levied on "persons" as defined. Therefore, the benefit accruing to the taxpayer from the fund is not reduced by any tax levied on the earnings of a retirement fund.

Beneficiaries are allowed to withdraw a lump sum of up to one-third of their retirement interest in the fund, unless the entire value of their pension is less than R247 500 (2023 year of assessment), in which case they may withdraw the whole amount in full as a lump sum (National Treasury: 2023). Any withdrawals from retirement funds prior to retirement are taxed at a higher rate than what would have been if the withdrawal had been made at retirement age (Rossouw: 2018). As from 1 March 2021, two-thirds of a m/ember's retirement interest in all retirement funds is subject to annuitisation (and, in the case of a provident funds, apportioned to ensure that contributions made prior to 1 March 2021 and the growth thereon may be paid out as a lump sum) (National Treasury: 2021a). The annuity payments are included in "gross income" in terms of paragraph (a) of the definition and are subject to tax according to the normal tax rates applying to the taxable income of individuals, other than lump-sum benefits from retirement funds (section 1 of the Income Tax Act).

The deduction of contributions from individuals' taxable income before tax is an effective incentive. However, the maximum annual tax deduction of R350 000 might not be attractive to individuals of high net worth. The lower tax rates applicable to lump sums also look good on paper but they have not been able to attract investments, therefore, the rates and incentives could be improved to encourage investment (South African Reserve Bank: 2021).

2.6 ENDOWMENT POLICIES

According to the decision in *Mangul v Old Mutual Life Insurance Co SA Ltd*, 2010 (6) SA 98 (SCA), the nature of an endowment policy is that, in return for a premium, an insurer undertakes to pay to the policyholder a sum of money on a fixed date in the future, or a sum of money (not necessarily the same amount) upon death of the life assured. In South Africa, endowment policies are contracts in which investors commit to a minimum investment period of five years, after which the proceeds are paid out tax free (*Old Mutual Life Insurance Co. SA. Ltd v Pension Fund Adjudicator and Others*, (7248/06) [2008] ZAKZHC 76). National Treasury (2014) explained that endowment policies were also introduced as an alternative non-retirement savings tax incentive to increase the household savings rate.

Premiums paid to the insurance company in respect of an endowment policy are not deductible (section 23(r) of the Income Tax Act, which prohibits the deduction of premiums paid on insurance policies that cover the person against illness, injury, disability, unemployment, or death – thus long-term policies), but the lump-sum receipt is exempt from tax in terms of section 10(1)(gH). Haldane (2020) explains that the investments can either be made in form of a lump sum or recurring contributions, and that the minimum investment period of five years encourages discipline because the investors, to avoid penalties, will not withdraw from the fund. According to Haldane, during the five-year restriction period, only one withdrawal is allowed and the withdrawal may be subject to a penalty, but after the first five years of the investment, withdrawals can be made from the fund at any time with no tax implications.

Endowment policies are taxed in the hands of the insurance company according to the five-fund approach (section 29A(3) of the Income Tax Act). The five-fund approach establishes different pools of funds: the untaxed policyholder fund, individual policyholder fund, company policyholder fund, corporate fund, and a risk policy fund. The taxable income derived by an insurer in respect of any year of assessment commencing on 1 January 2000, is determined in accordance with the provisions of the Income Tax Act, but subject to the provisions of sections 29A and 29B (section 29A(2) of the Income Act). Section 29A(10) of the Income Tax Act provides that the taxable income derived by an insurer in respect of the individual policyholder fund, company policyholder fund, corporate fund, and its risk policy fund, shall be determined separately according to the provisions of the Income Tax Act as if the fund had been a separate taxpayer. Endowment policies forming part of the individual policyholder fund are taxed at a flat rate of 30% in the hands of the insurer/policy fund, and capital gains are taxed at the rate of 12% (paragraph 3(d)(i) of Schedule 1 to the Rates and Monetary Amounts and Amendment of Revenue Laws Act, 22 of 2020).

This incentive may therefore benefit individuals with marginal tax rates above 30%, but does not benefit individuals with marginal tax rates below 30%. It is therefore clear that, if the intention of the government is to encourage savings by middle-income and lower-income bracket individuals, endowment policies are unlikely to have much of an impact in increasing household savings.

2.7 PURCHASED ANNUITIES

Purchased annuities are obtained by entering into a contract with an insurer, in terms of which the insurer agrees to pay the purchaser or the purchaser's spouse or surviving spouse an annuity or annuities until the death of the annuitant, or expiry of the specified term (section 10A(1) of the Income Tax Act). The purchaser makes a lump sum payment in return for an income for the rest of the purchaser's life or until the expiry of the specified term (section 10A(1) of the Income Tax Act). This lump sum paid by the purchaser is not deductible for income tax purposes. No amounts are payable to the purchaser by the insurer, other than the amounts payable in form of an annuity, or annuities, except where either the annuitant has died or the term of the annuity has ended and the amount becomes payable to a third party by way of such annuity (section 10A(1) of the Income Tax Act).

The capital element of any annuity amount payable to a purchaser or his or her spouse or surviving spouse, or to the deceased or insolvent estate of such spouse or surviving spouse is determined in accordance with subsection (3) (section 10A(2) of the Income Tax Act). Annuity income in respect of a purchased annuity is only partially taxable in the hands of the individual investor, as the capital element of the annuity is exempt and only the balance of the annuity amount is taxed. The determination of the capital element of each annuity payment is prescribed by a formula set out in section 10A(3), which, in simple terms, spreads the annuity purchase price over the expectation of life of the annuitant using prescribed mortality tables, or the term of the policy. Once the capital element is set, it remains at the same level irrespective of how long the annuitant lives (section 10A(3) of the Income Tax Act). Tax is charged on the taxable portion of the annuity payments according to the normal tax tables.

The statutory actuary of the insurer will calculate the capital element of the annuity amount according to the contract before payment is made to the annuitant (section 10(4) of the Income

Tax Act). Annuitants should choose a level of income that is sustainable to avoid a rapid erosion of the capital invested. Upon death of the annuitant, the remaining capital is paid to the beneficiaries (section 10(2) of the Income Tax Act). Annuitants may have joint life annuities (section 10A(1) of the Income Tax Act). With this type of annuity, when the main annuitant dies, there will be a stream of income for the remaining annuitant(s).

It is not possible, in a thesis, to provide an example that would illustrate tax savings on this type of investment, as this requires actuarial assumptions of life expectancies, earnings rates, etc. The exemption of the capital element of a purchased annuity is, however, likely to provide a tax saving that would make this an effective instrument to encourage this type of investment. The value in promoting savings is the fact that the capital amount cannot be withdrawn, but is used to provide a stream of annuity income.

2.8 WORKPLACE INVESTMENTS

South Africa has two forms of workplace investments specifically for employees, in addition to contributing to retirement funds on their behalf. In South Africa, shares issued to employees fall under section 8B or section 8C of the Income Tax Act.

2.8.1 Broad-Based Employee Share Plans

Section 8B of the Income Tax Act provides for taxation of amounts derived from a *Broad-Based Employee Share Plan*. Section 8B(3) defines the plan and reads as follows:

> (3) For the purposes of this section—
>
> "broad-based employee share plan" of an employer means a plan in terms of which—
>
> (*a*) equity shares in that employer, or in a company that is an associated institution as defined in the Seventh Schedule in relation to the employer are acquired by employees of that employer;
>
> (*b*) employees who participate in any other equity scheme of that employer or of a company that is an associated institution as defined in the Seventh Schedule in relation to that employer are not entitled to participate and where at least 80 per cent of all other employees who are employed by that employer on a permanent

basis on the date of grant (and who have continuously been so employed on a full-time basis for at least one year) are entitled to participate;

(*c*) employees who acquire the equity shares as contemplated in paragraph (*a*) are entitled to all dividends and foreign dividends and full voting rights in relation to those equity shares;

In terms of paragraph (b) of the definition of "broad-based employee share plan" in section 8B(3), employees who participate in any other equity scheme of the employer are excluded, and at least 80% of all permanently employed employees (continuously employed on a full-time basis for at least a year) must be entitled to participate in the scheme.

In terms of section 8B(1) of the Income Tax Act, notwithstanding section 9C (which provides that the disposal of shares held for at least three years is a receipt or accrual of a capital nature), any gain made from the disposal of a qualifying equity share or any right or interest in a qualifying equity share disposed of by an individual within five years from the date of the grant of the share is taxed as "remuneration" and included in the "gross income" of the individual for that year of assessment, unless the disposal is in the following circumstances:

- in exchange for another qualifying share;
- on the death of the person; or
- on the insolvency of the person.

Employees' tax will be deducted by the employer from any taxable gain, as this constitutes "remuneration" as defined in sub-paragraph (d) of paragraph 1 of the Fourth Schedule to the Income Tax Act. Capital gains tax is charged on disposals of the shares after the five-year period.

Employers provide this incentive to give employees a stake in the company, but it also enables employers to provide employees with a meaningful tax incentive, as employees are able to acquire the shares for no payment, or at a cost below the market value of the shares (section 8B(3)(a) of the Income Tax Act). Employees who acquire the equity shares are entitled to all dividends and foreign dividends and have full voting rights in relation to those equity shares from the date of the grant (section 8B(3)(c)).

2.8.2 Vesting of Equity Instruments by Directors and Employees

Section 8C of the Income Tax Act deals with the taxation of directors and employees on the vesting of equity shares. Section 8C(1)(a) states that:

> … notwithstanding section 9C and section 23(*m*), a taxpayer must include in or deduct from his or her income for a year of assessment any gain or loss determined in terms of subsection (2) in respect of the vesting during that year of any equity instrument, if that equity instrument was acquired by that taxpayer … by virtue of his or her employment or office of director of any company.

When the ownership of the shares vests immediately (ownership is unrestricted), or the ownership of the shares becomes unrestricted, any gains (the difference between the market value of the shares on the date of vesting and any consideration given for the shares) will be deemed to be remuneration and taxed as income. Capital gains tax is chargeable upon disposal of the shares, if held for three years or more, and if they are held as trading stock for speculation purposes for less than three years, the proceeds are included in "gross income".

Employees' tax will be deducted by the employer from any taxable gain, as this constitutes "remuneration" as defined in sub-paragraph (e) of paragraph 1 of the Fourth Schedule to the Income Tax Act.

While section 8C does not provide a tax incentive as the vesting gains are taxed as income, it does provide employees with the opportunity to acquire shares.

2.9 RETAIL SAVINGS BONDS

In the document titled "*Fixed Rate Retail Savings Bonds, as amended*", National Treasury (2021c) explained that retail savings bonds were introduced in South Africa to encourage household savings, together with other tax-free interest provisions. National Treasury wanted a retail bond offering guaranteed returns, bought from as little as R1 000, with no commission, no involvement of a third party agent, and no fees payable in respect of the bond. National Treasury (2021c) explained further that the retail savings bonds were meant to stimulate economic empowerment by providing a safe alternative investment instrument, while delivering solid and dependable returns, and creating healthy competition between investment instruments in the marketplace for the benefit of individuals. Investments are made by individuals with the Government of South Africa and earn a fixed interest for the term of the investment. These fixed rate retail savings bonds have a two-year, three-year or five-year term, and they earn interest according to a market-related fixed interest rate on the investment National Treasury: 2021b). The minimum permitted investment amount is R1 000 and the maximum is R5 000 000, investors are offered a fixed rate until maturity, and different rates apply at the maturity stage (National Treasury: 2021b). Investors have an option to receive interest payments every six months or re-invest the interest, and investors aged sixty and above have the option to receive their interest monthly (National Treasury: 2021d).

The savings bonds are also available as inflation linked retail savings bonds National Treasury: 2021d). Inflation linked retail savings bonds run for the same term as the fixed interest savings bonds, however, the capital amounts invested are adjusted according to the inflation rate and interest is payable every six months (National Treasury: 2021d). The interest rates are derived from the Government Bond Yield Curve, which reflects the interest rates over the various terms at which marketable government bonds or securities are traded daily on the Johannesburg Stock Exchange (National Treasury: 2021d). The minimum amount that can be invested in inflation linked retail savings bonds is R1 000 and the maximum is R1 000 000 (National Treasury: 2021d), and there is also no option for investors to receive their interest payments monthly.

According to their document titled "*Fixed Rate Retail Savings Bonds, as amended*", National Treasury (2021d) explained that withdrawals are permitted after the first 12 months of the investment, interest ceases to accrue after the maturity date or on early withdrawal, and the capital amount is paid back to the investor or reinvested not less than 15 days before the maturity date. Each lump sum invested forms its own investment as it is not possible to add to an existing investment; therefore, no merging of investments is allowed, even when the individual is reinvesting (National Treasury: 2021d). All withdrawals are made according to the provisions available and investors are only allowed two early withdrawals per calendar year (National Treasury: 2021d). The transfer of the Retail Savings Bond to a third party is not permitted, except upon the death of the registered investor, beneficiaries can be nominated at the time of registration of the retail savings bond, and the beneficiary will be paid upon the death of the insured (National Treasury: 2021d). The maturity date will be the date that the bond issuer receives the death certificate of the investor, and where there is no nominated beneficiary, the payment will be made to the estate of the investor (National Treasury: 2021d).

In South Africa, interest on investment bonds is subject to the annual interest exemption of R23 800 for individuals below the age of 65, and R34 500 for individuals aged 65 years and older (section 10(1)(i) of the Income Tax Act). The capital investment is also exempt from capital gains tax. Tax is levied at the normal rates on the interest, after the exemption is deducted. As confirmed in the document titled "*Fixed Rate Retail Savings Bonds, as amended*" (National Treasury: 2021d), all payments made to the investor in respect of retail savings bonds are made without deductions for, or on account of taxes imposed or levied on the amount, unless such withholding is required by the law; in such cases the bond provider pays the withholding tax and pays the net amount to the investor.

The savings bonds have, however, not proven to be effective in increasing household savings, as household savings remain low (South African Reserve Bank: 2021).

2.10 CONCLUSION

The following table summarises the tax rates and incentives applicable for the types of investments discussed in this chapter, that are available to individuals in South Africa.

Table 2.1: Summary of the tax rates and incentives for South African investments

Type of Investment	Tax	Incentives Applicable
Venture Capital Scheme	Capital gains tax is payable on disposal of the venture capital shares. Dividends paid to investors by the venture capital companies are subject to dividends tax.	Full deduction of the amount invested in a venture capital company before 21 July 2019 and up to a maximum of R2,5 million for investments made by natural persons and trusts and a maximum of R5 million for companies from 21 July 2019 to 30 June 2021.
Tax-Free Investments	Tax penalty at 40% for excess contributions.	No tax on interest, dividends or capital gains, below the threshold investment. The annual threshold for contribution is R36 000 and the lifetime threshold is R500 000.A 40% penalty is levied on the excess contribution that has not previously been taken into account.
Other Interest-bearing Investments	Tax is payable according to the tax tables, after deducting the interest exemption.	Exemptions are provided amounting to R23 800 for individuals below the age of 65 or R34 500 for individuals aged 65 and above.
Retirement Investments	Tax is payable on lump-sums and annuities at the prescribed rates.	Contributions are deducted from pre-tax salary, reducing the tax payable. The tax on lump-sum amounts received, *inter alia*, on retirement is levied at a maximum rate to 36%, after the tax-fee amount of R550 000 is deducted.
Endowment policies	Tax is paid by the insurer on all interest at a standard rate of 30%; capital gains tax is charged at 12%; dividends are taxed at 20%.	The tax rates paid by the insurer ensure a higher capital repayment than if individuals paying tax at a rate in excess of 30% had invested in other instruments.
Purchased Annuities	Tax is charged on the taxable portion of the annuity payments, according to the normal tax tables.	The capital element of the annuity is exempt from tax.

Type of Investment	Tax	Incentives Applicable
Workplace Investments – share investment schemes	Section 8B: gains on disposal of shares before the end of the five-year period are taxed as remuneration. Capital gains tax is charged on disposals of the shares after the five-year period. Section 8C: gains on the vesting of equity shares are taxed as remuneration. If disposed of within three years of vesting, gains are taxed as income if the shares are held for speculative purposes; otherwise gains are subject to capital gains tax.	Section 8B enables employees to acquire shares in the employer company at no or a low cost, and earn dividends on the shares from the date of the grant. Section 8C provides no tax incentive.
Retail savings bonds	Tax is levied at the normal rates on the interest, after the interest exemption is deducted. The capital investment is exempt from capital gains tax.	The annual interest exemption of R23 800 for individuals below 65 years and R34 500 for individuals aged 65 years and older applies.

Source: Author's own summary

Based on the analysis presented in this chapter, it appears that South Africa offers some investment opportunities and incentives for individuals. but this does not seem to have substantially increased the household savings rates.

The venture capital scheme in South Africa used to provide a tax incentive for investors with the necessary capital before it was discontinued. Investors that invested in qualifying companies were able to get a full tax deduction of the funds they had invested from 1 January 2009 to 21 July 2019, which was then capped at R2,5 million for trusts and individuals and R5 million for companies until 30 June 2021 when the provision was discontinued (SARS: 2022). The opportunity for Venture Capital Companies to provide funding to promote the growth of SMMEs is no longer available.

Individuals can invest in various forms of interest-bearing investments, where the interest is exempt from tax up to R23 800 per year of assessment for individuals who are not yet 65 years of age, and for those who are 65 years old and above, an exemption of up to R34 500. The interest and dividends on tax-free investments are fully exempt, up to the annual investment of R36 000, and a life-time maximum investment of R500 000. A penalty is charged at 40% on all amounts invested above these tax-free limits.

The proceeds from endowment policies are tax-free after maturity, which is usually after five years. Contributions made to endowment policies are not tax deductible, but the incentive for higher income individuals lies in the lower rates of tax paid by the insurer on the individual policy fund and the resulting increased capital repayment.

Contributions to retirement funds are deductible from income, up to a specified limit. Withdrawals from the retirement funds before retirement are taxed at the normal rate of tax, while lump sum amounts received on retirement or death are taxed at a favourable rate. This provides an important investment incentive for individuals to save for retirement.

Purchased annuities provide a tax advantage as the capital element of each annuity is exempt from tax.

Shares issued to employees in South Africa in terms of the section 8B Broad-Based Employee Share Scheme enable employees to acquire shares in their employer company at no or a very low cost, and earn dividends on the shares from the date of the grant of the shares. Shares acquired in terms of the section 8C Share Scheme convey no tax benefit, but enable directors and employees to acquire shares in their employer company.

Interest on Government Retail Savings Bonds in South Africa is subject to the annual tax-free interest exemption available on all interest-bearing investments. The conditions applying to these investment vehicles may make them attractive to individual investors.

The next chapter discusses investments that are offered in the United Kingdom and the tax incentives available, in order to identify investment incentive measures that could provide recommendations to be incorporated into South African tax legislation.

CHAPTER THREE: INVESTMENTS AND TAX INCENTIVES OFFERED IN THE UNITED KINGDOM

3.1 INTRODUCTION

This chapter focuses on the second goal of the research, which is to discuss the selected investments offered in United Kingdom, how the investments are taxed, and tax incentives provided to encourage investment. It describes the venture capital schemes, tax-free investments, retirement investments, endowment policies, purchased annuities, workplace investments and government bonds, as offered for individuals in the United Kingdom. The nature of each investment type is explained and applicable taxes, tax rates and incentives are discussed.

3.2 VENTURE CAPITAL SCHEMES

The United Kingdom offers various venture capital schemes to support the growth of small and medium size enterprises. Tax relief is available for individuals investing in certain companies, social enterprises, or venture capital trusts. There are four different venture capital schemes in the United Kingdom that offer tax relief to individuals to encourage investment in companies and social enterprises that are not listed or recognised on the stock exchange (Part 5 to 7 of the 2007 United Kingdom Income Tax Act). These schemes are the Enterprise Investment Scheme, the Seed Enterprise Investment Scheme, Social Investment Tax Relief, and Venture Capital Trusts. Investments can be made directly by individuals into a qualifying company using the venture capital scheme. Alternatively, individuals can invest in Venture Capital Trusts, which will invest the money in qualifying companies. Individuals can only invest from the age of 18 and above (Schedule 7 of the 2012 United Kingdom Finance Act).

Individuals who invest in a venture capital scheme are able to claim the various categories of tax relief (Parts 5 to 7 of the 2007 United Kingdom Income Tax Act):

- income tax relief against investments in qualifying companies or venture capital trusts;
- income tax relief on loans or debt financing to social enterprises;
- capital gains tax relief on gains from the investments; and

- capital gains tax relief when reinvesting previous capital gains in a scheme.

Tax relief can be claimed on investments in venture capital schemes in the tax year the investment is made, or the tax year before the investment is made, or it can be carried forward to future tax years. Relief can only be claimed against income tax paid in the United Kingdom (Parts 5 to 7 of the 2007 United Kingdom Income Tax Act).

3.2.1 The Enterprise Investment Scheme

The Enterprise Investment Scheme helps to raise money to grow businesses by offering tax relief to individuals buying new shares in a company that meets the prescribed requirements for the scheme (section 157(1) of the 2007 United Kingdom Income Tax Act). Companies can raise up to five million pounds per year or twelve million pounds in the company’s lifetime (section 173A). There is also a loss relief when enterprise investment scheme shares are sold at a loss (section 157). Investors selling their shares can choose to set off the loss against any income tax relief that would already have been granted against their income, either for the tax year in which the shares are sold or the previous tax year. Loss relief is realised on the investment by reducing the amount the investor needs to pay in form of a deduction of the loss against the investor’s marginal rate for capital gains tax (HM Revenue and Customs: 2014). The Enterprise Investment Scheme rules must be followed for investors to be able to claim tax relief relating to their investments (section 157(1)). The Enterprise Investment Scheme can only be used by companies that meet the following requirements:

- The Enterprise Investment Scheme only benefits companies within seven years of the first commercial sales by the companies (section 173A of the 2007 United Kingdom Income Tax Act).
- If no investments are received during the first seven years after the first commercial sale, money can still be raised if the company can prove that it wants to raise money for an activity that differs from the initial reason (section 173A).
- It must be proved that the funds are required for a completely new project and that will provide at least 50% of the company’s average annual turnover for five years or more (section 173A).

Tax relief is granted in the form of a 30% tax deduction from income in respect of investments into the companies of up to £1 million, or £2 million, if at least £1 million of that is invested in knowledge intensive companies. There is personal capital gains tax relief on 100% of the initial investment and the tax relief can be deferred to a future year (HM Treasury and HM Revenue and Customs: 2014). If an investor makes a claim to defer a gain, the gain may be charged to capital gains tax in a later year, usually when the shares are disposed of (HM Revenue and Customs: 2014). There is an exemption for capital gains tax on the sale of shares if income tax relief was received, and relief is also available for capital losses against income (HM Revenue and Customs: 2014). There is no tax relief on income from dividends.

3.2.2 Seed Enterprise Investment Scheme

The Seed Enterprise Investment Scheme is also designed to help to raise money for companies when starting their trade (section 257A of the 2007 United Kingdom Income Tax Act). This is done by offering tax relief to individual investors who buy new shares in the companies, provided the companies follow all the prescribed rules. The company can use the scheme if it carries out a new qualifying trade, is established in the UK, is not trading on a recognised stock exchange at the time of the share issue, has no arrangements to become a quoted company or a subsidiary of one at the time of the share issue, does not control another company unless that company is a qualifying subsidiary, has not been controlled by another company since the date of the company being incorporated, and the company and any of its subsidiaries may not have gross assets in excess of £350,000 when the shares are issued, may not be a member of a partnership, and may not have fewer than 25 full-time equivalent employees in total when the shares are issued (Part 5A of the 2007 United Kingdom Income Tax Act). Relief will be withheld or withdrawn if the rules are not followed for at least three years.

When individuals sell their assets and use the proceeds to invest in shares that qualify for the Seed Enterprise Investment Scheme, they do not have to pay capital gains tax, and they are also granted income tax relief for the investment (section 257AE of the 2007 United Kingdom Income Tax Act). This is called “reinvestment relief”. The asset for which the reinvestment tax relief is claimed must be sold in the same tax year, whether before or after the investment. Investors are granted a 50% income tax relief for their investment of up to £100 000; the maximum relief amount that can be claimed is therefore £50 000 (section 257AB).

There is also an exemption from capital gains tax on the sale of shares if income tax relief was received, and relief is also available for capital losses against income (HM Revenue and Customs: 2014). There is no tax relief on income from dividends (HM Revenue and Customs: 2014).

3.2.3 Social Investment Tax Relief

Social Investment Tax Relief is a State aid designed by the United Kingdom government to help raise money to support trading activities of community interest companies, community benefit societies, or charities (section 257J(1) of the 2007 United Kingdom Income Tax Act). The scheme does so by offering tax relief to investors for the shares they buy, or money they lend to enterprises, if the rules of the scheme are followed for three years (HM Revenue and Customs and HM Treasury: 2015). The funds raised must be used for a qualifying trade or in preparation for the qualifying trade in relation to community interest companies, community benefit societies, or charities (section 297 of the 2007 United Kingdom Income Tax Act).

Income tax relief is provided for investments that are made by an investor on his or her own behalf on or after 14 April 2014 and before 6 April 2023, if the conditions in Chapters 3 and 4 of the Act regarding personal reliefs and loss relief are met (section 257K of the 2007 United Kingdom Income Tax Act). Tax relief is provided by a deduction from income of 30% of the investment, up to a maximum of £1 million. Personal capital gains tax relief is available on 100% of the initial investment (HM Revenue and Customs and HM Treasury: 2015). If income tax relief was received, capital gains are exempt from capital gains tax when the shares are sold. Relief is also available for capital losses against income, except for loans (HM Revenue and Customs and HM Treasury: 2015). There is no tax relief on income from dividends.

Investments can be made in different companies through different schemes, but must be below the maximum amount allowed. Income tax relief cannot be claimed through social investment tax relief where the individual receives new shares or debt investments in a company in which the individual already holds shares, unless the shares were issued when the company was first formed or a compliance statement has been submitted for the shares containing a declaration that the company has met the requirements of the scheme and that it will continue to meet the requirements for the relevant period (section 257L of the 2007 United Kingdom Income Tax Act).

Social investment tax relief can only be claimed when the qualifying community interest companies, community benefit societies, or charities have been operating for at least four months, and not later than the fifth year after the self-assessment filing date for the tax year in which investments are made (section 257P of the 2007 United Kingdom Income Tax Act).

In the United Kingdom, there are community shares that also enjoy the benefits of the Social Investment Tax Relief (section 333 of the 2007 United Kingdom Income Tax Act). Community shares refer to the withdrawable share capital of co-operative and community benefit societies (Regulation 3 of the Social Investments (Accreditation of Social Impact Contractor) Regulation 3066 of 2014). All shareholders can apply formally for tax relief under the Seed Enterprise Investment Scheme, which will enable them to claim relief against their income tax and capital gains tax (Regulation 3 of the Social Investments (Accreditation of Social Impact Contractor) Regulation 3066 of 2014). Tax relief of up to 25% of the invested amount is provided for United Kingdom based taxpayers who invest in community shares. This is spread over 5 years, where individuals are allowed to claim 5% tax relief for each tax year for 5 years from the date of investment. According to section 335 of the 2007 United Kingdom Income Tax Act, the relevant tax years are the years into which investment falls and the subsequent four tax years. The investor must receive a tax relief certificate before relief can be claimed (section 348). Social Investment Tax Relief has was not extended in the United Kingdom and will only apply to investments made until 6 April 2023 (section 20 of the United Kingdom Finance Act, 26 of 2021, referred to as the “2021 United Kingdom Finance Act”).

3.2.4 Venture Capital Trusts

Venture Capital Trusts in the United Kingdom are defined as companies that subscribe for shares in or lend money to small unlisted businesses (section 259 of the 2007 United Kingdom Income Tax Act). Individuals invest by holding shares in the trusts (section 260(3)). The risk is diversified, as the trusts invest in a spread of small companies. Individual investors can claim 30% income tax relief on subscriptions of up to £200 000 (section 262(3)). They are also exempt from income tax on dividends in respect of ordinary shares acquired within the permitted maximum of the £200 000 investment, and capital gains tax on the disposal of ordinary shares acquired up to the maximum investment of £200 000. For investments in a Venture Capital Trust, claims can only be made in the tax year in which the investments are made (section 262(1)). Relief will be lost if shares are disposed of within five years of the date of investment (section 266).

Chapter 5 of Part 6 of the United Kingdom Income Tax (Trading and Other Income) Act, 5 of 2005, referred to as the "2005 United Kingdom Income Tax (Trading and Other Income) Act", provides that there is no liability for income tax on dividends on shares in a Venture Capital Trust. Section 151A of the 1992 United Kingdom Taxation of Chargeable Gains Act, also provides relief for all gains and losses that accrue to an individual on disposal of qualifying shares in a Venture Capital Trust, which was a Venture Capital Trust at the time the shares were acquired, and is still a Venture Capital Trust at the time of the disposal of shares. Schedule 5C of the 1992 United Kingdom Taxation of Chargeable Gains Act, also provides for a deferred charge on re-investment of shares issued before 6 April 2004 (the tax is payable in future periods). Individuals' unused qualifying expenditure on shares in Venture Capital Trusts can be set off against what would be taxable gains.

Venture Capital Trust investments have to be kept in the trust for five years (section 266 of the 2007 United Kingdom Income Tax Act). If any of the shares no longer qualify for the investment incentive, tax relief will be lost. For example, if the taxpayer gains a connection with a company in which the trust has invested, relief for the rest of the venture capital scheme investments can be claimed up to five years after 31 January of the year following the year in which the investment was made. For Venture Capital Trusts, relief can be claimed for up to four years after 31 January of the following tax year. There is an exemption for capital gains tax on the sale of shares (section 266). There is no personal capital gains tax relief on the initial investment and there is no relief for capital losses against income.

3.2.5 Tax Reliefs Summary

The following table summarises the income tax relief for Venture Capital Schemes in the United Kingdom according to sections 261 to 265 of the 2007 United Kingdom Income Tax Act.

Table 3.1: Summary of income tax relief for Venture Capital Schemes in the United Kingdom

Scheme	Maximum annual investment for which relief can be claimed	Percentage of investment on which an income tax deduction can be claimed	Tax relief on income from dividends
Enterprise Investment Scheme	£1 million £2 million if at least £1 million is invested in knowledge intensive companies	30%	No
Seed Enterprise Investment Scheme	£100,000	50%	No
Social Investment Tax Relief	£1 million	30%	No
Venture Capital Trust	£200,000	30%	Yes

Source: Author's own summary

To qualify for venture capital scheme tax relief, the shares must have been issued to the investor before 6 April 2025 (section 261(3) of the 2007 United Kingdom Income Tax Act). The shares must be subscribed for and issued for genuine commercial reasons and not as a part of a scheme or arrangement for tax avoidance (section 261(3)). There is no entitlement to relief where there is a linked loan made by any person to the individual or an associate of the individual during the period from the incorporation of the company, if the shares were issued at the incorporation of the company, or two years before the shares were issued to the individual, up to the fifth anniversary of the date the shares were issued (section 264). A linked loan is a loan that would not have been made or would not have been made on the same terms if the individual had not subscribed for the share or proposed to do so (section 264(3). Relief is restricted when there is a linked sale of other shares and the amount the individual subscribes for the shares is treated as reduced, but not below nil, by the total amount paid for the linked sale (section 264A). Linked sales occur where, in a Venture Capital Trust or a company that is or later becomes a Venture Capital Trust successor or predecessor, an individual subscribes for relevant shares where the purchase of shares was conditional upon the individual subscribing for shares in the Venture Capital Trust, or the subscription for the shares was conditional upon that purchase, or the relevant subscription for the shares and sale of purchased shares occur within six months of each other (section 264(5)). Individuals are not entitled to relief if any circumstances arise leading to the withdrawal or reduction of the relief where that relief had already been obtained (section 265).

The following table summarises capital gains tax reliefs that are granted for all Venture Capital Schemes in the United Kingdom.

Table 3.2: Summary of the capital gains tax relief for all Venture Capital Schemes in the United Kingdom

Scheme	**Personal Capital Gains Tax relief available on initial investment**	**Type of Capital Gains Tax relief on initial investment**	**Gains exempt from Capital Gains Tax on sale of shares**	**Relief available for capital losses against income**
Enterprise Investment Scheme	On 100% of investment	Deferral	If Income Tax relief was received	Yes
Seed Enterprise Investment Scheme	On 50% of investment, capped at £50 000	Exempt from tax	If Income Tax relief was received	Yes
Social Investment Tax Relief	On 100% of investment	Deferral	If Income Tax relief was received	Yes, except on loans
Venture Capital Trust	N/A	N/A	Yes	No

Source: Author’s own summary

Tax relief cannot be claimed where the investors and their associates are connected with the company (section 163 of the 2007 United Kingdom Income Tax Act). This applies where the individuals are employed by the company or any subsidiary (except for directors, in certain cases) and hold more than 30% of the company’s shares, voting rights, loan capital for social investment tax relief, or rights to assets if the company is wound up (section 170). Associates can be relatives, spouses and civil partners, business partners, or trustees of settlements where the investor is a beneficiary (section 163). These conditions apply for the Enterprise Investment Scheme from two years before the investment and a minimum of three years of the qualifying period. For the Seed Enterprise Investment Scheme, the conditions apply for a period of 12 months before the investment. For Social Investment Tax Relief, the conditions apply from the date the company is set up, and the investor may also not be a partner or trustee of the social enterprise (section 257BB).

Loans granted to a Social Investment Tax Relief Scheme (refer to 3.2.3 above) may also qualify for tax relief (section 257QE of the 2007 United Kingdom Income Tax Act). The loan may not be an arrangement for any party to be paid within three years of the investment and the loan must be at a reasonable commercial rate (section 384A). This loan must not be secured by any asset (section 384A).

3.2.6 Relief for Directors

Directors of a company that is part of a venture capital scheme may also receive tax relief. In the Enterprise Investment Schemes, individuals are not regarded as connected to the issuing company merely because they are directors of that company, unless they receive payment from the issuing company or a related person, or they are entitled to such payment (section 168(2) of the 2007 United Kingdom Income Tax Act).

Section 168(2) of the 2007 United Kingdom Income Tax Act provides for exceptions, where payment is permitted for directors in Enterprise Investment Schemes. Permitted payments include the following:

(i) reimbursement of work-related expenses;
(ii) payment of reasonable interest on a loan granted to the company;
(iii) dividends that do not exceed a normal return on the invested money;
(iv) payment for supplying goods at market value;
(v) payment of reasonable commercial rent; and
(vi) reasonable payment for services provided within the trade, except for secretarial, managerial, and other similar services.

Directors connected to the company are also offered tax relief in the Seed Enterprise Investment Scheme (HM Revenue and Customs and HM Treasury: 2015), and may claim tax relief if, at the time the shares were issued, they were unpaid directors of the company, and had not previously been involved in the same trade for which the company seeks investment (section 169(3) of the 2007 United Kingdom Income Tax Act). Directors who become paid directors can retain any tax relief previously received in respect of the Enterprise Investment Scheme. They can also claim tax relief after becoming paid directors if new shares are issued within three years of the company starting to trade (section 169).

3.3 TAX-FREE INVESTMENTS

In the United Kingdom, there are four income tax rates, which are known as the personal allowance, basic rate, higher rate, and additional rate.

Table 3.3: Tax table for income tax rates in the United Kingdom for 2023 to 2024

Band	Taxable income	Tax rate
Personal Allowance	Up to £12 570	0%
Basic rate	£12 571 to £50 270	20%
Higher rate	£50 271 to £125 140	40%
Additional rate	over £125 140	45%

Source: Author’s own summary

The rates differ when the taxpayer lives in Scotland. The following tax table shows income tax rates in Scotland:

Table 3.4: Tax table for income tax rates in the United Kingdom if the taxpayer lives in Scotland for 2023 to 2024

Band	Taxable income	Tax rate
Personal Allowance	Up to £12 570	0%
Starter rate	£12 571 to £14 732	19%
Basic rate	£14 733 to £25 688	20%
Intermediate rate	£25 689 to £43 662	21%
Higher rate	£43 663 to £125 140	41%
Top rate	over £125 140	46%

Source: Author’s own summary

Allowances applying before the taxpayer has to pay tax include the personal allowance, the starting rate for savings. and the personal savings allowance, which are discussed below (section 5 of the 2021 United Kingdom Finance Act, and section 10 of the 2007 United Kingdom Income Tax Act). Individuals may have a normal savings account and tax-free investments using the individual savings account (ISA) allowance of up to £37 700 annually for basic rate taxpayers, while for the higher rate taxpayers, the limit is £150 000 (section 5(1) of the 2021 United Kingdom Finance Act, and section 10(5) and 10(5A) of the 2007 United Kingdom Income Tax Act).

Personal allowance

Individuals are entitled to a personal allowance of £12 570 for the tax year if they meet the requirements for residence (section 35 of the 2007 United Kingdom Income Tax Act). Those with net income exceeding £100 000 will have their allowance reduced by half of the excess. For every £2 earned by the individuals, there will be a deduction of £1 from the personal allowance of £12 570 (section 35(2)). For example, if an individual’s net income is £104 000, the excess amount is £4 000 and half of the excess is £2 000, therefore £2 000 will be deducted from the individual’s personal allowance (£12 570 - £2 000) and the personal allowance remaining will be £10 570. Amounts that are not a multiple of £1 will be rounded off to the nearest £1. For those with net income exceeding £125 140, the allowance will be zero.

Savings allowance

Individuals are also entitled to a savings allowance each tax year (section 12B of the 2007 United Kingdom Income Tax Act). The starting rate for savings is £5 000, which means that personal allowance rate taxpayers can earn up to £5 000 of interest without having to pay tax on it (section 12). The more income taxpayers earn, the less their starting rate for savings will be. If any of an individual’s income for the year is additional rate income, the individual’s savings allowance for the year will be nil (section 12B(2). If any of the individual's income for the year is higher-rate income, and none of the individual's income for the year is additional-rate income, the individual's savings allowance for the year is £500 (section 12B(3). If none of the individual's income for the year is higher-rate income, the individual's savings allowance for the year is £1,000 (section 12B(3).

Each individual is granted the allowances every tax year and the amount of the allowances received depends on the taxpayer’s other income (section 10 of the 2007 United Kingdom Income Tax Act). The personal allowance can also be used to earn tax-free interest by taxpayers who do not use it up on their other income.

Tax-free individual savings accounts

Taxpayers can also invest in tax-free individual savings accounts (ISAs) (Regulation 4 of The United Kingdom Individual Savings Account Regulations, 1870 of 1998, referred to as the "1998 United Kingdom Individual Savings Account Regulations"). The maximum for tax-free savings in the 2023 tax year is £20 000, which is also referred to as the individual savings allowance (regulation 4ZA (1)). There are cash ISAs, stocks and shares ISAs, innovative finance ISAs, and lifetime ISAs (regulation 4(1A)). Taxpayers may utilise all types of ISAs each tax year.

All ISA holders must meet the requirements of Regulation 12B of the 1998 United Kingdom Individual Savings Account Regulations, to be included in the application form, pertaining to the details of the applicant, specific year that the Lifetime ISA will be opened, authorisation to the account manager to manage the account, declaration of the age of the applicant and declaration that the money used to open the account. The money that will be made on the investment belongs to the applicant. Lifetime ISAs can be used by investors to buy homes or to save for later life (Regulation 41 of the 1998 United Kingdom Individual Savings Account Regulations). Although the maximum for tax-free savings for the current (2023) tax year is £20 000, payments can be made up to £4 000 each tax year until the investor turns 50 years old (Regulation 4ZA (1A)). The United Kingdom government adds a 25% bonus of up to £1 000 each year for lifetime ISAs (section 1 of the United Kingdom Savings (Government Contributions) Act, 2 of 2017, referred to as the "2017 United Kingdom Savings (Government Contributions) Act"). At the age of 50, investors will neither be allowed to pay into their lifetime ISAs nor earn the 25% government bonus, although the account remains open and savings still earn interest or investment returns (Regulation 10A of the 1988 United Kingdom Individual Savings Account Regulations). No tax is chargeable in respect of interest, dividends, distributions or gains in respect of the ISA account investment and the government bonus, but excluding the building society bonus (Regulation 22). The building society bonus refers to any bonus and dividend paid or credited in respect of a share account with a building society (Regulation 22(3)).

Lifetime ISAs can be withdrawn when the taxpayer is buying a first home, when the taxpayer is over 60, or when the taxpayer is terminally ill and has less than twelve months to live (Part 3 of Schedule 1 of the 2017 United Kingdom Savings (Government Contributions) Act).

Withdrawing from the fund for reasons other than these will result in a 25% charge, which seeks to recover the bonus received from the government, and the extra charge will be applied to the original savings (Schedule 1). Therefore, changing long term savings to short term savings results in the investors receiving less than they originally invested. Before making a withdrawal, the charges must be considered.

For example, if the taxpayer's initial savings are £1 600, the 25% government bonus will be £400, a total of £2 000. If the investor wishes to withdraw the entire amount, the 25% charge will apply to the full amount. The taxpayer will have to pay over a withdrawal charge of £500 to the government, leaving £1 500, which is £100 less than what was initially saved. If the investor only needs to withdraw a portion of the savings, for example, only £60, then he or she will have to withdraw the £60 plus the 25% charge, which means that he or she has to withdraw £80 because £20 will have to cover the charge, so that the remaining amount will be the £60 needed. The investor will therefore have to withdraw more than is needed. Lifetime ISAs end at death of investor and there is no charge for withdrawal (Regulation 2G of the 1998 United Kingdom Individual Savings Account Regulations).

Junior individual savings accounts

There is also a provision for Junior ISA accounts (Regulation 2B of the 1998 United Kingdom Individual Savings Account Regulations). Junior ISAs are long-term savings accounts for children under the age of 18 (Regulation 2B). The savings limit for children for the 2023 tax year is £9 000 (Regulation 4ZB(1)). Amounts paid into junior ISA accounts in excess of £9 000 are not subscribed to the junior ISA accounts and must not be held in those accounts (Regulation 4ZB(1)). Children can either have a Junior ISA or a child trust fund, they cannot have both (Regulation 4 of the United Kingdom Individual Savings Account (Amendment) Regulations, 2020, referred to as the "2020 United Kingdom Individual Savings Account (Amendment) Regulations"). There are two types of Junior ISAs. There is a cash Junior ISA where no tax is paid on interest, and a stocks and shares Junior ISA where no tax is paid on capital gains or dividends (Regulation 4ZB(3) of the 1998 United Kingdom Individual Savings Account (Amendment) Regulations).

3.4. RETIREMENT INVESTMENTS

United Kingdom pension schemes include all schemes and arrangements, comprised in one or more instruments, that have the effect of providing benefits for individuals upon retirement, death, reaching a particular age, serious illness or incapacity, or any similar circumstances (section 150 of the 2004 United Kingdom Finance Act). These instruments include state pensions, work pensions arranged by an employer and personal pensions.

Definitions

The terms defined below are not found in South African legislation, but are found in the United Kingdom legislation.

- A pension commencement lump sum is a lump sum paid to a member when the member becomes entitled to it, or dies after becoming entitled to it, or before becoming entitled to it, but in anticipation of the becoming entitled to it (Paragraph 1 to 3 of schedule 29 of the 2004 United Kingdom Finance Act). It is paid while all or part of the member's lifetime allowance is available for the years it is applicable (the lifetime allowance was £1 073 000 – see below). It is paid within the period beginning six months before, and ending one year after the day on which the member becomes entitled to it. It is also paid when the member has reached the normal minimum pension age (or the ill-health condition is satisfied) and is not an excluded lump sum (Paragraphs 1 to 3).
- A drawdown pension means a short-term annuity or income withdrawal (Paragraph 4 of Schedule 28 to the 2004 United Kingdom Finance Act). It is one of the ways to withdraw from a pension while allowing the pension to keep growing, and a member can arrange, subject to what the rules of their scheme allow, for their drawdown pension to be a combination of both a short-term annuity and capped or flexible drawdown. (Schedule 28 to the 2004 United Kingdom Finance Act).
- An uncrystallised funds pension lump sum is the withdrawal of funds directly from the pension scheme without going into drawdown or buying a lifetime annuity (section 636A(1A) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act)
- The pension lifetime allowance was the maximum amount that individuals could build up in pension schemes over their lifetimes before they were required to pay tax

on the excess, which was £1 073 000 for the 2023 to 2024 tax years, but this has now been abolished (section 18 of the 2023 United Kingdom Finance Act).

What is Taxed?

The taxable pension income for a tax year is the full amount of the pension under the registered pension scheme accruing in that particular year, irrespective of when the amount is actually paid (section 579B of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act)). The person liable for tax is the person receiving or entitled to the pension under the registered pension scheme (section 579C). There are income tax exemptions for beneficiaries in some cases (section 579CZA). Section 579A, which provides for exemptions for certain annuities, does not apply to dependents' income withdrawal or nominees' income withdrawal if it is paid in respect of a deceased member of a registered pension scheme who had not reached the age of 75 at the date of the member's death, and to a person from the person's dependent's drawdown pension fund, dependent's flexi-access drawdown fund, or nominee's flexi-access drawdown fund in respect of a money purchase arrangement under a registered pension scheme (section 579CZA(1)). When the pension is inherited, beneficiaries do not pay tax unless it exceeds their personal allowance (section 35(1) of the 2007 United Kingdom Income Tax Act).

Tax Relief on Individuals' Pensions

Taxpayers could claim up to 100% income tax relief on their pension contributions, but the annual maximum allowance of £60 000 tax-free contributions to the pension fund applies for the 2023 to 2024 tax year, if they are eligible. Tax relief may be claimed by private pension contributors up to 100% of their annual earnings (section 188 of the 2004 United Kingdom Finance Act). Taxpayers get automatic relief for contributions if their employers deduct their pension contributions from their pay before deducting income tax, and if their income tax rate is 20%, the pension provider claims it as tax relief from the government and adds it to the taxpayer's pension, which is known as relief at source (section 192). If the income tax rate is 19% in Scotland, the pension provider can claim it as 20% and there is no need for the taxpayer to pay the difference (section 192). Tax relief is also available on contributions made to some overseas pension schemes, up to 100% of contributions. When a third party pays into the taxpayer's pension scheme, there is an automatic tax relief at a 20% rate if the pension provider claims it for the taxpayer (section 192).

Self-employed taxpayers in England, Wales or Northern Ireland may claim additional tax relief on their self-assessment tax return for contributions made to private pension funds of 20% up to the amount of income where 40% tax was paid, or 25% up to the amount of income where 45% tax was paid (HM Revenue and Customs: 2023). For example, if a taxpayer earns £60,000 in the 2023 to 2024 tax year and pays 40% tax on £10 000 and contributes £15 000 into a private pension, the taxpayer gets an automatic tax relief at source on the full £15 000 (HM Revenue and Customs: 2023). The taxpayer can then claim an extra 20% tax relief on £10,000 (the same amount on which the taxpayer paid higher rate tax) through a self-assessment tax return (HM Revenue and Customs: 2023). Self-employed taxpayers in Scotland may claim additional tax relief on their self-assessment tax return for contributions made to private pension funds of 1% up to the amount of income where 21% tax was paid, 21% up to the amount of income where 41% tax was paid or 25% up to the amount of income where 46% tax was paid (HM Revenue and Customs: 2023).

Tax on Lump Sums

No liability for income tax arises on a lump sum paid under a registered pension scheme if the lump sum is a pension commencement lump sum, serious ill-health lump sum paid to a member who has not reached the age of 75, a refund of excess contributions (where a member has paid pension contributions in a tax year of more than the maximum amount for which he or she can receive tax relief), or a transitional 2013/14 lump sum (section 636A(1) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). Tax is charged in relation to serious ill-health lump sums paid to a person aged 75 years and above, because the provision for no income tax liability is only applicable when the member has not reached the age of 75 (section 636A(3A)).

Where there is an uncrystallised funds pension lump sum paid under a registered pension scheme and the member is under the age of 75, the first 25% of the lump sum is tax-free, and this does not affect the member’s personal allowance (section 636A(1A) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). The remaining 75% will be taxed (section 636A(1A)). Tax is deducted from the remaining 75% before it is paid over to the beneficiary (section 579A). For example, if the taxpayer’s pension benefit is £30 000, the first £7 500 is tax free. The pension provider will then deduct tax from the remaining £22 500.

Where there is an uncrystallised funds pension lump sum paid under a registered pension scheme to a member aged 75 years and above, if the member’s lifetime allowance when the lump sum is paid is equal to or greater than the lump sum, no liability for income tax arises on the first 25% of the lump sum, and the remaining 75% will be taxed (section 636A(1B)(a) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). If the member's available lifetime allowance when the lump sum is paid is less than the lump sum, no liability for income tax arises on the part of the sum that is equal to 25% of the member's available lifetime allowance when the sum is paid, and the rest of the lump sum will be taxed. The pension lifetime allowance for the 2023 to 2024 tax years that individuals could build up in pension schemes over their lifetime before they were required to pay tax on the excess was £1 073 000 and the annual allowance that individuals could pay into a pension scheme before they had to pay tax was £60 000. However, the United Kingdom government abolished the lifetime allowance of £1 073 000; there is no longer a lifetime allowance after the 2023 to 2024 tax year, and subsequent tax years (section 18 of the 2023 United Kingdom Finance Act). Certain lump sums are to be taxed at the marginal rate (section 19). This applies to any part of the relevant lump sums under a registered pension scheme, disregarding section 18, chargeable to income tax under sections 214 to 226 of FA 2004 (section 19(3)-(4). It also applies in relation to any pension lump sum or part of the lump sum paid by or on behalf of a person who is outside the United Kingdom to a person who is resident in the United Kingdom (foreign pensions) (section 19(3)-(4). "Relevant lump sum" means a serious ill-health lump sum, a lifetime allowance excess lump sum, a defined benefits lump sum death benefit, or an uncrystallised fund lump sum death benefit.

Tax on Retirement Annuities

While a pension plan is a saving and investment product, a retirement annuity is an insurance contract that an individual buys from the provider to guarantee regular income (Santander: 2022). For annuities, the amount charged to tax in relation to each annuity is the "net taxable income" for the tax year (section 567 (1) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). The net taxable income is calculated by deducting the total amount of deductions allowed from the pension, annuity or item of pension income, from the taxable pension income of the member's pension, annuity or item of pension income (section 567(3)). Deductions allowed include amounts to avoid double taxation and 10% for overseas government pensions, where applicable (section 567(5). To avoid international double taxation, the amount of the deduction allowed from the taxable pension income is the amount counted as employment income (567A(3)). If the employment income exceeds the taxable pension income, the excess is carried forward to future tax years until the full employment income is deducted from taxable pension income (section 567A(4)). In determining the amount of taxable pension income for a pension, annuity or other item of pension income, any exempt income is to be excluded (section 567(4)(b)).

Tax when the Individual Lives Abroad

United Kingdom residents who do not live in the United Kingdom but are residents for tax purposes, must pay tax on their pension (section 189 of the 2004 United Kingdom Finance Act). The amount payable depends on the income of the taxpayer. Persons who are not United Kingdom residents but receive pensions as part of their income in the United Kingdom do not pay tax on their pension, although they may have to pay tax in the country they reside in (section 189). There are a few exceptions to this, and taxpayers may have to pay tax in both the country they reside in and the United Kingdom, if there is no Double Taxation Agreement between the United Kingdom and the country (section 788 of the United Kingdom Income and Corporation Taxes Act, 1 of 1988, referred to as the "1988 United Kingdom Income and Corporation Taxes Act"). Taxpayers can claim the migrant member relief if they move to the United Kingdom and they were paying into the pension scheme before they moved to the United Kingdom, receiving tax relief on the contributions before they moved, provided the scheme is a qualifying overseas pension scheme (section 194 of the 2004 United Kingdom Finance Act). Taxpayers can claim the double taxation relief if they were paying into the scheme before they moved to the United Kingdom, receiving tax relief on the contributions before they moved, and if the contributions are covered by a Double Taxation Agreement (section 646A of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act).

Higher Tax on Unauthorised Payments

Higher tax is payable on unauthorised pension payments (section 208 of the 2004 United Kingdom Finance Act). Unauthorised payments are payments made outside of the government's tax rules, which include some of the payments made before the age of 55, trivial commutation lump sums over £30 000, and continued payments into the member's pension fund after member's death (section 173 to 174, and Schedule 29). Tax of up to 55% will be charged on the unauthorised payments (sections 208 to 209). Trivial commutation is an option that enables people aged 55 and above to exchange their regular pension payments for a once-off cash lump sum (Schedule 29).

3.5 ENDOWMENT POLICIES

In the United Kingdom an endowment policy is defined as an investment product bought from a life assurance company in which benefits are payable on a specified date, if the life assured is still alive or on the death of the life assured (HM Revenue and Customs: 2021). The policy includes life assurance, so it will also pay out to a nominated beneficiary or beneficiaries when an investor dies during the term of the policy (HM Revenue and Customs: 2021). In the United Kingdom, endowment policy terms are usually 10 to 25 years. Regular payments are made monthly or annually by the investors and some of the funds are invested in stocks and shares while the other funds are paid into a life insurance policy (Green: 2020). Green explains that the contribution amount and the lump sum amount that is paid out depends on the service provider, and factors such as age and sex may have an impact on the terms. Green also advises that there is an option for low-cost endowments where there is a discount on premiums, but the amount paid out will also be smaller at maturity. Green continues to explain that policy holders who wish to cash in early have an option to sell their policies to third parties, the proceeds will potentially be more than what the policy providers can offer, and the policy holder who sells the policy has the freedom to invest his or her money elsewhere, while the new owner continues with the policy and claims the pay-out at the end.

Green (2020) refers to the four different types of endowment policies. The first type is the non-profit endowment policy in which there is an agreed lump sum to be paid out, which is usually cheaper because there is no chance to earn higher than the set amount. The second type is the with-profit endowment policy, which has an agreed payable lump sum and an additional amount if the fund performs well; it can generate a higher profit but has a higher risk because the maturity amount is not guaranteed. The third type is the unit-linked endowment policy where monthly instalments buy the policy holder units in investment funds, and the lump sum received depends on how well the investments have performed. The last type is the whole-of-life endowment policy, which lasts for the rest of the policyholder’s life and pays out to a beneficiary upon death. Green refers to bonuses that are paid annually, intermittently or at the end of the term. Bonuses are paid annually when the fund is performing well, intermittently if there are circumstances where profit is to be made, or at the end of the term together with the maturity amount. Policyholders can also have endowment policy mortgage plans which are designed to pay off the debt on the policyholder’s house (Help and Advice: 2021). The mortgage plan allows the policyholder to pay off only the interest on the mortgage bond, while the premiums go towards a savings goal which is the whole property mortgage.

There is a tax-free allowance for qualified policies. It must be determined whether the policy is a qualified policy according to paragraph 2 of Schedule 15 to the 1988 United Kingdom Income and Corporation Taxes Act. Qualifying policies are not subject to income tax, but under section 1(1) of the 1992 United Kingdom Taxation of Chargeable Gains Act, receipt of the benefit by an investor upon death, maturity, or sale or surrender, gives rise to capital gains tax at the applicable rate. The rate charged when the investor disposes of the endowment policy is 10%, while the rate charged to the beneficiaries upon death of the investor is 28% (section 1H). The 28% capital gains tax is charged after deducting the purchase price, premiums and taper relief exceeding the tax-free allowance for qualified policies. The tax-free allowance for capital gains is £5 500, which is the exempt amount for any year of assessment (section 3(2). An individual will not be chargeable to capital gains tax in respect of so much of his or her taxable amount for any year of assessment as does not exceed the exempt amount for the year (section 3(1). Taper relief is a tax relief granted when inheritance tax is due on a gift that is made within seven years prior to the death of the donor (HM Revenue and Customs: 2023). Taper relief only applies if the total value of gifts made in the seven years before the death of the donor is over the threshold of £325 000. The following table shows taper relief rates according to the time that passed between the gift being made by the donor and the death of the donor.

Table 3.5 Different rates for Taper Relief

Years between gift and death	**Rate of tax on gift**
3 to 4 years	32%
4 to 5 years	24%
5 to 6 years	16%
6 to 7 years	8%
7 or more years	0%

(United Kingdom. HM Revenue and Customs: 2023)

For non-qualifying endowment policies, the profit is subject to income tax at the marginal rate (which is the difference between the higher rate and the basic rate) for the high-rate taxpayers and this applies to the maturity amount as well (section 6 of the 2007 United Kingdom Income

Tax Act, 3 of 2007; and Maundrell: 2018). At maturity, tax is applicable to the maturity figure, less all premiums paid by the policyholder. Maundrell (2018) states that, for basic rate taxpayers, the proceeds will be tax-free. Marginally higher rate taxpayers will pay some tax but will benefit from “top slicing”, where the gain is divided by the number of tax years the investment has been held and adding that figure to taxable income for the year, after which the proportional tax rate is applied. The tax is paid by the investment fund before the returns are paid to the policy holder.

3.6 PURCHASED ANNUITIES

In the United Kingdom, purchased annuities also provide an income for a specified term in exchange for a lump sum. According to section 423 of the 2005 United Kingdom Income Tax (Trading and Other Income) Act, a purchased life annuity is an annuity granted for consideration in money’s worth in the ordinary course of business of granting annuities on human life and payable at the time ascertainable only by reference to the end of life. The term is usually for the rest of the annuitant’s life, but in some circumstances it ends after a fixed term, or continues after the death of annuitant, according to a specified condition in the contract (section 423(2)). The taxation of purchased life annuities includes an exempt sum or exempt proportion, and the capital element is exempt from tax while the interest is taxable (section 717). The exempt capital amount is obtained by dividing the purchase price of the annuity by the annuitant’s life expectation according to mortality tables (section 717). Each payment received by the annuitant comprises a return of part of the capital and interest. In circumstances where the exempt amount exceeds the annuity paid, the remainder of the exempt amount will be carried over to the next payment. Section 848 of the 2007 United Kingdom Income Tax Act provides for income tax deduction at source by the annuity provider. In terms of section 426 of the 2005 United Kingdom Income Tax (Trading and Other Income) Act, annuity payments received after tax has been deducted are treated as income tax having been paid by the recipient.

According to section 725 of the 2005 United Kingdom Income Tax (Trading and Other Income) Act, no liability for income tax arises on annual payments made under an immediate needs annuity. An immediate needs annuity is a contract for a purchased life annuity for the purpose of protection against consequences of the person being unable to live independently due to mental or physical impairment or injury, sickness or other infirmity.

Some annuities are excluded from the partial exemption (section 718 of the 2005 United Kingdom Income Tax (Trading and Other Income) Act). These include pension annuities, annuities attracting life insurance premium relief, annuities purchased under direction of a will, and annuities purchased out of income from property disposed of by a will, or settlement resulting from a will (section 718). However, lump sums inherited under a will with no conditions, or gifts of a lump sum will not be barred from exemption.

3.7 WORKPLACE INVESTMENT SCHEMES

In the United Kingdom, a number of workplaces offer their employees more than just a pension scheme. There are two main types of workplace investment schemes - Save As You Earn (SAYE) and Share Incentive Plans (SIPs) (Schedules 2 and 3 of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). These are designed to encourage savings and are not viewed as a replacement for pension funds.

3.7.1 Save As You Earn (SAYE)

SAYE is a scheme, in accordance with section 516(4) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act, established by a company to provide share options to be granted to employees and directors, and for the shares acquired to be paid for in accordance with approved savings arrangements (paragraph 2 of Schedule 3). Employees and directors have to be with the company for five years before they can qualify for the SAYE scheme (paragraph 6 of Schedule 3). These schemes run for three to five years. A maximum of £500 per month can be contributed into the scheme and a minimum of not more than £10 can be imposed by the scheme on the member’s monthly contributions (paragraph 25(3) of Schedule 3). When the scheme reaches maturity, the bonuses are paid out tax free, no income tax is charged on dividends from any shares owned by an employee and, unless invested in an ISA, employees can be paid their investment in cash at maturity, or use the investment to buy more shares in the company. Capital gains tax is charged if the shares are sold, but no capital gains tax is charged when the capital gains are paid into a pension fund or transferred to an ISA within 90 days of the scheme ending (HM Revenue and Customs: 2020).

No liability for income tax arises in respect of the exercise of the share option if the individual exercises it in accordance with provisions of SAYE and it is not an arrangement for the avoidance of tax on national insurance contributions (a tax on earnings and self-employed profits paid by employees, employers, and self-employed individuals) (section 519 of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). In terms of paragraph 37 of Schedule 3, the no-liability provision applies when the option is exercised after three years from the date the share option was granted, or the scheme-related employment has ended, or certain company events occurred. The provision also applies in the following circumstances:

- as a result of a general offer, compromise or arrangement, or takeover of the company and the individual receives cash in exchange for shares;
- when the decision to grant the option was made, the general offer, compromise or arrangement, or takeover offer had not been made; and
- when the decision was taken, no arrangements were in place or under consideration for making the general offer, compromise or arrangement or the making of a takeover offer.

3.7.2 Share Incentive Plans (SIPs)

SIPs are schemes in accordance with section 488(4) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act, established by a company for shares to be appropriated to employees without payment (regarded as free shares), or shares to be acquired on behalf of employees out of sums deducted from their salaries (regarded as partnership shares) (paragraph 2 of Schedule 2). The scheme provides for shares that can be gifted to the employee by the company up to a maximum of £3 600 per year, or can be bought by the employees from their earnings before tax deductions up to £1 800, or 10% of the employee’s salary (paragraphs 35 and 46 of Schedule 2). Employers can provide employees with a maximum of two shares for partnership shares bought, and they can buy more shares using the dividends received from the shares (paragraphs 65 and 66 of Schedule 2). SIP shares are exempt from income tax and capital gains tax if the shares stay in the scheme for more than five years (HM Revenue and Customs: 2020). If sold before that period elapses, the employee may have to pay income tax and National Insurance, due to a breach of obligation under paragraph 36(1)(b) of Schedule 2, which restricts disposals during the holding period (section 507).

Chapter 6 of Part 7 of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act provides for exemptions from income tax on shares obtained under SIPs, amounts that count as employment income, and Pay As You Earn (referred to as PAYE) deductions in connection with the amounts (as discussed below). There is no charge on the award or acquisition of shares in general (section 490). The provision applies to an award to an employee of free, matching or partnership shares under the plan, or on the acquisition of dividend shares on behalf of an employee. Employees will also not be liable for income tax on the value of the beneficial interest in shares that pass to them at the time of the award or acquisition. Beneficial interest refers the right to acquire or claim on equitable grounds, the shares held in the scheme.

There is no tax charge on partnership share money deducted from a salary (section 492 of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). There is no charge for the acquisition of dividend shares (section 493). There is no charge on cash dividends retained for reinvestment (section 883(1)).

Participants are not liable for income tax when shares cease to be subject to the plan due to the participant no longer being in the relevant employment for the following reasons (section 498(2) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act):

- injury or disability;
- dismissal by reason of redundancy;
- by reason of relevant transfer within the meaning of Transfer of Undertakings (Protection of Employment) Regulations 2006;
- if the relevant employment is by an associated company by reason of change of control or other circumstances making the company an associated company;
- retirement of the participant; or
- death of the participant.

Participants are not liable for income tax on relevant shares in a company being withdrawn from the plan in the following circumstances (section 498(2) of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act):

- where the withdrawal of the relevant shares from the plan relates to a transaction resulting from a compromise, arrangement or scheme falling within subsection (9), an offer forming part of a general offer falling within subsection (10), or the application of sections 979 to 982, or 983 to 985 of the United Kingdom Companies Act 46 of 2006 (referred to as "the 2006 United Kingdom Companies Act") where there is a takeover falling within subsection (13); or
- where the participant receives cash in exchange for the relevant shares as a result of, as the case may be, the transaction, the offer, or application of sections 979 to 982 of the 2006 United Kingdom Companies Act (which make provision for a "squeeze out" giving an offeror, in case of a takeover the right to buy out a minority shareholder), or sections 983 to 985 (which make provision for a "sell-out" giving a minority shareholder a right to be bought out by an offeror, in case of a takeover),.

When shares cease to be part of the plan, where the participant was being provided with employment income in form of those shares in relation to the relevant employment, there will be a PAYE charge (section 696 of the 2003 United Kingdom Income Tax (Earnings and Pensions) Act). Before the employer makes payments to the participant, a deduction of PAYE is made from the sum received from the trustees on shares ceasing to be subject to the plan (section 510). Section 515 also provides relief from stamp duty on transfers of partnership or dividend shares.

3.8 FIXED INTEREST SECURITIES

Government bonds are known as "gilts" in the United Kingdom (section 33 of the United Kingdom Bank of England Act, 11 of 1998). They are issued by the government, and by investing in them, an individual lends money to the government in return for a regular income in form of the interest generated for a specified period, after which the capital amount is paid back to the investor (Part I of Schedule 11 to the United Kingdom Finance Act, 21 of 1942).

Kaveh (2021) refers to the two types of gilts: standard gilts and index linked gilts. Kaveh explains that standard gilts have fixed interest pay-outs every six months until the maturity date of the gilts, and at maturity, the gilt holder receives the interest payment together with the capital invested. For example, if an individual invests £1 000 in a gilt and the interest rate is

5% per annum, the investor will earn interest of £50 per annum. If the investment matures after 10 years, the total interest would be £500. If the investor does not take the regular interest pay-outs, the total amount payable would be £1 500, which includes the capital and the interest. Index linked gilts have a different form of calculation for pay-outs, which is more flexible; the calculation depends on the inflation rate, and it is designed to keep the capital safe from inflation.

Government bonds are strongly affected by interest rates and economic policies (Kaveh: 2021). If interest rates fall, government bond prices rise and *vice versa*, and the credit rating of a country also affects the value of its bonds (CMC Markets: 2021). A credit rating is an estimate of the government's ability to meet its financial obligations. In this case, it would be the bond coupon. If the country's credit rating is high, the value of the bonds will also be high, and *vice versa*. Countries with a higher credit rating are seen to be more trustworthy (CMC Markets: 2021).

There are three risks associated with government bonds. There is an interest rate risk when purchasing a bond because an increase in interest rates would cause the bond market to fall in value, and thus investors have to look at the duration of the bond and its interest rate when purchasing. There is also inflation risk because inflation reduces the purchasing power of the bond's face value and any coupon payments. When inflation rises, it in turn reduces the value of the bond, but investors can opt for an inflation-linked bond that increases in value at the rate of inflation (CMC Markets: 2021). There is also liquidity risk, which can affect the ability of the investor to buy and sell bonds effectively, as sellers may be forced to accept lower prices when selling their bonds (CMC Markets: 2021). However, government bonds are less likely to be affected by liquidity risk compared to corporate bonds.

Fixed interest securities with a redemption date on or after 1 January 1992, are exempt from capital gains tax under section 115 of the 1992 United Kingdom Taxation of Chargeable Gains Act, however, investors are subject to income tax on the interest earned.

3.9 CONCLUSION

The following table summarises the tax rates and incentives applicable for the investments discussed in the chapter.

Table 3.6: Summary of Tax Rates and Incentives for United Kingdom investments

Type of Investment	**Tax**	**Incentives Applicable**
Venture Capital Scheme		Income tax relief against investments in qualifying companies or venture capital trusts; Income tax relief on loans or debts granted to social enterprises; Capital gains tax relief on gains from the investments; and Capital gains tax relief when reinvesting previous gains in a scheme. Community investment tax relief at 5% of the invested amount per year for 5 years starting from the year of investment
Tax-Free Investments – various individual savings accounts (ISAs)	25% penalty charge for early withdrawals from lifetime ISAs.	No tax on interest, dividends or capital gains below the limits provided. The United Kingdom government adds a 25% bonus up to £1 000 each year for lifetime ISAs.
Retirement Investments	Tax is paid at the prescribed rates when the individual's annual contributions to the pension fund exceed £60 000 for the 2023 to 2024 tax year. Where there is an uncrystallised funds pension lump sum paid under a registered pension scheme and the member is under the	Tax relief may be claimed by private pension contributors up to 100% their contributions. Lump sum withdrawals from a pension are tax free for the first of 25% of the withdrawal.

Type of Investment	Tax	Incentives Applicable
	age of 75, the first 25% of the lump sum is tax free, and this does not affect the member's personal allowance. The remaining 75% will be taxed Where there is an uncrystallised funds pension lump sum paid under a registered pension scheme to a member aged 75 years and above, if the member's lifetime allowance when the lump sum is paid is equal to or greater than the lump sum, no liability for income tax arises on the first 25% of the lump sum and the remaining 75% will be taxed Higher tax is payable on unauthorised payments.	An annual allowance of £40 000 applies. Provision is made for migrant member relief. Double Taxation relief is available. No liability for income tax arises when the lump sum received is a pension commencement lump sum, or serious ill health lump sum, for members below the age of 75 years, and refunds on excess contributions.
Endowment policies	For qualified endowment policies, capital gains tax is charged at 10% when the investor disposes of the endowment policy. The beneficiaries are charged capital gains tax at 28% upon death of the investor. For non-qualifying endowment policies, the profit is subject to income tax at the marginal rate.	Bonuses are paid annually when the fund is performing well. There is no income tax for qualified policies. Top slicing applies for marginally higher rate taxpayers on non-qualifying endowment policies. For basic rate taxpayers on non-qualifying endowment policies, the proceeds will be tax-free.

Type of Investment	Tax	Incentives Applicable
	At maturity, tax is applicable to the maturity figure, less all premiums paid by the policyholder.	
Purchased Annuities	Tax is charged on annuities according to the prescribed formula.	The capital element of a purchased annuity is exempt from tax. No income tax applies on annual payments made under an immediate needs annuity.
Workplace Investments	SAYE: Capital gains tax may be charged if the shares are sold. SIP: Shares are exempt from income tax and capital gains tax if the shares stay in the scheme for more than five years.	SAYE: Bonuses are tax free when the scheme reaches maturity. No income tax is charged on interest from any shares owned by an employee, unless invested in an ISA. No capital gains tax is charged when the capital gains are paid into a pension fund or transferred to an ISA within 90 days of the scheme ending. No liability for income tax arises in respect of the exercise of the share option. SIP: Employee shares are exempt from income tax if they stay in the SIP scheme for more than five years.

Type of Investment	Tax	Incentives Applicable
		There is no tax charge on the award or acquisition of shares in general. There is no tax charge for cash dividends retained for reinvestment. Participants are not liable for income tax when shares cease to be subject to the plan, or when they are no longer in the relevant employment in circumstances beyond their control.
Fixed Interest Securities	Investors are subject to income tax on the interest earned	A capital gains tax exemption applies.

Source: Author's own summary

The United Kingdom offers relief to individuals investing in Venture Capital Schemes. Individuals who invest in the Enterprise Investment Scheme can claim 30% tax relief for a maximum of £1 million invested in qualifying companies, and up to £2 million if the investment is made in a knowledge intensive company. Individuals who invest in the Seed Enterprise Investment Scheme can claim 50% tax relief for a maximum of £100 000 invested in the scheme. Individuals who invest in the Social Investment Tax Relief can claim tax relief of 30% for a maximum of £1 million invested in the scheme. Individuals who invest through Venture Capital Trusts can claim 30% tax relief for the maximum of £200 000 investments allowed annually. Tax relief may also be claimed on dividend income when individuals invest through the Venture Capital Trust. There is tax relief for income tax and capital gains tax of up to £300 000 for United Kingdom based taxpayers who invest in community shares, which can be applied for under the Seed Enterprise Investment Scheme.

In the United Kingdom, individuals have an Individual Savings Allowance and a Personal Savings Allowance. The Individual Savings Allowance is £20 000 per year. The Personal Savings Allowance for basic rate taxpayers is £1 000, for higher rate tax payers it is £500, and for the additional rate tax payer it is £0. Interest is tax free up to £5 000 for individuals with income of up to £17 570, which is reduced by £1 for every extra £1 that the individual earns in excess of £17 570.

Qualifying endowment policies are not subject to income tax. They are subject to capital gains tax at the rate of 10% upon sale or surrender or death of the investor, and at 28% for beneficiaries. Income from non-qualifying endowment policies is subject to income tax at the marginal rate for high-rate taxpayers and is tax-free for basic rate taxpayers.

Individuals investing in any form of retirement fund can claim income tax relief of up to 100% of their contributions to the fund. Relief at source can be claimed, up to 20%, if the deduction of the contribution is made by an employer before deducting income tax. Withdrawals from pensions are tax free up to 25% for pensioners above the age of 75.

The capital element of purchased annuities is exempt from tax. Tax is charged on the annuities according to a prescribed formula.

There are two main workplace investment schemes in the United Kingdom: SAYE and SIP. No income tax is charged on interest from shares owned by an employee through the SAYE scheme and bonuses are tax free. Capital gains tax is only payable where there is gain from the sale of the shares. Employee shares are exempt from income tax if they stay in the SIP scheme for more than five years.

Fixed interest securities (gilts and corporate bonds) are exempt from capital gains tax on the capital repayment.

The following chapter will compare the tax rates and incentives offered in South Africa and the United Kingdom.

CHAPTER FOUR: COMPARISON OF TAX INCENTIVE MEASURES

4.1 INTRODUCTION

This chapter focuses on the third goal of the research, which is to identify any incentive measures adopted in the United Kingdom that could be applied in South Africa to encourage investment in South Africa. This chapter provides a detailed comparison of the taxes and incentives applicable to each investment type in South Africa and the United Kingdom. Incentive measures adopted in the United Kingdom that can be used in South Africa to encourage investment are identified.

4.2 COMPARISON OF VENTURE CAPITAL SCHEMES

Individuals who invested in qualifying venture capital companies in South Africa from 1 January 2009 could claim a full tax deduction for these investments. From 21 July 2019 investments made by natural persons and trusts could only be deducted up to a maximum of R2,5 million, and for companies, a maximum of R5 million was allowed. If the venture capital company shares were held for longer than five years, deductions would not be subject to recoupment. Investments made after 30 June 2021 no longer qualified for deduction, as the provision was repealed.

Individuals in the United Kingdom who invest in a Venture Capital Scheme are able to claim income tax relief on investments made in qualifying companies, income tax relief on loans made to social enterprises, capital gains tax relief on gains from investments, and capital gains tax relief when re-investing previous gains in a Venture Capital Scheme. Tax reliefs allow individuals to make deductions from their income of amounts invested in the Venture Capital Schemes during the tax year. The tax reliefs can be claimed in addition to any personal allowances that individuals in the United Kingdom are entitled to. The Enterprise Investment Scheme helps to raise money to grow businesses by offering tax relief to individuals buying new shares in the company. Companies can raise up to five million pounds per year or twelve million pounds in the company’s lifetime. The Enterprise Investment Scheme provides relief when selling shares at a loss. The loss is realised on the investment by reducing the tax that the investor needs to pay in form of a deduction of the loss from the capital gains tax payable. Up to 50% re-investment relief is also available to investors who invest in a Seed Enterprise investment scheme. Investors are also eligible for community interest tax relief, and they are entitled to claim a deduction of 50% of the invested amount in respect of the investment for the year from their income tax.

With regard to a Venture Capital Trust, there is no liability for income tax on dividends from shares in this venture capital scheme. Individual investors can claim income tax relief on amounts invested of up to £200 000. They are also exempt from income tax on dividends in respect of ordinary shares acquired within the permitted maximum of £200 000, and capital gains tax on the disposal of ordinary shares acquired up to a maximum of £200 000. Venture Capital Trusts provide relief on all gains and losses that accrue to an individual on the disposal of qualifying shares. Directors of the Trusts are also eligible for relief.

Social Investment Tax Relief is a State aid designed by the United Kingdom government to help raise money to support trading activities of community interest companies, community benefit societies, or charities. It offers income tax relief to investors for the shares they buy, or money they lend to enterprises, if the rules of the scheme are followed for three years. Tax relief is provided by a deduction from income of 30% of the investment, up to a maximum of £1 million. Personal capital gains tax relief is available on 100% of the initial investment. In the United Kingdom, there are community shares that also enjoy the benefits of the Social Investment Tax Relief provided by a deduction from income of 30% of the investment, up to a maximum of £1 million. Community shares refer to the withdrawable share capital of co-operative and community benefit societies. Social Investment Tax Relief was not extended in the United Kingdom and will only apply to investments made until 6 April 2023.

There are no community shares or social investment tax reliefs in South Africa, similar to that available in the United Kingdom. In South Africa there is, however, a donations tax deduction for donations to charities that are approved in terms of section 30 of the Income Tax Act (section 18A of the Income Tax Act). Donors to these charities can deduct the donation, limited to 10% of their taxable income each year.

Discontinuing the venture capital scheme incentive in South Africa means that investors are now less likely to invest in small and medium size companies because the tax incentive is no longer available.

4.3 COMPARISON OF TAX-FREE INVESTMENTS

In South Africa**,** no tax is paid on interest, dividends and capital gains accruing to investors in respect of an investment in a tax-free financial instrument that is below the limit for tax-free investments, and there is a penalty for contributions exceeding the limits. If an investor contributes an amount in excess of R36 000 towards tax-free investments during any year of assessment, 40% of the excess contribution will be the amount of normal tax payable by the investor on the excess in respect of that year of assessment. If an investor contributes in excess of the amount of R500 000 towards tax-free investments in aggregate, 40% of the excess contribution, which has not previously been taken into account, will be the amount of normal tax payable on the excess by the investor in respect of the year of assessment in which the excess contribution was made. When calculating the aggregate capital gain or loss of the investor, gains and losses from the disposal of tax-free investments will be disregarded. On other interest-bearing instruments, investors under the age of 65 are granted an exemption of up to R23 800, and those over the age of 65 are granted R34 500.

In the United Kingdom there are allowances that apply before the taxpayer has to pay tax, which include a personal allowance, a starting rate for savings, and a personal savings allowance. Individuals are entitled to a personal allowance of £12 570 for the tax year if they meet the requirements for residence. The starting rate for savings is £5 000, which means that taxpayers can earn up to £5 000 of interest without having to pay tax on the interest. Those with net income exceeding £100 000 will have their allowance reduced by half of the excess above £100 000. Individuals may have a normal savings account, and tax-free investments, using the individual savings account (ISA) allowance of up to £37 700 for the 2023 to 2024 tax year. For taxpayers subject to the basic tax rate, the limit will be £37 700, while for taxpayers paying tax at the higher rate, the limit is £150 000. If the individual’s income for the year is additional rate income, his or her individual savings allowance becomes nil. If the individual’s income is higher rate income and none of the income is additional rate income, the individual’s personal savings allowance will be £500. If none of the individual’s income for the year is higher rate income, the allowance will be £1000.

In the United Kingdom, taxpayers are entitled to tax-free individual savings accounts (ISAs). The maximum amount for tax-free savings in the current tax year, 2023 is £20 000. Although the maximum amount for tax-free savings for the first tax year is £20 000, payments can be made up of to £4 000 each tax year until the investor turns 50 years old. The United Kingdom government adds a 25% bonus of up to £1 000 each year for lifetime ISAs. There are also Junior ISAs that are available as long-term savings accounts for children under the age of 18. The savings limit for children for the current tax year, 2023, is £9 000.

Most of the incentives for tax-free investments in South Africa and the United Kingdom are similar, except for the 40% penalty on excess contributions in South Africa, and bonuses provided by the government in the United Kingdom.

4.4 COMPARISON OF RETIREMENT INVESTMENTS

In South Africa, contributions to all retirement funds (pension, provident and retirement annuity funds) in terms of the rules of the fund, are deductible from the investor's pre-tax income, up to the limits provided for. The total deduction allowed for each year of assessment cannot exceed 27,5% of the higher of the person's remuneration or taxable income, before allowing any deductions and the inclusion of any taxable capital gain, up to a maximum deduction of R350 000 per year of assessment. If the employer contributes to a retirement fund on behalf of an employee, this is taxed as a "fringe benefit" in the hands of the employee, but is claimed as a deduction, together with any contributions made directly by the employee, subject to the limits provided for.

In South Africa, tax is calculated on the retirement lump sum benefit after deducting contributions to the retirement fund that previously did not qualify for deduction or were not exempt from normal tax. One-third of the retirement interest in respect of pension, pension preservation, provident, provident preservation, or retirement annuity funds can be taken in the form of a lump sum. Two-thirds of the retirement interest in respect of pension, pension preservation, provident, provident preservation, or retirement annuity funds must be received in form of an annuity (unless the total benefit amounts to R247 500, in which case it can be taken as a lump sum). The tax rates for retirement fund lump sums from 1 March 2023 to 29

February 2024 provide for a tax-free lifetime amount of R550 000, and a maximum rate of 36% on lump sums in excess of R1 089 000.

Unlike in South Africa, where the maximum contribution allowed as a deduction for each year of assessment may not exceed the prescribed limits, the United Kingdom does not limit the deduction of pension contributions and allows for tax relief by pension contributors up to 100% of their annual earnings. Taxpayers get automatic relief for contributions if their employers deduct their pension contributions from their salaries before deducting income tax, and if their income tax rate is 20%, the pension provider claims it as tax relief from the United Kingdom government on behalf of the member and adds it to the member's pension, which is known as relief at source.

When a third party pays into the taxpayer's pension, there is an automatic tax relief at a 20% rate if the pension provider claims it for the taxpayer. Taxpayers who do not pay income tax also get automatic tax relief at source at 20% on the first £2 880 paid into their pension fund each tax year, and the tax relief is claimed from the government by the pension provider on behalf of the member. For example, when a member wants to make a £100 contribution to his or her pension, he or she will only make a payment of £80 into the pension scheme. The pension provider claims £20 from the United Kingdom government and pays this into the scheme making up the pension contribution to £100.

Self-employed taxpayers in England, Wales, or Northern Ireland can claim additional tax relief on their self-assessment tax return for contributions made to a private pension fund of 20% up to the amount of income where 40% tax is paid, or 25% up to the amount of income where 45% tax is paid. Self-employed taxpayers in Scotland can claim additional tax relief on their self-assessment tax return for contributions made to private pension of 1% up to the amount of income where 21% tax is paid, 21% up to the amount of income where 41% tax is paid or 25% up to the amount of income where 46% tax is paid.

Making a lump sum withdrawal from a pension fund in the United Kingdom after reaching the age of 75 is tax free for the first of 25% of the withdrawal. Thereafter, the normal income tax rates will apply. The first 25% of the pension lump sum also does not affect the taxpayer's personal allowance, because tax is only charged on the remaining 75% of the lump sum. Tax is deducted from the remaining amount of the pension benefit after deducting both the first

25% and the personal allowance. No liability for income tax arises when the lump sum received is a pension commencement lump sum, serious ill health lump sum for members below the age of 75 years, and refunds of excess contributions where a member has paid pension contributions in a tax year of more than the maximum amount that can receive tax relief. There is no longer a lifetime allowance provided for on what an individual can accumulate on their pension before they have to pay tax. While 100% of the contributions to a pension fund can be deducted from income, the annual allowance that an individual can pay into a pension scheme before they have to pay tax is £60 000 for the 2023 to 2024 tax year. When the pension is inherited, beneficiaries do not pay tax unless it exceeds their personal allowance.

Taxpayers can claim the migrant member relief if they move to the United Kingdom and they were paying into the pension scheme before they moved to the United Kingdom, receiving tax relief on the contributions before they moved, and if the scheme is a qualifying overseas pension scheme. Taxpayers can also claim the Double Taxation relief if they were paying into the scheme before they moved to the United Kingdom, receiving tax relief on the contributions before they moved, if the contributions are covered by a Double Taxation Agreement.

The basic provisions in both countries are similar. However, the United Kingdom does not limit the amount of pension contributions allowed as an annual deduction. The maximum amount of relief to which an individual is entitled to for a tax year is the amount of the individual's United Kingdom earnings chargeable to income tax for the year. Previously, tax was only paid when the individual's private pension exceeded £1 073 100. However, this has now been abolished and tax is now only payable on certain lump sums. There is no liability for income tax when the lump sum received is a pension commencement lump sum, serious ill health lump sum and refunds for excess contributions in the United Kingdom. Provision is also made for migrant member relief in the United Kingdom.

4.5 COMPARISON OF ENDOWMENT POLICIES

In South Africa, endowment policies offer tax benefits to investors with marginal tax rates in excess of 30%, as income is taxed in the hands of the insurer at this rate, and capital gains are taxed at 12% (compared to 18% for individuals), thus providing a higher capital payment on maturity. Premiums paid to the insurer are not tax deductible and, after the first five years of the investment, withdrawals can be made from the fund at any time with no tax implications.

In the United Kingdom, qualifying policies are not subject to income tax, but capital gains tax is applicable. The capital gains tax rate charged when the investor disposes of the endowment policy is 10%. However, the rate applying to the beneficiaries upon death of the investor is 28%, after deducting the purchase price, premiums, and tapering relief exceeding the tax-free allowance. For non-qualifying endowment policies, the profit is subject to income tax at the marginal rate for the high-rate taxpayers, and this applies to the maturity amount as well. At maturity, tax is applicable to the maturity figure less all premiums paid by the policyholder. For basic rate taxpayers, the proceeds will be tax-free. Marginally higher rate taxpayers will pay some tax but will benefit from “top slicing” (the gain is divided by the number of tax years the investment has been held) and adding this figure to taxable income for the year, to which the proportional tax rate is applied. Unlike in South Africa, where income tax is charged at a flat rate of 30% in the hands of the insurance company/policy fund the United Kingdom charges income tax on non-qualifying policies at the marginal rate of the individual policy holders, which accommodates low-income earners. The tax is paid by the investment fund before the returns are paid to the policy holder.

4.6 COMPARISON OF PURCHASED ANNUITIES

In South Africa, annuity income in respect of a purchased annuity is only partially taxable in the hands of the individual investor, as the capital element of the annuity is exempt and only the balance of the annuity amount is taxed. The determination of the capital element of each annuity payment is prescribed by a formula, which spreads the annuity purchase price over the expectation of life of the annuitant using prescribed mortality tables, or the term of the policy. Once the capital element is set, it remains at the same level irrespective of how long the annuitant lives.

Similarly, the capital element of purchased life annuities in the United Kingdom is also exempt from tax, which is an exempt sum or exempt proportion, while the remainder of the annuity payment is taxable. The exempt capital amount is obtained by dividing the purchase price of the annuity by the annuitant’s life expectation according to mortality tables. In circumstances where the exempt amount exceeds the annuity paid, the remainder of the exempt amount will be carried over to the next payment.

The United Kingdom provides, in addition, for an immediate needs annuity, which is a life annuity purchased for the purpose of protection against the consequences of the person being unable to live independently due to mental or physical impairment, or injury, sickness or other infirmity. No liability for income tax arises on annual payments made under the immediate needs annuity policy.

4.7 COMPARISON OF WORKPLACE INVESTMENT SCHEMES

The two forms of workplace investments in South Africa are the Broad-Based Employee Share Plans, and Vesting of Equity Instruments by directors and employees. Employees are able to acquire the Broad-Based Employee Share Plan shares for no payment or at a cost below the market value of the shares. No income tax is payable on the shares acquired by the employee. Any gains made on disposal by an employee of a qualifying equity share, or any right or interest in a qualifying equity share in respect of the broad-based employee share plan within five years from the date of grant of the shares will be included in the "gross income" of the employee disposing the shares, unless the disposal is in exchange for another qualifying share, is on the death of the employee, or on the insolvency of the person. Employees' tax will be deducted from any taxable gain. This scheme confers a tax benefit and provides an investment incentive.

On vesting of equity instruments, which fall under section 8C of the Income Tax Act, the director or employee must include in or deduct from his or her income for a year of assessment any gain or loss determined in respect of the vesting during that year of any equity instrument, if that equity instrument was acquired by that taxpayer by virtue of his or her employment or office as director of any company. Any gains arising when the ownership of the shares vests immediately or the ownership of the shares becomes unrestricted, will be deemed to be remuneration and taxed as income. Employers will also be required to withhold employees' tax. Equity instruments falling under section 8C confer no tax benefit and the section does not provide a tax incentive.

The two main types of workplace investment scheme in the United Kingdom (SAYE and SIP) offer tax benefits and incentives to employees. When a SAYE scheme reaches maturity, the bonuses become tax free. Capital gains tax is charged if the shares are sold, but there is no capital gains tax charged when the capital gains are paid into a pension fund. There is no liability for income tax in respect of the exercise of the share option if the individual exercises it in accordance with provisions of the SAYE and it is not an arrangement for the avoidance of tax on national insurance contributions (a tax on earnings and self-employed profits paid by employees, employers, and the self-employed individuals) by reducing the amount of earnings. The exemption applies when exercised after three years from the date the share option was granted, or the scheme-related employment has ended, or certain company events have occurred. There is no charge on the award to or acquisition of shares by the employees in the SAYE scheme. Employees will also not be liable for income tax on the value of the beneficial interest on shares that passes to them at the time of the award or acquisition.

SIP shares are exempt from income tax if the shares stay in the scheme for more than five years. Provision is made for exemptions from income tax on shares obtained under SIPs, the value of shares that the member received as remuneration from employment, and employees' tax deductions in relation to the amounts. There is no charge on cash dividends paid in respect of SIP shares that are retained for reinvestment. There is also no liability for income tax on dividends on shares ceasing to be part of SIP, except in the case of dividends paid to non-residents. Participants are not liable for income tax when shares cease to be subject to SIP due to the participants no longer being in the relevant employment because of disability, job redundancy, relevant transfer, the company becoming an associated company, retirement, and death of the participant. Participants are not liable for income tax on relevant shares in a company being withdrawn from the plan, if the withdrawal of the relevant shares from the plan relates to a transaction resulting from a compromise, arrangement or scheme falling within an offer forming part of a general offer where there is a takeover, or as a result of the transaction, the participant receives cash in exchange for the relevant shares. There is also relief from stamp duty on transfers of shares. When shares cease to be part of SIP, and the participant was being provided with employment income in the form of those shares and the remuneration would have been subject to tax, the tax will be charged.

The workplace investment schemes provided in the United Kingdom offer more incentives than the scheme in South Africa.

4.8 COMPARISON OF FIXED INTEREST SECURITIES

In South Africa, interest earned on retail savings bonds is subject to the annual exemption of R23 800 for investors below the age of 65, and R34 500 for investors aged 65 years and above. The capital investment and the repayment of the amount invested are exempt from capital gains tax. Payments made to the investor in respect of retail savings bonds are made without deductions for, or on account of taxes imposed or levied on the amount, unless such withholding is required by the law; in such cases the bond provider pays the withholding tax and pays the net amount to the investor.

In the United Kingdom, fixed interest securities with a redemption date on or after 1 January 1992, are exempt from capital gains tax, but the investors are subject to income tax on the interest earned. They have fixed interest pay-outs every six months until the maturity date of the gilts. At maturity, the gilt holder receives the final interest payment together with the capital invested.

Although the incentives are not exactly the same, the incentives provided for fixed interest securities in the United Kingdom and in South Africa are not significantly different.

4.9 COMPARISON OF INVESTMENTS AND INCENTIVES

The following table summarises and compares the tax rates and incentives applicable for the types of investments available to individuals in South Africa and the United Kingdom.

Table 4.1: Summary and comparison of the tax rates and incentives for investments in South Africa and the United Kingdom

Type of Investment	Tax		Incentives Applicable	
	South Africa	**United Kingdom**	**South Africa**	**United Kingdom**
Venture Capital Scheme	Capital gains tax is payable on disposal of the venture capital shares. Dividends paid to investors by the venture capital companies are subject to dividends tax.		Full deduction of the amount invested in a venture capital company before 21 July 2019, and up to a maximum of R2,5 million for investments made by natural persons and trusts and a maximum of R5 million for companies from 21 July 2019 to 30 June 2021.	Income tax relief (which allows individuals to deduct from their gross income, the amounts invested up to the maximum permitted for each type of investment) on investments in qualifying companies or venture capital trusts; income tax relief on loans or debts granted to social enterprises; capital gains tax relief on gains from the investments; capital gains tax relief when reinvesting previous gains in a scheme; and community investment tax relief at 5% of the invested amount per year for 5 years starting from the year of investment
Tax-Free Investments	Tax penalty at 40% for excess contributions.	25% penalty charge for early withdrawals from lifetime ISAs.	No tax on interest, dividends or capital gains, below the threshold investment.	No tax on interest, dividends or capital gains below the limits provided. The government adds a 25% bonus up to £1 000 each year for lifetime ISAs.
Other Interest-bearing Investments	Tax is payable on interest according to the tax tables, after	The starting rate for savings is £5 000, which means that taxpayers can earn up to £5 000 of	Exemptions provided amounting to R23 800 or R34 500, depending on the age of the investor.	Individuals pay tax on interest exceeding their starting rate for savings.

Type of Investment	Tax		Incentives Applicable	
	South Africa	**United Kingdom**	**South Africa**	**United Kingdom**
	deducting the exemption.	interest without having to pay tax on it.		
Retirement Investments	Tax is payable on lump-sums and annuities at the prescribed rates.	Tax is paid at the prescribed rates when the individual's contributions to the pension fund exceed £60 000 for the 2023 to 2024 tax year. Tax on 75% of the lump sum is payable after the age of 75. No liability for income tax arises when the lump sum received is a pension commencement lump sum, serious ill health lump sum for members below the age of 75 years and refunds on excess contributions. Higher tax is payable on unauthorised payments.	Contributions are deducted from pre-tax salary, up to the maximum limits, reducing the tax payable. The tax on lump-sum amounts received on retirement is levied at a maximum rate of 36%, after the (life-time) tax-fee amount of R550 000 is deducted.	Tax relief may be claimed by private pension contributors up to 100% their contributions. However, the tax-free annual allowance is limited to £60 000 for the 2023 to 2024 tax year. No income tax applies in respect of income on investments held for purposes of a registered pension scheme. Lump sum withdrawals from a pension after reaching the age of 75 are tax free for the first of 25% of the capital. Provision is made for migrant member relief. Double Taxation relief is available.
Endowment policies	Tax is paid by the insurer on all income at a standard rate of 30%; and at 12% on capital gains.	For qualified endowment policies, capital gains tax is charged at 10% when the investor disposes of the endowment policy.	The tax rates applying to the insurer ensure a higher capital repayment than if individuals paying tax at a rate in excess of 30% had invested directly.	Bonuses are paid annually when the fund is performing well. There is no income tax for qualified policies.

Type of Investment	Tax		Incentives Applicable	
	South Africa	**United Kingdom**	**South Africa**	**United Kingdom**
	Premiums are not tax deductible, and the pay-out of the policy is exempt from tax.	The beneficiaries are charged capital gains tax at 28% upon death of the investor. For non-qualifying endowment policies, the profit is subject to income tax at the marginal rate. At maturity, tax is applicable to the maturity figure, less all premiums paid by the policyholder.		For basic rate taxpayers on non-qualifying endowment policies, the proceeds will be tax free. Top slicing applies for marginally higher rate taxpayers on non-qualifying endowment policies.
Purchased Annuities	Tax is payable on the taxable portion of the annuity payments.	Tax is payable on the taxable portion of the annuity payments.	The capital element of the annuity is exempt from tax.	The capital element of the annuity is exempt from tax. No income tax applies on annual payments made under an immediate needs annuity.
Workplace Investments – share investment schemes	Section 8B: gains on disposal of shares before the end of the five-year period are taxed as remuneration. Capital gains tax is charged on	Capital gains tax is charged if the shares are sold. SIP shares are exempt from income tax if the shares stay in the scheme for more than 5 years.	Section 8B enables employees to acquire shares in the employer company at no or a low cost, and earn dividends on the shares from the date of the grant.	SAYE: Bonuses are tax free when the scheme reaches its maturity. No income tax is charged on interest from any shares owned by an employee, unless invested in an ISA.

Type of Investment	Tax		Incentives Applicable	
	South Africa	**United Kingdom**	**South Africa**	**United Kingdom**
	disposals of the shares after the five-year period. Section 8C: gains on vesting of equity shares are taxed as remuneration. If disposed of within three years of vesting and the shares are held for speculative purposes, gains are taxed as income, otherwise subject to capital gains tax.			No capital gains tax is payable when the capital gains are paid into a pension fund. No liability for income tax arises in respect of the exercise of the share option. SIPs Employee shares are exempt from income tax if they stay in the SIP scheme for more than 5 years. There is no tax liability on the award or acquisition of shares. There is no tax payable on cash dividends retained for reinvestment. Participants are not liable for income tax when shares cease to be subject to the plan due to the participants no longer being in the relevant employment in circumstances beyond their control.
Fixed Interest Securities – retail savings bonds and gilts	Tax is levied at the normal rates on the interest, after the interest exemption is deducted.		The annual interest exemption of R23 800 for individuals below 65 years and R34 500 for individuals aged 65 years and above applies.	A capital gains tax exemption applies.

Source: Author’s own summary

The comparison of the taxes and incentives applicable to the selected investments in South Africa and the United Kingdom, indicates that there are some similarities on how certain investments are taxed. However, in respect of most of the investments, the United Kingdom provides more favourable tax incentives than South Africa.

4.10 CONCLUSION

The question that this research seeks to answer is whether there are any investment incentive measures provided in United Kingdom tax legislation that could provide recommendations to be incorporated into South African tax legislation to encourage investment. This chapter compared the taxes and incentives applicable for the investments in South Africa and the United Kingdom.

The next chapter concludes the research. The goals of the research addressed in each chapter are briefly discussed. The tax incentives in South Africa and the United Kingdom are briefly compared, and South African policy recommendations are made. Limitations of the study and suggestions for further research are also identified.

CHAPTER FIVE: CONCLUSION

5.1 INTRODUCTION

This chapter concludes the thesis, linking the goals of the research to what was covered in each chapter. It provides a summary of the findings and recommendations, and a conclusion to the research. It briefly discusses the limitations of the research and makes a suggestion for further research.

5.2 THE GOALS OF THE RESEARCH

The goal of this research was to determine whether there are any tax incentives for individuals offered in the United Kingdom that can be adopted in South Africa to encourage investments. The sub-goals of the research were as follows:

- Discuss the selected investments offered in South Africa, how the investments are taxed, and tax incentives provided to encourage investment.
- Discuss investments offered in the United Kingdom, how they are taxed, and tax incentives provided to encourage investment.
- Identify any incentive measures adopted in the United Kingdom that could be used in South Africa to encourage investment.
- Recommend investment incentive measures that could be adopted in South Africa.

The first chapter provided a background to the research and introduced the types of investments on which this research focuses. It explained why the United Kingdom was the country of choice for the research. It also summarised the literature dealing with the need for investment, and investment incentives in South Africa and elsewhere. The research question, the goal and sub-goals were described. The chapter also explained the research methodology adopted for the research. It concluded with an overview of the chapters to follow.

The first sub-goal of the research was to discuss the selected investments offered in South Africa, how the investments are taxed, and tax incentives provided to encourage investment. This was dealt with in chapter two, and it was concluded that, based on the analysis presented, South Africa offers some investment opportunities and incentives for individuals, but this does not seem to have increased the household savings rates substantially.

The second sub-goal of the research was to discuss investments offered in the United Kingdom, how they are taxed, and tax incentives provided to encourage investment. This was discussed in chapter three.

The third sub-goal of the research was to identify any incentive measures adopted in the United Kingdom that could be used in South Africa to encourage investment. This was discussed in chapter four of the research, where a comparison was made between the taxes and incentives provided for investments in the two jurisdictions.

The fourth sub-goal of the research was to recommend investment incentive measures that could be adopted in South Africa. After comparing the taxes applying to each type of investment and the incentives provided in each jurisdiction in chapter four, the present chapter (chapter five) presented for tax incentives that could be incorporated into South African tax legislation to encourage investment by individuals.

5.3 COMPARISON OF TAX INCENTIVES

Individuals are now less likely to invest in small and medium size companies because the tax incentive allowing for deduction from income of the amount invested in venture capital companies is no longer applicable. A similar tax incentive for venture capital schemes remains in the United Kingdom legislation.

Tax-free investment incentives offered in the United Kingdom are also offered in South Africa. However, the United Kingdom does not charge a penalty for excess contributions similar to the 40% penalty charged in South Africa.

Most taxes and incentives for pensions in South Africa and the United Kingdom are similar However, there are some incentives available in the United Kingdom that are not available in South Africa. In the United Kingdom, there is no limit on the deductible amount of contributions to a retirement scheme. The first 25% of a lump sum withdrawal is tax-free free, therefore, tax is only charged on the remaining 75%. There is also no income tax on lump sums received as a pension commencement lump sum, serious ill health lump sums. and the refund of excess contributions. In the United Kingdom, pensioners receive a migrant member relief.

In the United Kingdom, there is a tax-free allowance for qualifying endowment policies. For non-qualifying policies, the tax rate charged when the investor disposes of the endowment policy is 10% and the rate charged on beneficiaries upon death of the investor is 28%. The profit on non-qualifying policies is subject to income tax at the marginal rate for the high-rate taxpayers, and this applies to the maturity amount as well. For basic rate taxpayers, the proceeds will be tax-free. Marginally higher rate taxpayers will pay some tax but will benefit from “top slicing”. In South Africa income is taxed in the hands of the insurer at a 30% rate, and capital gains are taxed at 12% (compared to 18% for individuals), providing a higher capital payment on maturity. Premiums paid to the insurer are not tax deductible and, after the first 5 years of the investment, withdrawals can be made from the fund at any time with no tax implications.

Both South Africa and the United Kingdom exempt the capital element of purchased annuities when calculating the tax liability. However, the United Kingdom provides for no liability for income tax on an immediate needs annuity.

Shares awarded in terms of employee share investment schemes in South Africa are taxed according to section 8B and 8C of the Income Tax Act. Section 8B provides for the taxation of Broad-Based Employee Share Plan, where gains on the disposal of shares before the end of the five-year period are taxed as remuneration, and capital gains tax is levied on disposals of the shares after the five-year period. Section 8C provides for taxation on vesting of equity instruments by employees and directors, where gains on vesting of equity shares are taxed as remuneration. If disposed of within three years of vesting and the shares are held for speculative purposes, gains are taxed as income, otherwise the gains are subject to capital gains tax.

By contrast, workplace investments in the United Kingdom, are exempt from income tax and other incentives are also available. In the United Kingdom, the two main workplace investments are SAYE and SIP. In the SAYE scheme, bonuses are tax free when the investment reaches maturity, and no income tax is charged. There is also no income tax charge on the award of shares in the SAYE scheme. In SAYE scheme capital gains tax is charged when the shares are sold unless the proceeds are paid into a pension fund. In the SIP scheme, shares are exempt from income tax if they stay in the scheme for more than 5 years. In the SIP scheme, there is an exemption from income tax on shares obtained under SIPs, amounts that are deemed to be remuneration from employment, and employees' tax deductions in relation to the amounts. There is no charge on cash dividends paid in respect of SIP shares that are retained for reinvestment. There is also no liability for income tax on dividends on shares ceasing to be part of SIP, except in the case of dividends paid to non-residents. Participants are not liable to income tax when shares cease to be subject to SIP due to the participants no longer being in the relevant employment because of circumstances beyond their control.

In South Africa, interest earned on retail savings bonds is subject to the annual interest exemption of R23 800 for investors below the age of 65, and R34 500 for investors aged 65 years and above (together with other interest-bearing investments). In the United Kingdom, fixed interest securities (gilts) with a redemption date on or after 1 January 1992, are exempt from capital gains tax. Taxable fixed interest pay-outs are made every six months until the maturity date of the gilts. At maturity, the gilt holder receives the final interest payment together with the capital invested.

5.4 POLICY RECOMMENDATIONS

Based partly on the incentives provided in the United Kingdom, together with other possible tax incentives, the following recommendations are made for South Africa.

Venture Capital Company Investments:

- the Venture Capital Company incentive should be re-enacted; or
- income tax relief should be introduced for venture capital schemes made directly into qualifying companies; and
- capital gains tax relief should be provided on gains from the disposal of venture capital schemes, after a suitable period of time.

Tax-free investments:

- remove the 40% penalty and levy income tax according to the rates prescribed in the tax tables on contributions exceeding the limit;
- increase the tax-free investment threshold in line with inflation, or amend the section 10(1)(i) interest exemption to apply to the interest on contributions in excess of the thresholds; and
- the government could add bonuses to investments by individuals.

The section 10(1)(i) interest exemption:

- although National Treasury has stated that the interest exemptions are to remain at their present levels in future, to be eroded by inflation, in order to increase savings by individuals, the existing exemptions should be increased each year in line with inflation.

Purchased annuities:

- there should be no liability for income tax on the annuity payments in the case of disability, sickness, and other similar circumstances.

Section 8B Broad-Based Share Incentive Scheme:

- no dividends tax should apply on cash dividends retained for reinvestment into the share incentive scheme; and
- no income tax liability should apply for employees when shares are disposed of, due to the employees no longer being in the relevant employment in circumstances beyond their control.

Workplace Savings Schemes:

- consider introducing workplace savings schemes similar to the savings schemes applying in the United Kingdom.

Investments for retirement:

- consider allowing all contributions to pension funds to be deductible from income; or
- consider increasing the maximum annual deductible contribution of R350 000 annually in line with inflation; and
- encourage individuals to retain a larger proportion of their retirement fund interest, by considering allowing a tax-free lump sum withdrawal of 25% on retirement or death in terms of the rules of the fund, with the remaining 75% payable as an annuity and subject to normal tax rates.

No recommendations are made for endowment policies and retail savings bonds.

An important recommendation to increase savings by individuals may be to mount an education campaign, possibly even at secondary school level, to inform people about the need to save, and to introduce the various savings incentives to them.

5.5 LIMITATIONS OF THE STUDY

This study only focuses on incentives available for certain selected types of investments for individuals in South Africa in comparison to the United Kingdom. It does not focus on investment incentives provided in other countries, apart from the United Kingdom.

5.6 SUGGESTION FOR FURTHER RESEARCH

Future research can extend the study to other tax jurisdictions to recommend sustainable ways in which to implement changes that can encourage investments by individuals in South Africa.

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