A first batch of legislation for inclusion in the **Revenue Laws Amendment Bill, 2005**, is hereby released for public comment.

It would be appreciated if comments on the draft legislation could be furnished by **Friday, 19 August 2005**. Due to time constraints, it will not be possible to respond individually to comments received. However, receipt of comments will be acknowledged and fully considered by the National Treasury and SARS.

Comments must be submitted to either:

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DRAFT REVENUE LAWS AMENDMENT BILL

BATCH ONE

GENERAL EXPLANATORY NOTE:

[ ] Words in bold type in square brackets indicate omissions from existing enactments.

________ Words underlined with a solid line indicate insertions in existing enactments.

BILL

BE IT ENACTED by the Parliament of the Republic of South Africa, as follows:—

Amendment of section 2 of Act 40 of 1949

1. Section 2 of the Transfer Duty Act, 1949, is hereby amended by the insertion after subsection (1) of the following subsection:

"(2) If the Minister of Finance has foreshadowed any—

(a) change in the rate of the transfer duty contemplated in subsection (1); or

(b) any other change to the provisions of this Act which has the effect that the acquisition of certain property will no longer be subject to transfer duty,

with effect from a date preceding the date on which the legislation giving effect to that change is promulgated, that change in the rate or to the provisions of this Act so foreshadowed applies with effect from the date determined by the Minister and lapses at the earlier of the date on which that legislation is promulgated or 6 months after that date so determined.".

It often occurs that changes are announced in the Budget Review with regard to the rates of transaction taxes with effect from a date (e.g. 1 March) preceding the date on which the legislation introducing that rate change is promulgated. It becomes

problematic to implement these changes before the legislation is in place as there is nothing on which a deeds registrar can rely when registering the transfer of property, if the amount of transfer duty paid in respect of the property does not coincide with the amount required to be paid in terms of the Act.

It is, therefore, proposed that a provision be inserted in the Transfer Duty Act, 1949, to address this issue. This will ensure that the proposed changes to the rates apply with effect from the date determined by the Minister in the Budget Review and that they lapse at the earlier of the date on which the legislation giving effect thereto is promulgated or, if no such legislation is passed, after 6 months from the date so determined.

Amendment of section 9 of Act 40 of 1949

2. Section 9 of the Transfer Duty Act, 1949, is hereby amended by the deletion of subsections (16) and (17).

This clause deletes provisions which have become obsolete.

Amendment of section 3 of Act 45 of 1955

3. (1) Section 3 of the Estate Duty Act, 1955, is hereby amended by the insertion in subsection (3) after paragraph *(b)* of the following paragraph:

"*(c)* any property donated under a donation in terms of which a donee as defined in section 55 of the Income Tax Act, 1962 (Act No. 58 of 1962), will not obtain any benefit thereunder until the death of the donor;".

(2) Subsection (1) shall come into operation on … and applies in respect of the estate of any person who dies on or after that date.

Section 3(3) of the Estate Duty Act, 1955, deems certain property to be the property of the deceased for the purposes of calculating the dutiable amount of the estate. Certain schemes have been developed in terms of which both estate duty and donations tax are avoided. In terms of one of these schemes a donation is made during the lifetime of the donor, subject to the condition of that the donee does not enjoy any benefit until the death of the donor. The value of the assets so donated still forms part of the property in the estate of the deceased, but the donee claims the donation as a liability against the estate.

It is claimed that the effect of the scheme is that the value of the property donated is exempt from donations tax and no estate duty is levied upon that value, as the claim of the donee against the estate reduces the dutiable amount on which estate duty is levied. A case of this nature is presently being tested in the courts, but to place it

beyond doubt, it is proposed that donations which are exempt from donations tax as the donees do not receive benefits until the death of the donor, must be deemed to be property of the deceased. It is proposed that the amendment should apply to the deceased estates of persons who die on or after date of tabling of the Bill.

Two other options to deal with this problem also include—

(a) to withdraw the donations tax exemption. This would, however, result in imposing a tax on a transaction which may never take place, e.g. where the asset no longer exists at the time of death. It will also impose the tax upfront where the actual donation only takes place years later;

(b) to exclude from the deduction of debts against the estate, any such donation which is, effectively, a legacy to an heir.

Comments are also requested on these other two options.

Amendment of section 1 of Act 58 of 1962

4. (1) Section 1 of the Income Tax Act, 1962, is hereby amended—

(a) by the insertion after the definition of "average exchange rate" of the following definition:

"'beneficiary' in relation to a trust means a person who has a vested or contingent interest in the whole or portion of the receipts or accruals or the assets of that trust;";

It has recently been argued that the word "beneficiary" must be given a narrow meaning as only including beneficiaries with vested rights. It is proposed that a wide definition of "beneficiary" be introduced to clarify that it includes contingent beneficiaries. This definition must be read with the opening words to section 1, i.e. that the definition applies to the extent that the context doesn't indicate otherwise. Where in the context of a provision of the Act the narrow meaning of the word is intended, i.e. to specifically refer to vested interest, this is specifically stated in the relevant provision.

(b) by the deletion in the definition of "connected person" of the words following paragraph *(e)*;

This amendment is consequential upon the insertion of the definition of "beneficiary" as mentioned above.

(c) by the deletion of paragraph *(lB)* of the definition of "gross income";

This subclause deletes an obsolete provision.

(d) by the substitution in the definition of "gross income" for paragraph *(n)* of the following paragraph:

“*(n)* any amount which in terms of any other provision of this Act is specifically required to be included in the taxpayer's income, **[and]** which amount shall for the purposes of this paragraph **[all amounts which in terms of subsection (4) of section eight are required to be included in the taxpayer's income shall]** be deemed to have been received by or to have accrued to the taxpayer **[from a source within the Republic notwithstanding that such amounts may have been recovered or recouped outside the Republic]**:”.

This amendment is consequential upon the introduction of a worldwide basis of taxation.

Amendment of section 7 of Act 58 of 1962

5. Section 7 of the Income Tax Act, 1962, is hereby amended by the insertion after subsection (8) of the following subsection:

“(8A) Any amount incurred by the person contemplated in subsection (8) in relation to the amount received or accrued to that person, must be deemed to have been incurred by the resident in whose income that amount is included in terms of that subsection.”.

Section 7(8) of the Income Tax Act, 1962, attributes income of a non-resident back to a resident if the income is derived by virtue of a donation made by the resident to that non-resident. This provision was amended in 2004 to address certain arguments raised, i.e. that it only applied in respect of income of a resident which is derived from a source in the Republic. It was argued that the provision referred to “income” as defined which, in the case of a resident, includes only amounts from a South African source. Section 7(8) was, therefore, amended to attribute all the receipts and accruals of a foreign person to the resident, if it would have constituted income had they been received by or accrued by a resident. The effect of this amendment, however, is that receipts and accruals are attributed, but the expenses of the foreign person are not taken into account. It is, therefore, proposed that section 7 be amended to provide that any expenses incurred by the foreign person must be deemed to have been incurred by the resident.

Amendment of section 8A of Act 58 of 1962

6. Section 8A of the Income Tax Act, 1962, is hereby amended by the substitution in subsection (5) for paragraph *(b)* of the following paragraph:

"*(b)* any gain made by the taxpayer <u>(other than a gain in respect of which section 8C applies)</u> by the exercise, cession or release of the second right, shall be determined and included in the taxpayer's income as though such gain had been made by the exercise, cession or release of the first right, and for the purpose of determining such gain, the amount to be deducted under subsection (2)(*a*) or (3) in respect of the amount or value of the consideration given by the taxpayer for the second right shall be deemed to be the consideration given by the taxpayer for the first right or the grant of such right, less so much of the amount or value of that consideration as has been offset by any consideration other than the consideration consisting of the second right.".

Section 8A applies to equity instruments acquired by an employee as a result of the exercise of any right granted before 26 October 2004. Equity instruments acquired by way of cession or release after section 8C came into operation (i.e. 26 October 2004) fall within the new provisions of section 8C. The effect of this is that equity instruments (rights) acquired by the taxpayer by virtue of his or her employment as consideration for the cession or release of a right as contemplated in section 8A(5) will be subject to the provisions of section 8C.

Where the second right as contemplated in section 8A(5) that is acquired is a restricted right as contemplated in section 8C, the gain will be included in income or the loss will be allowed when a vesting event occurs in relation to that right. Where the second right is unrestricted the gain or loss will be brought to account when it is acquired. The proposed amendment clarifies the position that where the gain is taxable in terms of section 8C the provisions of section 8A(5)(b) do not apply.

Amendment of section 8B of Act 58 of 1962

7. Section 8B of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution for subsection (1) of the following subsection:

"(1) There must be included in the income of **[an employee]** <u>a person</u> for a year of assessment any **[amount received by or accrued to]** <u>gain made by</u> that **[employee]** <u>person</u> during that year from the

disposal of any qualifying equity share or any right or interest in a qualifying equity share, which—

(*a*) was acquired by that **[employee]** person in terms of a broad-based employee share plan; and

(*b*) is disposed of by that **[employee]** person within five years from the date of grant of that qualifying equity share, otherwise than—

(i) in exchange for another qualifying equity share as contemplated in subsection (2);

(ii) on the death of that person; or

(iii) on the insolvency of that person.";

Section 8B was introduced in the Income Tax Act, 1962, last year to deal with the taxation of broad-based equity plans. To address certain practical issues which have been raised with regard to the application of this section, three changes to the section are being proposed.

Firstly, in terms of section 8B any amount received or accrued to an employee on the disposal of a 'qualifying equity share' given or sold by an employer to an employee in terms of a 'broad-based employee share plan' is subject to tax if it is sold within five years from the 'date of grant' of that qualifying equity share. Even if the employee leaves the employ of the employer, the amount should be subject to tax if it is sold before the period of five years. The use of the word "employee" in the different provisions of the section has the effect that employees who leave the employer's service would not be taxable on the amount received or accrued for the disposal of the share before the five year period. It is proposed that this be corrected throughout the section.

Secondly, it had been envisaged that the employer would donate the shares to the employees but the Companies Act requires in certain circumstances that a minimum amount must be paid for the share. It is proposed that provision be made for the deduction of that minimum amount and a definition of "gain" be introduced to achieve this.

Thirdly, there is uncertainty as to what the position is where an employee dies or goes insolvent before the five year period has passed as the Act regards the person and his or her deceased or insolvent estate to be separate persons for tax purposes. Death and insolvency are normally regarded as "no fault disposals" for the purposes of share incentive schemes and it is proposed that tax not be raised in these circumstances.

(b) by the substitution for subsection (2) of the following subsection:

"(2) If **[an employee]** a person as a result of a subdivision, consolidation, conversion or restructuring of the equity share capital of the employer or any company in the same group of companies as that employer disposes of a qualifying equity share in exchange solely for

any other equity share in that employer or any company in the same group of companies as the employer, that other equity instrument acquired in exchange is deemed to be—

(a) a qualifying equity share which was acquired by that **[employee]** person on the date of grant of the qualifying equity share disposed of in exchange; and

(b) acquired for a consideration equal to the consideration (if any) given for the qualifying equity share disposed of in exchange.";

As explained above it is proposed that provision be made for the deduction of the minimum amount paid for the shares.

(c) by the substitution in subsection (3) for paragraph *(c)* of the definition of "broad-based employee share plan" of the following paragraph:

"*(c)* the **[employees]** persons who acquire the equity shares as contemplated in subsection (1)*(a)* are entitled to all dividends and full voting rights in relation to those equity shares; and";

(d) by the substitution in subsection (3) for subparagraph (ii) and (iii) of paragraph *(d)* of the definition of "broad-based employee share plan" of the following subparagraphs:

"(ii) a right of any person to acquire those equity shares from the **[employee]** person who acquired the equity shares as contemplated in subsection (1)*(a)* at market value; or

(iii) a restriction in terms of which **[that employee]** the person who acquired the equity shares as contemplated in subsection (1)*(a)* may not dispose of those equity shares for a period, which may not extend beyond five years from the date of grant;";

(e) by the insertion in subsection (3) of the following definition after the definition of "date of grant":

"'gain' in relation to the disposal by a person of a qualifying equity share or a right or interest in a qualifying equity share, means the amount by which any amount received by or accrued to that person from that disposal exceeds the consideration (if any) given by him or her for that qualifying equity share, right or interest;".

It is proposed that a definition of "gain" be introduced.

Amendment of section 8C of Act 58 of 1962

8. Section 8C of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subsection (1) for subparagraph (i) of paragraph *(b)* of the following subparagraph:

"(i) was acquired **[in exchange for the disposal]** by the exercise or conversion of, or in exchange for the disposal of, any other equity instrument **[which had already vested in terms of]** where this section applied in respect of the vesting of that other equity instrument before that disposal; or";

This section was introduced last year to replace section 8A and to deal with executive type share incentive schemes in a more appropriate way. One of the exclusions to these provisions are equity instruments acquired as a result of the exercise of an option on which there were no restrictions at the time of disposal. The reason being that the gain on the option would already have been taxed on acquisition if it was unrestricted when acquired or at the time the restrictions were lifted if it was an unrestricted option. The word "exchange" does not accurately describe the exercise of an option or conversion of a financial instrument and the wording has been clarified by adding references to the exercise or conversion of an equity instrument.

(b) by the substitution for subsection (2) of the following subsection:

"(2)(*a*) The gain to be included in the income of a taxpayer **[is]**—

(i) in the case of—

(aa) a disposal contemplated in subsection (5)(*c*); or

(bb) a disposal by way or release, abandonment or lapse of an option or financial instrument contemplated in paragraph *(a)* or *(b)* of the definition of 'equity instrument',

is the amount received or accrued in respect of that disposal which exceeds the sum of any consideration in respect of that equity instrument; or

(ii) in any other case, is the sum of—

(*aa*) the amount by which the market value of the equity instrument determined **[on the date on which]** at the

time that it vests in that taxpayer exceeds the sum of any consideration in respect of that equity instrument; and

(*bb*) the amount (if any) determined in terms of subsection (4)(*b*).

(*b*) The loss to be deducted from the income of a taxpayer **[is]**—

(i) in the case of—

(aa) a disposal contemplated in subsection (5)(*c*); or

(bb) a disposal by way or release, abandonment or lapse of an option or financial instrument contemplated in paragraph *(a)* or *(b)* of the definition of 'equity instrument',

is the amount by which the sum of any consideration in respect of that equity instrument exceeds the amount received or accrued in respect of that disposal; or

(ii) in any other case, is the amount by which the consideration in respect of the equity instrument exceeds the market value of that equity instrument determined **[on the date]** at the time that it vests in that taxpayer.";

Subsection (2) prescribes how gains and losses on the vesting of an equity instrument are to be calculated. The main rule is that any consideration paid for the equity instrument must be deducted from the market value of the equity instrument on the date of vesting. There are situations where the taxpayer is compelled to sell the restricted equity instrument for less than market value, for example, when the taxpayer leaves the employment before the period prescribed in the scheme. In these circumstances the method of calculation of the gain or loss is the consideration paid for the equity instrument deducted from the actual consideration received. This method has been extended to situations where there is release, abandonment or lapse of an option or convertible financial instrument.

Subsection (3) has been amended to describe in more precise detail when vesting of an equity instrument takes place and this subsection has consequentially been amended to bring it into line with subsection (3).

(c) by the substitution in subsection (3) for subparagraphs (iii) and (iv) of paragraph *(b)* of the following subparagraphs:

"(iii) **[when]** immediately after that equity instrument, which is an option contemplated in paragraph (*a*) of the definition of "equity instrument", terminates (otherwise than by the exercise of that equity instrument); and

(iv) immediately before that taxpayer dies, if all the restrictions relating to that equity instrument are or may be lifted on or after death.”;

Subsection (3) has been amended to describe in more precise detail when vesting of an equity instrument takes place and the effect of this in item (iii) above is that the value must be measured immediately after termination and it will, therefore, be nil.

The second amendment to item (iii) can be illustrated by an example. A scheme provides that the option granted may be exercised after one year and the share acquired as a result of the exercise may not be sold for a period of three years. Prior to the proposed amendment the termination of the option would have triggered a gain while the option actually remained restricted as the share was restricted. An equity instrument is deemed to have vested immediately before death and concern has been expressed that in terms of some share incentive schemes taxpayers may lose their rights on death and an amount may be taxed even though nothing will accrue to the estate or heirs. It is proposed that the vesting only takes place if the rights that the taxpayer had can be exercised by the executor of the estate, heirs or beneficiaries.

(d) by the substitution in subsection (5) for paragraph *(c)* of the following paragraph:

“(*c*) Paragraph (*a*) does not apply where a taxpayer disposes of any restricted equity instrument (including by way of forfeiture or cancellation) to his or her employer, an associated institution or other person by arrangement with the employer in terms of a restriction imposed in relation to that equity instrument for an amount **[not exceeding the consideration in respect]** which is less than the market value of that restricted equity instrument.”;

There are situations where the taxpayer is compelled to sell the restricted equity instrument to his or her employer or a trust administered by the employer for a price equal to the consideration paid for it. For example, when the taxpayer leaves the employment before the period prescribed in the scheme. Subparagraph (5)(c) provides that the anti-avoidance rules which target disposals to “connected persons” do not apply in these circumstances. It is proposed that the wording be clarified to make it clear that options which are forfeited or cancelled are also included.

Unlike listed shares there is not a ready made market in private company shares. Some private companies that introduce share incentive schemes use different methods to determine the acquisition consideration and the value on vesting. These amounts that are determined may be less than the true market value of the shares. As the provisions of the section read at present the market value of the share would have to be used in these circumstances, which is not equitable. It is proposed that all equity instruments which are disposed of for less than the market value of the share be dealt with in the subsection and the method of calculation of the gain or loss on the disposal of the equity instruments described in subsection (5)(c) be the

consideration paid for the equity instrument deducted from the actual consideration received.

(e) by the substitution in subsection (7) for the proviso to the definition of "consideration" of the following proviso:

"Provided that where a taxpayer acquires—

(a) an equity instrument in exchange for any other equity instrument, as contemplated in subsection (4)(*a*), the market value of the equity instrument given in exchange must not be taken into account in determining the consideration in respect of the equity instrument so acquired; or

(b) a right to acquire any marketable security in exchange for any other such right, as contemplated in section 8A(5), and the right so acquired constitutes an equity instrument acquired in the manner contemplated in subsection (1), the consideration for that equity instrument must be determined as if it was acquired in the manner contemplated in subsection (4)*(a)*;";

In terms of section 8(2)(b) of the Revenue Laws Amendment Act, 2004 any right to acquire a marketable security (an option) which is exchanged for another, for example, as a result of a reorganisation, and to which the provision of section 8A(5) would have applied, must be dealt with in terms of the new section 8C. It is proposed that the method of determining the consideration for the acquisition of the right be introduced in section 8C.

(f) by the substitution in subsection (7) for paragraph *(b)* of the definition of "restricted equity instrument" of the following paragraph:

"*(b)* which is subject to any restriction that could result in the taxpayer forfeiting ownership or the right to acquire ownership of that equity instrument otherwise than at market value;";

(g) by the deletion in subsection (7) of the word "or" at the end of paragraph *(e)* of the definition of "restricted equity instrument";

(h) by the substitution in subsection (7) for the words in the definition of "restricted equity instrument" following subparagraph (ii) of paragraph *(f)* of the following words:

"if there is a decline in the value of the equity instrument after that acquisition; **[and]** or".

Amendment of section 10 of Act 58 of 1962

9. (1) Section 10 of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subsection (1) for paragraph *(g*B*)* of the following paragraph:

"*(g*B*)* any—

(i) compensation paid in terms of the Workmen's Compensation Act, 1941 (Act No. 30 of 1941), or the Compensation for Occupational Injuries and Diseases Act, 1993 (Act No. 130 of 1993); or

(ii) pension paid in respect of the death or disablement caused by any occupational injury or disease sustained or contracted by an employee before 1 March 1994 in the course of employment—

(aa) where that employee would have qualified for compensation under the Compensation for Occupational Injuries and Diseases Act, 1993, had that injury or disease been sustained or contracted on or after 1 March 1994; and

(bb) to the extent that the pension does not exceed the limits specified in that Act;";

The Workmen's Compensation Act, 1941 ("the WCA"), was repealed with effect from 1 March 1994, and replaced by the Compensation for Occupational Injuries and Diseases Act, 1993 ("the COID Act"). Prior to 1 March 1994, the WCA provided benefits similar to what is now provided under the COID Act. However, in terms of the WCA, employees who earned in excess of a specified amount (R55 068 per annum) were excluded from the Act and could, therefore, not become entitled to compensation under that Act. Employers therefore arranged separate insurance policies to cover these employees against disability as a result of injuries and diseases sustained or contracted in the course of employment. The COID Act, on the other hand, covers all employees regardless of their level of earnings, although the benefits payable in terms of this Act are limited. The situation now exists that certain persons who currently receive compensation in the form of a pension, in respect of injuries or disease sustained or contracted before the new Act came into operation, are subject to tax on the amounts received as these amounts are not paid

in terms of one of those Acts. Had the injury or disease been sustained or contracted by those persons on or after 1 March 1994, these payments would have qualified for the exemption as they would have qualified for benefits under the COID Act. As announced in the Budget Review this year, the exemption provision will be reviewed to ensure that it applies to all disability pensions regardless of the date of injury or disease and this amendment gives effect to this proposal.

(b) by the substitution in subsection (1) for the words in paragraph *(n*E*)* preceding subparagraph (i) and subparagraphs (i) and (ii) of the following words and subparagraphs:

"*(n*E*)* any amount (including any taxable benefit determined under the provisions of the Seventh Schedule, but excluding any gain or loss as a result of any transaction in respect of which section 8C applies or the cancellation of any such transaction) received by or accrued to an employee, as so defined, under a share incentive scheme operated for the benefit of employees of the taxpayer's employer, as so defined, which was derived—

(i) upon the cancellation of a transaction under which the taxpayer purchased shares under **[such]** that scheme**[, and in respect of which section 8A applies]**; or

(ii) upon the repurchase from the taxpayer, at a price not exceeding the selling price to him or her, of shares purchased by him or her under **[such]** that scheme**[, and in respect of which section 8A applies]**,".

Section 10(1)(nE) exempts from tax any amount received by or accrued to an employee under a share incentive scheme operated by the employee's employer upon the cancellation of a transaction under which the employee purchased shares or upon the repurchase from the employee, at a price not exceeding the selling price, of shares purchased. This is referred to as the "stop loss provision" and allows the employer to extricate employees from share incentive schemes if the value of the shares decreases.

Section 8C unlike section 8A allows losses to be claimed and the "stop loss provision" is, therefore, not required for equity instruments to which section 8C applies. The operation of the "stop loss provision" was restricted to section 8A shares when section 8C was introduced. Section 10(1)(nE) was, however, also introduced to provide relief for share purchase schemes which fall under the Seventh Schedule as fringe benefits. The restriction of the section to section 8A shares was, therefore, too narrow and it is proposed that its operation be extended to shares acquired in term of a share purchase schemes.

Amendment of section 11 of Act 58 of 1962

10. Section 11 of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in paragraph *(j)* for the words preceding the proviso of the following words:

"*(j)* **[such]** an allowance **[as may be made each year by the Commissioner]** in respect of **[such]** so much of any debts due to the taxpayer as **[he]** the Commissioner considers to be doubtful, if those debts would have been allowed as a deduction under any other provisions of this Act had they become bad:";

Section 11(j) of the Income Tax Act, 1962, provides for an allowance to be made in respect of debts due to a taxpayer as the Commissioner considers to be doubtful. This allowance must, however, be included in the income of the taxpayer in the following year of assessment. Some taxpayers have recently tried to argue that the allowance in respect of these doubtful debts may be granted even though the deduction would not be allowed if the debt had become bad. It is, therefore, proposed that this provision be clarified to specifically provide that the allowance will only be granted if the debts would have been allowed as a deduction under another provision of the Act had they become bad.

(b) by the substitution in paragraph *(l*A*)* for the words preceding the proviso of the following words:

"*(l*A*)* an amount equal to the market value of any qualifying equity share granted to an employee of that person as contemplated in section 8B, as determined on the date of grant as defined in that section less any consideration (if any) given by that employee for that qualifying equity share, which applies *in lieu* of any other deduction which may otherwise be allowed to that person or any other person in respect of the granting of that share:".

A concession was introduced for broad-based employee share plans and if the share granted in terms of the plan are held for at least five years the amount of income from the disposal of the shares is not subject to tax. As further encouragement to introduce these plans the employer is entitled to deduct the market value of qualifying equity shares on the date of grant. It is envisaged that the share shares would normally be donated by the employer but in certain circumstances the employer may be required by the Companies Act to charge a small amount. It is proposed that where a small amount is charged, the amount allowed to the employer as a deduction be reduced by the amount charged.

Amendment of section 12H of Act 58 of 1962

11. Section 12H of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subsection (1) for paragraph *(b)* of the following paragraph:

"*(b)* a learner during that year of assessment completed any registered learnership agreement entered into by that employer (or by any company which forms part of the same group of companies as that employer) with that learner during that year or any previous year of assessment in the course of any trade carried on by that employer.";

Section 12H of the Income Tax Act, 1962, provides for the deduction of an allowance in respect of learnership agreements when an employer enters into a learnership agreement and a further deduction when a learnership is completed. Section 12H provides that the deduction by an employer upon completion is only allowable if the learnership was entered into between that employer in that year or a previous year of assessment. The section therefore does not make provision for transfer of employees within a group of companies. It is proposed that section 12H be amended to also allow the deduction for completion in these instances.

(b) by the substitution in subsection (2) for item *(aa)* of subparagraph (i) of paragraph *(a)* of the following item:

"*(aa)* 70 per cent of—

(A) in the case of a learnership with a duration of less than 12 months, the total amount of the remuneration of that learner for the period of that learnership as stipulated in the agreement of employment between that learner and employer; or

(B) in any other case, the annual equivalent of the remuneration of that learner stipulated in the agreement of employment between that learner and employer; or";

(c) by the substitution in subsection (2) for item *(aa)* of subparagraph (ii) of paragraph *(a)* of the following item:

"*(aa)* in the case of a learnership with a duration of—

(A) less than 12 months, the total amount of the remuneration of that learner for the period of that learnership as

stipulated in the agreement of employment between that learner and employer; or

(B) 12 months or more, the annual equivalent of the remuneration of that learner stipulated in the agreement of employment between that learner and employer; or";

(d) by the substitution in subsection (2) for subparagraph (i) of paragraph *(b)* of the following paragraph:

"(i) in the case of a learnership with a duration of—

(aa) less than 12 months, the total amount of the remuneration of that learner for the period of that learnership as stipulated in the agreement of employment between that learner and employer; or

(bb) 12 months or more, the annual equivalent of the remuneration of that learner stipulated in the agreement of employment between that learner and employer; or".

The deduction in terms of section 12H in respect of a learnership is determined with reference to the annual equivalent of the remuneration of the learner as stipulated in the agreement of employment. The reason for calculating the deduction with reference to the annual equivalent was to ensure that employers get the full deduction in the case where the learnership commences halfway through the year. It was also the understanding at the time when these provisions were introduced that the minimum period for most learnerships would be 12 months, as they required to complete a certain number of hours to comply with the NQF levels on which the learnerships were based. However, it now appears that there are a number of short term learnerships with a duration as short as one month. The effect of this is that the employer could upon entering into a learnership claim a deduction equal to 12 times the monthly remuneration and again upon completion at the end of that month again claim 12 times the monthly remuneration as a further deduction. This was not the intention of this provision and it is, therefore, proposed that section 12H be amended to address this anomaly.

Amendment of section 18A of Act 58 of 1962

12. Section 18A of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subsection (1) for the words in paragraph *(b)* preceding subparagraph (i) and subparagraph (i) of the following words:

"*(b)* any public benefit organisation approved by the Commissioner under section 30, which**[—**

(i)] provides funds or assets to any public benefit organisation, institution, board or body contemplated in paragraph *(a)*; **[and]** <u>or</u>";

(b) by the deletion in subsection (1) of subparagraph (ii) of paragraph *(b)*;

(c) by the substitution in subsection (2A) for paragraphs *(a)* and *(b)* of the following paragraphs:

"*(a)* in the case of a public benefit organisation, institution, board or body contemplated in <u>subsection (1)(*a*)</u> which carries on activities contemplated in **[Part]** <u>Parts</u> I <u>and II</u> of the <u>Ninth Schedule</u>, that donation will be utilised solely in carrying on activities contemplated in Part II of the <u>Ninth Schedule</u>;

(b) in the case of a public benefit organisation contemplated in <u>subsection (1)(*b*)</u>—

<u>(i) that organisation will distribute or incur the obligation to distribute at least 75 per cent of all funds received by way of donation during that year of assessment in respect of which receipts are issued, within 12 months after the end of that year of assessment; and</u>

<u>(ii)</u> **[which]** <u>if that public benefit organisation</u> provides funds to public benefit organisations, institutions, boards or bodies that carry on public benefit activities contemplated in Part II of the <u>Ninth Schedule</u> and to other entities, that donation will be utilised solely to provide funds to a public benefit organisation, institution, board or body contemplated in <u>subsection (1)(*a*)</u>, which will utilise those funds solely in carrying on activities contemplated in Part II of the <u>Ninth Schedule</u>; or";

Section 18A provides that a deduction will be allowed from the taxable income of a taxpayer in respect of a donation which was actually paid or transferred to a public benefit organisation (PBO), provided that the PBO has distributed or incurred the obligation to distribute 75% of the donations for which receipts were issued in the preceding year of assessment. The intended effect is that 75% of the donations for which tax deductions were granted must be distributed within 12 months following the year of assessment during which the donation was received. It is difficult to monitor

this distribution requirement and it also places donors in a difficult position as they do not have access to the financial records of the PBO and are not able to determine whether this requirement has been complied with. It is proposed that section 18A be amended to provide that the criteria must be forward looking and that the PBO undertakes to distribute 75% of the donations within a specified period.

(d) by the substitution in subsection (5) for the words following paragraph *(b)* of the following words:

"the Commissioner may by notice in writing addressed to that person direct that donations to **[such]** that fund shall **[not]** no longer qualify for deduction under the provisions of this section in respect of any year of assessment specified in **[such]** that notice, and any **[claim by any taxpayer for such deduction shall accordingly be disallowed]** donation in respect of which any receipt has been issued during that year by that public benefit organisation, institution, board or body shall be deemed to be taxable income which accrued to that public benefit organisation, institution, board or body in that year.";

(e) by the substitution for subsection (5A) of the following subsection:

"(5A) If the Commissioner has reasonable grounds for believing that any regulating or co-ordinating body of a group of public benefit organisations, contemplated in section 30(3A) or a group of institutions, boards or bodies contemplated in subsection (6)—

(a) with intent or negligently fails to take any steps contemplated in that section or subsection, to exercise control over any public benefit organisation, institution, board or body in that group; or

(b) fails to notify the Commissioner where it becomes aware of any material failure by any public benefit organisation, institution, board or body over which it exercises control to comply with any provision of this section,

the Commissioner may by notice in writing addressed to that regulating or co-ordinating body direct that donations to public benefit organisations, institutions, boards or bodies in that group shall **[not]** no longer qualify for deduction under the provisions of this section in respect of any year of assessment specified in **[such]** that notice and

any **[claim by any taxpayer for such deduction shall accordingly be disallowed]** <u>donation in respect of which any receipt has been issued during that year by any public benefit organisation, institution, board or body in that group must be deemed to be taxable income which accrued to that public benefit organization, institution, board or body in that year</u>.";

(f) by the insertion after subsection (5A) of the following subsection:

"<u>(5B) If any public benefit organisation, institution, board or body fails to comply with the requirements contemplated in subsection (2A)*(a)* or *(b)*, so much of any donation in respect of which a receipt has been issued during any year of assessment as has not been utilised or distributed, as the case may be, in the manner contemplated in subsection (2A), must be deemed to be taxable income which accrued to that public benefit organisation, institution, board or body in that year.</u>".

In terms of the current provisions of section 18A, where the qualifying tax deductible donations have been used for purposes other than for the section 18A objects of the PBO or the PBO issued receipts for amounts which do not qualify under that section, the donation will not be allowed as a deduction by the donor. This effectively means that the taxpayer to whom the receipt was issued by the PBO needs to be tracked down in order for SARS to disallow the deduction. In order to address this and other practical difficulties with this provision, it is proposed that the penalty provisions be amended to provide that where the PBO is in breach of section 18A, that PBO will be liable to pay the tax on the full amount of the donations in respect of which receipts were issued.

Amendment of section 23 of Act 58 of 1962

13. (1) Section 23 of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in paragraph *(m)* for the words preceding subparagraph (i) of the following words:

"*(m)* subject to **[paragraph]** <u>paragraphs *(b)* and</u> (*k*), any expenditure, loss or allowance, contemplated in section 11, which relates to any employment of, or office held by, any person (other than an agent or representative whose remuneration is normally derived mainly in the form of commissions based on his or her sales or

the turnover attributable to him or her) in respect of which he or she derives any remuneration, as defined in paragraph 1 of the Fourth Schedule, other than—";

The limitation in section 23 of miscellaneous deductible business expenses incurred by salaried employees, has the unintended impact of denying certain legitimate home office expenses where employees are forced by their employer to bear the cost of maintaining a home office as their central business location. These employees include, for example, religious ministers. As was announced in the Budget Review this year, the rules will be changed to allow employees to fully deduct these legitimate expenses and this amendment gives effect to that proposal.

(b) by the substitution in paragraph *(m)* for subparagraph (iii) of the following subparagraph:

"(iii) any deduction which is allowable under section 11(*a*) in respect of any premium paid by that person in terms of an insurance policy, to the extent that—

(*aa*) **[to the extent that]** it covers that person against the loss of income as a result of illness, injury, disability or unemployment; and

(*bb*) **[in respect of which all]** the amounts payable in terms of that policy as contemplated in item *(aa)* constitutes or will constitute income as defined;".

(2) Subsection (1)*(b)* is deemed to have come into operation on 1 March 2002.

Section 23(m) was amended in 2003 to provide for the deductibility of income continuation policies to the extent that the premium relates to cover for the loss of income following illness, injury, disability or unemployment. Where a policy therefore provides other benefits (i.e. such a policy also provides life cover) only so much of the premium as relates to the income continuation benefits will be allowed as a deduction. Section 23(m), however, has a further requirement and that is that the amounts payable in terms of the policy must constitute income as defined. The life benefit portion payable in terms of the policy will not constitute income and it was the intention to just refer to the benefits in respect of which a deduction is allowed. It is, therefore, proposed that section 23(m) be amended to reflect this intention. The previous amendment in 2003 came into operation on 1 March 2002 and it is proposed that this further amendment should also come into operation on that date.

Amendment of section 24 of Act 58 of 1962

14. Section 24 of the Income Tax Act, 1962, is hereby amended by the deletion of subsections (3), (4), (5) and (6).

This clause deletes provisions which have become obsolete.

Amendment of section 24M of Act 58 of 1962

15. Section 24M of the Income Tax Act, 1962, is hereby amended by the substitution in subsection (1) for paragraph *(a)* of the following paragraph:

"*(a)* cannot be quantified in that year must for purposes of this Act be deemed not to have **[been]** accrued to that person in that year; and".

This amendment is of a textual nature.

Amendment of section 35 of Act 58 of 1962

16. Section 35 of the Income Tax Act, 1962, is hereby amended by the deletion in subsection (2) of paragraph *(f)*.

Section 35 of the Income Tax Act, 1962, was amended in 2000 to provide that the withholding tax on royalties shall be a final withholding tax. Section 35(2)(f) which requires the person in respect of whom the tax applies to render a return of income for the relevant year of assessment. This paragraph is amended to reflect that the tax withheld and paid to the Commissioner in terms of this section is a final payment in respect of the taxpayer's liability for tax.

Amendment of section 56 of Act 58 of 1962

17. Section 56 of the Income Tax Act, 1962, is hereby amended—

(a) by the deletion in subsection (1) of subparagraphs (iv) and (v) of paragraph *(g)*;

In terms of section 56(1)(g) of the Income Tax Act, 1962, donations of property consisting of rights to certain property situated outside the Republic are exempt from donations tax. In 2001 the South African tax system shifted from a source-based system to a worldwide system of taxation and certain exemption provisions contained

in section 56(1)(g) which are based on source are in conflict with this change in policy. It is, therefore, proposed that these exemptions be deleted.

(b) by the substitution in subsection (1) for paragraph *(k)* of the following paragraph:

"*(k)* as a voluntary award—

(i) the value of which is required to be included in the gross income of the donee in terms of paragraph (*c*), (*d*) or (*i*) of the definition of 'gross income' in section 1; or

(ii) the gain in respect of which must be included in the income of the donee in terms of section 8A, 8B or 8C;".

The subsection exempts from donations tax voluntary awards made by employers to employees that are taxed as fringe benefits. It is proposed that the share incentive gains taxable in terms of sections 8A, 8B and 8C also be exempted.

Amendment of section 66 of Act 58 of 1962

18. (1) Section 66 of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution for subsection (1) of the following subsection:

"(1) The Commissioner must annually give public notice that all persons who are personally or in a representative capacity liable to taxation under this Act or who are required by the Commissioner to furnish returns for the assessment of tax, must furnish returns within the period prescribed in that notice, or such longer period as the Commissioner may allow, for the purposes of assessments in respect of the years of assessment specified in that notice.";

(b) by the insertion after subsection (1) of the following subsection:

"(1A) The Commissioner may, in the notice given in terms of subsection (1), exempt any person who would otherwise be required to furnish a return for the assessment of tax, from furnishing such a return.".

(2) Subsection (1) is deemed to have come into operation on 1 January 2005 and applies in respect of any year of assessment ending on or after that date.

Section 66 of the Income Tax Act, 1962, was amended in 2004 to simplify the provisions and to delete the period within which returns must be furnished and to allow the Commissioner to determine the period within which returns must be so furnished. It is proposed that section 66 be amended to clarify that certain persons are required to submit returns in order to enable the Commissioner to determine whether they are liable to taxation under the Act. These persons include, inter alia, South African companies who, by virtue of the application of the provisions of a double taxation agreement with any other country are regarded solely as residents of that other country and, therefore, no longer fall within the definition of "resident".

Amendment of section 76A of Act 58 of 1962

19. Section 76A of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subsection (1) for the words in paragraph *(a)* of the definition of "reportable arrangement" following subparagraph (iii) of the following words:

"but does not include any arrangement contemplated in subsection (1A) or any arrangement identified by the Minister by notice in the *Gazette*, which is not likely to lead to any undue tax benefit;";

(b) by the substitution in subsection (1) for paragraph *(b)* of the definition of "reportable arrangement" of the following paragraph:

"*(b)* any arrangement contemplated in subsection (1B) or which has certain characteristics identified by the Minister by notice in the *Gazette* which are likely to lead to an undue tax benefit;";

(c) by the insertion after subsection (1) of the following subsections:

"(1A) Paragraph *(a)* of the definition of 'reportable arrangement' does not include any arrangement which constitutes—

(a) a loan, advance or debt in terms of which—

(i) the borrower receives an amount of cash and agrees to repay at least the same amount of cash to the lender at a determinable future date; or

(ii) the borrower receives a fungible asset and agrees to return an asset of the same kind and of the same or equivalent quantity and quality to the lender at a determinable future date;

(b) a lease*;*

(c) a transaction undertaken through an exchange regulated in terms of the Securities Services Act, 2004 (Act No. 36 of 2004);

(d) a transaction in participatory interests in a scheme regulated in terms of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002):

Provided that—

(i) the arrangement is—

(aa) undertaken on a stand-alone basis and is not directly or indirectly connected to, or directly or indirectly dependent upon, any other arrangement (whether entered into between the same or different parties); or

(bb) an arrangement that would have qualified as having been undertaken on a stand-alone basis as required by paragraph (i), were it not for a connected arrangement that is entered into for the sole purpose of providing security and no tax benefit is obtained or enhanced by entering into such security arrangement; and

(ii) that arrangement is not entered into—

(aa) with the main purpose of obtaining or enhancing a tax benefit; or

(bb) in a specific manner or form with the main purposes of obtaining or enhancing a tax benefit.

(1B) Paragraph *(b)* of the definition of 'reportable arrangement' includes—

(a) any arrangement which would have qualified as a hybrid equity instrument as defined in section 8E, if the prescribed periods in that section had been five years; or

(b) any arrangement which would have qualified as a hybrid debt instrument as defined in section 8F, if the prescribed periods in that section had been five years,

but does not include any instrument listed on an exchange regulated in terms of the Securities Services Act, 2004 (Act No. 36 of 2004).".

Section 76A of the Income Tax Act, 1962, makes provision for the reporting of certain arrangements which contain certain elements which are likely to lead to an undue tax benefit. The Minister of Finance may by notice in the Gazette identify certain types of arrangements which are not likely to lead to an undue tax benefit, as well as arrangements which contain characteristics which may lead to undue tax benefits. The Minister identified certain transactions for purposes of section 76A in Government Gazette 27209 of 28 January, 2005.

Section 69 of the Revenue Laws Amendment Act, 2003, which inserted the reportable arrangement provisions in the Income Tax Act, 1962, provides that any arrangement identified by the Minister in terms of section 76A must be tabled in Parliament within 12 months from the date of publication of the notice for incorporation into the Income Tax Act, 1962. This clause gives effect to this provision and incorporates the arrangements so identified by the Minister in the Act.

Amendment of section 88 of Act 58 of 1962

20. Section 88 of the Income Tax Act, 1962, is hereby amended by the addition of the following subsection:

"(3) The provisions of section 102(3) apply *mutatis mutandis* in respect of any amount refundable and any interest payable by the Commissioner under subsection (1).".

Section 88 of the Income Tax Act, 1962, provides that the obligation to pay any tax is not suspended by an appeal, but if an assessment is altered on appeal, and an adjustment is made, the amounts paid by the taxpayer is refundable with interest. Although the refund is effectively made under the general provisions of the Act, it is proposed that it be clarified that the set off provisions relating to refunds as contained in section 102(3) of the Act are also applicable in respect of these refunds of amounts paid pending the outcome of an appeal.

Amendment of section 93 of Act 58 of 1962

21. Section 93 of the Income Tax Act, 1962, is hereby amended by the substitution in subsection (2) for paragraph *(b)* of the following paragraph:

"*(b)* if such person fails to comply with the notice or in answer to the notice denies his liability for the said amount or for any part thereof, and the President of the **[special]** tax court has certified that he has afforded the

person concerned an opportunity of presenting his case, and that on the information submitted to him by the Commissioner and by such person (if any), the amount specified in the certificate appears to be payable by such person in terms of a final determination under the income tax laws of such other country,".

This amendment is of a textual nature.

Amendment of paragraph 1 of Fourth Schedule to Act 58 of 1962

22. Paragraph 1 of the Fourth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in the definition of "remuneration" for paragraph *(d)* of the following paragraph:

"*(d)* **[the market value of any qualifying equity share contemplated]** <u>any gain determined</u> in <u>terms of</u> section 8B, **[determined on the date of disposal, which has been disposed of by that person and where the receipts and accruals from that disposal]** <u>which</u> must be included in that person's income under that section;".

This amendment is consequential upon the amendment of section 8B to include the gain in the income of the taxpayer as opposed to the market value.

Amendment of paragraph 11A of Fourth Schedule to Act 58 of 1962

23. Paragraph 11A of the Fourth Schedule to the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subparagraph (1) for item *(b)* of the following item:

"*(b)* **[the market value]** <u>any gain made from the disposal</u> of any qualifying equity share as **[defined]** <u>contemplated</u> in section 8B; or";

(b) by the substitution in subparagraph (1) for the words following item *(c)* of the following words:

"the amount of that gain **[or that market value]** must for the purposes of this Schedule be deemed to be an amount of

remuneration which is payable to that employee by the employer by whom that right was granted or from whom that equity instrument or qualifying equity share was acquired, as the case may be.”;

(c) by the substitution for subparagraph (3) of the following subparagraph:

“(3) The provisions of this Schedule apply in relation to the amount of employees’ tax deducted or withheld under subparagraph (2) as though that amount had been deducted or withheld from the amount of the gain **[or in respect of the market value, as the case may be,]** referred to in subparagraph (1).”;

(d) by the substitution for subparagraph (5) of the following subparagraph:

“(5) If that employer is, by reason of the fact that the amount to be deducted or withheld by way of employees’ tax exceeds the amount from which the deduction or withholding is to be made, unable to deduct or withhold the full amount of employees’ tax during the year of assessment during which the gain arises **[or the qualifying equity share is disposed of, as the case may be]**, he or she must immediately notify the Commissioner of the fact.”;

(e) by the substitution for subparagraph (6) of the following subparagraph:

“(6) Where an employee has under any transaction to which the employer is not a party made any gain or an employee has disposed of any qualifying equity share as contemplated in subparagraph (1), that employee must immediately inform the employer thereof and of the amount of that gain **[or the market value of that qualifying equity share, as the case may be]**.”.

These amendments are consequential upon the amendment of section 8B to include the gain in the income of the taxpayer as opposed to the market value.

Amendment of paragraph 16 of Fourth Schedule to Act 58 of 1962

24. Paragraph 16 of the Fourth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution for subparagraph (2) of the following subparagraph:

"(2) Any liability for employees' tax or interest on employees' tax or any penalty imposed under this Part of any person who in terms of the definition of 'employer' in paragraph 1 is an employer by virtue of his having paid or become liable to pay remuneration in a fiduciary capacity or in his capacity as a trustee in an insolvent estate, an executor, or an administrator of a benefit fund, pension fund, provident fund, retirement annuity fund or any other fund, or **[from the]** <u>as a</u> representative employer, shall be limited to the extent only of any assets belonging to the person, body, trust, estate or fund represented or administered by him which may be in his possession or under his management, disposal or control.".

This amendment is of a textual nature.

Amendment of paragraph 9 of Seventh Schedule to Act 58 of 1962

25. Paragraph 9 of the Seventh Schedule to the Income Tax Act, 1962, is hereby amended by the deletion in subparagraph (1) of paragraph *(c)* of the definition of "remuneration".

This amendment deletes a reference to a provision which has been deleted.

Amendment of paragraph 1 of Eighth Schedule to Act 58 of 1962

26. Paragraph 1 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended—

(a) by the insertion in the definition of "recognised exchange" of the word "or" at the end of paragraph *(a)*;

(b) by the substitution in the definition of "recognised exchange" of paragraph *(c)* of the following paragraph:

"*(c)* an exchange in a country other than the Republic which is similar to an exchange contemplated in paragraph *(a)* **[or *(b)*]** and which has been recognised by the Minister for the purposes of the Schedule by notice in the *Gazette*;".

The amendment is of a textual nature as paragraph (b) of the definition was deleted last year.

Amendment of paragraph 11 of Eighth Schedule to Act 58 of 1962,

27. Paragraph 11 of the Eighth Schedule to the Income Tax Act is hereby amended by the addition to subparagraph (2) of the following item:

"*(k)* by a person on the cession or release of a right to acquire a marketable security in whole or in part for a consideration which consists of or includes another right to acquire a marketable security in the circumstances contemplated in section 8A(5).".

Paragraph 11 deals with the disposal and acquisition of assets and paragraph 11(2) provides that certain disposals will not be disposals for the purpose of the Eighth Schedule. Section 8A provides for the taxation of gains made by employees in respect of the rights to acquire marketable securities. In terms of subsection (5) of this section, if the right to acquire a marketable security is ceded or released by an employee for a consideration which consists of or includes another right to acquire a marketable security, a roll-over is allowed. The second right is deemed not to be consideration for the first right, the gain made on the second right is taxable and any consideration paid for the first right is deemed to be consideration for the second right. The gain made on the disposal of the first right will effectively be taxed as part of the gain on the second right and it is, therefore, proposed that the disposal of the first right not be a disposal for capital gains tax purposes.

Amendment of paragraph 12 of Eighth Schedule to Act 58 of 1962

28. Paragraph 12 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the addition to item *(a)* of subparagraph (2) of the following subitem:

"(iv) any right to acquire any marketable security contemplated in section 8A;".

In terms of paragraph 12(2) when persons cease to be resident they are treated as if they had disposed of their assets at market value on the day they emigrated and the capital gains or losses are determined on that date. Certain assets are excluded from these provisions and it is proposed that rights to acquire marketable securities (i.e. options) contemplated in section 8A also be excluded as the gain made on the exercise, cession or release of the right will be taxable as income in terms of section 8A. Where the right has been exercised but as a result of condition imposed by the employer the employee cannot dispose of the marketable security acquired and section 8A(1)(b) applies, the exclusion proposed will not exclude the capital gain from the operation of the provisions of paragraph 12(2).

Amendment of paragraph 20 of Eighth Schedule to Act 58 of 1962,

29. Paragraph 20 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in subparagraph (3) for item *(b)* of the following item:

"*(b)* has for any reason been reduced or recovered or become recoverable from or has been paid by any other person (whether prior to or after the incurral of the expense to which it relates), to the extent which such amount**[—**

(i)] is not taken into account as a recoupment in terms of section 8(4)*(a)* or paragraph *(j)* of the definition of "gross income" of an amount contemplated in item *(a)*; **[or**

(ii) does not represent the recovery or reduction of an amount contemplated in item *(c)*.]"

The proposed amendment is of a textual nature as paragraph 20(3)(c) of the Eighth Schedule was deleted in 2004 and the proposed amendment removes a unnecessary reference to the paragraph.

Amendment of paragraph 33 of Eighth Schedule to Act 58 of 1962,

30. Paragraph 33 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended—

(a) by the deletion in subparagraph (3) of the word "or" at the end of item *(b)*;

(b) by the addition in subparagraph (3) of the following item:

"*(c)* the improvement or enhancement of immovable property which that person leases from a lessor; or".

Paragraph 33 deals with part disposals of assets in a CGT environment and subparagraph (3) lists certain circumstances which are not regarded as part-disposals for purposes of the paragraph. Persons who have improved immovable property used for business purposes which they lease from a lessor have claimed capital losses of the bare dominium of the building materials they have permanently affixed to the immovable property in the year in which the materials are so affixed. In the lessee's hands the lease is a capital asset and any improvements to the immovable property affected by the lessee is an improvement to the lease as the lessee has the use of the improvements until the expiry of the lease. The improvements form part of the base cost of the lease in terms of paragraph 20(1)(e) of the Eighth Schedule. On disposal of the lease, for example, on expiry of the lease the cost of improvements can be claimed as part of the base cost. The amendment is proposed to ensure that the cost of improvements is only brought to account on the disposal of the lease.

Amendment of paragraph 39 of Eighth Schedule to Act 58 of 1962

31. Paragraph 39 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in subparagraph (3) for item *(b)* of the following item:

"*(b)* a fund of an insurer contemplated in section 29A does not include another such fund of that insurer in respect of the disposal of an asset **[in terms of section 29A (6), or (7)]** by such fund to another such fund.".

Paragraph 39 provides that a person's loss determined in respect of the disposal of an asset to a connected person is ring-fenced (clogged) and may only be set off against capital gains from the disposal of other assets to the same connected person. The taxation of long-term insurers is based on the trustee principle which draws a distinction in the tax treatment of taxable income of the insurance companies attributable to the different categories of policyholders and shareholder interests in these companies. For this reason the four funds of long-term insurers are regarded as separate taxpayers and separate companies for purposes of determining tax on capital gains.

Transfers of assets between the funds as a result of changes in the tax status of policyholders or an annual balancing of assets and liabilities as required in terms of section 29A(6) and (7) of the Income Tax Act are already excluded from the scope of the clog-loss rule. It is proposed that all transfers between the four funds be treated in this manner and that transfers in terms of section 29A(8) also be excluded from the clog-loss rule. Any capital losses made on disposals between funds will, therefore, not be "clogged" but will be taken into account in the year of disposal in determining the taxable income of the relevant fund of the long-term insurer.

Amendment of paragraph 42 of Eighth Schedule to Act 58 of 1962

32. Paragraph 42 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in subparagraph (3) for item *(b)* of the following item:

"*(b)* a fund of an insurer contemplated in section 29A does not include another such fund of that insurer in respect of the disposal of an asset **[in terms of section 29A (6), or (7)]** <u>by such fund to another such fund</u>.".

Paragraph 42 provides that if a person sells financial instruments (e.g. shares) and that person or a connected person buys identical financial instruments back within the 45 day period, the seller is treated as having sold the assets at his or her base cost (i.e. no loss allowed) and the purchaser is treated as having acquired it for the sale price less the amount of the loss that the seller would have made. This results in a roll-over of the loss to the purchaser of the identical instruments. Transfers of assets between the funds of a long-term insurer as a result of changes in the tax status of policyholders or an annual balancing of assets and liabilities as required in terms of section 29A(6) and (7) of the Income Tax Act are already excluded from paragraph 42. However, assets can also be transferred between the funds in terms of section 29A(8) of the Income Tax Act. The application of the provisions of paragraph 42 may then result in the unintended consequence that unrealised gains and losses may be transferred between the different funds of a long-term insurer and ultimately be taxed in a tax favourable manner on realisation. In accordance with the trustee principle of taxation applied to long-term insurers and to ensure that the different funds are taxed on the capital gains or losses which arise in the relevant funds it is proposed that the roll-over provisions of paragraph 42 should not apply to transactions between the funds of a long-term insurer.

Amendment of paragraph 55 of Eighth Schedule to Act 58 of 1962,

33. Paragraph 55 of the Eighth Schedule to the Income Tax Act is hereby amended by the substitution in subparagraph (1) of the words preceding subitem (i) of item *(c)* of the following words:

"*(c)* in respect of a policy that was taken out to insure against the death, disability or severe illness of that person by any other person who was a partner of that person, or held any shares or similar interest in a company in which that person held any shares or similar interest, for the purpose of enabling that <u>other</u> person to acquire, upon the death, disability or severe illness of that person, the whole or part of—".

It is proposed that the English text of paragraph 55 be amended to bring it into line with the Afrikaans text.

Amendment of paragraph 64B of Eighth Schedule to Act 58 of 1962

34. Paragraph 64B of the Eighth Schedule to the Income Tax Act is hereby amended by the substitution in paragraph (2) for the proviso to subitem (ii) of item *(a)* of the following proviso:

"Provided that in determining the total equity share capital in a foreign company, there shall not be taken into account any share which would have constituted an **[affected instrument]** <u>hybrid equity instrument</u>, as contemplated in section 8E, but for the three year period requirement contained in that section; and".

The definition of "affected instrument" in section 8E was deleted in 2004 and replaced with a definition of "hybrid equity instrument". The amendment proposed aligns the paragraph with section 8E.

Amendment of paragraph 72 of Eighth Schedule

35. (1) Paragraph 72 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in subparagraph (b) of the following subparagraph:

"*(b)* a capital gain <u>(including any amount that would have constituted a capital gain had that person been a resident)</u> attributable to that donation, settlement or other disposition has arisen during a year of assessment and has during that year vested in or is treated as having vested in any person who is not a resident (other than a controlled foreign company, in relation to that resident),"

Paragraph 72 attributes a capital gain back to the donor where—
(a) a resident has made a donation, settlement or other disposition to a non-resident (including a non-resident trust),
(b) a capital gain attributable to that donation, settlement or other disposition has arisen during a year of assessment, and
(c) that capital gain has vested in a non-resident.

Paragraph 2 provides that the Eighth Schedule only applies to a non-resident in respect of the disposal of SA immovable property (including the disposal of shares in certain companies holding SA immovable property) and assets of a permanent establishment in SA. The Eighth Schedule, therefore, has a fairly narrow application to non-residents. It may be argued that it is only such SA source gains that can arise in the hands of a non-resident and which can be attributed from that non-resident to a resident in terms of paragraph 72. Such an interpretation would severely limit the scope of this provision and defeat the purpose of the legislature. It is, therefore, proposed that paragraph 72 be amended to make it clear that attribution can occur in respect of an amount that would have constituted a capital gain in the hands of a non-resident had that non-resident been a resident. A similar amendment was effected by the Revenue Laws Amendment Act, 2004 to the equivalent provision in the Principal Act (section 7(8)). This ensured that ordinary income from a non-SA source could be attributed from a non-resident to a resident.

Amendment of paragraph 4 of Part I of Ninth Schedule to Act 58 of 1962

36. Paragraph 4 of Part I of the Ninth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution for subparagraph *(k)* of the following subparagraph:

"*(k)* Career guidance and counseling services provided to persons **[for purposes of]** attending any school or higher education institution as envisaged in subparagraphs (*a*) and (*b*).".

Currently, the Ninth Schedule to the Income Tax Act, 1962, lists as a public benefit activity "career guidance and counselling services provided to persons for purposes of attending any school or higher education institution". It is proposed that this provision be amended slightly to ensure that the career guidance and counselling must be provided to persons already attending a school or higher education institution as the guidance and counselling would be provided to scholars for purposes of deciding on a career rather than for purpose of attending a school or higher educational institution.

Amendment of paragraph 3 of Part II of Ninth Schedule to Act 58 of 1962

37. Paragraph 3 of Part II of the Ninth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution for subparagraph *(m)* of the following subparagraph:

“*(m)* Career guidance and counseling services provided to persons **[for purposes of]** attending any school or higher education institution as envisaged in subparagraphs (*a*) and (*b*).”.

Currently, the Ninth Schedule to the Income Tax Act, 1962, lists as a public benefit activity “career guidance and counselling services provided to persons for purposes of attending any school or higher education institution”. It is proposed that this provision be amended slightly to ensure that the career guidance and counselling must be provided to persons already attending a school or higher education institution as the guidance and counselling would be provided to scholars for purposes of deciding on a career rather than for purpose of attending a school or higher educational institution.

Amendment of paragraph 10 of Part I of Ninth Schedule to Act 58 of 1962

38. Paragraph 10 of Part I of the Ninth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution for items (i) to (iv) of the following items:

“(i) **[any]** public benefit organisation which has been approved in terms of section 30;

(ii) **[any]** institution, board or body contemplated in section 10(1)*(c*A*)*(i), which conducts one or more public benefit activities in this part (other than this paragraph);

(iii) **[any]** association of persons carrying on one or more public benefit activity contemplated in this part (other than this paragraph), in the Republic; or

(iv) **[any]** department of state or administration in the national or provincial or local sphere of government of the Republic, contemplated in section 10(1)*(a)* or *(b)*.”.

These amendments are of a textual nature.

Amendment of section 3 of Act 77 of 1968

39. Section 3 of the Stamp Duties Act, 1968, is hereby amended by the addition of the following subsection:

“<u>(3) If the Minister has foreshadowed any—</u>

(a) change in the duties contemplated in subsection (1); or

(b) other change to the provisions of this Act which has the effect that any instrument is no longer subject to those duties,

with effect from a date preceding the date on which the legislation giving effect to that change is promulgated, the change in the duties or to the provisions of this Act so foreshadowed applies with effect from the date determined by the Minister and lapses at the earlier of the date on which that legislation is promulgated or 6 months after that date so determined.".

It often occurs that the Minister of Finance announces a change in the rates of certain transaction taxes in the Budget Review with effect from a date which precedes the date on which the legislation which gives effect to that rate change is promulgated. It becomes problematic to implement these changes before the legislation is in place as there is nothing on which a person can rely when paying the reduced amount of duty in respect of the registration of transfer of a share. It is, therefore, proposed that a provision be inserted in the Stamp Duties Act, 1968, to address this issue. This will ensure that the changes proposed apply with effect from the date determined by the Minister and that they lapse at the earlier of the date on which the legislation giving effect thereto is promulgated or, if no such legislation is passed, after 6 months from the date so determined.

Substitution of section 2 of Act 31 of 1998

44. (1) The following section hereby substitutes section 2 of the Uncertificated Securities Tax Act, 1998:

"**Imposition of tax**

2. (1) There shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the uncertificated securities tax, in respect of **[the issue of, and]** every change in beneficial ownership in any securities, at the rate of 0,25 per cent of the taxable amount of such securities determined in terms of this Act.

(2) If the Minister of Finance has foreshadowed any—

(a) change in the rate of uncertificated securities tax contemplated in subsection (1); or

(b) other change to the provisions of this Act which has the effect that the transfer of beneficial ownership in any security is no longer subject to uncertificated securities tax,

with effect from a date preceding the date on which the legislation giving effect to that change is promulgated, the change in the rate or to the provisions of this Act so foreshadowed applies with effect from the date determined by the Minister and lapses at the earlier of the date on which that legislation is promulgated or 6 months after that date so determined.”.

(2) Subsection (1) shall—

(a) to the extent that it inserts subsection (2), come into operation on the date of promulgation of this Act; and

(b) to the extent that it amends the rest of section 2, come into operation on 1 January 2006 and applies in respect of the issue of any security on or after that date.

It often occurs that the Minister of Finance announces a change in the rates of certain transaction taxes in the Budget Review with effect from a date which precedes the date on which the legislation which gives effect to that rate change is promulgated. It becomes problematic to implement these changes before the legislation is in place as there is nothing on which a person can rely when paying the reduced amount of tax in respect of the issue or transfer of beneficial ownership in a security. It is, therefore, proposed that a provision be inserted in the Uncertificated Securities Tax Act, 1998, to address this issue. This will ensure that the changes proposed apply with effect from the date determined by the Minister and that they lapse at the earlier of the date on which the legislation giving effect thereto is promulgated or if no such legislation is passed after 6 months from the date so determined.