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REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

REVENUE LAWS AMENDMENT BILL, 2003

NATIONAL TREASURY

[W.P. 2 ¾ '03]

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CONTENTS

Income Tax Act 58 of 1962

INTRODUCTION

The Revenue Laws Amendment Bill, 2003, introduces amendments to the Marketable Securities Tax Act, 1948, the Transfer Duty Act, 1949, the Estate Duty Act, 1955, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Value-Added Tax Act, 1991, the Skills Development Levies Act, 1998, the Uncertificated Securities Tax, 1998, the Taxation Laws Amendment Act, 2000, the Revenue Laws Amendment Act, 2001, the Second Revenue Laws Amendment Act, 2001, the Unemployment Insurance Contributions Act, 2002, and the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003.

CORPORATE RESTRUCTURING RULES

A new comprehensive corporate reorganisation regime was introduced from 1 October 2001.This regime was modified and clarified in 2002 in response to taxpayer comments. A few issues, however, remained unresolved. In order to remedy any remaining minor issues, the National Treasury and SARS requested public comment with respect to the corporate reorganisation regime (and collateral related amendments) regarding issues that involve clarification of ambiguities, removal of inconsistencies, and changes to reflect the corporate reorganisation regime's initial intent.

Most of the proposed amendments merely refine the present regime or clarify aspects thereof. The proposals regarding elective relief, the ring-fencing of trading stock and financial instruments, the treatment of financial instrument holding companies and unbundling transactions are, however, more substantive.

Elective versus mandatory relief

Provision was made during 2002 for elective rollover relief in the case of company formations and liquidation transactions, while rollover relief remained mandatory in the case of share-for-share transactions, amalgamations and unbundlings. It is proposed that an elective regime be implemented for the latter forms of corporate relief where the transactions involved are between companies forming part of the same group of companies. The provisions in respect of share-for-share transactions, amalgamations and unbundlings will in terms of this proposal apply unless excluded by the parties. This differs from the position in respect of company formations and intra-group and liquidation transactions where rollover relief applies only if the parties so elect.

The ring-fencing of trading stock and financial instruments

The corporate rules contain anti-avoidance provisions to prevent the shifting of built-in gain assets into a company transferee through the mechanism of a company formation transaction, share-for-share transaction, intra-group and amalgamation transaction and liquidation distribution. Without these anti-avoidance rules, taxpayers could use the rollover mechanism to shift built-in gain assets into a transferee company with excess losses. Transferee companies could then immediately sell those assets and set off any resulting gain against their own excess capital losses. Amendments effected in 2002 extended the rule regarding the ring-fencing of capital gains from capital assets disposed of within 18 months to trading stock or allowance assets acquired under the above-mentioned transactions that are disposed of within the 18 month period. This was an attempt to ensure the consistent treatment of capital assets, allowance assets and trading stock in this regard. It has become clear, on further reflection, that the rule regarding the ring-fencing of trading stock is too broad in so far as it covers trading stock regularly and continuously disposed of in the course of a going concern. It is therefore proposed that trading stock acquired in terms of one of the abovementioned transactions be excluded from the 18 month ring-fencing rule if it is of the same kind or of the same or equivalent quality as trading stock regularly and continuously disposed of by the transferee. Paragraph *(b)* of the proposed definition of trading stock to be inserted in section 41 is aimed at achieving this result.

The 18 month ring-fencing rule applying in respect of company formations and share-for share, amalgamation, intra-group and liquidation transactions does not apply in respect of involuntary disposals as contemplated in paragraph 65 of the Eighth Schedule. Paragraph 65 does not, however, provide for involuntary disposals of financial instruments. The second substantive proposal regarding the 18 month rule is aimed at extending the list of exclusions from the ring-fencing rule to involuntary disposals of financial instruments.

Financial instrument holding companies

As a general rule the corporate restructuring provisions do not allow financial instruments to be transferred in a tax neutral manner. A definition of "domestic financial instrument holding company" which significantly relaxed the limitation on the transfer of financial instruments was introduced during 2002. The definition and the criteria built into the definition are applied throughout Part III to limit company formation transactions, share-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distribution transactions. Where more than 50 per cent of the market value or actual cost of all the assets of a company together with any controlled company in relation to that company is attributable to financial instruments, the transfer of the shares in the financial instrument holding company is unacceptable, as a general rule. However, an exception is made for debts in respect of goods sold or services rendered by that company or transferor where the amount of the transaction was included in the income of that entity or a controlled group company in relation to that entity and the debt is an integral part of a business conducted by the company involved as a going concern. Shares held in controlled group companies as well as loans, advances or debts between companies which form part of that group of companies are also disregarded when determining the percentage of all assets of a group of companies in relation to a company consisting of financial instruments. An important further exception is made for financial instruments of, or financial instruments transferred to certain regulated financial institutions, e.g. banks, insurance companies and collective investment schemes.

The proposed amendments to the definition of "domestic financial instrument holding company" clarify the rules regarding the calculation of the historic cost of a company's assets when determining whether its financial instruments exceed the 50% ratio. The proposed changes to the rules allowing financial instruments consisting of loans, advances or debts within a group to be disregarded, limit the excluded loans to those between a company and any controlled group company in relation to that company or between controlled group companies in relation to that company. Other proposed changes to the definitions of "domestic financial instrument holding company" and 'foreign financial instrument holding company" in section 9D are aimed at aligning them.

Unbundling transactions

A new definition of "unbundling transaction" is proposed. In terms of the current provisions, the qualifying interest of the unbundling company in the unbundled company must consist of equity shares acquired at least 18 months prior to the transaction, shares acquired in terms of a substitution (as contemplated in paragraph 78(2) of the Eighth Schedule) of equity shares so acquired, or shares acquired in terms of a transaction contemplated in Part III or a transaction which would have qualified as such had the parties made the required election or had that asset been a gain asset at the time of disposal. The current formulation is confusing in some respects and does not clearly reflect the underlying intent. Shares can, moreover, as a general rule be disposed of by means of an unbundling transaction before the expiry of 18 months after their acquisition in terms of a transaction contemplated in Part III without triggering held-over gains or the ring-fencing rule. This cannot be reconciled with the current requirement of an 18 month holding period prior to an unbundling transaction. The proposed definition dispenses with the 18 month requirement. It provides, furthermore, for proportional unbundlings, in the case of an unlisted unbundling company, to the extent to which the shares in the unbundled company are disposed of to a company that is a member of the same group of companies as that unbundling company. It also provides for a disposal of shares by means of an unbundling transaction effected to comply with an order made in terms of the Competition Act 89 of 1998 irrespective of whether or not the shares constitute the minimum shareholding normally required for an unbundling transaction.

FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES

Content currently under *CLAUSES 28 and 29*.

PUBLIC PRIVATE PARTNERSHIPS

Current law

There is neither a definition of what a Public Private Partnership ("PPP") is nor what the tax treatment of the various PPP projects is. Uncertainty exits around the tax treatment of Government grants received by the PPP to assist it with the acquisition of capital assets. In most cases depending on whether the project is a toll road, a hospital or a rail project the tax treatment differs in accordance with the different sections of the tax code. Current law proves problematic in certain PPP project where the ownership of the underlying land is not transferred by Government to the PPP. Thus the expenditure incurred by the PPP on project assets that attach to the land (therefore not owned by the PPP) cannot be deducted.

Reason for change

(A) Government Grants

To—
(i) align the South African tax treatment with international practice,
(ii) provide clarity to the PPP on the tax treatment of assets since the legal ownership of assets only affects the tax implications,
(iii) eliminate the circular flow of tax i.e. by subjecting grants for capital expenditure to tax creates a circular effect thereby necessitating an increase to the grant by Government to the PPP by the tax due, that Government in turn will receive

from the South African Revenue Service when the tax revenues are paid over,

(iv) align the applicable sections in the tax code that require that the capital assets must be "owned " or "acquired" by the taxpayer for the taxpayer to qualify for the specific capital deduction, and

(v) clarify whether the grant received by the PPP to acquire capital assets is capital or revenue in nature.

(B) Capital Allowances

Generally the Government grant received for capital expenditure may only partially fund the design, construction and acquisition of capital assets. The concessionaire will be required to fund the remaining portion of the total expenditure incurred. On the termination of the concession period or the early termination of the concession contract all the capital assets will revert to Government. It would thus be equitable to provide the concessionaire with a tax deduction for the capital expenditure which will not be funded by the Government grant. Current law does not fully address this situation and would need to (i) clarify whether the capital contribution will reduce the amount that qualifies for a capital allowance and (ii) clarify what capital allowances and deductions are available to the PPP.

(C) PPP

Current tax law does not define a PPP, however Treasury Regulation 16 contains a definition of a P PP that will qualify for this preferential tax treatment.

Proposed legislation

(A) Government Grants

Grants that are actually applied to fund capital expenditure will be exempt from tax in terms of section 10. This would be in line with the tax treatment of other Government incentives, which are exempt from tax in terms of section 10(zA) to section 10(zH). This is in line with UK and Malaysian practice and will align South Africa's tax treatment to international practice.

(B) Capital Allowances

The income tax legislation is expanded to make provision for these unique and distinctive types of PPP assets. Government grants to fund capital expenditure will reduce the cost of capital assets for capital allowance purposes and the base cost for Capital Gains Tax purposes. Finally where an asset consists of depreciable and non-depreciable assets, the grant may be allocated at the instance of the PPP firstly and as far as possible to non-depreciable assets, and secondly to depreciable assets which have the longest write off period.

(C) Definition of a PPP

Treasury Regulation 16 defines a PPP as:

" … a commercial transaction between an institution and a private party in terms of which—

(a) the private party either performs an institutional function on behalf of the institution for a specified or indefinite period or acquires the use of state property for its own commercial purposes for a specified or indefinite period;

(b) the private party receives a benefit for performing the function or by utilising state property, either by way of:

(i) compensation from a revenue fund;
(ii) charges or fees collected by the private party from users or customers of a service provided to them; or
(iii) a combination of such compensation and such charges or fees.”

This definition distinguishes between two basic types of PPP, one involving the performance by a private party of an “institutional function” and the other involving some form of “use of state property” by a private party for its own commercial purposes. For the first type of PPP, the concept “institutional function” is broadly defined as an ongoing service, task, assignment or other function that an institution performs in the “public interest” on behalf of Government where such performance and delivery are subject to specified outcomes. For the second type of PPP, the use of state property is defined as all movable and immovable property belonging to the State including intellectual property rights. Use may include a variety of use forms such as a lease or concession.

In the majority of PPP projects that involve the construction of infrastructure, Government will make land (often with existing improvements) available to the private party. During the project term the private party will manage the operation and maintenance of such land and infrastructure. A particular feature about PPP’s is that the land (immovable property) belongs or will revert (movable or immovable property) back to Government at the end of the concession period. Usually a PPP agreement results in a special purpose vehicle (“SPV”) incorporated in the Republic as a private limited liability company for the sole purpose of exercising its rights and performing of obligations under the PPP agreement.

RESEARCH AND DEVELOPMENT

Current law

Research and development (R&D) expenditure, by virtue of its nature, will not, generally, fall within the provisions of the general deduction formula. Indeed there may not even be a trade as yet thereby preventing the deduction for R&D expenditure. Capital expenditure is allowed only once research commences, which may be after all other expenditure has taken place. Moreover research must be undertaken by the taxpayer or by a Council for Scientific and Industrial Research (“CSIR”) approved research institution. Capital expenditure also requires CSIR approval.

CSIR approval relies on the declaration by the taxpayer’s independent auditors that the expenditure being approved was undertaken for R&D purposes. In order for the independent auditors to provide such an assurance, reliance is placed on Generally Accepted Accounting Practice (“GAAP”).

Reason for change

The South African rules have become obsolete and too restrictive and do not go far enough in recognising modern day developments, A more flexible system that is in line with modern reality that encourages innovation, and is comparable to international trends is appropriate. The current system discourages R&D through a complex system where, if research is successfully completed before 4 years and the expenditure has not been written off in full, the balance will not be deductible as no further certificates from the CSIR will be received.

The CSIR as a regulator (in terms of approving research and development) for taxpayers is generally seen as a complicating factor in promoting R&D. The tax abuse CSIR approval was meant to mitigate is no longer of great concern. Firstly, because the current R&D provisions have not kept up with the other tax provisions that offer a more generous tax dispensation. For the most part, these amendments bring the R&D provisions in line with those existing provisions. Secondly, the concern in respect of buying intangible property is adequately dealt with in other provisions.

Section 11B

This proposed section deals only with new (self generated) R&D undertaken by the taxpayer in the Republic that may lead to the creation of an intangible such as an invention, patent, design, copyright, other similar property or knowledge (trade mark is specifically excluded). Failed or abandoned research is not penalised, as the tax deduction granted under this provision is not recouped under these circumstances. The taxpayer may outsource R&D to a third party (other than a connected person), if the payment is for R&D and all the risks and rewards of the R&D remain with the taxpayer. The contracted party must not have "off the shelf" R&D for sale to the taxpayer, in other words the contracting party's R&D must be fully innovative.

A new definition of "research and development" will replace the current definition of "scientific research". Generally this is in line with GAAP and will form the basis of the legislation. However this definition narrows the GAAP definition with specific exclusions, such as research in the fields of social sciences, arts, humanities or management, as well as market research, sales or marketing promotion and testing or routine activities associated with the product or process.

Foremost must be the presence of an appreciable element of innovation. This is usually seen as an activity departing from the routine and breaking new ground. The proposal encourages experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge for its own sake or directed towards a specific practical aim or application. Complimentary to this, is the use of this scientific or technical knowledge to produce new materials, devices, products or services or to install new processes or systems before the commencement of commercial production or applications.

Examples of excluded activities (i) expenditure on land, (ii) market research, design and drawing work associated with production standardisation, pre-production activities or sales and marketing promotion, and (iii) routine activities, such as testing analysis either of equipment or product for the purposes of quality control, periodic alterations to existing products, services or processes even though these may represent some improvement, calibration of standards and testing and analysis of materials, components and processes or modifications to reflect the test finding to the prototype and further testing, computer maintenance or software

Expenditure incurred in creating an intangible can be grouped into 2 main categories.
(i) normal operating expenses; and
(ii) expenditure in acquiring a capital asset, such as a building, machinery, plant, implement, utensil or article.

Broadly speaking, under normal operating expenses, the creation of an intangible follows a research phase and a developmental phase. GAAP distinguishes between these phases and treats the associated expenditure differently. In the research phase all costs are expensed and in the developmental phase all costs are capitalised. To encourage research and development the tax deduction will not make this distinction and all costs associated with that intangible (including registration costs to obtain

legal protection) are deductible immediately.
Assets of a capital nature can be depreciated on a 40:20:20:20 basis similar to other provision in the tax code. All these assets (except for buildings) must be exclusively used for research and development in that year of assessment to qualify for the preferential allowance. The allowance for buildings that are not used exclusively for research and development must be apportioned.

The taxpayer may make an election (once only) at the time the capital asset is brought into use to claim a deduction under this section or any other section of the tax code (that may be more advantageous). The deduction can only be made either under this provision or another provision but no double deduction is permitted.

RING-FENCING OF ASSESSED LOSSES

Current Law

Section 11 of the Income Tax Act currently lays down the general requirements for deducting expenditures and losses to the extent a person derives income from carrying on any trade. Section 11 must be read in conjunction with section 23, the latter of which contains criteria for denying deductions for various items, such as domestic and private consumption.

Reasons for Change

Not every activity is a trade, even if intended or labeled by the taxpayer as such. Whether or not an activity is a trade is a question of law that depends on the "facts and circumstances" of each case. These "facts and circumstances" are deliberately left open to accommodate the wide range of trade activities existing in a modern economy.

While this "facts and circumstances" test is generally appropriate, special concerns exist when taxpayers disguise private consumption. More often than not, private consumption can be masqueraded as a trade (i.e., a hobby) so that individuals can set-off these expenditures and losses against other income (usually salary or professional income). This attempt to deduct hobby-like expenses undermines the ability to pay principle of the Income Tax system because wealthier individuals have more means to disguise hobby expenses as a trade. Hence, a more stringent "facts and circumstances" test will be introduced as a means to uncover these artificially labelled trades.

Proposed Law (Section 20A)

1. General Rule

Section 20A aims to improve the integrity of the tax system by preventing expenditures and losses normally associated with suspect (i.e., disguised hobby) activities from being deducted as a means to reduce taxable income. Subsection (1) sets forth the general rule, which seeks to ring-fence assessed losses from suspect trades (as described in subsection (2)) to prevent these losses from being deducted against any other income that a taxpayer generates. This deduction limitation applies only to natural persons (not to other taxpayers such as companies or trusts).

Furthermore, the rules under this section do not prevent natural persons from using losses from a suspect trade against other income from that trade. However, these losses may be wholly disallowed if the losses stem from an activity that fails to qualify as a trade after application of the general "facts and circumstances" test.

2. Threshold for Ring-Fencing

Section 20A ring-fencing involves a two-part threshold, which determines the level of taxable income at which the taxpayer will become subject to scrutiny. The first part of the threshold focuses on the taxpayer's taxable income level, and the second part focuses on the loss-generating activity.

2.1 *Part 1 - Maximum Marginal Rates*

Section 20A ring-fencing applies only to natural persons whose taxable income equals or exceeds the amount at which the maximum marginal tax rate becomes applicable (currently 40 per cent imposed on taxable income exceeding R255 000). This part of the threshold is determined before set-offs of any assessed (i.e., net) losses incurred from any trade (not just from suspect trades described in paragraphs *(a)* and *(b)* of subsection (2)) that arise during the tax year at issue or any loss carryover from a prior year. This aspect of the threshold ensures that Section 20A ring-fencing is targeted solely at higher income individuals who have the means for disguising hobbies as trades. This threshold can be illustrated by the following example:

Example

Facts. Individual is a medical practitioner and a dealer in collectible cars. In 2005, Individual generates R440 000 taxable income from the individual's medical practice. The collectible car dealing activities incur an assessed loss of R30 000 in the same year.

Result. Individual's income from the medical practice is the sole amount taken into account for purposes of the maximum marginal rate threshold. Current and prior losses from the collectible car dealing are ignored. Section 20A potentially applies as the R440 000 from the medical practice exceeds the maximum marginal rate threshold for natural persons in 2005.

2.2 *Part 2 – Suspect Loss Trades*

Only losses from suspect trades are subject to potential ring-fencing. This aspect of the threshold represents an "either or" test. Under this "either or" test, the taxpayer has a suspect trade if the trade fails the "three out of five year" loss rule or has been explicitly listed as a suspect trade.

(a) "Three Out Of Five" Year Loss Trades

Under this aspect of the threshold, a loss activity is treated as a suspect trade if assessed losses arise during three out of the past five years, including the current tax year. Loss years are determined without regard to loss carry forwards. Sustained losses of this kind are frequently an indicator of a suspect trade because natural persons would rarely continue with trade-generating losses on a long-term scale as it does not make sense from an economic perspective unless tax motives are present.

Example 1

Facts. Individual operates a trade during the 2005 to 2009 tax years, respectively generating assessed losses of R12 000, R15 000, R20 000, R6 000, and R3 000 in each of those years.

Result. The trade is a suspect trade from 2007 onwards. The trade has incurred assessed losses for three years.

Example 2

Facts. Individual operates a trade from 2005 until 2009. The trade results in a R12 000 assessed loss in 2005, R4 000 of taxable income in 2006, R2 000 of taxable income in 2007, R20 000 of assessed loss in 2008, and R3 000 of assessed loss in 2009.

Result. The trade is a suspect trade in 2009. The taxable income arising in 2006 and 2007 count in individual's favour (thereby delaying suspect trade treatment), even if the R12 000 assessed loss remains partially unused as a loss carryover in 2006 and 2007.

Losses incurred in any year of assessment ending on or before 28 February 2004 will not count against a taxpayer.

(b) *Listed Suspect Trades*

Under this aspect of the threshold, a loss activity is treated as suspect if the loss activity falls within one of the eight categories on the list. These listed activities have been selected based on past experiences in terms of revenue enforcement and in terms of international comparative administrative approaches. More often than not, this information suggests that taxpayers use activities of this nature to generate little gross income as compared to their expenses because taxpayers are actually seeking to disguise private consumption.

This list of suspect activities generally contains qualifiers in order to ensure that this list is not overly punitive. For instance, many of the activities described below will be suspect only if practiced by the taxpayer or a relative. This focus is important because suspect activities practiced by the taxpayer (or relative) suggest a hobby element; whereas, a mere passive investment in which the taxpayer has no active operational involvement does not.

The following suspect categories have been identified:

(i) ***Sporting activities*** practiced by the taxpayer (or relative) include, for example, any form of sport, hunting, yachting or boat racing, horse racing, water-skiing and scuba diving.

(ii) ***Dealing in collectibles*** by the taxpayer (o r relative) include, for example, cars, stamps, coins, antiques, militaria, art and wine.

(iii) ***The rental of residential accommodation*** is included unless at least 80% of residential accommodation is used by persons who are not relatives in relation to the taxpayer for at least half of the year of assessment. Residential accommodation within this category is intended to include the rental of holiday homes, bed and breakfast establishments, guesthouses and dwelling houses. For instance, townhouses and guesthouses subject to a long-term lease of 1-year or more would fall outside the suspect list because the taxpayer (or relative) cannot obtain access for private use. On the other hand, the bed and breakfast leasing of a few rooms within the taxpayer's main home would fall under the suspect list. Holiday homes used by the taxpayer and not used by persons who are not relatives for at least half of the year of assessment would be similarly suspect.

(iv) ***The rental of transportation*** (for example, aircraft, cars and boats) constitutes a suspect activity unless at least 80% of the transport assets are used by persons who are not relatives in relation to the taxpayer for at least half of the year of assessment.

(v) ***The showing of animals in competitions*** by the taxpayer (or relative) is suspect and includes, for example, the showing of horses, dogs and cats.

(vi) ***Farming or animal breeding*** by the taxpayer other than on a full-time basis is suspect, such as weekend or casual farming. One notable activity within this suspect class would be game farming.

(vii) ***Performing or creative arts*** practiced by the taxpayer (or relative) scores as a suspect activity and includes, for example, acting, singing, film making, photography, writing, pottery and carpentry. As stated above, mere passive investment in these activities would not generally fall within the suspect class. For instance, investment in commercial film making would not be suspect if the taxpayer (or relative) has no real involvement with the making of the film, whereas the making of home movies may suggest a hobby-like element.

(viii) ***Gambling or betting*** by the taxpayer (or relative) includes trying one's luck at a casino on a regular basis, card playing, lottery purchases and sports betting.

3. "Facts and circumstances" Escape Hatch

As stated above, the threshold qualification under subsection (2) generally results in ring-fenced treatment for the assessed losses (i.e., net losses) of a suspect trade. However, subsection (3) provides an escape route that allows the taxpayer to prevent ring-fenced deduction treatment by proving that the activity at issue is a legitimate trade despite suspect classification in subsection (2).

In order for an activity to escape the subsection (2) taint, the activity must constitute a "business" (as opposed to a hobby or a mere venture). More importantly, this business must have a **reasonable prospect** of generating taxable income within a **reasonable period** (which is determined pursuant to an objective standard rather than mere subjective taxpayer intent). This determination is based on the "facts and circumstances" in respect of which the taxpayer has the onus of proving (see section 82 of the Income Tax Act of 1962). This "facts and circumstances" test must have "special regard" to the "facts and circumstances" outlined in paragraphs *(a)* to *(f)* of subsection (3). Other "facts and circumstances" may also be considered should unique circumstances arise.

The "facts and circumstances" to which special regard will be had are as follows:

(a) *Proportionality of losses to income* - This factor focuses on the proportion of gross income the taxpayer derives from that activity in relation to the deductions arising in respect of that activity. If a taxpayer has relatively small amounts of gross income and claims large deductions, this disproportionality highlights a risk to the Fiscus. However, should the taxpayer be generating large amounts of gross income in relation to deductions, this proportionality will

be a favourable factor.

(b) *Advertising and selling* - Typically, trading requires regular selling and marketing initiatives in terms of time and expense (including advertisements). More often than not, hobby activities tend to incur large amounts of expenses/losses while the level of selling activities is minimal. The taxpayer must demonstrate selling/advertising efforts in terms of activities performed or expenses incurred.

(c) *Commercial manner* - Consideration must be given to whether the activity is carried on in a business-like manner. A hallmark of a trade is the business-like system or method pursuant to which the activities are carried out. This factor takes into account:
   - (i) The number of full-time employees employed in the activity (as opposed to part-time help (distinguishable from employees limited to the high season) which could involve relatives). Employees providing services of a domestic or private nature are excluded for this purpose (e.g., domestic servants and residential gardening workers regardless of whether they are also involved in the trade or not);
   - (ii) The commercial setting where the activity is situated (i.e., the business is located in a commercial district and the business-like nature of its appearance);
   - (iii) The amount and value of the equipment used exclusively for the business (hence, mixed use property, such as yachts, will be excluded from qualifying as a favourable factor); and
   - (iv) The amount of time a taxpayer spends at the premises conducting the activity.

(d) *Proportionality of period of losses to the duration of the activity* - Account will be taken of the number of years in which the activity incurs a loss in proportion to the total number of years that the taxpayer has been engaged in that activity. In determining the ratio, consideration will be given to:
   - (i) Any unexpected or unforeseen events that may give rise to losses (for instance, heavy rains or droughts would provide grounds for mitigating sustained losses for farmers); and
   - (ii) The nature of the activity (for instance, does the activity typically have a long start-up period such as olive farming).

(e) *Taxpayer's future business plans* - Favourable consideration will be given to the business plans and steps put in place by the taxpayer to prevent or limit further losses. Consideration will also be given as to whether the taxpayer intervened strategically to ensure the activity will ultimately be profitable.

(f) *Availability of property for recreational use or personal consumption* - This factor goes to the heart of the matter, but is often the most difficult to prove or disprove. A taxpayer will have to provide proof confirming that the asset was generally unavailable or not actually used by the taxpayer (or relative) for recreational use or personal enjoyment. For instance, where a taxpayer has a holiday home at the coast, the taxpayer will have to prove that the property was not readily available for personal use with details of periods when persons other than the taxpayer (or relatives) occupied the home during the tax year.

4. "Six Out of Ten Year Loss Trades"

The "facts and circumstances" escape route provided by subsection (3) does not apply if the taxpayer has incurred six years of losses during the last ten years of assessment (including the current year at issue). This test is applied in the same manner as the "three out of five" year threshold in subsection 2*(a)*.

This automatic prohibition for losses incurred for six out of ten years is premised on the notion that a person from an economic perspective could not afford a legitimate trade indefinitely if continuous losses are sustained (unless motives other than profit were present). Hobbies, on the other hand, frequently generate sustained losses for indefinite periods. Farming was excluded from the six out of ten year prohibition because many forms of legitimate farming entail long-term losses before the expectation of profit can be realised.

Losses incurred in any tax year ending on or before 28 February 2004 will not count against a taxpayer.

5. Permanent Ring-Fencing

Ring-fenced losses falling within section 20A are ring-fenced forever and may only be offset against income from that trade. Taxpayers will never be able to use these ring-fenced losses against income from other trades either during the current tax year during which the ring-fenced losses occur or in a subsequent year (in the form of a carry forward), for example:

Example

Facts. Taxpayer is an accountant and maintains a residential guesthouse that qualifies as a listed suspect trade under subsection (2)*(b)*. In 2005, Taxpayer generates R530 000 taxable income as an accountant and R12 000 of assessed loss from the guesthouse. The taxpayer is unable to demonstrate a reasonable prospect of generating taxable income.

Result. The R12 000 of assessed loss from the guesthouse is ring-fenced in 2004. This ring-fenced treatment of the R12 000 assessed loss will continue for all subsequent years after 2005.

6. Set-Offs Against Recoupment

Generally, losses of a trade subject to ring-fencing under subsection (1) can be freely used against income from that trade. Subsection (6) clarifies that losses of a trade can similarly be used against income from recoupments under section 8(4)*(a)* associated with that trade, even if the recoupment income arguably does not otherwise qualify as income from conducting that trade.

This use of ring-fenced losses against recoupment income stems from the assumption that any recoupment most likely originates from depreciation or other losses that were ring-fenced. In contrast, ring-fenced losses cannot be offset against capital gains associated with the same trade because capital gains represent investment profits (as opposed to trading profits).

7. Multiple Farming Activities Deemed to Qualify as a Single Trade

Assessed losses from a single trade can only be set off against income from the same trade. Whether one or more related activities constitute the same trade or multiple trades is a question of fact. However, subsection (7) provides that multiple farming activities will be deemed to constitute a single trade for purposes of section 20A. This unified treatment of all farming activities is appropriate because farming typically entails multiple diverse activities.

8. Reporting Requirement

Subsection (8) creates a reporting obligation for taxpayers subject to section 20A. Under this rule, a taxpayer must report each suspect trade as per the tax return form described under subsection (2)*(a)* (i.e., under the "three out of five year" test) or subsection (2)*(b)* (i.e., under the "suspected activity" list). This rule ensures that suspect trades are readily identifiable by SARS.

9. Penalty for Failure to Report

Subsection (9) sets out the consequences for failure to report as set out in subsection (8). Under this section, failure to report under subsection (8) creates automatic ring-fencing under subsection 20A, even if the taxpayer can prove the legitimacy of the trade under the "facts and circumstances" test of subsection (3).

Only one circumstance exists in which the failure to report will not trigger automatic ring-fencing. This circumstance will arise if the taxpayer can demonstrate that reasonable grounds exist for believing that the suspect trade at issue was part of a bigger trade.

10. Effect of "three out of five" and "six out of ten" year roles

The application of the "three out of five year" and the "six out of ten year" rules will be applied only by taking into account assessed losses for tax years commencing on or after 1 March 2004.

11. Terminology

Subsection 11 provides that "assessed loss" means "assessed loss" as defined in section 20(2) and "relative" in relation to a person means a parent, child, stepchild, brother, sister, grandchild or grandparent of that person.

12. Effective Dates

Section 20A will come into operation on 1 March 2004 and apply in respect of tax years commencing on or after that date.

VALUE-ADDED TAX - PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS

Since 1994 many of the functions performed by Government have been taken over by entities outside National and Provincial government. The transfer of funds from National and Provincial departments (referred to as "public authorities" in the VAT Act) creates many interpretation problems. In some cases transfers of funds were zero-rated, sometimes standard rated and other times exempt resulting in anomalies in the application of the relevant sections of the VAT Act.

A review has been carried out to clarify the VAT dispensation of these transfers, now called "grants".

VAT is a tax on the consumption of goods and services by final consumers. In many respects the Government is a final consumer.

In order to give effect to a consistent VAT treatment of grants, a number of amendments to the Value-Added Tax Act, 1991 are proposed:

1. Grants to Constitutional Institutions as defined in Schedule 1 to the Public Finance Management Act (PFMA) will fall outside the VAT system. No VAT will be levied by these institutions but they will incur VAT on their purchases of goods and services like any other final consumer.

   Subclause *(f)* of clause 166 excludes the activities of Constitutional Institutions from the definition of "enterprise".

2. National and Provincial public entities as defined in Part A and C of Schedule 3 will also be excluded from the definition of "enterprise" unless they are in competition with the private sector and the Minister of Finance directs that they are carrying on an enterprise. The proposed amendments relating to these entities are contained in clauses 166 subclause *(d).* The definition of a "designated public body or public private partnership" is introduced in section 1 which defines the entities that are regarded as vendors for VAT purposes.

3. Major National Government and Provincial Government enterprises as well as public private partnerships as defined in Schedule 2, Part B and D of Schedule 3 and Regulation 16 of Treasury Regulations issued under the PFMA, respectively, will be regarded as VAT vendors and grants to them will be taxable at the standard rate, unless they are otherwise exempt from VAT. The provisions relating to these bodies are contained in clauses 166 *(c)* and 167*(b).* Grants to a "designated public body or public private partnership" are included in the definition of "consideration" in section 1. There grants to a "designated public body or public private partnership" are accordingly taxable at the standard rate as a result of the amendment to section 8(5).

4. Grants payable to various bodies and vendors are dealt with in clause 166 *(g).* Due to the deletion of the definition of "transfer payment" the definition of "grant" is introduced in section 1 to clarify payments made by public and local authorities. Specifically excluded from the definition of "grant" are payments made by public or local authorities in respect of any goods or services supplied to them. The VAT implications of grants will differ, depending to whom they are paid.

5. Grants paid to vendors, other than those referred to in paragraphs 2 and 3 above, will not be subject to VAT and it follows that no input tax will be claimable on inputs funded from these grants. The amendment to the definition of "consideration' as per clause 166*(b)* keeps the grant outside the scope of VAT and accordingly, the amendment to section 17(2) by the introduction of paragraph *(e)* as per clause 174*(c)* prevents input deductions where grants are paid to entities which is not a "designated public body or public private partnership:.

   An exception is proposed in respect of grants made to welfare organisations which will be zero-rated in terms of section 11(2)*(n)* as amended by clause 170*(b).*

6. The introduction of proviso (iv) to amend section 8(2) will not require any

vendor which a Constitutional Institution, or Public Entity listed in Schedule 1 or 3 of the Public Finance Management Act to account for VAT upon deregistration as a result of that vendor ceasing to be a vendor in light of the amendments to the definition of “enterprise” introduced by this Act

These amendments will come into effect on a date to be fixed by the President by proclamation in the *Gazette* .

CLAUSE 1

Marketable Securities: Amendment of section 1 of the Marketable Securities Tax Act, 1948

Subclause (a): In terms of this clause it is proposed to bring the provisions relating to a lending arrangement in alignment with the definition as set out in the Uncertificated Securities Tax Act, 1998 and this provision will come into operation on the date of promulgation of this Act.

Subclause (b): Currently, no definition of “person” exists explicitly in the Act. Experience has shown that courts interpret “person” to exclude trusts or other similar entities, which would normally qualify as persons. The proposed amendment helps to modernize and to converge the Act with the other Acts.

CLAUSE 2

Marketable Securities: Amendment of section 3 of the Marketable Securities Tax Act, 1948

Subclause (a): An acquisition of marketable securities in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962) is exempt from marketable securities tax. This exemption was extended in 2002 to an acquisition of securities in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of the market value of the asset exchanged for those securities. The proposed changes extend the exemption to an acquisition of securities in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules regardless of whether those securities are acquired as capital assets or trading stock. This amendment will therefore extend the list of requirements to be ignored when determining whether the transaction in terms of which those securities are acquired would have constituted a transaction or distribution contemplated in the corporate reorganisation rules. The proposals also align the wording of the exemption in respect of unbundling transactions with that applying in respect of company formations, share-for-share and other corporate transactions.

Subclause (b): This amendment aims to align the MST in full with the provisions of the Uncertificated Securities Tax in full regarding lending arrangements.

CLAUSE 3

Marketable Securities: Insertion of section 4A in the Marketable Securities Tax Act, 1948

The proposed amendment introduces a general anti-avoidance provision into the MST Act which is similar to those contained in other tax Acts administered by the Commissioner.

CLAUSE 4

Marketable Securities: Insertion of section 8A of the Marketable Securities Tax Act, 1948

The clause proposes the introduction of an amendment which allows the Commissioner to appoint a person as an agent to collect outstanding MST. The provision is similar to the provisions contained in other Acts administered by the Commissioner.

CLAUSE 5

Marketable Securities: Amendment of section 9 of the Marketable Securities Tax Act, 1948

This amendme nt is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 6

Marketable Securities: Insertion of section 9E in the Marketable Securities Tax Act, 1948

The proposed amendment requires members to retain records of MST for periods of 5 years and brings the MST Act in line with other Acts administered by the Commissioner. It is proposed in the amendment applies to records relating to purchase marketable securities on or after the date of promulgation of this Act.

CLAUSE 7

Transfer Duty: Amendment of section 1 of the Transfer Duty Act, 1949

Subclause (a): The proposed amendment is consequential upon the introduction of a paragraph *(d)* to the definition of “fair market value”.

Subclause (b): The proposed amendment introduces a new method of valuing shares in a share block company. It proposes that the fair market value be the sum of the fair market value of the share and the amount of the loan obligation assumed by the acquirer of the share. Previously the shares had to be valued using the method prescribed in paragraph *(b)* of the definition.

CLAUSE 8

Transfer Duty: Amendment of section 5 of the Transfer Duty Act, 1949

Subclause (a): The purpose of the amendment is to prevent the use of tripartite agreements which are designed to avoid transfer duty. In terms of the section, if a property transaction is cancelled or dissolved by the operation of a resolutive condition before registration of the acquisition in a deeds registry, the amount paid and retained by the seller and any amount paid by either party to the transaction will be consideration on which transfer duty is payable. It is proposed that the consideration should consist of the amounts paid and retained by the seller and any amount paid by the taxpayer to the seller for the cancellation. A further condition proposed is that on the cancellation or dissolution of the transaction, the property must completely revert to the seller and the buyer must have relinquished all rights and may not receive any consideration arising from such cancellation or dissolution.

Subclause (b): Transfer duty is imposed on conversion from share block to a sectional title interest in terms of this section. As a result of the imposition of transfer duty on a natural persons acquisition of shares in a Share Block Company owning residential property last year, this section will result in double taxation if it is not removed and it is proposed that it be deleted.

It is proposed that these provisions come into operation on the date of promulgation of this Act and apply in respect of the acquisition of property on or after that date.

CLAUSE 9

Transfer Duty: Amendment of section 9 of the Transfer Duty Act, 1949

Subclause (a): The provisions in the Income Tax Act, 1962, relating to public benefit organisations were amended in 2000 to change the requirements for and approval process of these exempt bodies. Organisations which were previously exempt under separate provisions of the Income Tax Act, 1962, were now all required to apply for exemption and, if approved, qualify for exemption under section 10*(c*N*)* of that Act. These organisations must apply for exemption before 31 December 2003. Specific transitional arrangements were, however, included to ensure that these bodies continue to enjoy exemption until approval for exemption is granted by the Commissioner under section 10(1)*(c*N*)*.

Public benefit organisations which are exempt under section 10(1)*(c*N*)* of the Income Tax Act, 1962, also enjoy exemption for purposes of transfer duty. This proposed amendment ensures that these bodies also continue to enjoy the transfer duty exemption during the period until approval is granted in term of section 10(1)*(c*N*)* of the Income Tax Act, 1962.

Subclause (b): A transfer duty exemption was inserted in 2002 to provide for the exemption of an acquisition of property in terms of an amalgamation or intra-group transaction or in terms of any liquidation distribution contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). The proposed amendment extends this exemption to any acquisition of property in terms of a transaction that would have constituted an amalgamation or intra-group transaction or liquidation distribution as contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of whether that property is acquired as a capital asset or trading stock. This proposal will align this exemption with that exempting acquisitions of marketable securities under such transactions from marketable securities tax – see the notes on *CLAUSE 2 subclause (a)*.

Subclause (c):

Section 9(18): This amendment provides an exemption for mineral rights as a result of the disposal or acquisition in terms of the Mineral and Petroleum Resources Development Act.

Section 9(19): As explained in subclause *(b)* of Clause 8, if the conversion from share block shares to sectional title was not exempted it would result in double tax. This provision provides for exemption of transfer duty where a natural person acquires a right to property in terms of sectional title where a share block company is converted to a sectional title.

CLAUSE 10

Transfer Duty: Amendment of section 11A of the Transfer Duty Act, 1949

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 11

Transfer Duty: Insertion of sections 13A, 13B and 13C in the Transfer Duty Act, 1949

The Commissioner has the power in terms of the Income Tax Act and the Value-Added Tax Act,1991, to take steps to recover taxes and duties outstanding and it is proposed in the amendment that the same power to collect tax be introduced into the Transfer Duty Act. The provisions proposed will permit the Commissioner to:—

- Take judgment against any person for outstanding duty and penalty; and
- Appoint a person as an agent to collect tax from any moneys due by that agent to another person who in turn owes the Commissioner tax.

CLAUSE 12

Transfer Duty: Amendment of section 16 of the Transfer Duty Act, 1949

This proposed amendment is aimed at curbing artificial transactions whereby persons use nominees to avoid transfer duty and provides that section16 of the Transfer Duty Act should be read with section 5(2)*(a)* of the Act. The proposal is that where a person has sold a property acting as an agent for another person, he or she must furnish the seller on the day of the auction or on the day that the agreement is concluded, the document appointing him or her as agent.

CLAUSE 13

Transfer Duty: Insertion of section 17A in the Transfer Duty Act, 1949

The Commissioner is in terms of the Income Tax Act and the Value-Added Tax Act permitted to impose 200 per cent additional tax for tax evasion. The amendment proposes that the Commissioner have the power to impose 200 per cent additional duty for evasion in terms of the Transfer Duty Act.

CLAUSE 14

Transfer Duty: Amendment of section 18 of the Transfer Duty Act, 1949

The proposed amendment provides that payment of the duty cannot be suspended by lodging an appeal, unless the Commissioner otherwise directs. This provision is the same as the provisions in the Income Tax and Value-Added Tax Acts. The amendment also provides that any interest paid by the Commissioner on successful appeals is a drawback from the National Revenue Fund.

CLAUSE 15

Transfer Duty: Insertion of section 20B in the Transfer Duty Act, 1949

The proposed amendment introduces a general anti-avoidance provision into the Transfer Duty Act which is similar to those contained in other tax Acts administered by the Commissioner.

CLAUSE 16

Estate Duty: Amendment of section 4 of the Estate Duty Act, 1955

The provisions in the Income Tax Act, 1962, relating to public benefit organisations were amended in 2000 to change the requirements for and approval process of these exempt bodies. Organisations which were previously exempt under separate provisions of the Income Tax Act, 1962, were now all required to apply for exemption and, if approved, qualify for exemption under section 10*(c*N*)* of that Act. These organisations must apply for exemption before 31 December 2003. Specific transitional arrangements were, however, included to ensure that these bodies continue to enjoy exemption until approval for exemption is granted by the Commissioner under section 10(1)*(c*N*)*.

In terms of the Estate Duty Act, 1955, bequests to public benefit organisations which are exempt under section 10(1)*(c*N*)* of the Income Tax Act, 1962, are exempt from estate duty. This proposed amendment ensures that bequests to these bodies continue to enjoy the estate duty exemption during the period until approval is granted in term of section 10(1)*(c*N*)* of the Income Tax Act, 1962.

CLAUSE 17

Estate Duty: Amendment of section 8A of the Estate Duty Act, 1955

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 18

Income Tax: Amendment of section 1 of the Income Tax Act, 1962

Subclause (a): Provisions were inserted in the Income Tax Act, 1962, in 2001 to provide for electronic filing of tax returns and electronic signatures on these returns. An e-filing system has also been implemented by SARS. The proposed amendment make provision for electronic notices and assessments to be issued by the Commissioner.

Subclause (b): A definition of "date of sequestration" is inserted to clarify that the date of sequestration is—

- the date of voluntary surrender of an estate, if accepted by the Court; or
- the date of provisional sequestration of an estate, if a final order of sequestration is granted by the Court.

A definition of "depreciable asset" is also inserted in the Act meaning an asset in respect of which a capital deduction or allowance is allowable in terms of this Act which is determined with reference to the cost or value of that asset. This does, however, not include any deduction for purposes of determining any taxable capital gain or capital loss from the disposal of that asset. The term "depreciable asset" is used for purposes of determining the inclusion of any amount recouped in the case where an asset is disposed of and replaced by a further asset. See notes on REINVESTMENT IN REPLACEMENT ASSETS.

Subclause (c):

Current Law

Despite the shift to worldwide taxation in 2001, large portions of foreign income remain outside the South African income tax net by virtue of "designated country exception". Under this provision, income from listed foreign countries is exempt if it was derived from a country with a similar tax system to South Africa's and subject to a statutory rate of at least 27 per cent. The underlying rationale was to eliminate high taxed foreign income, most of which would generate marginal additional revenue for the South Africa fiscus after offsetting foreign tax credits.

Reasons for change

The current system creates an impression that South Africa's tax system favours certain countries over others. The use of the list concept is also problematic because many countries have hidden incentives that do not simply eliminate statutory income or cannot be uncovered without a full understanding of the entire tax system involved.

Proposal

It is proposed that the designated country exception be removed for all purposes, including for purposes of sections 9D(Controlled Foreign Companies), 9F(foreign source income), and section 64B(STC).

Subclause (d): The definition of dividend is amended by deleting the provisions relating to the granting of benefits by a company to shareholders in the form of a disguised dividend. The granting of these benefits and the transfer of assets are fully dealt with in the STC provisions.

Subclause (e): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (f): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (g): A new definition of "lending arrangement" is proposed for purposes of tax treatment of disposals and dividends received from shares which are transferred in terms of such an arrangement.

Subclause (h):

Current Law

With the introduction of the worldwide system of taxation, a special exemption from worldwide taxation and the foreign dividend tax was introduced in respect of International Headquarter Companies (IHC). In order to qualify for this IHC exemption, the entity had to be exclusively foreign owned, and it had to have more than 90 per cent of its value stem from equity or loan capital of more than 50 per cent owned foreign companies. This regime was designed so that foreign investors could use South African facilities as a regional headquarters.

Reasons for change

Under the international best practice, the exemption could be viewed as "Harmful Preferential Tax Regime". The 90 per cent foreign ownership requirement makes the IHC a ring-fencing regime, whereby a country isolates its own economy from tax concessions by providing a special regime solely to foreign controlled taxpayers. International pressure requires that regimes of this kind be eliminated. The regime was also ineffective. Firstly, in terms of Exchange Control Regulations, the South African Reserve bank restricted the flow of 90 per cent foreign owned South African subsidiaries. Secondly, as the IHC was a non-resident for tax purposes, it could not qualify for the benefits of certain Double Taxation Agreements entered into by South Africa with other countries.

Proposal

It is, therefore, proposed that the IHC regime should be removed.

Subclause (i): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (j) and (k): A person is a resident of the Republic if that person is ordinarily resident in the Republic, or if a person is physically present in the Republic for a certain number of days during the relevant year of assessment and the three preceding years of assessment. The "physical presence"-test is a year by year test. If a person qualifies as a resident in terms of this test, that person is deemed to be a resident from the first day of the year of assessment during which that person so qualifies. This proposed amendment clarifies this position.

Subclause (l): For purposes of determining whether a person is a resident of the Republic in terms of the "physical presence"-test, the days that a person is in transit through the Republic are not taken into account. This, however, only applies where a person does not enter the Republic through a port of entry. In terms of the Immigration Act, 2002 (Act No. 13 of 2002), a person may only enter the Republic through a port of entry. The term "port of entry" as defined in section 1 of the Immigration Act, 2002 refers only to foreigners who enter the Republic and does not include South African residents or citizens. Hence, the law pertaining to South African residents and citizens is unclear. The proposed amendment will clarify this issue so that the "port of entry" refers to all South African residents, citizens and foreigners who enter the Republic through a "port of entry". The Minister of Home Affairs may, however, authorise any person or category of persons to enter the Republic at a place other than a port of entry. It is proposed that "physical presence" test also take account of the possibility that a person may enter the Republic at such other place.

Subclause (m): This amendment is consequential to the deletion of the definition of "headquarter company". See *subclause (h)*.

Subclause (n): This amendment is consequential upon the new provisions relating to the deduction of research and development expenses.

CLAUSE 19

Income Tax: Amendment of section 3 of the Income Tax Act, 1962

Subclause (a) and (b): Since the South African Revenue Service no longer forms part of the public service, the wording in section 3 of the Income Tax Act, 1962, is amended to extend the wording as the reference to "officer" still contains an association with persons appointed under the Public Service Act.

Subclause (c): The proposed amendment deletes references to obsolete provisions.

CLAUSE 20

Income Tax: Amendment of section 4 of the Income Tax Act, 1962

The amendments proposed to section 4 of the Income Tax Act, 1962, makes it clear that persons who are engaged by the Commissioner on a contractual basis to provide professional services are also bound by the secrecy provisions and are also required to take and subscribe to the oath or solemn declaration of secrecy.

CLAUSE 21

Income Tax: Amendment of section 5 of the Income Tax Act, 1962

These amendments are consequential upon the amendments introduced by the Taxation Laws Amendment Act, 2002 (Act No. 30 of 2002) that certain farmers, fishers and diamond diggers be brought into the standard arrangement as far as their year-end and provisional tax is concerned.

CLAUSE 22

Income Tax: Amendment of section 6quat of the Income Tax Act, 1962

Subclause (a) and (b): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (c): This amendment ensures that the granting of a foreign tax credit for a CFC is dependent on the submission of required information with regard to the CFC.

Subclauses (d): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (e): This amendment ensures foreign tax credits are available to dividends received by collective investment scheme holders following transfer of flow through provisions to the proviso.

Subclause (f) and (g): This amendment is collateral to new sections 9D(1A) and 9D(12). Both sections allow certain South African shareholders of foreign companies to be taxed currently (upon election) on their pro rata share of foreign company income. This election effectively provides these South African shareholders with section 6*quat* rebates (i.e., foreign tax credits) for the foreign taxes paid by the foreign company with respect to their pro rata share of foreign income. This amendment to subsection (1B) eliminates all excess foreign tax credits generated from this election. The purpose of the section 9D elections is to eliminate the burden of double taxation, not to generate excess foreign tax credits (which could be used to reduce South African tax against unrelated foreign income).

Subclause (h): These foreign tax credit provisions are no longer required in view of dividend exemption for substantial shareholdings.

Subclause (i): The amendment ensures that duplicated credit and deduction for foreign tax credits cannot take place following transfer of deduction option to section 11*(r)*.

Subclause (j): This amendment is consequential on the repeal of section 9E.

CLAUSE 23

Income Tax: Amendment of section 7 of the Income Tax Act, 1962

See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 24

Income Tax: Amendment of section 8 of the Income Tax Act, 1962

Subclause (a): See notes on RESEARCH AND DEVELOPMENT.

Subclause (b) and (c):

Current Law

Relief for the reinvestment of proceeds stemming from the sale of business assets currently exists in a limited way. The capital gains from these sale proceeds may be deferred for 5 years regardless of the useful life of the new replacement asset acquired. No relief exists for ordinary revenue arising from reinvested proceeds.

Reason for Change

Many countries fully exempt the sale of depreciable business assets if the sale proceeds are reinvested for further business use. Imposition of tax in these instances would otherwise hinder businesses in their attempt to upgrade because the sales proceeds needed for reinvestment would be reduced by the taxes paid. In South Africa, only partial relief exists to mitigate this side effect.

Proposed Law

Taxpayers will receive comprehensive reinvestment relief under proposed section 8(4)*(e)* through *(e*E*)* and proposed paragraph 66 of the Eighth Schedule. This relief will defer all ordinary revenue (i.e., recoupment) and capital gains generated on the sale of movable depreciable assets if fully reinvested in other movable depreciable assets. This deferred ordinary revenue or gain will be spread over the life of the newly acquired asset so that the resulting ordinary revenue and gain will be fully offset by the depreciation taken with respect to the newly acquired asset (technically referred to as the replacement asset).

Basic Requirements and Operation

Rollover reinvestment relief is wholly elective. In order to be eligible for this election:

(a) The asset disposed of must be depreciable as contemplated in section 11*(e)*, 12B, 12C, 12E, 14 and 14bis (hence buildings will not qualify);
(b) The asset must be sold for a capital gain or at least for an amount otherwise triggering ordinary revenue under section 8(4));
(c) An amount at least equal to the amount received for the asset disposed of must be used to buy the new asset (i.e., the whole amount received on sale must be reinvested, not just a portion);
(d) The asset acquired must be an asset situated within South Africa; and
(e) Replacement of the old must occur within 18 months of the disposal.

Note that these provisions do not require any tracing of funds. Requirement *(c)* above simply requires the taxpayer to reinvest "an amount that at least equals" the amount received on sale of the initial asset. Requirement *(c)* does not require that the exact sums received be used for reinvestment because monetary funds are fungible.

Example 1

Facts: Company Z purchased machine A with a useful life of 10 years for R1 000. Company Z claims an allowance of R400 based on 4 years of straight-line depreciation, leaving a tax cost of R600. As part of a general effort to upgrade its operations, Company Z sells machine A for R1 200 and then purchases machine B for R 1 600 within 2 months thereafter. Machine B can be depreciated on a 40:20:20:20 basis over a 4 -year period.

Result. The proposal defers the R400 taxable income and R200 capital gain resulting from sale of machine A over the 40:20:20:20 depreciation period of machine B as shown below:

	Year 1	Year 2	Year 3	Year 4
Deduct:				
Allowance machine B	(R640)	(R320)	(R320)	(R320)
Add:				
Recoupment machine A. (R1000-R600=R400/4)	R100	R100	R100	R100
Capital gain machine A. (R1200-R1000=R200/4)	R50	R50	R50	R50

Special consideration must be had for situations in which the replacement asset is sold. If the replacement asset is sold without reinvestment, all the deferred recoupment and gain remaining on the initial asset will be triggered (in addition to any recoupment or gain stemming from the disposal of the replacement asset). If the replacement asset is sold for further reinvestment, both the ordinary revenue and gain stemming from the initial asset and the replacement asset are deferred over the life of the new (i.e., second) replacement asset.

Example 2

Facts: The facts are the same as in *Example 1*, except that Company Z sells machine B at the beginning of year 3 for an amount exceeding machine B's depreciated cost.

Result. In addition to any recoupment or capital gain stemming from machine B, the sale of machine B triggers all the remaining deferred recoupment and capital gain stemming from the sale of machine A. Hence, the remaining R200 of recoupment income and R100 capital gain is now triggered in full.

Example 3

Facts: The facts are the same as in *Example 1*, except that Company Z sells machine B for R1 100 cash at the beginning of year 3 and then purchases machine C for R1 400 6 months later. The sale of machine B triggers R780 of potential recoupment (i.e., R1 100 of sale proceeds less the R320 depreciated tax cost). Machine C can be depreciated on a 40:20:20:20 basis over a 4 -year period.

Result. The R140 of recoupment from the sale of machine B as well as the remaining R200 of deferred recoupment and R100 of deferred capital gain stemming from the sale of machine B can be deferred over the useful life of machine C as illustrated below:

	Year 1	Year 2	Year 3	Year 4
Deduct:				
Allowance machine C.	(R560)	(R280)	(R280)	(R280)
Add: Recoupment machine A. (R1000-R600=R400/2=R200/4).	R50	R50	R50	R50
Capital gain machine A. (R1200-R1000=R200/2=R100/4).	R25	R25	R25	R25
Recoupment machine B. (R1100-R320=R780/4	R195	R195	R195	R195

CLAUSE 25

Income Tax: Amendment of section 8E of the Income Tax Act, 1962

Section 8E treats dividends on shares as South African sourced interest income if the share qualifies as an "affected instrument." Among other circumstances, a share will be treated as an "affected instrument" if that share generates a yield akin to a bond (i.e., akin to disguised interest). Under current law, these situations arise when the dividend is calculated with reference to any specified rate of interest or is otherwise to be calculated having regard to the amount of capital subscribed for the share paying the dividend.

The proposed amendment provides an additional circumstance in which the dividend yield will be treated akin to disguised interest. This additional situation will arise if the dividend yield is calculated with regard to the amount of any loan or advance made directly or indirectly by any shareholder (or any connected person). Although this amendment applies to both domestic and foreign shares, this amendment is mainly designed to prevent foreign round-tripping schemes designed to generate South African source interest deductions along with tax-free foreign dividends.

Example 1

Facts: South African Company acquires shares in a foreign company at the cost of R1 million. South African Company pays for the shares by issuing a promissory note to repay the R1 million at a 10 per cent interest rate. The shares acquired act as security for failure to repay. The shares will provide a dividend yield equal to 1 per cent less than the yield on the promissory note (the 1 per cent differential being held back as a fee for the other parties to be involved in the transaction).

Result. The dividend yield on the foreign shares will be treated as taxable interest in the hands of South African Company because the dividend yield is calculated based on the promissory note (i.e., a loan made by the shareholder).

Example 2

Facts: The facts are the same as *Example (1)*, except that South African Company immediately contributes all the foreign shares to a wholly owned South African Subsidiary in exchange for newly issued South African Subsidiary shares.

Result. The result is the same as *Example (1).* The shares are still treated as taxable interest because the payments are based on amounts payable by a connected person.

CLAUSE 26

Income Tax: Amendment of section 9 of the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 27

Income Tax: Amendment of section 9B of the Income Tax Act, 1962

The amendment is consequential upon transfer of the definition of lending arrangement to section 1.

CLAUSE 28

Income Tax: Amendment of section 9D of the Income Tax Act, 1962

Subclauses (a) to (e), (g), (j), (k), (l), (n) and (u): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (f): South African shareholders that hold from 10 to 25 per cent in a foreign company can elect to treat their participation rights in that foreign company as controlled foreign company interest. The 10 to 25 per cent threshold takes into account the interests of connected persons regardless of whether those connected persons do not choose to utilise the election provided under this subsection. This election essentially mitigates the removal of the indirect tax credit system of section 9E by allowing South African shareholders to be taxed currently on foreign income in order to receive the benefit of section 6*quat* rebates (but note that no excess rebates can be generated from this election by virtue of section 6*quat*(1B)). This election may be made on a year-by-year basis.

Example

Facts: South African Company owns 20 per cent of the ordinary shares of U.K. Company, the remainder of which is owned by an unconnected foreign individual. In 2005, U.K. Company generates 50 000 pounds of passive net income subject to a 30 per cent U.K. tax. In 2006, U.K. Company distributes all remaining 35 000 pounds to its shareholders as a dividend on a pro rata basis.

Result. South African Company can elect to be subject to tax on its pro rata share of the 50 000 pounds earned by U.K. Company as if U.K. Company were

> a controlled foreign company. Hence, South African Company is deemed to receive 10 000 of pounds of income along with 3 000 pounds of 6*quat* rebates (resulting in zero of South African taxes). South African Company can disregard all 7 000 pounds of dividends received in the following year because all these dividends represent previously taxed income (see section 10(1)(k)(ii)*(cc)*).

Subclauses (h) and (i): Under current law, a CFC cannot deduct items such as interest, royalties, rents, section 31 adjustments, currency exchange losses if these items relate to amounts arising with respect to other CFCs in the same controlled group of companies to the extent the other CFC treats the comparable amount as exempt under section 9D(9)(*f*A). This current rule ensures that parity exists between both CFCs (i.e., if one CFC receives the benefit of exemption, the other CFC loses the corresponding deduction). The proposed amendment modifies this rule in light of newly proposed section 9D(12), which allows South African residents to treat section 9D(9)(*f*A) as includible CFC income. Under the proposed change, the CFC can deduct the above items associated with section 9D(9)(*f*A) to the extent a South African resident treats section 9D(9)(*f*A) amounts as includible income. This proposed change effectively maintains the current system of parity - intra-group CFC costs are deductible unless associated with corresponding exempt intra-group CFC net income.

Subclauses (m), (o), and (p): Section 9D(9)*(b)* generally exempts CFC income attributable to a business establishment. Two exceptions to this exemption are sections 9D(9)*(b)*(i) and (ii). Under section 9D(9)*(b)*(i), business establishment income will not receive the exemption if attributable to transfer pricing. Under section 9D(9)*(b)*(ii), business establishment income will additionally not receive the exemption if within a structure that represents the strong potential for shifting income outside South Africa through transfer pricing. This latter exception is designed to supplement the complex facts and circumstances nature of transfer pricing. Both sections 9D(9)*(b)*(i) and (ii) are solely intended to bring CFC income into the tax net if that income is seemingly shifted to countries that impose lower levels of tax than the current South African rate. Under the proposed amendment, both sections no longer apply if the diversionary income is subject to tax by another country at an effective tax rate that equals or exceeds the South African tax otherwise imposed.

Subclauses (q), (r): Under present law, passive income generated by a CFC is generally subject to tax under section 9D even if that income is attributable to a business establishment. However, two types of passive income attributable to a business establishment will qualify for exemption - *de minimis* passive income (item *(aa)* income) and passive income stemming from the principal activities of a banking or financial services, insurance or rental business (item *(bb)* income).

The current *de minimis* passive exemption allows passive CFC income to be exempt if that income (gross income and gross capital gains) does not exceed 5 per cent of the total. None of this passive income is exempt once the 5 per cent threshold is exceeded. The proposed amendment shifts the policy of this exemption in favour of an objective working capital exemption. Most businesses have a small amount of working capital that is necessary for the proper functioning of that business. The current all-or-nothing cut off also makes little sense. Under the proposed amendment, the exemption if shifted to a 10 per cent threshold with amounts below that threshold remaining exempt even if the total passive amounts exceed the 10 per cent threshold.

Example 1

Facts: South African Company owns all the shares of CFC. CFC generates R200 000 of gross income from the trading operations of its business establishment. CFC also maintains working capital that generates R23 000 of passive income.

Result. Under the amendment, R20 000 of the passive income is exempt under section 9D(9)*(b)*(iii)*(aa)*. The excess R3 000 falls within the CFC tax net.

Example 2

Facts: South African Company owns all the shares of CFC. CFC solely holds portfolio investments generating R200 000 of passive income. CFC does not have an business establishment.

Result. Section 9D(9)*(b)*(iii)*(aa)* does not apply under present or proposed law. None of the passive income is attributable to a business establishment.

Proposed changes to section 9D(9)*(b)*(iii)*(aa)* also clarify the interaction of this exemption with other section 9D(9) exemptions. Under the proposed exemption, the 10 per cent calculation is determined without reference to the exemptions contained in section 9D(9)*(e)* through *(h)* or to amounts not included as income (such as dividends that are exempt by virtue of the participation exemption under proposed section 10(1)*(k)*(ii).

Subclause (s): Section 9D(9)*(f)* exempts dividends received by a CFC to the extent these amounts represent CFC profits that were previously included as income by the same South African shareholder. The proposed amendment changes how this calculation is made in line with the proposed stacking rules of section 10(1)*(k)*(ii)*(c)*.

Subclause (t): Section 9D(9)*(h)* currently contains a participation for dividends and the sale of shares by CFCs. Under this exemption, dividends from the foreign shares and the sale of foreign shares will be exempt if the CFC receiving the dividend or selling the shares has a more than 25 per cent share interest in the foreign company. The proposed amendment moves the dividend exemption for interest into section 10(1)*(k)* and adjusts the exemption for selling shares so the exemption matches the dividend exemption. Hence, the more than 25 per cent threshold now can be calculated with reference to holdings by other controlled group companies, and all foreign equity shares falling within the disguised debt rules of section 8E (without reference to the three year requirement) are no longer are eligible for the exemption.

Subclause (v): South African shareholders that hold from 10 to 25 per cent in a CFC can elect to treat all their pro rata share of CFC income as taxable under section 9D even if that income would otherwise be exempt under section 9D(9). This mechanism is an all-or-nothing election – South African shareholders cannot electively choose to bring only certain portions of otherwise exempt income into the net. Like section 9D(1A), this election essentially mitigates the removal of the indirect tax credit system of section 9E by allowing South African shareholders to be taxed currently on foreign income in order to receive the benefit of section 6*quat* rebates (but note that no excess rebates can be generated from this election by virtue of section 6*quat*(1B)). This election may be made on a year-by-year basis. The 10 to 25 per cent threshold takes into account the interests of connected persons regardless of whether those connected persons choose to utilise the election provided under this subsection.

Example

Facts: South African Company owns all the ordinary shares of U.K. Company. In 2005, U.K. Company generates 400 000 pounds of trading stock income attributable to a U.K. business establishment as well as 20 000 pounds of passive income from related working capital. All this CFC income is subject to a 30 per cent U.K. tax. In 2006, U.K. Company distributes all remaining 294 000 pounds to South African Company as a dividend.

Result. South African Company can elect to treat all the CFC income despite the exemptions of section 9D(9)*(b)*. In 2005, all the U.K. CFC income is subject to South African tax, but fully reduced by section 6*quat* rebates. South African Company can disregard the 2006 dividend because this dividend represents previously taxed income (see section 10(1)*(k)*(ii)*(cc)*).

This election can also be combined with the election of section 9D(1A). Hence, if a South African resident owns a 20 per cent share in a foreign company that is not a CFC, that resident can elect to include all of that resident's 20 per cent pro rata share of foreign company income, even if that income would otherwise be exempt under section 9D(9).

CLAUSE 29

Income Tax: Repeal of section 9E of the Income Tax Act, 1962

Current Law

Under present law, gross income includes any amount received or accrued as dividends including any "foreign dividend" as defined in section 9E. A foreign dividend is defined as any actual dividend declared from profits derived from a foreign company and any deemed dividend declared by any company (as contemplated in section 64C).

Section 9E contains a series of rules that provide direct and indirect tax credits, technically referred to as 6quat rebates. If a resident shareholder holds at least 10% of the equity share capital of the foreign company declaring the dividend, foreign corporate taxes paid will be allowed as an indirect tax credit and withholding tax paid will be allowed as a direct tax credit.

This regime has a series of exemptions. These exemptions include exemptions for dividends from dual listed foreign companies on the JSE Securities Exchange and those stemming from previously taxed South African profits. Other exemptions include exemptions applicable for unbundlings as well as a Ministerial exemption.

Reasons for change

The current system of taxing foreign dividends under section 9E has the unintended effect of discouraging dividend inflows. This problem is most readily apparent in situations where South African taxpayers owning a meaningful interest in a foreign subsidiary delay or avoid the repatriation of dividends to avoid South African tax.

Proposal

It is proposed that tax on foreign dividends should be removed if a resident shareholder has an interest of more than 25 percent in a foreign company paying the dividend. Dividends below this threshold will no longer be eligible for indirect tax credits under section 6quat. Indirect tax credits are problematic in terms of enforcement and compliance because of the difficulties of tracing historic profits to applicable foreign taxes. Moreover, little reason exists to maintain this complex system for the small class of South African shareholders otherwise remaining within the indirect tax credits system (i.e. those between the 10 – 25 percent range). Even in these limited instances, efforts have been taken to mitigate the loss of indirect tax credits. Hence, section 9D will now allow South African shareholders to receive tax credits for taxes paid by a foreign company if these shareholders elect to be taxed currently. The stacking rules for exempting previously taxed profits have also been amended in favour of taxpayers. While most of section 9E has been repealed, some of the section 9E exemptions have been moved to new section 10(1)(k). These exemptions include exemptions for dual listed companies and previously taxed South African income. The Ministerial exemption has been removed as superfluous in light of the new exemption for more than 25 percent foreign shareholding.

CLAUSE 30

Income Tax: Repeal of section 9F of the Income Tax Act, 1962

Section 9F, which exempts foreign source income from designated countries, is hereby repealed as part of the overall elimination of the designated country exception. All foreign source income, such as foreign branch income or foreign interest income, etc. will now be subject to tax regardless of the country where it arose.

CLAUSE 31

Income Tax: Amendment of section 9G of the Income Tax Act, 1962

The amendments to section 9G are largely technical in nature. First, the definition of foreign currency has been revised in order to be consistent with other recently changed provisions to the Act. Second, the relationship between section 9G and section 25D has been clarified. Currency conversions under section 9G stand on their own without reference to section 25D. Lastly, the currency conversion rules for equity instruments acquired after 1 October 2001 are currently unclear. The proposed amendment clarifies that expenses incurred to acquire trading stock of this kind after 1 October 2001 are translated to the South African currency at the average exchange rate during the tax year in which that expenditure was incurred. Opening stock calculations for the same trading stock are similarly calculated with reference to the same year of expenditure.

Subclause (a): This amendment brings the reference to the currency of the Republic in line with other references to the South African currency in the Income Tax Act.

Subclause (b): This amendment clarifies the average rate of exchange to be used where a foreign equity instrument is disposed off during a tax year following the tax year of acquisition thereof.

CLAUSE 32

Income Tax: Amendment of section 10 of the Income Tax Act, 1962

Subclause (a): This amendment is for clarification purposes and brings the wording in line with the other exemption provisions. Technically, amounts received by or accrued to a person and not revenues, form the basis for determining a liability for income tax.

Subclause (b): Section 10(1)*(cH)* exempts the receipts and accruals of mining rehabilitation funds or entities. The current provisions contain various deficiencies and uncertainties and the proposed amendment—

- clarifies that the funds of the relevant exempt entity may only be used to discharge the rehabilitation obligation on the closure of a mine;
- specifies the types of instruments or investments in which unutilised funds may be invested;
- provides that the Commissioner approves the Constitution of the body to section 10 which provides for its exemptions;
- introduces certain provisions to prevent non-compliance; and
- introduces a mechanism whereby the Department of Minerals and Energy must certify that money withdrawn from the exempt entity has indeed been used for the sole purpose of the entity.

Subclause (c) and (d): These amendments are consequential upon the repeal of section 9E.

Subclause (e), (f), (g), (h) and (i): Section 10(1)*(k)* is being revised to reflect the elimination of section 9E and the introduction of the exemption for dividends received from more than 25 per cent owned foreign companies. The core of this change is reflected in the enactment of new section 10(1)*(k)*(ii).

Participation Exemption

Under current law, most dividends received by CFCs do not create taxable income under section 9D by virtue of the participation exemption of section 9D(9)*(h)*. This exemption effectively exempts dividends received by CFCs from shareholdings that represent an active stake in a foreign company (a rough comparable to the business establishment exemption). The participation exemption of section 9D(9)*(h)* in respect of foreign dividends has been moved to section 10(1)*(k)*(ii)*(aa)* with the effect that dividends from more than 25 per cent owned foreign companies will now be exempt if received by South African shareholders as well as by CFCs. This exemption ensures that South African taxpayers will not be penalized for bringing back dividends onshore.

Turning to more technical issues, any person (i.e., any South African person or CFC) will receive exemption for dividends received from a foreign company if that person holds more than 25 per cent of that foreign company's total equity share capital. This more than 25 per cent share interest includes share interests held by other companies within the same controlled group of companies as the person receiving the dividend.

This exemption also contains two sets of rules to prevent this exemption from becoming a mechanism for employing tax avoidance round-tripping transactions (i.e., schemes designed to generate deductions by shifting payments offshore followed by the tax-free return of those funds in the form of exempt foreign dividends). The first set of rules prevent the application of this exemption with respect to shareholdings comparable to debt (i.e., shares qualifying as section 8E instruments without regard to the three year requirement contained in that section). Dividend paying shares involved in round-tripping schemes frequently contain criteria that are comparable to debt-like instruments. Shares falling within this suspect class cannot produce exempt dividends nor can they be relied upon by other parties for purposes of their own more than 25 per cent calculation. The second set of rules contain a more generalized anti-avoidance provision as a rearguard defense against schemes overcoming objective criteria of the first set of rules. Under this backup provision, the exemption is similarly denied for dividends that form part of any scheme to generate exempt dividends while that person (or any connected person) make corresponding payments which are deductible for South African tax purposes.

Example 1

Facts: Foreign Company 1, a shell company with no meaningful assets, has issued 100 ordinary shares, all of which are held by foreign persons. South African Company 1 owns all the shares of South African Company 2. South African Company 1 acquires participating preferred shares of Foreign Company 1 in exchange for a R10 million promissory note payable to Foreign Company 1 at a 15 per cent interest rate. South African Company 1 transfers all the participating preferred shares to South African Company 2. The participating preferred shares will provide a dividend equal to all the profits of Foreign Company 1 but no greater than R1,5 million per year.

Result. The dividends on the preferred shares do not qualify for the participation exemption. The dividends are effectively calculated on the basis of the note payable by South African Company 1 (i.e., person connected to the shareholder receiving the dividend). The dividends are also part of a scheme to generate exempt dividends with corresponding deductions against South African income.

Example 2

Facts: The facts are the same except that South African Company 2 owns 10 ordinary shares of Foreign Company.

Result. Any dividends received by South African Company 2 with respect to the ordinary shares also do not receive the benefit of the participation exemption. South African Company 2 cannot rely on the suspect preferred shares as a means for obtaining exemption with respect to the ordinary shares.

Dual Listed Foreign Companies

Under the current section 9E(7)*(c)*, dividends from certain dual listed foreign companies on the JSE Securities Exchange are exempt from tax. In addition to moving the exemption to section 10(1)*(k)*(ii)*(bb)*, the proposed amendment revises the exemption in the light of the removal of the designated country exception and the extension of the participation exemption to dividends received by South African parties.

As revised, all dividends from a dual listed foreign company (i.e., a company listed on the JSE Securities Exchange and listed on a recognized foreign exchange) are exempt from tax. The shareholder receiving the dividend need not hold any threshold level of shares to receive the exemption. The only ownership requirement still outstanding is that South African residents must own more than 10 per cent of the foreign company in the aggregate (i.e., the listing on the JSE Securities Exchange must be meaningful).

Dividends Out of Previously Taxed Foreign Profits

Foreign dividends from a CFC are not subject to tax to the extent those dividends represent previously taxed profits under section 9D. This rule prevents double taxation of the same profits. This exemption currently exists under section 9E and is now being moved to new section 10(1)*(k)*(ii)*(cc)*.

Under current law, dividends are deemed distributed out of profits pursuant to a year-by-year method on a last-in first-out basis. If a dividend represents a portion of a specific year's profits, the dividend is deemed to come out of a proportionate share of the year's profits if different types of profits arise during that year. Taxpayers may choose to shift the ordering of the year-by-year method through shareholder or director resolution but may not choose to change the proportionate allocation of profits within a single year. This total system of allocating profits was mainly important for indirect credits but also applied to the issue of previously taxed profits under section 9D.

The above tracing method is complicated because the shareholder receiving the dividends can only determine the tax consequence of a dividend by looking at how the profits were generated by the dividend-paying company. This tracing may require the review of profits over many years and may ultimately require another look-though to the profit of other companies if the profits at issue stem from lower-tier dividends.

The proposed amendment eliminates this complex tracing method with a simpler mechanism that is more taxpayer favourable. Under the new approach, all foreign dividends from a CFC are exempt until those foreign dividends exceed the amount of previously taxed section 9D income from that CFC (less any prior exempt dividends). No tracing of profits is required; all the calculations can be achieved solely at the shareholder level.

Example 1

Facts: Five South African residents each own 20 per cent of the shares of CFC. In 2004, CFC generates R150 000 of active business establishment income and R50 000 of passive income. Of the R50 000 passive amount, R35 000 gives rise to section 9D income for the shareholders (the other R15 000 amount is exempt by virtue of the *de minimis* exception). At the end of 2004, CFC distributes a R10 000 dividend to each of the five shareholders. Assume the income of CFC is totally exempt from foreign tax due to a foreign tax holiday.

Result. Each South African resident has R7 000 (R35 000 divided by 5) of section 9D income by virtue of their interest in the CFC. The R10 000 dividend received by each shareholder is exempt to the extent of R7 000 each by virtue of the previously taxed exemption of section 10(1)(k)(ii)(cc). The exemption applies regardless of the profits utilized by CFC to distribute the dividend.

Example 2

Facts: Five South African residents each own 20 per cent of the shares of CFC. CFC generates R88 889 of passive income in 2004, and R60 000 of active business establishment income in 2005. CFC distributes a R10 000 dividend to each of the five shareholders at the end of 2004 and another R10 000 to each of the five shareholders at the end of 2005. Assume the income of CFC is totally exempt from foreign tax due to a foreign tax holiday.

Result. In 2004, each South African resident has R16 000 (R80 000 divided by 5) of section 9D CFC income, but all of the dividends are exempt by virtue of the previously taxed exemption of section 10(1)*(k)*(ii)*(cc)*. In 2005, the CFC income does not generate section 9D income for the shareholders. Of the R10 000 dividend amount received by each shareholder, the dividend gives rise to R4 000 of income (R10 000 dividend - (the R16 000 of previously taxed CFC income – the prior R10 000 exempt dividend)).

The proposed previously taxed exclusion also takes into account section 9D income stemming from lower tier CFCs. South African shareholders receiving dividends not only reduce the dividend amount for previously taxed earnings of the CFC but also section 9D amounts stemming from lower-tier CFCs held by virtue of the CFC paying the dividend.

Example

Facts: Five South African residents each own 20 per cent of the shares of CFC 1, and CFC 1 owns all the shares of CFC 2. In 2004, CFC 1 generates R100 000 of active business establishment income, and CFC 2 generates R66 667 of passive income. At the end of 2004, CFC 1 distributes a R10 000 dividend to each of the five shareholders. Assume the income of CFC 1 is totally exempt from foreign tax due to a foreign tax holiday.

Result. Each South African resident has R12 000 (R60 000 divided by 5) of section 9D income by virtue of their interest in the CFC 2 (which is held through CFC 1). The R10 000 dividend received by each shareholder is exempt by virtue of the previously taxed section 9D income of CFC 2. (Note: If CFC 2 distributes a dividend of R10 000 to CFC 1, this CFC-to-CFC dividend would be exempt from tax by virtue of the newly proposed section 9D(9)*(f)*).

South African Amounts

Section 9E(7)*(e)*(ii) and (iv) currently exempt foreign dividends to the extent that these amounts directly or indirectly stem from South African profits treated as South African taxable income or from South African company dividends (which were most likely subject to the Secondary Tax on Companies). These rules have been moved to proposed section 10(1)*(k)*(ii)*(dd)*.

Subclause (j): In terms of section 10(1)*(o)* of the Income Tax Act, 1962, any remuneration received by or accrued to a person in respect of services rendered outside the Republic is exempt if that person was outside the Republic for a certain period. In determining the number of days that a person was so outside the Republic, the days that a person is in transit through the Republic are not taken into account. This, however, only applies where a person does not enter the Republic through a port of entry. In terms of the Immigration Act, 2002 (Act No. 13 of 2002), a person may enter the Republic through a port of entry. The Minister of Home Affairs may, however, authorise any person or category of persons to enter the Republic at a place other than a port of entry. It is proposed that in determining the period that a person is outside the Republic for purposes of section 10(1)*(o)* the possibility that a person may enter the Republic at such other place must also be taken into account.

Subclause (k): The exemption granted previously to certain domestic companies holding gold mining shares is now withdrawn as no discernable policy rationale exists for its continuance.

Subclause (l): The proposed amendment deletes a reference to an obsolete provision.

Subclause (m): See notes on PUBLIC PRIVATE PARTNERSHIPS.

Subclause (n): This amendment clarifies the current interpretation that the exemptions from the payment of income tax in terms of section 10 do not cover capital gains determined in the Eighth Schedule. The Eighth Schedule contains the exemption provisions relating to capital gains.

CLAUSE 33

Income Tax: Amendment of section 11 of the Income Tax Act, 1962

Subclause (a):

Interest Deductions Allowed Against Foreign Dividends

Under current section 9E, taxpayers can deduct interest payments to the extent this interest stems from amounts borrowed to acquire foreign shares generating foreign dividends. However, these interest deductions are ring-fenced against foreign dividends that qualify as includible income. With repeal of section 9E (see *CLAUSE 29*), this provision has been moved to new section 11*(bC)* without substantive change.

Subclause (b), (c) and (d):

Acquisition of Intangibles

Current Law

Section 11*(gA)* presently limits most allowances for amortizing intangibles to 5 or 10 per cent of the cost (with no allowances for trademarks). These rules (as well as section 11*(gB)*) generally apply to the "devising or developing" of intangibles; "obtaining, restoring or extending" legal rights with respect to intangibles, and "acquiring by assignment" of intangibles.

Reasons for Change

The current limitations for intangibles were mainly intended to prevent the recycling of intangibles among connected persons in order to refresh the amortization allowances of previously existing intangibles. These recycling schemes were especially useful prior to the enactment of Capital Gains Tax on 1 October 2001. Under the standard recycling scheme during this period, one connected person would sell a previously existing intangible to another connected person at an inflated price. The sale would have been tax-free, and the connected person purchasing the intangible would have an inflated value to amortise as an allowance. The connected person purchasing the intangible also frequently accelerated the allowance by claiming that the intangible acquired has a short useful life.

While concerns about the recycling of intangibles arguably continue to exist, the current limitations for intangibles contradict the proposed attempt to encourage research and development. Current limitations against "devising or developing" as well as "obtaining, restoring or extending" legal rights run contrary to proposed section 11B, which provides a full and immediate deduction for these efforts (see *CLAUSE 35*).

Proposed Law

1. Transition to Proposed Section 11(gC)

The proposed amendments remedy the above concerns by limiting the above provisions to the acquisition of previously existing intangibles. The rules for "devising or developing" as well as "obtaining, restoring or extending" legal rights will be wholly dropped from the above provisions by restricting current section 11*(gA)* and *(gB)* so that these provisions will no longer apply to expenditures incurred during any tax year on or after 1 January 2004. These provisions will be replaced with new section 11*(gC)*, which will apply only to the acquisition of previously existing intangibles. New section 11*(gC)* also removes a number of obsolete provisions contained in section 11*(gA)* and clarifies a few uncertainties (such as the application of the immediate write-off of amounts not exceeding R5 000).

2. Operation of Proposed Section 11(gC)

Proposed section 11*(gC)* provides an allowance for expenditures actually incurred for the acquisition of certain previously existing intangibles (not to devising, developing or creating of intangibles). These intangibles include: inventions or patents, designs, and copyrights as defined under the appropriate South African acts. These intangibles also include intangible property of a similar nature (other than trade marks) as well as any knowledge connected to (or any right to have knowledge imparted with respect to) the use such invention, patent, design, copyright or similar intangible property.

Similar to other allowances, the allowance for these intangibles will be allowed only once the taxpayer brings the intangible into use for the first time for purposes of the taxpayer's trade. Expenditures for the acquisition of an intangible will be fully allowed during the tax year incurred as long as that total expenditure for that acquisition does not exceed R5 000. If the total expenditure for that acquisition exceeds R5 000:

(A) The allowance will be limited to 5 per cent of the expenditure over an annualised straight-line basis if incurred to acquire any qualifying invention, patent, copyright or intangible of a similar nature (including associated knowledge);

(B) The allowance will be limited to 10 per cent of the expenditure over an annualised straight-line basis if incurred to acquire any qualifying design or property of a similar nature (including associated knowledge).

Proposed section 11*(gB)* also contains rules against inflating the allowance through connected person recycling sales that mirror other allowance provisions (such as section 12C(4)). These rules limit the allowance for acquiring an intangible if the taxpayer acquires an intangible from a connected person. This limited allowance amount equals the lesser of the expenditure to that connected person for that intangible, or the fair market value of the intangible as determined on the date acquired by the taxpayer from the connected person.

Subclause (f):

Current Law

Normally when depreciable assets are sold at a loss, that loss qualifies as a capital loss unless the asset is deemed to be scrapped, in which case that loss is from ordinary revenue. Under current law, scrapping is not defined. The definition has been left open to interpretation. The courts have held that a “scrapping event” must include a decision to scrap with the asset being useless or redundant for the purpose of trade, followed by a cessation of use. In practice, SARS takes the view that scrapping occurs only if an asset is useless or unsuitable for further use but usually accepts that this requirement is satisfied if a modern or improved model is purchased as a replacement.

Reasons for change

In an effort to facilitate the upgrading of assets, a change in the current scrapping allowance will be provided. The current failure to provide ordinary losses for the sale of depreciable assets outside the scrapping context encourages taxpayers to hold onto their old assets instead of disposing of them for more optimal business assets. Under the current system, taxpayers have an incentive to hold onto their old business assets solely as a means to claim ordinary losses through depreciation rather than selling at a capital loss.

Proposed Law (Section 11((o))

It is proposed that the current scrapping regime be eliminated in line with international best practice. Taxpayers will now be able to claim losses from ordinary revenue on the sale of devalued depreciable business assets if those assets have short useful lives regardless of obsolescence. In effect, this full ordinary loss treatment will eliminate the incentive for taxpayers to hold onto their old business assets solely for the purpose of claiming ordinary losses through depreciation. This incentive does not apply to assets with long useful lives because the incentive to hold for purposes of obtaining ordinary loss on depreciation does not outweigh the immediate capital loss on sale.

Proposed section 11*(o)* enables a taxpayer to claim an ordinary loss on the sale of certain depreciable business assets regardless of the facts and circumstances. The taxpayer will be entitled to an ordinary loss equal to the difference between the amount received on selling less the cost (after the cost has been reduced by any depreciation). If a taxpayer sells an asset at a gain, refer to the rollover reinvestment rules.

In order to qualify for this loss, the depreciable asset sold by the taxpayer must:

(i) be an asset qualifying for a capital allowance or deduction in terms of sections 11(e), 12B, 12C, 12E, 14 or 14*bis*. (i.e., machinery, plant, implements, utensils, articles, aircraft and ships used by a taxpayer for purposes of trade as opposed to buildings); and

(ii) not have an expected useful life that exceeds 10 years.

A number of provisos take into account the adjustment of costs for purposes of determining a loss in terms of this section.

Example

Facts: The taxpayer purchases a manufacturing asset for purposes of his trade for R500. The taxpayer decides to sell the asset after having depreciated the asset by R300. The taxpayer sells the asset for R130

Result: The taxpayer will receive an ordinary loss of R70 (R200 – R130). This result will apply regardless of whether the asset is obsolete.

Subclause (g) and (h):

Repeal of Current Research and Development Provisions

The current provisions for deducting expenditures associated with research and development (technically referred to as scientific development) will no longer apply to expenditures incurred during any tax year commencing on or after 1 January 2004. These provisions have been moved to section 11B (see *CLAUSE 35*), which modernises and liberalises the deduction for these expenditures in order to facilitate South African research and development.

Subclause (i): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 34

Income Tax: Insertion of sections 11A of the Income Tax Act, 1962

Current Law

Under current law, expenditures and losses incurred by a taxpayer before commencement of a trade may not qualify for deduction under section 11*(a)*. The non-deductibility of these start-up costs stems from the fact that the taxpayer is not yet carrying on "trade." The non-deductibility of start-up costs thus merely represents an application of ordinary tax principles.

Reasons for Change

Many countries allow start-up costs to be either deducted on the date of commencement of a trade or deducted over a certain period of time thereafter. Considering that new business formation is vital to our economy, sound economic principles dictate that ordinary tax principles should be disregarded in these circumstances.

Proposed Law

Proposed Section 11A provides taxpayers investing in new business ventures with a special deduction for start-up costs incurred before the commencement of trade. Costs that would have been allowed had trade commenced are now deductible in the year trading has commenced, irrespective of the year in which the costs have been incurred.

Start-up costs in this case refers to costs such as advertising and marketing promotion, insurance, accounting and legal fees, rent, telephone, licenses and permits, market research and feasibility studies etc.

Subsection 2 ringfences start-up costs. Start-up costs incurred prior to the commencement of trade can only be set off against income from that trade. This ringfencing prevents taxpayers from artificially disguising costs as business expenses (similar to the new ringfencing provisions of section 20A).

Subsection 3 provides a special deduction for small business corporations. Section 12E small business corporations receive a double deduction for start-up costs. However, this double deduction cannot exceed R20 000. For example, if a section 12E company incurs R100 000 of start-up costs, this company receives a deduction of R120 000 in lieu of the standard R100 000 amount. This double deduction provides a further incentive for the growth and development of the small business sector.

CLAUSE 35

Income Tax: Insertion of sections 11B of the Income Tax Act, 1962

See notes on RESEARCH AND DEVELOPMENT.

CLAUSE 36

Income Tax: Amendment of section 12C of the Income Tax Act, 1962

This amendment deletes the sunset clause on accelerated depreciation on assets used in the process of manufacture.

CLAUSE 37

Income Tax: Amendment of section 12E of the Income Tax Act, 1962

Subclause (a): This amendment provides that a *de minimis* shareholding in other companies should not disqualify a company or close corporation from being a small business corporation.

Subclause (b): This paragraph measures the proportion of investment income of a company or close corporation to determine whether it is a small business corporation. This amendment ensures that capital gains are also taken into account.

CLAUSE 38

Income Tax: Amendment of section 12H of the Income Tax Act, 1962

Subclause (a): This amendment makes it possible to claim a double deduction to the extent envisaged in section 12H by overriding section 23B – prohibition of double deduction.

Subclause (b): This amendment is of a textual nature.

CLAUSE 39

Income Tax: Insertion of section 13quat of the Income Tax Act, 1962

Under current law, the tax depreciation of buildings is generally low, either being nil, 2% or 5%. No provision exists for the accelerated tax depreciation of buildings. Like many countries, South Africa has a number of urban areas that are impoverished and suffering from extensive urban decay. In order to address these concerns and maintain existing infrastructure that was developed at great cost, governments internationally have increasingly utilised tax measures to support efforts aimed at regenerating these urban areas. These narrowly targeted capital allowances seek to attract private sector businesses to areas where interest would otherwise be lacking. The proposed legislation therefore introduces a tax incentive as a response, coming in the form of an accelerated depreciation allowance for investments in the inner cities. The core objectives of the incentive are to promote urban renewal and development by promoting investment by the private sector in the construction and improvement of buildings.

Subsection (2)

General:

The proposed section 13*quat* provides taxpayers investing in under utilised designated urban areas with a special depreciation allowance. The allowance will cover the erection, extension, addition or improvement (the latter three which hereafter will be referred to as "refurbishment") of any commercial or residential building in a demarcated area. The allowance is deductible in the year the erected building or the refurbished part of the building is respectively brought into use by the taxpayer for purposes of trade. This tax expenditure will benefit owners, users or lessors of such buildings. The detailed set of criteria required for this incentive are fully described below.

Demarcated Areas

The urban development allowance will apply to demarcated areas only. Accordingly, only buildings that are erected or refurbished within these areas will qualify for the incentive. Several criteria (set out in subsection 6) have been taken into account in demarcating qualifying zones (demarcated areas) within the selected metropolitan and urban areas. This approach is adopted in order to ensure that the impact of the incentive is maximised in these parts of the cities and towns that are most in need of development. International experience suggests that successful urban renewal occurs only if efforts are concentrated at specific locations.

Commencement of erection or refurbishment

As with any legislation, the proposed income tax amendments contain an effective date. Under this effective date, the contract in terms of which the erection or refurbishment is carried out must have be signed by all parties involved on or after the date of tabling the Amendment Bill. No relief is available for projects occurring before the effective date because these projects would have been performed in any event, thereby leading to a dead-weight loss.

Certificate of Occupancy

A Certificate of Occupancy must support the erection or refurbishment of any commercial or residential building. The purpose of the certificate is to differentiate between substantial changes and minor changes (i.e. repairs). Minor changes have been excluded from the incentive because these changes will have no meaningful impact on urban renewal.

Subsection (3)

Amount of allowance

The allowance covers all the costs of the erection or refurbishment of any commercial or residential building. These costs include the costs that a taxpayer has incurred in demolishing or destroying any existing building (or any part thereof) and costs that have been incurred with respect to permanent fixtures directly adjoining the site. These latter costs involve provision for amenities like water, power, sewage, access or parking for the building, drainage, security for the building (including fences, cameras and surveillance equipment), means of waste disposal, sidewalks and landscaping (including earthworks, greenery and irrigation). The amount of the allowance is dependant on whether the taxpayer erects a new building or refurbishes an existing commercial or residential building.

Depreciation on erection of new buildings

Taxpayers erecting a new commercial or residential building within a demarcated area will receive a 17-year write-off period. Specifically, they will receive a 20 percent write-off in the first year and an annual 5 percent write-off for the following 16 years.

Example

Facts: The taxpayer constructs a new commercial building for consumer retail purposes. The new construction costs R100 million.

Result: Under current law, the taxpayer receives a 0 percent deduction. Under proposed law, the taxpayer can deduct 20 percent of cost the in the 1st year (i.e., R20 million). Thereafter, the taxpayer can deduct 5 percent of the cost for the next 16 years (i.e., R5 million per annum for the next 16 years). The estimated tax savings for companies in this circumstance is R6 million in the 1st year (R20 million x 30 percent) and R2 million in each year thereafter (R5 million x 30 percent x 16).

Depreciation on refurbishment of existing building

A taxpayer who refurbishes a building will receive a 20 percent straight-line depreciation allowance over a 5-year period. The purpose of this enhanced incentive is to maintain structures considered worthy of retention and to maximise the use of all the sunken capital in existing buildings, which were developed at great cost. In order to qualify as a refurbishment, taxpayers must preserve a substantial part of the building's existing structural or exterior framework (i.e. all the 4 walls or all the steel frameworks of the existing building must be preserved). In addition, any extension or addition to an existing building must be of an incidental nature to the improvement.

Example

Facts: The taxpayer refurbishes an old commercial building for consumer retail purposes. The refurbishment costs R100 million.

Result: Under current law, the taxpayer receives a 0 percent deduction. Under proposed law, the taxpayer can deduct 20 percent of the cost over 5 years (i.e., R20 million over 5 years). The estimated tax savings over 5 years is R6 million per year for companies in this circumstance (R20 million x 30 percent x 5).

Subsection (4)

Reporting Requirement

This subsection creates a reporting obligation in order for taxpayers to obtain deductions under section 13quat. Under this rule, a taxpayer must provide certain additional information when filing an income tax return. This information must be filed every year in which a section 13quat allowance is claimed. Failure to submit this prescribed information for the year means the deduction will not be available for that year. The reason for this subsection is to ensure that Government's revenue costs allocated to urban renewal are carefully monitored to review the affordability thereof. This subsection also provides a means of monitoring the success of the project through transparent tax expenditure reporting and budgeting.

In terms of this section, a taxpayer must attach a certificate from the local authority confirming that the building is situated within a demarcated area of that local authority. In addition, a taxpayer must state the total amount of costs incurred by him for the erection or refurbishment of the building, and the extent to which those costs relate to any part of a building in respect of which a certificate of occupancy has been granted. Lastly, details as to whether the costs were incurred or will still be incurred in the erection or the refurbishment of a building must be provided.

Subsection (5)

Limitation of allowance

As with all depreciation allowances, a taxpayer receives the deduction only while still owning the building. If a taxpayer disposes of the building, the deduction in respect of that building ceases.

Subsection (6)

Geographic Targeting - Designation of Inner City Districts

Subsection 6 stipulates that the Municipal Councils for each of the 15 municipal areas identified in the 2003 Budget are responsible for the designation of one inner city district within their municipal boundaries. Each designation will specifically constitute an inner city district which traditionally formed the social and economic heart of a municipality and which has the potential with financial incentives to act as a catalyst for the rejuvenation of a wider area suffering from economic decline.

While tax incentives can be useful, urban renewal cannot be achieved by tax incentives alone. Tax incentives should merely act as a complementary intervention to best facilitate the achievement of development objectives. Hence, several criteria have been included in demarcating qualifying zones that seek to ensure that the proposed tax incentive complements other existing urban renewal efforts.

The criteria for selecting a single inner city district are set out in the following order of importance:

(a) *Municipality's Integrated Development Plan*
The demarcated area must be consistent with that municipality's integrated development plan. This plan often encompasses a short-term delivery strategy of approximately 3 to 5 years. The purpose of the Integrated Development Plan is to bring about the rejuvenation of the area through a series of actions, which aim to:

- Support existing residential functions through refurbishment of existing properties, sensitively designed new developments, and the provision of adequate amenity or recreation space;
- Support the development of a broad based social mix in the area;
- Provide opportunities for employment to locate to the area;
- Impose linkages within the area and outside; and
- Bring vacant, derelict and unused buildings or sites back into productive use.

(b) *Long-term economic development strategy*
The designated area must be consistent with that municipality's economic development strategy. This long-term economic development strategy should be aimed at a period of approximately 20 to 30 years.

(c) *Partnerships*
The demarcated area must contain Public Private Partnerships or agreements entered into either with business improvement districts, city improvement districts, or development agencies as a means to promote the area. Partnerships with business improvement districts, city improvement districts and development agencies can be formed by establishing a section 21 company, which is approved by council resolution (i.e., The Mandela Bay Development Agency). Contractual agreements can also be entered into through a memoranda of understanding.

(d) *Contribution to total revenue*
This factor requires that the demarcated area currently contribute, or have previously contributed, the largest portion of the total revenue (i.e. rates and taxes) for the municipal area. Further, the level of contribution must evidence a declining trend. In other words, the demarcated area must currently be, or previously been, a focal point, but now demonstrates a high degree of urban

decay relative to other parts of the city.

(e) *Additional Financial Measures*
Each municipality must provide additional financial measures to support and enhance regeneration within its area. These additional financial measures can take any number of forms, such as reduced property rates and local user charges.

Subsection (7)

Publication in Government Gazette

The designated area may be published by notice in the Government Gazette only after the Minister of Finance is satisfied that the selected area satisfies the requirements as set out in subsection 6 above.

Subsection (8)

Commissioner's Report

SARS must annually provide information about the tax preferential urban renewal project to the Minster of Finance so that the Minister can fully report to Parliament regarding:

(a) the number of taxpayers entitled to claim the allowance in that particular year;
(b) the total amount of costs, which will be allowable as a deduction to taxpayers in that particular year;
(c) the total amount of deductions allowable by taxpayers in that particular year; and
(d) the total amount of tax revenue foregone during the period.

This requirement ensures proper monitoring of the project and annual accountability to Parliament.

CLAUSE 40

Income Tax: Amendment of section 18A of the Income Tax Act, 1962

Subclause (a): This amendment provides for the types of assets or property donated to qualifying organisations which may qualify for a tax deduction. The donation of assets which could be used for tax avoidance purposes are excluded, i.e. intangible and other assets where the valuation of such assets could be manipulated and also where assets constitute business assets and should not be acquired by section 18A organisations.

Subclause (b): This amendment ensures that donations to qualifying organisations which were exempted under certain provisions of section 10 which were repealed in 2000, continue to be tax deductible during the period until approval is granted in terms of section 10(1)*(c*N*)*.

Subclause (c): This amendment provides that donations to the State will also qualify as a tax deductible donation.

Subclause (d): This amendment is consequential upon the incorporation of the Transfrontier Conservation Area provisions.

Subclause (e): This amendment enables conduit funds to engage in a number of public benefit activities, not all of which qualify for section 18A benefits to donors.

Subclause (f): Five per cent of taxable income at the tax threshold of R30 000 equals R1 500, therefore the granting of the deduction of R1 000 serves no purpose and is repealed.

Subclause (g): Incorporation of the provisions of the regulations issued in September 2002 relating to transfrontier conservation areas into the Income tax Act.

Subclause (h): Provision is made for organisations and bodies to carry on public benefit activities all of which do not qualify for section 18A benefits. These subsections limit tax deductible benefits to qualifying activities by introducing control measures.

Subclause (i): Provision is made that the deduction allowable to the donor in respect of assets (other than trading stock) donated, is limited to the lower of the cost to the donor or the fair market value of the asset, on the date of the donation.

CLAUSE 41

Income Tax: Amendment of section 20 of the Income Tax Act, 1962

Subclause (a): See notes on RING-FENCING OF ASSESSED LOSSES.

Subclause (b): Paragraph *(b)* of the proviso to section 20(1) was inserted following the introduction of the worldwide basis of taxation. This provision ensures that losses incurred from carrying on any trade outside the Republic cannot be set-off against the income derived from any trade carried on in the Republic. At the time, the Act introducing this amendment was published, the words were not correctly aligned which incorrectly reflected that the words following paragraph *(b)*(ii) also applied to paragraph *(a)*. This amendment rectifies this printing error.

CLAUSE 42

Income Tax: Insertion of section 20A in the Income Tax Act, 1962

See notes on RING-FENCING OF ASSESSED LOSSES.

CLAUSE 43

Income Tax: Amendment of section 22 of the Income Tax Act, 1962

Subclause (a): This amendment is consequential upon the introduction of a definition of “lending arrangement” in section 1 of the Act.

Subclause (b): This amendment is consequential upon the amendment in paragraph *(c)* below.

Subclause (c): This provision ensures that the donation of trading stock is tax neutral for the donor of the trading stock and that unrealised gains are not taxable as a result of the donation.

Subclause (d): This amendment results from the reference to the newly defined term "lending arrangement" in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962). The prior reference to section 23(1) of the Stamp Duties Act, 1968 (Act No. 77 of 1968) is now no longer required.

Subclause (e): The reason for this amendment is the same as for Clause 43(d).

CLAUSE 44

Income Tax: Amendment of section 23 of the Income Tax Act, 1962

Subclause (a): This amendment provides for apportionment of a single insurance premium in order that the portion relating to loss of income as a result of illness, injury, disability of unemployment may be disallowed without affecting any portion that may be deducted for income tax purposes.

Subclause (b): See notes on PUBLIC PRIVATE PARTNERSHIPS.

CLAUSE 45

Income Tax: Amendment of section 23B of the Income Tax Act, 1962

This amendment deletes a reference to an obsolete provision.

CLAUSE 46

Income Tax: Amendment of section 23F of the Income Tax Act, 1962

These amendments delete references to obsolete provisions.

CLAUSE 47

Income Tax: Amendment of section 24G of the Income Tax Act, 1962

This amendment deletes a reference to an obsolete provision.

CLAUSE 48

Income Tax: Amendment of section 24I of the Income Tax Act, 1962

Subclause (a): The amendment is of a textual nature and is intended to clarify the wording and to promote uniformity throughout the Act.

Subclause (b): The amendment is of a textual nature and intends to clarify the meaning of the subsection.

Subclause (c): This amendment is of a textual nature.

CLAUSE 49

Income Tax: Substitution of section 25C of the Income Tax Act, 1962

Currently, as a result of the wording of the section, there is confusion as to which person should be regarded as one and the same person for the purposes of this section. The section has now been reworded to clarify the position.

CLAUSE 50

Income Tax: Substitution of section 25D of the Income Tax Act, 1962

Current Law

Section 25D provides the general rule for purposes of determining taxable income when the initial starting point of the calculation begins in foreign currency. Taxpayers first "determine" the calculation in the applicable foreign currency and then "translate" the calculation in Rands at the average exchange rate for the year at issue.

Reasons for change

The relationship between section 25D and other currency provisions contained within the Income Tax Act is unclear. The actual operation of section 25D is also unclear, including the currency rules for foreign permanent establishments.

Proposed Law

Subsection 1

The proposed amendment to subsection 1 clarifies that amounts received, accrued or incurred in foreign currency are initially "determined" in:

(1) the financial reporting currency utilised by a foreign permanent establishment if attributable to that establishment; or

(2) the actual currency received, accrued or incurred in all other cases (i.e., the currency is not attributable to a foreign permanent establishment).

However, foreign permanent establishments must rely on the actual currency in lieu of the financial reporting currency if the financial reporting currency involved falls within the common monetary area (i.e., Namibia, Swaziland, Lesotho or the Rand). This exception prevents foreign branches from choosing the Rand or a Rand equivalent currency solely as a means to artificially avoid currency gains and losses. This rule will have no effect on foreign permanent establishments within the common monetary area because the actual and financial reporting currencies will be the same.

The proposed amendment also clarifies that the general rules provided above apply "unless expressly otherwise provided" in this Act. Hence, the provisions of section 9G and paragraph 43 of the Eighth Schedule generally take precedence over this provision.

Subsection 2

The proposed amendment to subsection 2 clarifies that once an amount has been determined under subsection 1(or any other provision of the Income Tax Act), the determined amount must be translated into Rands by applying the average exchange rate for the tax year of the determination.

Example

Facts: South African Company imports and re-exports trading stock in Pounds solely from its South African location. The trading stock costs 100 pounds and the sale proceeds from the trading stock amounts to 120 Pounds. The cost and sale arise within the same year. The average exchange rate for the year is 10 Rands to the Pound.

Result. Under subsection 1, South African Company first determines taxable income in Pounds, which results in a net positive amount of 20 pounds. Under subsection 2, the 20 pound amount is converted into Rands at R200 (i.e., the average exchange rate for the year).

CLAUSE 51

Income Tax: Amendment of section 30 of the Income Tax Act, 1962

Provision is made for organisations which receive 90 per cent or more of their donations from non-residents to qualify as a public benefit organisation where those organisations act as conduits to benefit persons outside South Africa.

CLAUSE 52

Income Tax: Amendment of section 31 of the Income Tax Act, 1962

This amendment deletes a superfluous reference as a result of the amendment to the definition of "resident" earlier this year.

CLAUSE 53

Income Tax: Amendment of section 35 of the Income Tax Act, 1962

Withholding tax on royalties is now a stand alone tax and no longer a normal tax. Its base is, therefore, no longer part of taxable income, but an amount that accrues in terms of section 35. Therefore, provision must be made for the imposition of additional tax and penalties in the case of non-payment of any withholding tax on royalties.

CLAUSE 54

Income Tax: Amendment of section 41 of the Income Tax Act, 1962

Subclause (a): The concept of a *"depreciable asset"* was replaced in 2002 with the concept of an *"allowance asset"*: The corporate rules extend rollover treatment to any asset of a person if that asset qualifies for a deduction or allowance under the Act that must be included in the income of that person in the year following that in which it was allowed or that is subject to recoupment in the hands of that person. The inclusion or potential recoupment associated with an asset transferred in terms of a company formation transaction shifts to the transferee company. All the remaining allowances or deductions associated with that asset also shift to the transferee company as if that company held those assets all along. The proposed amendment clarifies that the deductions or allowances concerned are limited to those taken into account when determining the portion of a person's taxable income not consisting of any taxable capital gain, for example a deduction under section 11*(a)* or *(e)* or section 12C.

Subclauses (b) and (c): See notes on CORPORATE RESTRUCTURING RULES - *Financial instrument holding companies*.

Subclause (d): This amendment is of a textual nature.

Subclause (e): It is proposed that a definition of "trading stock" be inserted for purposes of Part III. Paragraph *(a)* of the proposed definition makes it clear that rollover relief in terms of a company formation, intra-group or amalgamation transaction or liquidation distribution also applies in respect of livestock or produce disposed of by means of one of those transactions. Paragraph *(b)* of the definition limits the operation of the 18 month ring-fencing rule in respect of trading stock - see notes on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

Subclause (f): The prescribed steps for the liquidation or winding up of a company include the requirement that a company must have disposed of all of its assets, other than assets required to satisfy liquidation or winding up costs or to satisfy anticipated liabilities to the Commissioner. It is proposed that assets required to satisfy anticipated tax liabilities to foreign jurisdictions be included in this exclusion.

CLAUSE 55

Income Tax: Amendment of section 42 of the Income Tax Act, 1962

Subclause (a): Only potential gain assets qualify for the rollover in respect of a corporate formation transaction. It is proposed that this requirement be relaxed to allow the disposal of assets the market value of which is equal to or exceeds their base cost or the amount taken into account in respect of that asset in terms of section 11*(a)* or 22. This will allow for the disposal of debt claims that would otherwise be disqualified only in terms of this requirement. This proposal reflects the original intent underlying the corporate rules.

Subclauses (b) and (d): The proposed changes clarify the rules regarding the effect of a disposal in terms of a corporate formation transaction. They provide, in the case of trading stock, for a rollover to the transferee company of the amount at which the transferor reflected that stock for tax purposes, thereby correcting an oversight in the amendments effected in 2002. They also clarify that a valuation effected by the transferor in respect of an asset disposed of under a company formation transaction can be used by that transferor in respect of the shares acquired from the transferee company in return for that asset.

Subclause (c): The amendment clarifies that valuation of asset can be rolled over to shares acquired in return for that asset.

Subclause (d): This amendment is of a textual nature.

Subclause (e) and (g): The disposal of an asset to a company under a company formation transaction for a consideration consisting partly of something other than equity shares issued by that company, will in terms of subsection (4) qualify only partly for relief. The proposed changes provide that the assumption of a debt by a transferee company as contemplated in subsection (8) will not be treated as other consideration for purposes of subsection (4), thereby clarifying the relationship between subsection (4) and (8). They also clarify the apportionment rules of subsection (4) according to which the amount qualifying for rollover relief must be determined.

Subclause (f): This amendment is of a textual nature.

Subclause (h): A failure by a transferor to maintain a qualifying interest in the transferee company for a period of at least 18 months after a company formation transaction triggers a deemed disposal, in the transferor's hands, of any remaining shares still retained in the company at a price equal to their market value at the time of their acquisition under that company formation, thereby triggering the roll-over gain at the time of the company formation transaction. The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see NOTES on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

Subclause (i): Transfers of property securing any debt subject to subsection (8) receive full rollover treatment. However, tax-free treatment in this circumstance comes with a price upon the eventual disposal of the equity shares in the transferee company. The proposed changes clarify the rule governing such disposal by the transferor. The transferor must, in the case of shares held as capital assets, treat the face value of the debt as a capital distribution in respect of that share for purposes of paragraph 76 or, in the case of shares held as trading stock, as an amount to be included in the transferor's income.

Subclause (j): The proposed change is consequent upon the deletion of the definition of "financial instrument" from paragraph 1 of the Eighth Schedule and its insertion in section 1.

CLAUSE 56

Income Tax: Amendment of section 43 of the Income Tax Act, 1962

Subclause (a): See notes on CORPORATE RESTRUCTURING RULES - *Elective versus mandatory relief.*

Subclause (b): This amendment is of a textual nature.

Subclause (c): The proposed amendments clarify the rollover rules regarding a valuation of a target share effected by the transferor by making it explicit that the transferor can use that valuation in respect of the shares acquired from the acquiring company in return for that target share.

Subclause (d): The proposals clarify the apportionment rules according to which the amount qualifying for rollover relief must be determined where a transaction qualifies only partly as a share-for share transaction.

Subclause (e): A failure by a transferor to maintain a qualifying interest in the acquiring company for a period of at least 18 months after a share-for-share transaction triggers a deemed disposal, in the transferor's hands, of any remaining shares still retained in the company at a price equal to their market value at the time of their acquisition under that share-for-share transaction. This rule is similar to the rule contained in section 42(6). The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see NOTES on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

Subclause (f): A failure by an acquiring company to maintain a qualifying interest in the target company for a period of at least 18 months after a share-for-share transaction triggers the roll-over gain at the time of the share-for-share transaction. The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see notes on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

CLAUSE 57

Income Tax: Amendment of section 44 of the Income Tax Act, 1962

Subclause (a) and (b): Specific rules to provide relief for amalgamation transactions were introduced during 2002. The current rules provide for mandatory rollover relief where a company disposes of all of its assets by means of an amalgamation, conversion or merger. The first proposal in this regard provides for the retention, by an amalgamated company, of assets needed to settle its trading debts. The second proposal provides for a form of elective relief in the case of amalgamations – see notes on CORPORATE RESTRUCTURING RULES - *Elective versus mandatory relief.*

Subclause (c): The relief provided for in respect of a disposal in terms of an amalgamation transaction currently applies only in so far as that disposal is effected in exchange for equity shares in the resultant company. However, debts owed by an amalgamated company are often taken over by the resultant company as part of an amalgamation. The proposed change extends the rollover relief to amalgamations also involving the assumption, by the resultant company, of such debts.

Subclause (d): A shareholder who disposes of shares in an amalgamated company in return for shares in the resultant company as part of an amalgamation transaction, qualifies for relief similar to that applying in respect of share-for-share transactions. The proposed changes clarify the rollover rules in this regard.

Subclause (e): The proposals regarding subsection (7) clarify the apportionment rules according to which the amount qualifying for rollover relief must be determined where a transaction qualifies only partly as an amalgamation transaction.

Subclause (f): The rules regarding the treatment, for purposes of STC, of the disposal, by an amalgamated company to its shareholders and as part of an amalgamation transaction, of shares in the resultant company acquired by that amalgamated company in terms of that transaction, are similar to those applying in respect of unbundling transactions. The disposal of those shares to its shareholders is not subject to STC in the hands of that amalgamated company. Any such shareholder who is a company cannot, however, set off the shares so acquired when determining the net amount of its dividends under section 64B(3) on which its STC liability is based. The shares so acquired are also deemed, for purposes of section 64B(5)*(c)*, to be profits which are not of a capital nature. This ensured that those shares would be subject to STC upon the liquidation of that company. Shares so acquired by such company will, however, in terms of an amendment effected to section 64B(5)*(c)* during 2002, in any event be subject to STC on the liquidation of that company. It is therefore proposed that this deeming provision be deleted.

Subclause (g): The amount of any other consideration to which a person becomes entitled, upon the disposal of shares in an amalgamated company under a transaction qualifying only partly for rollover relief as contemplated in subsection (7), is treated, for purposes of the STC payable by that amalgamated company, as a deemed dividend. The proposed changes limit the deemed dividend to the amalgamated company's profits and reserves available for distribution in order to make it consistent with section 64C(4)*(c)* and clarify the date of accrual of such deemed dividend.

Subclause (h): A rollover gain is triggered where a person who acquired shares in a resultant company in return for shares in an amalgamated company as part of an amalgamation transaction, fails to maintain a qualifying interest in a resultant company for a period of at least 18 months after that acquisition. The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see notes on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

Subclause (i): The proposed changes regarding the exclusion, as a general rule, of disposals of financial instruments from rollover relief, align this rule with the similar rule in respect of share-for-share transactions contained in section 43(7).

Subclause (j): Rollover relief under section 44 is available only if the steps required to terminate the amalgamated company's existence, as contemplated in section 41(4), have been taken within 6 months after the date of the amalgamation transaction. It is proposed that an amalgamation also be excluded from rollover relief where an amalgamated company at any stage withdraws or invalidates any step so taken. This will align the rule with the provisions of section 64B(5)*(c)*.

CLAUSE 58

Income Tax: Amendment of section 45 of the Income Tax Act, 1962

Subclause (a): An intra-group transaction is a transaction between two companies where both companies form part of the same group of companies. The proposed change clarifies that those companies must qualify as members of the same group of companies as at the close of the day of such transaction.

Subclause (b): Rolled-over gains and losses are in effect triggered where a transferor company and a transferee company cease to be members of the same group of companies in relation to each other. This is done by means of a deemed disposal and reacquisition, by the transferee company, of an asset acquired from that transferor company in terms of an intra-group transaction. The proposed changes make it clear that such deemed disposal and reacquisition of an asset will not affect any capital allowances or deductions to which that transferee company may be entitled in terms of section 11*(e)*, 12B, 12C or 12E. The deemed disposal and reacquisition of the affected asset is therefore ignored for this purpose.

Subclause (c): It is proposed that involuntary disposals of assets (including financial instruments) within 18 months after their acquisition in terms of an intra-group transaction, be excluded from the ring-fencing rule applying in respect of the held-over capital or revenue gains or losses triggered by such a disposal.

Subclause (d): Specific categories of financial instruments are not subject to the general restrictions regarding the availability of rollover relief under the corporate restructuring provisions. Financial instruments not qualifying as one of the excluded categories will also qualify for rollover relief if they are transferred as part of a going concern provided they do not exceed 5 per cent of the value of the assets so transferred. The proposed amendment rectifies an oversight to ensure that financial instruments qualifying for the exclusion in subparagraph (iv) of paragraph *(a)* of subsection (6) be excluded when determining the ratio of instruments not otherwise qualifying for an exclusion that are transferred as part of a going concern.

CLAUSE 59

Income Tax: Amendment of section 46 of the Income Tax Act, 1962

Subclause (a): See notes on CORPORATE RESTRUCTURING RULES – *Unbundling transactions.*

Subclause (b): Where an unbundling company disposes of shares to its shareholders or its holding company in terms of an unbundling transaction, that unbundling company is currently treated as having disposed of those shares for proceeds equal to the base cost or amount otherwise taken into account in respect of those shares. The unbundling company will, therefore, not realise any capital or revenue gain or loss from that disposal. The proposed changes simplify this rule.

Subclause (c), (d) and (e): The proposed amendments relating to paragraphs *(a)*, *(b)* and *(d)* are mainly consequential upon the reformulation of the definition of “unbundling transaction”. They also clarify the rule in paragraph *(b)* governing the apportionment of the cost of the shares previously held in the unbundling company between those previously held shares and the unbundled shares as well as the rollover rule in paragraph *(d)*.

Subclause (f): The proposed amendments are consequential upon the reformulation of the definition of “unbundling transaction” and correct a cross-reference.

Subclause (g): The proposed amendments are consequential upon the reformulation of the definition of “unbundling transaction”. They also effect amendments relating to STC similar to those proposed in respect of section 44(9) – see the notes on section 44(9) above.

Subclause (h) and (i): The proposed amendments are consequential upon the reformulation of the definition of “unbundling transaction”.

Subclause (j): See notes on CORPORATE RESTRUCTURING RULES - *Elective versus mandatory relief.*

CLAUSE 60

Income Tax: Amendment of section 47 of the Income Tax Act, 1962

Subclause (a): A disposal of an asset by a liquidating company currently qualifies for rollover relief in respect of a liquidation distribution only if that company disposes of all of its assets to its holding company, thus excluding relief if any asset is retained or disposed of to a minority shareholder. The proposed amendments provide for the retention, by a liquidating company, of assets required to settle its trading debts as well as for partial relief to the extent to which its assets are disposed of to its holding company.

Subclause (b): Where a holding company disposes of any share in a liquidating company as a result of the liquidation, winding up or deregistration of that liquidating company, that holding company is currently treated as having disposed of those shares for proceeds equal to the base cost or amount otherwise taken into account in respect of those shares. The holding company will, therefore, not realise any capital or revenue gain or loss from that disposal. The proposed changes simplify this rule.

Subclause (c): Rollover relief under section 47 is available only if the steps required to terminate the liquidating company's existence, as contemplated in section 41(4), have been taken within 6 months after the date of the liquidation distribution. It is proposed that a liquidation distribution also be excluded from rollover relief where a liquidating company at any stage withdraws or invalidates any step so taken. This will align the rule with the provisions of sections 44(13) and 64B(5)*(c)*.

CLAUSE 61

Income Tax: Amendment of section 56 of the Income Tax Act, 1962

Transactions not occurring at fair value can raise a number of concerns, including donations tax, deemed STC dividends, and deemed capital gains taxes. These issues often arise with corporate groups where group members sell to one another at accounting cost rather than fair value. A disposal of property under a donation or a deemed donation is currently exempt from donations tax in terms of section 56(1)*(r)* to the extent that such disposal is deemed to be a dividend in terms of section 64C. The proposed substitution of this provision extends the exemption to donations between companies that are members of the same group of companies.

CLAUSE 62

Income Tax: Amendment of section 61 of the Income Tax Act, 1962

The provisions relating to donations tax do not currently provide for additional tax and penalties where a person—

- makes default in rendering a return in respect of any year of assessment;
- omits from his return any amount which ought to have been included therein; or
- makes an incorrect statement in any return rendered by him which results or would if accepted result in the assessment of the normal tax at an amount which is less than the tax properly chargeable.

It is proposed that section 61 be amended to provide that any reference in section 76 to taxable income of a taxpayer is deemed to include a reference to the value of any property disposed of by that taxpayer under a donation

CLAUSE 63

Income Tax: Amendment of section 64B of the Income Tax Act, 1962

Subclause (a): The amendment is consequential on the insertion of subparagraphs (iii) and (iv) of the definition of “dividend cycle”.

Subclause (b): The amendment clarifies the starting date of the first dividend cycle when a company comes into existence for the first time or becomes resident

Subclause (c): The amendment clarifies the closing date of the first dividend cycle when it is brought to a close by a deemed dividend.

Subclause (d): The amendment clarifies the closing date of the first dividend cycle for an long term insurance company when it is brought to a close by a deemed dividend.

Subclause (e): The amendment clarifies the closing date of any subsequent dividend cycle when it is brought to a close by a deemed dividend.

Subclause (f): The amendment is consequential on the repeal of section 9E.

Subclause (g): This amendment is of a textual nature.

Subclause (h): The amendment is consequential on the repeal of section 10(1)*(s)*.

Subclause (i): As part of the quid pro quo for the extension of the deadline for the preparation of valuations for CGT purposes, the proposal makes t clear that the deadline will also apply to valuations for the purposes of the exemption of the distribution of capital profits from STC. The provision is extended to deal with companies becoming resident in South Africa.

Subclause (j): The provision is extended to exempt profit derived prior to becoming a resident from STC.

Subclause (k): The amendment ensures consistency between this provision and the dividend cycle provisions.

Subclause (l): The amendment ensures that the exemption is only available where the company to which the dividend accrues controls (and controlled) the company declaring the dividend. It prevents the shifting of STC exemption within a group.

Subclause (m): The amendment is consequential on deletion of subparagraph (iv).

Subclause (n): The source principle in this subparagraph is no longer appropriate following the switch to residence. It has been repealed as three year window in subparagraph has now expired.

Subclause (o): This amendment allows a company declaring a dividend to benefit from the paragraph *(f)* relief where the company to whom the dividend accrues was formed by one or more companies in the same group of companies as the company declaring the dividend. The company which was so formed is deemed to have been in existence from the date its controlling group company was formed. This has the effect of meeting the requirement that the dividend is to be declared out of profits earned during the period the declaring company formed part of the same group of companies as the controlling group company shareholder.

Subclause (p): The source principle in this subparagraph is no longer appropriate following the switch to residence.

Subclause (q): This amendment repeals a reference to an obsolete provision.

Subclause (r): This amendment repeals a reference to an obsolete provision.

CLAUSE 64

Income Tax: Amendment of section 64C of the Income Tax Act, 1962

Subclause (a): The amendment is consequential on the restructuring of section 64C.

Subclause (b): Subsection (2) and (3) are merged for greater clarity. Profit priority rule repealed as superfluous. Item *(f)* replaces the "notwithstanding" formulation, which is repealed.

Subclause (c): Subsection (2) and (3) are merged for greater clarity.

Subclause (d) and (f): The amendment is consequential on merger of subsection (2) and (3).

Subclause (e),(g),(h),(i),(l),(o) and (p): The amendment is consequential on the deletion of the definition of "recipient".

Subclause (j): Ensures that an exemption is only available for a loan made by a company to another group company which is a resident.

Subclause (k): The amendment is of a textual nature.

Subclause (m): This amendment mirrors the exemption in terms of section 64B(5)*(f)* where an amount is deemed to be a dividend declared to a shareholder which is a controlling group company in relation to the company "declaring" the dividend.

Subclause (n): This amendment provides for an exemption n situations where an amount is deemed to be a dividend declared by a company to another company which is a controlled group company n relation to the company "declaring" the dividend.

Subclause (q): Clarifies the timing of a deemed dividend, which is important for purposes of determining the close of a dividend cycle and the payment of STC.

CLAUSE 65

Income Tax: Substitution of section 65 of the Income Tax Act, 1962

This amendment provides that the Commissioner may also prescribe where any return or other form must be submitted.

CLAUSE 66

Income Tax: Amendment of section 66 of the Income Tax Act, 1962

Subclause (a): This amendment is consequential upon the amendment of section 25C and this amendment clarifies for which periods persons who are sequestrated must submit returns

Subclause (b): This amendment is of a textual nature.

CLAUSE 67

Income Tax: Insertion of section 67 of the Income Tax Act, 1962

Taxpayers have a civil duty to register for tax purposes. No specific provision exists to oblige taxpayers to register for normal tax and no penalty currently exists for failure to register. It is, therefore, proposed to specifically place an obligation on taxpayers to register for tax when they become liable for normal tax and to provide for penalties for failure to register.

CLAUSE 68

Income Tax: Amendment of section 70 of the Income Tax Act, 1962

Consequential upon the repeal of section 9E of the Income Tax Act, 1962.

CLAUSE 69

Income Tax: Amendment of section 70B of the Income Tax Act, 1962

Consequential upon the insertion last year of the definition of "financial instrument" in section 1 of the Income Tax Act, 1962. .

CLAUSE 70

Income Tax: Substitution of section 72A of the Income Tax Act, 1962

This amendment reflects a revision of the reporting requirements in respect of Controlled Foreign Companies (CFCs).

CLAUSE 71

Income Tax: Amendment of section 73A of the Income Tax Act, 1962

Subclause (a): This amendment is of a textual nature.

Subclause (b): This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and

Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 72

Income Tax: Amendment of section 74 of the Income Tax Act, 1962

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 73

Income Tax: Amendment of section 75 of the Income Tax Act, 1962

Taxpayers have a civil duty to file tax returns. The current penalty for failure to file is trivial. It is, therefore, proposed to increase the penalties for failure to file tax returns.

CLAUSE 74

Income Tax: Insertion of Part IA in Chapter [sections 76A to 76F] of the Income Tax Act, 1962

It is proposed that a new Part IA be introduced to regulate the reporting of arrangements that could possibly offer a tax benefit to a person or participant in such an arrangement. The purpose of the new measure is to act as an early warning system to SARS to enable it to determine at an earlier stage whether the arrangement is potentially abusive of the tax system. At present most of these arrangements are only disclosed to SARS when the relevant entity submits its tax return, which may only be a year after the entity's tax year.

A reportable transaction briefly includes an arrangement which—
- is subject to confidentiality relating to the tax treatment thereof;
- contains a contingency as to the variation of the tax treatment of the arrangement *vis a vis* the assumptions made as to the tax treatment of the arrangement;
- the Minister may identify by way of a notice in the Gazette.

Every company or trust which derives a tax benefit or claims the arrangement to be proprietary to it, must report that transaction to the Commissioner.

The transaction must be reported at the earlier of the last date of signature thereof or the date of implementation of the transaction.

Reporting of the reportable transaction is for administrative purposes only and the fact that it has been reported does not have the effect that the Commissioner has approved the transaction.

Failure to report such a reportable transaction does, however, have the effect that the company or trust may not claim any tax benefits in terms of the transaction. The further consequence of failure to report is that an offence in terms of the Act has been committed.

CLAUSE 75

Income Tax: Amendment of section 79B of the Income Tax Act, 1962

This amendment is in addition to the amendment to section 25C to clarify for which periods a person who is sequestrated is assessed. Where a sequestration order is set aside any assessments issued as a result of that sequestration must be withdrawn.

CLAUSE 76

Income Tax: Amendment of section 81 of the Income Tax Act, 1962

Section 81(2) provides that the period within which an objection must be made, may be extended where the Commissioner is satisfied that "reasonable grounds" exist for the delay in lodging the objection. The limitation of the period of time within which the objection must be lodged is very important to ensure effective tax administration. In enacting time limits, it is the intention of the legislature that disputes should be brought to notice and resolved as speedily as possible so as to ensure the orderly administration of fiscal Acts and the collection of taxes. In practice it was evident that the onus of demonstrating "reasonable grounds" for the delay is fairly easily dischargeable. Therefore, the clear rationale of the legislature in limiting the period for objection was being negated. In certain jurisdictions no condonation of the prescribed periods for the filing of an objection is allowed, such is the seriousness with which such jurisdictions regard these prescribed periods. Furthermore, SARS is now bound to deal with objections and appeals within the time periods prescribed by the rules promulgated in terms of s107A of the Act. The limitation of the condonation of the filing of a late objection, after 60 days of the date of assessment (and before the expiry of 3 years after the date of the assessment), to "exceptional circumstances" is mitigated by the following factors:

- Adequate notice in the assessment notice and other public notice regarding the applicable time periods;
- The right, in terms of the new dispute resolution rules promulgated in terms of s 107A, to request reasons for the assessment where SARS has not provided, in the notice of assessment, such reasons. In the latter event, an objection need not be filed before receipt of such reasons.
- The remedies available in the event that SARS does not condone the late filing of the objection, for example the right to object against such decision of SARS, alternative dispute resolution ("ADR") or, where ADR is not appropriate or successful, to appeal to the Tax Court.

CLAUSE 77

Income Tax: Amendment of section 83 of the Income Tax Act, 1962

Subclause (a):

Subsection 4C

This amendment is necessary to remedy procedural shortcomings in the Tax Court procedure.

Subsection 4D

This amendment is necessary to ensure that the Tax Court has sufficient powers in terms of the Act to deal with all procedural aspects that may arise as a result of the new dispute resolution rules promulgated by the Minister of Finance in terms of S107A of the Act.

Subclause (b): This amendment is of a textual nature.

Subclause (c): This amendment is necessary to align the periods prescribed in rule 8, of the rules promulgated in terms of s107A, with section 83A(7).

CLAUSE 78

Income Tax: Amendment of section 83A of the Income Tax Act, 1962

This amendment was necessary to align the periods prescribed in rule 8 of the rules promulgated in terms of s107A, with section 83A(7).

CLAUSE 79

Income Tax: Insertion of Part IIIA in Chapter III [sections 88A to 88G] of the Income Tax Act, 1962

This Part incorporates into the legislation the provisions relating to the settlement of disputes which are currently contained in regulations

CLAUSE 80

Income Tax: Amendment of section 89quat of the Income Tax Act, 1962

This amendment provides for the suspension of interest payable upon a refund where the Commissioner is delayed due to any default or delay to comply with any provision of the Income Tax Act, 1962, by the taxpayer until the date of compliance by that taxpayer.

CLAUSE 81

Income Tax: Amendment of section 104 of the Income Tax Act, 1962

This amendment is consequential upon the insertion of Part IA of Chapter 3 to the Income Tax Act, 1962 and provides that where any person fails to report a "reportable transaction" that person will be guilty of an offence.

CLAUSE 82

Income Tax: Amendment of section 106 of the Income Tax Act, 1962

As part of the detail of the e-filing legislation introduced in prior years, current law will be modified to allow for electronic notices and assessments.

Subclauses (a) and (c): These amendments are of a consequential nature.

Subclauses (b) and (d): As part of the detail of the e-filing legislation introduced in prior years, current law will be modified to allow for electronic notices and assessments.

CLAUSE 83

Income Tax: Amendment of paragraph 1 of the First Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 84

Income Tax: Amendment of paragraph 8 of the First Schedule to the Income Tax Act, 1962

This amendment deletes a reference to an obsolete provision.

CLAUSE 85

Income Tax: Amendment of paragraph 12 of the First Schedule to the Income Tax Act, 1962

As explained in Clause 101 (paragraph 20A of the Eighth Schedule) farmers are allowed in certain circumstances to write off all or portion of their capital development expenditure as part of the base cost on disposal of immovable property on which farming operations were carried on. If a farmer elects to write capital expenditure off as part of base cost then the expenditure carried forward in terms of paragraph 12(3) must be reduced by this amount.

CLAUSE 86

Income Tax: Amendment of paragraph 19 of the First Schedule to the Income Tax Act, 1962

This amendment deletes a reference to an obsolete provision.

CLAUSE 87

Income Tax: Amendment of paragraph 1 of the Second Schedule to the Income Tax Act, 1962

Up until 1998, the lump-sum payment to a member of the GEPF was exempt. When the exemption was removed, a provision was inserted to protect the interests of employees up to the date of the exemption termination. This rule, however, provided that no past service bought back after that date was permissible for tax purposes to enjoy the benefit of the past service protection rule.

The proposed amendment provides for an equitable tax dispensation in respect of tax payable on gratuity benefits paid from the GEPF to civil servants and former members of non-statutory forces where such members buy back past service.

CLAUSE 88

Income Tax: Amendment of paragraph 6 of the Fourth Schedule to the Income Tax Act, 1962

The current penalties for violating PAYE are insufficient. In order to promote consistency with other regimes, it is proposed that penalties of up to two hundred per cent be available in these circumstances.

CLAUSE 89

Income Tax: Insertion of paragraph 6A in the Fourth Schedule to the Income Tax Act, 1962

The amendment places a personal liability on the public officer, directors or shareholders if employees' tax is not paid over to SARS.

CLAUSE 90

Income Tax: Substitution of paragraph 11 of the Fourth Schedule to the Income Tax Act, 1962

The Commissioner has always had the discretion to vary the payment of employees' tax in the cases of hardship or to correct errors. The amendment provides that in similar circumstances where companies have to pay over tax for directors, relief can be provided.

CLAUSE 91

Income Tax: Amendment of paragraph 11C of the Fourth Schedule to the Income Tax Act, 1962

Subclause (a): The amendment clarifies the position that in the formula for the deduction of tax from directors, the amount of remuneration must be determined on the remuneration received from that company.

Subclause (b): The amendment provides that if the director was not employed by the company for the preceding year the Commissioner must determine the remuneration.

Subclause (c): The amendment is of a consequential nature as a result of the extension of the relief provision in paragraph 11.

Subclause (d): The amendment extends the rights of employers to recover tax from a director where the company has paid employees tax on behalf of the director.

Subclause (e): Directors complained that although they received remuneration on the same basis as ordinary employees, a more complex method of determining the employees' tax was imposed on them. The amendment provides that if more than 80 per cent of the directors' remuneration is fixed monthly payments then the same method of deduction can be used for their employees' tax as is used for ordinary employees. Only directors whose bonuses exceed 20 per cent of their annual remuneration will have to use the other method of calculation for directors.

CLAUSE 92

Income Tax: Amendment of paragraph 19 of the Fourth Schedule to the Income Tax Act, 1962

Provisional tax must be paid based on the previous year's taxable income in certain circumstances when the assessment for the previous year has been issued more than 14 days before the provisional payment has to be made. It is proposed that this period be extended to 60 days.

CLAUSE 93

Income Tax: Amendment of paragraph 20A of the Fourth Schedule to the Income Tax Act, 1962

The Commissioner can impose additional tax if a person fails to submit a return. The amendment proposes that the additional tax may be imposed on the taxpayer when the Commissioner increases the amount of the estimate on which the provisional tax is calculated.

CLAUSE 94

Income Tax: Amendment of paragraph 21 of the Fourth Schedule to the Income Tax Act, 1962

The amendment provides that any foreign tax a provisional taxpayer has paid in income taxed in the Republic may be taken into account when calculating provisional tax.

CLAUSE 95

Income Tax: Amendment of paragraph 1 of the Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 96

Income Tax: Amendment of paragraph 2 of the Eighth Schedule to the Income Tax Act, 1962

This proposed amendment is of a consequential nature and is as a result of the introduction of Part XIII of the Schedule.

CLAUSE 97

Income Tax: Amendment of paragraph 11 of the Eighth Schedule to the Income Tax Act, 1962

The definition of “lending arrangement” was previously contained in the Stamp Duties Act, 1977, but has now been introduced into the Income Tax Act and this is a consequential amendment.

CLAUSE 98

Income Tax: Amendment of paragraph 12 of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): Paragraph 12 deems certain events to be disposals, for example, cessation of residence or conversion of capital assets to trading stock. When these events occur the person is treated as having disposed of his/her assets for proceeds equal to their market value and to have reacquired those assets at that same market value.

The reference to proceeds in paragraph 12(1) has caused some uncertainty, because in some cases the market value of the asset would include amounts that are subject to tax as ordinary income. In terms of paragraph 35(3)*(a)* proceeds normally excludes such amounts. However, by stating that proceeds are equal to market value the provisions of paragraph 35(3)*(a)* are bypassed and the result is double taxation. Our courts have held that there is a ‘necessary implication’ in the Act against double taxation, and this can be used to address the problem. It is proposed to eliminate any uncertainty by replacing the word ‘proceeds’ with the term ‘amount received or accrued’. This makes it clear that the provisions of paragraph 35(3)*(a)* must still be applied to the amount of the deemed receipt or accrual.

Example

On 1.3.03 John buys a government bond for R100 when the prevailing interest rate is 10%. He earns R5 in interest every six months on 31 August and 28 February. On 27.02.04 John emigrates when prevailing interest rates are 5%. As a result of the decline in interest rates the market value of the bond has increased to R200. The market value of his instrument including the accrued interest is R205 (R200 capital plus R5 accrued interest). As the law stands the “proceeds” are R205 and the capital gain is R205 – 100 = R105. In terms of the proposed amendment the proceeds will be R205 – R5 = R200 and the capital gain will be R200 – R100 = R100.

Subclause (b): The definition of “resident” has been amended to include the requirement for residency and as a consequence the requirement has been deleted from this item.

Subclause (c): Where the creditor forgives the debt of a debtor, the debtor is treated as having a capital gain equal to the amount of the debt forgiven. This has resulted in companies that owe money to other group companies not being deregistered or liquidated because of the potential tax consequences and this results in additional cost to groups of companies and unnecessarily increases the number of companies on register.

To alleviate the problem described above it is proposed that the provisions of paragraph 12(5) not apply where the debtor and creditor are part of the same 'group of companies'. The term 'group of companies' is defined in s 1 and essentially refers to a group where the controlling company holds at least 75% of the equity share capital of a controlled group company.

The impact on the creditor

In terms of paragraph 56(1) the creditor company will not be able to claim a capital loss in respect of the cancellation or discharge of the debt owed to it (unless paragraph 56(2)*(b)* or *(c)* applies). Had paragraph 12(5) resulted in a capital gain in the hands of the debtor, the creditor would have been entitled to a capital loss in terms of paragraph 56(2)*(a).* However, since the capital gain will no longer arise, paragraph 56(2)*(a)* does not apply and paragraph 56(1) results in the loss being denied. This provides a symmetrical treatment of both debtor and creditor.

Exceptions to the exclusion of group companies rule

There is an exception to the general rule that paragraph 12(5) does not apply to groups of companies. This applies in two circumstances when the rule has been abused as part of a scheme to avoid any CGT that would otherwise have arisen under paragraph 12(5).

The two circumstances are as follows:

(a) Debt acquired from non-member of group

The provisions of paragraph 12(5) will apply where the debt (or any substituted debt) was acquired directly or indirectly from a person who is not a member of the group of companies.

Example 1

Holdco owns all the shares in Subco. In 2003 Subco owed R100 000 to Propco. Propco is not a member of the Holdco group of companies. Holdco purchased Subco's debt from Propco for R60 000 and thereafter waived its right to claim the debt from Subco. In this case Holdco will have a capital loss of R60 000 in terms of paragraph 56 while Subco will have a capital gain of R100 000 in terms of paragraph 12(5).

(b) The company becomes a member of the group of companies after the debt arose.

Example 2

Holdco owns all the shares in Subco. In 2003 Subco owed R100 000 to Propco. Propco is not a member of the Holdco grou8p of companies. Holdco purchased the shares of Propco and then Propco writes off the debt of Subco. The relief from the operation of paragraph 12(5) and Propco will have a capital loss of R100 000 and Subco will have a capital gain of the same amount.

CLAUSE 99

Income Tax: Amendment of paragraph 19 of the Eighth Schedule to the Income Tax Act, 1962

Subclauses (a) and (b): These proposed amendments are of a consequential nature. In the paragraph use is made of the phrases “holding company” and “intermediate company” and they have the same meaning as these phrases in section 64B of the Income Tax Act. The phrase “holding company” in section 64B was deleted in 2002 and a new definition of “group of companies” was introduced in section 1of the Act. The proposed amendments bring the paragraph in line with the new definition.

Subclause (c): This amendment is of a consequential nature and brings the paragraph in line with the new definition of “group of companies.

CLAUSE 100

Income Tax: Amendment of paragraph 20 of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): This amendment is of a textual nature and brings the wording in line with the definition of “recognized exchange”.

Subclause (b): This amendment is of a consequential nature and brings it in line with the deletion of section 9E and the introduction of the exemption in section 10.

Subclause (c): See notes on REINVESTMENT RELIEF.

CLAUSE 101

Income Tax: Insertion of paragraph 20A of the Eighth Schedule to the Income Tax Act, 1962

Farmers are allowed as a deduction certain capital expenditure they incur in terms of paragraph 12 of the First Schedule to the Income TaxAct. This expenditure may only be allowed as a deduction against income derived from farming income. The way in which the deduction is allowed in terms of the First Schedule is that if the capital expenditure exceeds the income from farming, the full expenditure is allowed as a deduction and an amount equal to the excess expenditure is added to the income so that they cancel each other out. The excess expenditure is carried forward to the next year of assessment and deemed to be expenditure incurred in that year.

The expenditure cannot form part of base cost in terms of paragraph 20 of the Eighth Schedule as paragraph 20(3)*(a)* requires that expenditure contemplated in this paragraph must be reduced by any expenditure that has been allowed as a deduction in determining taxable income of a person. Situations can arise on the death of a farmer or where farming operations cease and the farm is disposed of that there is still a balance of the capital expenditure that is available to be written off because the farmer has had insufficient ordinary farm income against which it could be written off.

An amendment is proposed that any balance of such expenditure or part thereof, on election of the farmer or on his or her death by the executor, be allowed as a deduction in the determination of any capital gain on the disposal of the property to match any increase in the proceeds as a result of the capital improvements made. Two restrictions are proposed. Firstly, if the farmer has adopted or determined market value as the valuation date of the immovable property only expenditure incurred after 1 October 2001 may be taken into account in determining the amount in respect of which an election can be made. Secondly, the amount of the capital expenditure in respect of which an election may be made may not exceed the proceeds from the sale of the immovable property reduced by other amounts allowable as base cost—

- in the case of a pre-valuation asset, the valuation date value of the asset plus any paragraph 20 expenditure incurred after 1 October 2001, and
- in any other case, the expenditure contemplated in paragraph 20.

Where a person has made an election as contemplated in this paragraph and any balance of expenditure is still carried forward in terms of the First Schedule adjustment will have to be made to that balance of expenditure. The consequential amendment is dealt with in the amendments to the First Schedule.

CLAUSE 102

Income Tax: Amendment of paragraph 27 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 27 prescribes the method to determine the valuation date value of an asset where—

- the asset was acquired before valuation date;
- proceeds do not exceed expenditure, allowable in terms of paragraph 20,

incurred before and after the valuation date.

Subclause (a): Paragraph 27(3)*(b)* deals with the situation where paragraph 27(3)*(a)* does not apply. That situation occurs where—

- the asset is sold for proceeds less than or equal to its cost, and
- the market value on valuation date is equal to or greater than the pre-CGT cost of the asset.

Under these conditions the valuation date value of the asset is the lower of the market value and the time apportionment base cost (TAB) of the asset.

It has, however, been found that TAB will always be lower than market value, and as a result the reference to market value is superfluous. The technical explanation for this is as follows:

TAB is determined in accordance with the formula

Y = B + [(P – B) x N/N + T]

Where
B = expenditure incurred before the valuation date
P = Proceeds generated by pre-CGT expenditure
N = Number of years before valuation date
T = Number of years after valuation date
Simply put, the valuation date value (TAB) is arrived at by adding a pre-CGT gain to

the pre-CGT expenditure. A pre-CGT loss would, of course, be deducted.

In order for TAB to be greater than market value, P – B in the TAB formula would have to be a positive figure (in other words, a gain). When an asset is sold for proceeds less than or equal to cost – a requirement for entry into paragraph 27, P –B will always be either zero (where proceeds = B) or a negative figure (where P is less than B). It is therefore evident that TAB can never exceed market value where market value is greater than pre-CGT expenditure and the asset is sold at or below cost. Paragraph 27(3)*(b)* is therefore superfluous and it is proposed that it be deleted. Under this proposal situations not covered by the existing paragraph 27(3)*(a)* will be dealt with under paragraph 27(4) which requires that TAB be used.

In summary, the deletion of paragraph 27(3)*(b)* is simply a technical amendment designed to remove superfluous wording. It has no impact on the way in which the provision was applied previously.

It is proposed that these amendments be deemed to have come into operation on 1 October 2001.

Subclause (b): This is a technical amendment to restrict the application of the provision to assets contemplated in subparagraph (1) which always was the intention.

CLAUSE 103

Income Tax: Amendment of paragraph 30 of Eighth Schedule to the Income Tax Act, 1962

This amendment is a correction of a printing error by the insertion of a bracket after "B_1".

CLAUSE 104

Income Tax: Amendment of paragraph 33 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 33 prescribes rules for determining the base cost of assets when a part of the asset is disposed of.

Subclauses (a) to (d): Persons who lease assets, such as fixed property, and who have affected improvements to the property, have interpreted the Eighth Schedule as allowing them to claim as a capital loss the bare dominium of the cost of the improvements in the year that they are affected. The argument advanced is that although they will have use of the asset they lose the ownership of the asset when it is affixed to the property The purpose of the proposed amendment is to clarify the position that the bare dominium of the cost of any asset used to improve a leased asset cannot be claimed as a capital loss as a part disposal when the improvement is affected. The cost of improvements to the leased asset qualifies as part of the base cost in terms of paragraph 20 and will be brought into account for capital gains tax purposes on the termination of the lease.

Example

> Grocer (Pty) Ltd enters into a 10 year lease for a shop and spend R100 000 on the shop front and fixtures on which no income tax allowances can be claimed. The bare dominium of the improvements calculated over a period of 10 years is R32 198 which the company wishes to claim as a capital loss in the year the improvements are effected. In terms of the proposed amendment the expenditure will form part of the base cost of the asset i.e. the lease, and if on termination of the lease no compensation for the improvements is received the capital loss will be allowed at the time of the expiry of the lease.

Subclause (e): Paragraph 33 does not cater for the determination of the time-apportionment base cost of the part of the asset disposed of as the different subparagraphs refer to "base cost" and not to "expenditure" incurred to acquire the asset. It is proposed that the paragraph be amended to cater for the use of the time-apportionment base cost method of determining the base cost.

CLAUSE 105

Income Tax: Amendment of paragraph 39 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 39 provides that a person must disregard capital losses determined in respect of the disposal of an asset to a connected person. It is proposed that this provision be extended to also cover capital losses determined in respect of the disposal of any asset to—

- a company which is a member of the same group of companies as that person, and
- a trust with a beneficiary which is a member of the same group of companies as that person immediately after the transaction.

This would, for example, include disposal of an asset to a company in terms of a company formation transaction, where that person receives shares in exchange for that asset.

CLAUSE 106

Income Tax: Amendment of paragraph 43 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 43 provides rules for the translation of expenditure incurred in a foreign and proceeds received or accrued in a foreign currency for assets other than foreign currency which is dealt with in Part XIII of the Schedule.

Subclause (a): The amendment is of a consequential nature as a result of the amendment of section 25D.

Subclause (b): See notes on FOREIGN DIVIDENDS AND CONTROLLED FOREIGN COMPANIES.

Subclause (c): This amendment is consequential upon the amendment of section 25D.

Subclause (d): Paragraph 43(4) deals specifically with the position of capital gains and losses arising from the disposal of—

- foreign equity instruments, which is a defined term and essentially means foreign liquid assets, and
- assets the capital gains or losses of which are derived or deemed to be derived from a source in the Republic as contemplated in section 9(2).

The purpose of the paragraph is to bring the capital gain or loss on the disposal of these assets as well as the capital gain or loss as a result of the currency fluctuation to account on disposal of the asset. The exclusion of assets contemplated in section 9(2)*(b)*(i) from the operation of paragraph 43(4) had the unintended consequence that a resident could acquire and dispose of South African source assets in foreign currency and thereby escape CGT consequences on the appreciation or depreciation of the Rand. It is proposed that that this unintended consequence be rectified.

Subclause (e): The subparagraph deals with two types of assets and as a result of a textual error only one type of asset is mentioned in paragraph 43(4)*(b)*(ii) and it is proposed that this error be corrected.

Subclause (f): On reconsideration it was found that it was not necessary to denominate a currency for the base cost in the circumstances described in paragraph 42 and 67 and amendment is proposed.

Subclause (g): This amendment proposes that the currency in which a foreign debt that is forgiven must be denominated is the currency of the debt.

Subclause (h): There is concern that persons may use the currency of a country in the common monetary area to escape taxation on foreign currency fluctuations and it is proposed that this currency be excluded from the definition.

CLAUSE 107

Income Tax: Amendment of paragraph 55 of the Eighth Schedule to the Income Tax Act, 1962

Paragraph 55 prescribes the circumstances in which the capital gains or losses on the disposal of long-term policies are disregarded. As a general rule the capital gains or losses determined in respect of second hand policies are subject to CGT but there are certain exceptions.

Subclause (a): Item *(b)* provides for the situation where an employer has taken out a policy on the life of an employee and paid the premiums on the policy which were deductible in terms of section 11*(w)*. The policy is ceded to the employee normally when the employee leaves the services of the employer and the value of the policy is taxable as ordinary income in the hands of the employee. This is technically a second hand policy but in terms of the item any capital gain or loss on this disposal is disregarded. Concern has been expressed that the wording may exclude persons who are not employees on the date of disposal of the policy and it is proposed that this matter be clarified.

Subclause (b): Item *(c)* of subparagraph (1) provides for the situation where a person takes out a policy to insure against the death of a partner or co-shareholder so that he or she can acquire the interest in the partnership or shares or similar interest in the company of if the partner or co-shareholder dies. If the partnership is disbanded or the person is no longer a shareholder the policy may be ceded to the person whose life was insured and this paragraph provides that any capital gain when the policy pays out is disregarded. As the item is worded it only operates on the death of the person insured and it was intended also to apply in the circumstances where the insured became disabled or severely ill. It is proposed that the wording be changed to give effect to what was intended.

CLAUSE 108

Income Tax: Substitution of paragraph 62 of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment provides for the disregarding of capital gains arising as a result of donations to the Government, Provincial local authorities and bodies which operate for the good of the general public.

CLAUSE 109

Income Tax: Substitution of paragraph 63 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 63 seeks to disregard all capital gains and losses in respect of the disposals by persons that are fully exempted from tax in terms of section 10, as opposed to those persons who are exempted in respect of specific types of receipts and accruals only. The proposed changes are to ensure that this is achieved.

CLAUSE 110

Income Tax: Substitution of paragraph 65 of the Eighth Schedule to the Income Tax Act, 1962

The provisions of this paragraph are aligned with the provisions of paragraph 66 of the Eighth Schedule.

CLAUSE 111

Income Tax: Substitution of paragraph 66 of the Eighth Schedule to the Income Tax Act, 1962

The provisions of this paragraph are aligned with the provisions of section 8(4)*(e)* to *(e*E*)*.

CLAUSE 112

Income Tax: Amendment of paragraph 67 of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): This amendment is of a textual nature.

Subclause (b): This amendment provides that where a spouse transfers an asset to the other spouse the capital gain must be denominated in the same currency it was incurred by the transferor.

CLAUSE 113

Income Tax: Amendment of paragraph 67A of Eighth Schedule to the Income Tax Act, 1962

Part IX of the Eighth Schedule provides for roll-overs which effectively defer the taxation of specified capital gains.

Paragraph 67A rolls over any capital gains or losses in respect of participatory interest in collective investment schemes in property until the date of disposal of the interest. In terms of the Collective Investment Schemes Control Act, 2002, capital distributions may be made to investors while the portfolio remains in force which was not permitted in terms of the previous Act. In order to cater for these capital distributions it is proposed that all cash and the market value of any assets received by or accrued to a holder of a participatory interest after valuation date which does not constitute gross income in that holder's hands should constitute proceeds when that interest is disposed of.

CLAUSE 114

Income Tax: Insertion of paragraph 67B of Eighth Schedule to the Income Tax Act, 1962

A company which operates a share block scheme in relation to immovable property which wishes to open a sectional titles register so that it can allow share block holders the right to take transfer of the property for which they hold the right of use, must follow the procedures prescribed in the First Schedule to the Share Blocks Control Act, 1980. In terms of this Schedule the share block holder who wishes to take transfer of the property must surrender his or her share certificate and right of use of the property and in return transfer of the property is given. Although seen from the point of view of the share block holder this is merely a change in the form of ownership of the immovable property, this is a disposal that can give rise to a capital gain or capital loss. In order not to create cash flow difficulties it is proposed that the recognition of the capital gain or loss be disregarded in the hands of the company and the person who acquires the sectional title unit. The capital gain or capital loss made by the person acquiring the unit is deferred until the person actually disposes of the immovable property. It is also proposed that the person acquiring the unit be treated as if—

- the expenditure incurred in respect of the acquisition and improvement of the share block interest was incurred to acquire and improve the sectional title unit; or
- the market value determination of the share block interest if made within the prescribed period be treated as if it were the market value of the sectional title interest; and
- the date the share block interest was acquired and the use to which it was put is the same as the date of acquisition and use of the unit. This will enable the person to use the time-apportioned base cost if the share block interest was a pre-valuation date asset and the full period of ordinary residence in the immovable property for the purposes of the R1million primary residence exclusion.

CLAUSE 115

Income Tax: Insertion of paragraph 67C of the Eighth Schedule to the Income Tax Act, 1962

This amendment deals with mineral rights held before the introduction of the Mineral and Petroleum Resources Development Act and mining rights issued in terms of that Act and deems them to be one and the same asset.

CLAUSE 116

Income Tax: Amendment of paragraph 72 of Eighth Schedule to the Income Tax Act, 1962

This amendment is of a consequential nature as a result of the deletion of the definition of "foreign entity" in section 9D.

CLAUSE 117

Income Tax: Amendment of paragraph 74 of Eighth Schedule to the Income Tax Act, 1962

Subclause (a) and (c): The deletion of the definition of company in this paragraph means that the definition of "company" in section 1 applies which has the effect that portfolios in collective investment schemes in equities now fall within these provisions. These amendments ensure that capital distributions of Collective Investment Schemes in securities reduce the base cost of investors so that CGT is imposed when the participatory interest is disposed of.

Subclause (b): This paragraph introduces rules which prescribe when the capital distributions of companies are treated as having accrued to shareholders so that their base cost in the shares can be reduced. See also *CLAUSE 119.*

CLAUSE 118

Income Tax: Amendment of paragraph 75 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 75 provides that distribution of an asset by a company to a shareholder must be treated as having been made for proceeds equal to the market value of the asset. The market value must be determined on the date the distribution is approved by the directors or by some other person with comparable authority conferred by the memorandum and articles of association of the company.

A comprehensive set of provisions exists with regard to the dates of declaration of dividends for the purposes of secondary tax on companies in section 64B(4) of the Income Tax Act. It is proposed that rules similar to those in section 64B(4) be introduced in paragraphs 74 and 75 to clarify the position.

CLAUSE 119

Income Tax: Amendment of paragraph 78 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 78 deals with the shareholder level consequences of the issue of shares by a company.

Subclause (a): Paragraph 78(2) provides a tax-free roll over for CGT purposes where new shares are substituted for previously held shares by reason of a subdivision, consolidation or similar arrangement. The 'base cost' of the previously held shares is allocated to the new shares with reference to the market value of the new shares.

It is proposed that the reference to the base cost of the previously held shares be replaced by references to—

- the expenditure incurred in terms of paragraph 20;
- the dates on which the expenditure was incurred; and
- any market value adopted or determined in terms of paragraph 29(4),

in respect of the previously held shares.

The intention always was that the expenditure, date of incurral thereof and market value on valuation date in respect of the previously held shares be carried over to the new shares. Under the previous wording it was unclear how the time-apportionment base cost (TAB) method was to be applied to the new shares. Under TAB the base cost is only determined when the new shares are disposed of and the proceeds are known. It was always the intention that paragraph 78(2) be applied in this manner, and this amendment now merely gives effect to this intention. Furthermore, the amendment provides clarity as to what constitutes expenditure before the valuation date in respect of the new shares for the purpose of applying the kink tests in paragraphs 26 and 27.

Subclause (b): Paragraph 78(3) deals with the situation where cash or assets *in specie* plus shares are given to a shareholder in substitution of previously held shares. A capital gain or loss is determined in respect of the non-share portion of the substitution.

For the same reasons explained in subclause *(a)* it is proposed that the reference in paragraph 78(3) to 'base cost' be replaced with a reference to the expenditure incurred and the market value adopted or determined in terms of paragraph 29(4).

It is proposed that the amendment be deemed to come into operation on 1 October 2001

CLAUSE 120

Income Tax: Amendment of paragraph 84 of the Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature and clarifies the definition by being more specific.

CLAUSE 121

Income Tax: Amendment of paragraph 86 of the Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature and intended to clarify the wording.

CLAUSE 122

Income Tax: Amendment of paragraph 88 of the Eighth Schedule to the Income Tax, 1962

Subclause (a): This amendment is of a textual nature and intended to clarify the wording.

Subclause (b): This amendment is of a consequential nature as the requirement deleted in this paragraph is included in the definition of "resident".

Subclause (c): This amendment is of a textual nature.

CLAUSE 123

Income Tax: Amendment of paragraph 92 of the Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature as the provision has been moved to paragraph 86.

CLAUSE 124

Income Tax: Amendment of paragraph 93 of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): This amendment is of a textual nature.

Subclause (b): This amendment fixes the date on which the value of any foreign liability must be determined.

CLAUSE 125

Income Tax: Substitution of paragraph 94 of the Eighth Schedule to the Income Tax Act, 1962

It is proposed that the undefined terms 'foreign currency gain' and 'foreign currency loss' be replaced by the defined terms 'foreign currency capital gain' and 'foreign currency capital loss'. The latter terms are defined in paragraph 86.

CLAUSE 126

Income Tax: Amendment of paragraph 96 of Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 127

Income Tax: Amendment of paragraph 1 of Part I of the Ninth Schedule to the Income Tax Act, 1962

This amendment adds the promotion of access to media and a free press to the list of activities which allows public benefit organisations to qualify for exemption.

CLAUSE 128

Income Tax: Amendment of paragraph 3 of Part I of the Ninth Schedule to the Income Tax Act, 1962

Subclause (a): Amends the activity relating to the residential care for retired persons by introducing the requirement that residential care for poor and needy persons is provided without recovery of cost, i.e. by way of subsidisation by retired persons who are not poor and needy.

Subclause (b): The activity has been split into two separate activities in order to grant section 18A benefits for the activity in (i).

Subclause (c): A new activity is introduced which will enable an organisation carrying on the activity to qualify for tax exempt status.

CLAUSE 129

Income Tax: Amendment of paragraph 11 of Part I of the Ninth Schedule to the Income Tax Act, 1962

Subclause (a): This amendment is of a textual nature.

Subclause (b): The activity is extended to include the company or organisation which handles the bid to host an international event approved by the Minister of Finance, e.g. the 2010 Soccer Bid Company.

CLAUSE 130

Income Tax: Amendment of paragraph 1 of Part II of the Ninth Schedule to the Income Tax Act, 1962

The activities listed below are added to the list of activities which would qualify public benefit organisation which carry on these activities to qualify for tax deductible contributions.

CLAUSE 131

Income Tax: Amendment of paragraph 2 of Part II of the Ninth Schedule to the Income Tax Act, 1962

The activities listed below are added to the list of activities which would qualify public benefit organisation which carry on these activities to qualify for tax deductible contributions.

CLAUSE 132

Income Tax: Amendment of paragraph 3 of Part II of the Ninth Schedule to the Income Tax Act, 1962

The activities listed below are added to the list of activities which would qualify public benefit organisation which carry on these activities to qualify for tax deductible contributions.

CLAUSE 133

Income Tax: Addition of paragraph 5 of Part II of the Ninth Schedule to the Income Tax Act, 1962

The activities listed above are added to the list of activities which would qualify public benefit organisation who carry on these activities to qualify for tax deductible contributions.

CLAUSE 134

Customs and Excise: Amendment of section 1 of the Customs and Excise Act, 1964

Definitions for “degrouping depot” and “degrouping operator” are inserted in view of the licensing of degrouping depots for air cargo as proposed in new section 64G.

A definition for “International Trade Administrative Commission” is inserted as a result of the implementation of certain provisions of the International Trade Administration Act (Act No. 71 of 2002). References in the Act to the Board on Tariffs and Trade accordingly require amendment. Where the Director-General: Trade and Industry was empowered in terms of the Schedules to the Customs and Excise Act to issue permits, the Director-General was substituted by the International Trade Administration Commission with effect from 1 June 2003.

CLAUSE 135

Customs and Excise: Amendment of section 3 of the Customs and Excise Act, 1964

Subsections (3) and (4), which presently provide for internal review of decisions, are deleted as new provisions in respect of internal administrative appeals and alternative dispute resolution are included in the proposes new Chapter XA.

CLAUSE 136

Customs and Excise: Amendment of section 4 of the Customs and Excise Act, 1964

The insertion of two new subsections, 3E and 8A, are proposed.

Subsection 3E follows the provisions of section 4(1)*(b)* of the Income Tax Act, 1962 (Act No. 58 of 1962) to provide for access of the Auditor-General to documents in the possession or custody of the Commissioner or a Controller.

A new subsection 8A empowers officers specifically with regard to section 107(2)*(a)* to stop or detain goods in order to ascertain whether the provisions of the Act or other law have been complied with. The release of goods may also be stopped at any time while goods are under customs control or any premises licensed under the Act.

Where the officer or the Controller decides that it may be necessary to establish whether the goods are liable to forfeiture, a detention under section 88(1)*(a)* may be substituted for the detention under subsection (8A).

CLAUSE 137

Customs and Excise: Amendment of section 6 of the Customs and Excise Act, 1964

The proposed subsection (1)*(hc)* enables the Commissioner to prescribe or appoint places where degrouping depots for air cargo may be established. Air cargo may be removed from a transit shed, to a degrouping depot before due entry thereof for the storage, detention, unpacking or examination of consolidated packing or its contents for the removal to another degrouping depot for the delivery to importers of such contents after due entry. Air cargo may also be consolidated in a degrouping depot for export and such other purposes as may be specified by rule. The existing paragraph *(hc)* also provides for the removal of air cargo before due entry to another transit shed, before due entry, but in view thereof that transit sheds are not yet licensed, the reference to such removal is deleted.

CLAUSE 138

Customs and Excise: Amendment of section 35A of the Customs and Excise Act, 1964

The proposed amendment enables the Commissioner to make rules regarding distinguishing marks and numbers which must or must not appear on cigarettes containers in addition to the existing provision for a stamp impression. In terms of the provisions a licensee of a customs and excise warehouse may not remove cigarettes or allow cigarettes to be removed from such warehouse for home consumption or export unless they are packed, stamped or marked in the prescribed manner.

The amendment will enable the Commissioner to curtail the smuggling of cigarettes.

CLAUSE 139

Customs and Excise: Amendment of section 44 of the Customs and Excise Act, 1964

Subsection (5) is amended and subsection (5C) is inserted to provide for the liability for duty of a degrouping depot operator and the circumstances in which such liability ceases.

CLAUSE 140

Customs and Excise: Amendment of section 46 of the Customs and Excise Act, 1964

In subsection (1)*(c)* and subsection (2), "International Trade Administration Commission" is substituted for "Board on Tariffs and Trade" in view of item 5(1) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002).

CLAUSE 141

Customs and Excise: Amendment of section 47 of the Customs and Excise Act, 1964

Subsections (1) and (7) are amended in consequence of the provision in new Chapter VA for the imposition of an environmental levy.

Subsection (9) requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution. Presently the section contains reference to section 95A which relates to internal administrative appeals and had not yet come into operation. Section 135 of Act 60 of 2001 which inserted section 95A is accordingly repealed.

Certain amendments will come into operation when Chapter XA comes into operation.

CLAUSE 142

Customs and Excise: Insertion of Chapter VA [sections 47C to 47H] in the Customs and Excise Act, 1964

This chapter provides for the imposition of an environmental levy.

Provision for such a levy at the rate of R10 per kg is made in Part 3 of Schedule No. 1 on certain imported and locally manufactured carrier and flat bags or sacks which is included in Schedule 1 to this Bill.

The levy is payable in addition to any duty prescribed in any heading or subheading of Part 1 of Schedule No. 1 (section 47D(1)). Any duty imposed on imported goods which are also liable to the environmental levy will thus be liable to both the duties.

Section 47D(2) provides that, subject to the provisions of the Chapter, the environmental levy is deemed to be a duty leviable under the Act, except for the purposes of any customs union agreement contemplated in section 51 or any other law.

In terms of section 47E, the provisions of the Act relating to the importation of goods and imported goods and the manufacture of excisable goods, and entry for home consumption, removal from any customs and excise manufacturing warehouse and payment of duty contemplated in section 19A apply *mutatis mutandis* to environmental levy goods imported into or manufactured in the Republic. These provisions are subject to such exceptions and adaptations as may be prescribed in the Chapter, any Schedule or any rule.

The procedures prescribed in respect of "duty at source" in terms of section 19A may therefore, subject to the exceptions and adaptations provided, be applied to environmental levy goods manufactured in the Republic.

In terms of section 47F the Minister may provide under section 75(15) for rebates, refunds and drawbacks on environmental levy goods.

In terms of section 47G, no environmental levy goods may be manufactured in the Republic except in a customs and excise manufacturing warehouse licensed in terms of the Act.

Section 47H enables the Commissioner to make rules in respect of various matters for the administration of the section.

CLAUSE 143

Customs and Excise: Amendment of section 48 of the Customs and Excise Act, 1964

Subsection (2) is amended in consequence of the provision in new chapter VA for an environmental levy.

Subsection (2A) is amended by the substitution for "Director-General: Trade and Industry" of "International Trade Administration Commission" in terms of item 5(2) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002)

CLAUSE 144

Customs and Excise: Substitution of section 54 of the Customs and Excise Act, 1964

This proposed amendment which prescribes additional requirements in respect of imported cigarettes relates to the proposed amendment of section 35A.

CLAUSE 145

Customs and Excise: Substitution of section 57A of the Customs and Excise Act, 1964

This section provides for the imposition of provisional payments in respect of anti-dumping, countervailing or safeguard duty at the request of the Board on Tariffs and Trade. "International Trade Administration Commission" is substituted for "Board on Tariffs and Trade" in view of the provisions of item 2(2) and 5(1) of the International Trade Administration Act, 2002 (Act No. 71 of 2002).

CLAUSE 146

Customs and Excise: Insertion of section 64G in the Customs and Excise Act, 1964

This section provides for the licensing of a degrouping depot. The provisions are primarily enabling in that requirements in respect of licensing and procedures may be prescribed by rule.

CLAUSE 147

Customs and Excise: Amendment of section 65 of the Customs and Excise Act, 1964

As in the case of the amendment of section 47(9), this section requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution and in view of the reference therein to section 95A.

Certain amendments will come into operation when Chapter XA comes into operation.

CLAUSE 148

Customs and Excise: Substitution of section 69 of the Customs and Excise Act, 1964

Specific provision is made in subsection (1) for the value for duty purposes of DVD's, recorded compact discs, audio tapes and video tapes manufactured in the Republic that are dutiable in terms of item 124.65 of Section B of Part 2 of Schedule No. 1.

The section is further amended for the same reason as section 47(9) is amended. It requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution and in view of the reference therein to section 95 A.

Certain amendments will come into operation when Chapter XA comes into operation.

CLAUSE 149

Customs and Excise: Amendment of section 75 of the Customs and Excise Act, 1964

Subsection (2)*(c)* is amended to substitute "International Trade Administration Commission" for "Board of Trade and Industries" in view of items 2(1) and 5(1) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002).

Paragraph *(c)* is added to section 11A to provide that the amount duly refundable in terms of any item of Schedule No. 6 may be an amount that may be set off by a licensee of a customs and excise warehouse in terms of section 77 where the goods have been entered or deemed to have been entered for home consumption and payment of duty in accordance with the provisions of the Act. This provision arises from the introduction of the "duty at source" system. The amendment is intended to clarify the application of set-off to any amount refundable under such item for the purposes of the subsection.

CLAUSE 150

Customs and Excise: Insertion of Chapter XA [sections 77A to 77P] in the Customs and Excise Act, 1964

This Chapter is inserted to provide firstly in Part A for internal administrative appeals. The legislation is mostly enabling in terms of which the Commissioner may prescribe various procedures by rule. Provision is also made for an appeal committee which may consist of officers or officers and other persons and will make recommendations to the Commissioner or decide on matters.

Part B provides for alternative dispute resolution (ADR). The Minister may, after consultation with the Minister of Justice, promulgate rules to provide for alternative dispute resolution. The rules may also include categories of decisions which are not suitable for alternative dispute resolution. Rules for alternative dispute resolution in respect of income tax disputes have already been promulgated by the Minister under section 107A of the Income Tax Act, 1962, (Act No. 58 of 1962).

Part C provides for the circumstances in which the Commissioner may settle a dispute. The contents follow the provisions previously published under section 93A. in GN R.468 of 1 April 2003.

CLAUSE 151

Customs and Excise: Amendment of section 80 of the Customs and Excise Act, 1964

Paragraph *(r)* is inserted to provide for an offence where a person without lawful cause fails to comply with a notice of appointment as agent in terms of section 114A within a period specified in such notice.

CLAUSE 152

Customs and Excise: Amendment of section 89 of the Customs and Excise Act, 1964

Section 89 is amended for the same reason section 47(9) is amended. The section requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution and in view of the reference therein to section 95A.

CLAUSE 153

Customs and Excise: Substitution of section 93 of the Customs and Excise Act, 1964

The existing provision is restructured in subsection (1).

The proposed amendment further adds a subsection (2) which provides that any person who alleges ownership of any ship, vehicle, container or other transport equipment, plant, material or goods, must prove ownership to the satisfaction of the Commissioner. If two or more persons claim ownership of the same goods, ownership must be decided by a competent court.

The amendment allows the courts, as opposed to the Commissioner, to settle disputes between two or more persons regarding ownership of goods in certain instances.

CLAUSE 154

Customs and Excise: Amendment of section 101 of the Customs and Excise Act, 1964

The reference to data created by means of a computer as defined in section 1 of the Computer Evidence Act, 1983 (Act No. 57 of 1983) is deleted as that Act was repealed by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 155

Customs and Excise: Amendment of section 101A of the Customs and Excise Act, 1964

Subsection (10) is amended to provide for the submission of reports electronically by using the Internet as prescribed by rule.

CLAUSE 156

Customs and Excise: Insertion of section 114A and 14B in the Customs and Excise Act, 1964

Section 114A

This provision follows section 47 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991). In terms of the proposed section the Commissioner may if he thinks it necessary declare any person to be the agent of any other person, and the person so declared must for the purposes of the Act be the agent of such other person in respect of payment of any amount of duty, interest, fine, penalty or forfeiture payable by such other person under the Act and may be required to make payment of such amount from any moneys which may be held by him or her for or be due by him or her to the person whose agent he or she has been declared to be.

In terms of a proviso the person who is so declared an agent who is unable to comply with the requirements of the notice of appointment as agent, must advise the Commissioner in writing of the reasons for not complying with that notice within the period specified in the notice.

Failure to comply with such notice of appointment as agent without lawful cause within the period specified in such notice is an offence in terms of section 80(1)*(r)*.

Section 114B

In terms of the proposed section the Commissioner has the same remedies against all property of any kind rested in or under the control or management of any person acting in a fiduciary capacity as he or she would have against other property of any person liable to pay any duty, interest fine, penalty or forfeiture payable under the Act and “in as full and ample a manner”. This provision follows section 49 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991).

CLAUSE 157

Customs and Excise: Substitution of Part 3 of Schedule No. 1 to the Customs and Excise Act, 1964

This amendment is consequential upon the insertion of Chapter VA in the Customs and Excise Act, 1964. Refer to *CLAUSE 142*.

CLAUSE 158

Stamp Duties: Amendment of section 4 of the Stamp Duties Act, 1968

Subclause (a): The provisions in the Income Tax Act, 1962, relating to public benefit organisations were amended in 2000 to change the requirements for and approval process of these exempt bodies. Organisations which were previously exempt under separate provisions of the Income Tax Act, 1962, were now all required to apply for exemption and, if approved, qualify for exemption under section 10*(c*N*)* of that Act. These organisations must apply for exemption before 31 December 2003. Specific transitional arrangements were, however, included to ensure that these bodies continue to enjoy exemption until approval for exemption is granted by the Commissioner under section 10(1)*(c*N*)*.

Public benefit organisations which are exempt under section 10(1)*(c*N*)* of the Income Tax Act, 1962, also enjoy exemption for purposes of stamp duty. This proposed amendment ensures that these bodies also continue to enjoy the stamp duty exemption during the period until approval is granted in term of section 10(1)*(c*N*)* of the Income Tax Act, 1962.

Subclause (b): This amendment ensures that organisations which were exempted under certain p rovisions of section 10, repealed in 2000, continue to enjoy the Stamp Duty exemption during the period until approval is granted in terms of section 10(1)*(c*N*)*.

CLAUSE 159

Stamp Duties: Amendment of section 7 of the Stamp Duties Act, 1968

Stamp duties have been gradually being eliminated in line with international best practice. Stamp duties have been removed from new insurance policies and fixed deposits. One item left unchanged involves negotiable certificate of deposit (NCD’s). NCD’s are classified as “marketable securities” under the Stamp Duties Act, but are subject to tax as fixed deposit accounts. NCD’s typically entail large sums of money that are utilised by commercial entities. As part of the technical amendments to company reorganisation in the Income Tax Act of 1962, collateral amendments are required in the Stamp Duties Act to facilitate economic turnover.

Subclause (a): Item 13 of Schedule 1 deals with the form of duty to be paid, it does not however indicate when the duty is payable. This amendment makes it clear that on the issue or transfer of NCD's duty is payable.

Subclause (b): A consequential amendment that helps to modernise and to converge this Act with the other tax Acts.

CLAUSE 160

Stamp Duties: Amendment of section 23 of the Stamp Duties Act, 1968

Subclause (a): Marketable Securities Tax (MST) is gradually being replaced by Uncertificated Securities Tax (UST), in particular with respect to marketable securities. As a first step the definition of lending arrangement has become superfluous as it is also contained in the UST Act and the MST Act. This now obsolete definition is deleted.

Subclause (b): Consequential amendment following the deletion of the definition of "lending arrangement", as this subparagraph has beco me obsolete.

Subclause (c): All of the other tax Acts require that records be kept by a person for at least five years. This amendment simply aligns the Stamp Duties Act record retention period to all the other tax Acts.

CLAUSE 161

Stamp Duties: Inse rtion of section 30A in the Stamp Duties Act, 1968

This proposed amendment allows the Commissioner to appoint an agent to collect outstanding stamp duty as is the case in the Income Tax and Value -Added Tax Act.

CLAUSE 162

Stamp Duties: Amendment of section 31 of the Stamp Duties Act, 1968

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 163

Stamp Duties: Amendment of Item 7 of Schedule 1 to the Stamp Duties Act, 1968

In order to facilitate the mortgage bond market, the 2002 legislation removed all stamp duties where creditors cede their interests in bonds. As a matter of parity duty relief is proposed for the substitution of debtors.

CLAUSE 164

Stamp Duties: Amendment of Item 13 of Schedule 1 to the Stamp Duties Act, 1968

Subclause (a) & (b): Stamp duties have been gradually eliminated in line with international best practice. Already stamp duties were removed from new insurance policies and fixed deposits. One item left unchanged involves negotiable certificates of deposit (NCD's). NCD's are classified as "marketable securities" under the Stamp Duties Act, but are subject to tax as fixed deposit accounts. NCD's typically entail large sums of money that are utilised by commercial entities. As part of the technical amendments to company reorganisation in the Income Tax Act of 1962, collateral amendments are required in the Stamp Duties Act to facilitate economic turnover. In this light the definition of "fixed deposit" only refers to NCD's.

Subclause (c): Consequential upon the substitution in the introductory paragraph of Item 13 and it deletes obsolete language.

Subclause (d): Consequential upon the substitution in the introductory paragraph of Item 13.

CLAUSE 165

Stamp Duties: Amendment of Item 15 of Schedule 1 to the Stamp Duties Act, 1968

Subclause (a): It is proposed that interest bearing debentures be exempt from Stamp Duty as announced by the Minister in his 2003 Budget Speech. It is also proposed that shares in a Share Block Company also be exempted as the transfer of the shares is subject to transfer duty or VAT.

Subclauses (b) and (c): A registration of transfer of any marketable security acquired in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962) is exempt from stamp duty. This exemption was extended in 2002 to the registration of transfer of securities acquired in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of the market value of the asset exchanged for those securities. The proposed changes align the wording of the exemption in respect of unbundling transactions with that applying in respect of company formations, share-for-share and other corporate transactions. It is also proposed that the exemption be extended to securities acquired in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules regardless of whether those securities are acquired as capital assets or trading stock. This proposal is in line with that in respect of the exemption, from marketable securities tax, of securities so acquired - see the notes on *CLAUSE 2.*

Subclause (d): The amendment proposed confirms that it is only debentures that constitute as marketable securities that are subject to the duty

Subclause (e): The amendment proposed confirms that it is only debentures that constitute as marketable securities that are subject to the duty

Subclause (f): This amendment is a deletion of an obsolete provision.

Subclause (g): This amendment is a deletion of an obsolete provision.

Subclause (h): This amendment is of a textual nature.

Subclause (i): This amendment is of a textual nature.

Subclause (j): This amendment is a deletion of an obsolete provision.

CLAUSE 166

Value-Added Tax: Amendment of section 1 of the Value-Added Tax Act, 1991

Subclause (a):

Current law

Under current law the word 'cost' is understood to be the accounting cost of the asset. In terms of the vendor's accounting practice certain costs that are excluded from the VAT net (such as finance costs and direct labour) are capitalised into the cost of getting the asset to its current location and ready for use. These capitalised expenses form part of the cost of the asset. Under current law, a vendor incurring expenditure of a capital nature, as described above, and subsequently obtaining VAT registration status (or an increase in taxable supplies) receives inflated VAT input credits for the capital expenditures under the conversion formula.

Reason for change

This creates the unintended consequence between a vendor who uses the conversion formula (to claim additional input tax when the taxable use of the asset is increased, or where an existing asset is introduced into a business that has recently registered as a vendor) and a vendor who has always been registered or does not need to use the conversion formula. This anomaly allows the vendor using the conversion formula to claim input tax deductions on items of expenditure that did not originally carry any VAT when they were acquired.

Proposal

A new definition of "adjusted cost" is introduced to limit input tax and output tax adjustments in sections 16(3)(h), 18(2), (4) and (5) to amounts which bore VAT, or would have borne VAT prior to the commencement date or which are or would have been subject to a notional input deduction in respect of second-hand goods. This amendment is necessary as the object of levying output tax, or allowing input tax where there is a change in use of assets, is to take account of the VAT not previously taken into account. As the cost of an asset may include many costs which were not subject to VAT (for example interest and wages), these expenses should not form part of the cost when the taxable use of an asset changes.

Subclause (b): The definition of "consideration" is amended in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

Subclause (c): A new definition of “designated public body or public private partnership” is inserted, and is dealt with in the noted PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

Subclause (d): The definition of “enterprise” is amended in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

Subclause (e): The deletion of the reference to paragraphs (i) and (vii) of the definition of “remuneration” in paragraph 1 of the Fourth Schedu le to the Income Tax Act in proviso (iii) to the definition of “enterprise” is consequential upon the deletion of these paragraphs in the Income Tax Act.

Subclause (f): A new proviso (proviso (viii)) is added in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

Subclause (g): The definition of the word “grant” is introduced in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

Subclause (h): A definition of the word “month” is introduced as this word is used a number of times in the Act.

Subclause (i) and (j): An amendment is introduced to exclude from the definition of “second-hand goods” any rights in property acquired as a result of the surrender or conversion of prospecting, mining, exploration or production rights as defined in Schedule 1 of the Mineral and Petroleum Resources Development Act, 2002.

Subclause (k): The definition of the word “transfer payment” is deleted as it has been replaced with the definition of the word “grant” to describe payments from public and local authorities.

CLAUSE 167

Value-Added Tax: Amendment of section 8 of the Value-Added Tax Act, 1991

Subclause (a): Sub-clause *(a)* introduces a proviso to section 8(2) in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS

Subclause (b): The substitution of section 8(5) is made in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

Subclause (c): Under current law where goods are transferred by a vendor to his or her branch or main business outside the Republic the vendor is deemed to supply goods to supply goods in the course or furtherance of his or her enterprise. The current use of the word “transfers” leads to the abuse where the ownership title was transferred to an entity outside the Republic (at the zero rate) without the physical transfer / export of the goods. Section 8(9) of the Act is amended to provide that the goods must be consigned or delivered to a foreign branch or main business of a vendor which is outside South Africa. This amendment is to ensure that the zero-rating will apply only if the goods or services are consigned or delivered to such branch or main business.

CLAUSE 168

Value-Added Tax: Amendment of section 9 of the Value-Added Tax Act, 1991

This amendment is consequential upon the amendment in section 8(9) to provide that the time of supply in regard to the supply of goods to a branch or main business outside South Africa is amended from the time the goods are transferred or the services are performed to the time when they are consigned or delivered.

CLAUSE 169

Value-Added Tax: Amendment of section 10 of the Value-Added Tax Act, 1991

Subclause (a): This amendment is consequential upon the amendment in section 8(9).

Subclause (b): This amendment is consequential upon the amendment in section 1 of the definition of "adjusted cost".

CLAUSE 170

Value-Added Tax: Amendment of section 11 of the Value-Added Tax Act, 1991

Subclause (a): The introduction of paragraph *(n)* to section 11(1) proposes that consideration received as a result of the continuation, conversion or renewal of a prospecting, mining, exploration or production right as defined in Schedule 1 and 2 of the Mineral and Petroleum Resources Development Act, 2002, be subject to VAT at the zero rate.

Subclause (b): This subsection provides for the zero-rating of grants to welfare organisations and is amended as a consequence of the amendment to section 8(5) affecting public entities.

Subclause (c): The amendment to section 11(2)(o) is consequential upon the amendment to section 8(9) in respect of services provided to foreign branches to limit the zero-rating of services used outside the Republic.

Subclause (d): This amendment deletes section 11(2)*(p)* in consequence of the introduction of the concept of grants made by a public authority or local authority.

Subclause (e): The subsection 11(2)*(q)* allows for the zero-rating of foreign grants and the amendment is consequential upon the amendment to section 8(5).

Subclause (f):
(1): The amendment to section 11(3) to provide for documentary evidence to be obtained where goods are sold while in a customs warehouse is consequential upon the amendment to section 13.

(2): This amendment shall be deemed to have come into operation on 1 January 2002 and shall apply in respect of any supply made on or after that date.

CLAUSE 171

Value-Added Tax: Amendment of section 13 of the Value-Added Tax Act, 1991

Subclause (a): Under present law VAT on importation of goods into the Republic is triggered on the date they are deemed to be imported in terms of the Customs and Excise Act. VAT is only levied when the goods are entered into the domestic market. The overhead costs of maintaining such a warehouse cannot be claimed as a VAT input because present law disregards the goods until importation. Goods held in a licensed Customs and Excise warehouse that are never intended for the domestic market (i.e. exclusively held for re-export) are currently disregarded for VAT purposes, and falls outside the scope of the VAT net. No input tax deduction is therefore allowed on the overhead costs of the warehouse which relate to the goods to be exported. The amendment to proviso (ii) to section 13 provides that the supply of goods in a Customs warehouse is a taxable supply (albeit at the zero rate). Where previously the supply was disregarded for VAT purposes, enterprises engaged in the transit trade may now claim input tax in respect of expenses relating to the storage of such goods.

Subclause (b): This amendment shall be deemed to have come into operation on 1 January 2002 and shall apply in respect of any supply made on or after that date.

CLAUSE 172

Value-Added Tax: Amendment of section 14 of the Value-Added Tax Act, 1991

Subclause (a): Under current law VAT is payable on the importation of goods and / or services by VAT vendors and non-VAT vendors. Certain relief from VAT on importation is provided in cases where, if those goods were purchased in the Republic, they would have been subject to VAT at the zero per cent or they would have been exempt from VAT. Educational services supplied in the Republic are exempt from VAT. An anomaly exists where imported services supplied by recognised foreign educational institutions are subject to VAT which is not in line with the exemption granted for the supply of educational services in the Republic. The amendment provides for the addition of paragraph *(c)* to section 14(5) to exempt South African students from VAT on imported services where these services are supplied by recognised foreign educational institutions.

Subclause (b): This amendment shall be deemed to have come into operation on 1 December 1998.

CLAUSE 173

Value-Added Tax: Amendment of section 16 of the Value-Added Tax Act, 1991

Where goods or services are used only partly for the purpose of making taxable supplies, and are subsequently sold, an input tax adjustment is allowed for the input tax previously denied. The amendment to section 16(3)*(h)* limits the adjustment to costs that bore VAT, would have borne VAT or would have been subject to a notional input tax deduction. This amendment must be read with the new definition of “adjusted cost” as per subclause *(a)* of *CLAUSE 166*.

CLAUSE 174

Value-Added Tax: Amendment of section 17 of the Value-Added Tax Act, 1991

Subclause (a): Under current law any form of entertainment includes meals supplied to crew on board by an operator of any conveyance during the journey. Input tax is prohibited on meals and refreshments supplied by the employer to its crew on board the conveyance. The abuse that the provision intended to address was where "entertainment" was provided in lieu of a salary. Clearly meals provided to cabin crew on board a conveyance is not the abuse that the provision intended to target. The amendment to subparagraph (iii) of paragraph *(a)* to section 17(2) allows suppliers of transport services an input tax deduction in respect of meals and refreshments supplied to crew on board the conveyance.

Subclause (b): Under current law any form of entertainment includes meals and accommodation of employees when employees are hospitalised, at the employers expense, due to injuries sustained during work related activities. This prohibits the employer from claiming any input tax credits relating to those activities. Employees that are hospitalised receive meals and accommodation over and above receiving medical care. VAT ruling 299 of 25 November 1991, states that expenses paid where an employee is injured at work are incurred in the normal course or furtherance of the vendor's enterprise and he may therefore claim an input tax deduction. The addition of subparagraph (vii) of paragraph *(a)* to section 17(2) allows an input tax deduction in respect of meals and refreshments supplied in hospital to employees, unless the costs thereof are charged for separately.

Subclause (c): Paragraph *(e)* to section 17(2) is added in the light of the proposed amendments affecting public entities and is dealt with in the notes PUBLIC ENTITIES, ENTERPRISES AND PARTNERSHIPS.

CLAUSE 175

Value-Added Tax: Amendment of section 18 of the Value-Added Tax Act, 1991

Subclause (a): The amendment to section 18(4) limits the VAT adjustment to costs which bore VAT, would have borne VAT or would have been subject to a notional input tax deduction in line with the introduction of the definition of "adjusted cost" as per *CLAUSE 166*.

Subclause (b): The amendment to section 18(5) limits the VAT adjustment to costs which bore VAT, would have borne VAT, or would have been subject to a notional input tax deduction in line with the introduction of the definition of "adjusted cost" as per *CLAUSE 166*.

CLAUSE 176

Value-Added Tax: Amendment of section 20 of the Value-Added Tax Act, 1991

Subclause (a): Under current law the recipient of the goods or services need only supply his name and address for inclusion on the tax invoice in order for him to claim an input tax deduction. This has lead to some vendors abusing the system by claiming multiple deductions using numerous vendors with similar names. The reason for this is to eliminate this abusive practice by increasing the VAT invoice reporting requirements. The amendment to paragraph *(c)* of subsection (4) to section 20 requires tax invoices exceeding R1 000 to indicate the purchaser's VAT number in addition to other particulars already stipulated in the Act.

Subclause (a): This amendment shall come into operation on 1 March 2005 and shall apply in respect of any supply made on or after that date.

CLAUSE 177

Value-Added Tax: Amendment of section 21 of the Value-Added Tax Act, 1991

Subclause (a): This amendment is consequential upon the amendment in section 20 that introduced the requirement for the VAT registration number of the recipient, on the invoice when making purchases of more than R1 000. A similar amendment was required for the issue of credit notes.

Subclause (b): This amendment is consequential upon the amendment in section 20 that introduced the requirement for the VAT registration number of the recipient, on the invoice when making purchases of more than R1 000. A similar amendment was required for the issue of debit notes.

Subclause (c): This amendment shall come into operation on 1 March 2005 and shall apply in respect of any supply made on or after that date.

CLAUSE 178

Value-Added Tax: Amendment of section 22 of the Value-Added Tax Act, 1991

The definition of month is deleted from this section as it is now defined in section 1.

CLAUSE 179

Value-Added Tax: Amendment of section 23 of the Value-Added Tax Act, 1991

The definition of month is deleted from this section as it is now defined in section 1.

CLAUSE 180

Value-Added Tax: Amendment of section 28 of the Value-Added Tax Act, 1991

The definition of month is deleted from this section as it is now defined in section 1.

CLAUSE 181

Value-Added Tax: Amendment of section 31 of the Value-Added Tax Act, 1991

Under current law it is a criminal offence for parties to make unauthorised or fraudulent use of tax invoices with respect to the VAT Export Incentive Scheme. If a person is found guilty of an offence they are liable on conviction to a fine or to imprisonment for a period not exceeding 60 months. An abusive practice of late involves the falsification or alteration of tax invoices, to purport that a larger amount of VAT was paid for the goods and / or services by the recipient than was actually the case. In many instances the people involved in these schemes are non-vendors who resided in an export country. The falsified tax invoice is presented to the VAT Refund Administrator for a refund prior to the recipient leaving the Republic. This amendment is aimed at curbing this abusive practice. In addition to the present criminal charges, the introduction of sub-section *(f)* enables the Commissioner to issue assessments on non-vendors who have obtained irregular refunds under the VAT Export Incentive Scheme.

CLAUSE 182

Value-Added Tax: Insertion of section 31A and 31B in the Value-Added Tax Act, 1991

The introduction of section 31A is to enable the Commissioner to rectify erroneous assessments.

The introduction of section 31B is to enable the Commissioner to withdraw erroneous assessments.

CLAUSE 183

Value-Added Tax: Amendment of section 32 of the Value-Added Tax Act, 1991

Recently changes have been made to the Income Tax Act No. 58 of 1962, as amended, in relation to the "Rules of tax court" and the "Settlement of disputes". This amendment ensures that these changes are added to the VAT Act, by the deletion of the obsolete wording and to make reference to the provisions contained in the Income Tax Act.

CLAUSE 184

Value-Added Tax: Amendment of section 39 of the Value-Added Tax Act, 1991

Subclause (a): Section 39(4) is re-introduced to levy interest and penalties on the late payment of VAT on goods imported.

Subclause (b): The definition of month is deleted from this section as it is now defined in section 1.

CLAUSE 185

Value-Added Tax: Amendment of section 46 of the Value-Added Tax Act, 1991

The amendment requires that a representative vendor be a natural person who is a resident of the Republic.

CLAUSE 186

Value-Added Tax: Amendment of section 57 of the Value-Added Tax Act, 1991

The amendment is in line with the Electronic Communications and Transactions Act 25 of 2002.

CLAUSE 187

Value-Added Tax: Amendment of section 74 of the Value-Added Tax Act, 1991

This amendment is consequential upon the changes to the Customs and Excise Act. It allows the Minister to amend Schedule No. 1 and the notes thereto in order to align the VAT Act to the provisions of various other Acts pertaining to trade and industry as well as Customs and Excise.

CLAUSE 188

Value-Added Tax: Amendment of Schedule 1 to the Value-Added Tax Act, 1991

The amendment to Item No 490.40/00.00/01.00 of paragraph 8 to Schedule 1 aligns the exemption on importation as a result of the recommendation by the Board of Trade and Industry no longer being required. The Board of Trade and Industry no longer issues permits for the temporary importation of construction plant and machinery and this item of the Schedule is accordingly amended to delete that requirement.

CLAUSE 189

Uncertificated Securities Tax: Amendment of section 1 of the Uncertificated Securities Tax Act, 1998

Subclause (a): This amendment proposes the replacement of the definition of "lending arrangement". The new definition *inter alia* provides for the on-lending of listed securities and requires the borrower to deliver the securities within a 10 business day period after the date of agreement. The borrower is contractually required to compensate the lender for any distributions made in respect of the shares. The lending arrangement is deemed not to be a lending arrangement if the parties do not meet the requirements laid down. This is a textual amendment to clarify uncertainty on lending arrangements.

Subclause (b): The amendment proposes a definition of "person" for the purposes of the Act.

CLAUSE 190

Uncertificated Securities Tax: Amendment of section 6 of the Uncertificated Securities Tax Act, 1998

Subclause (a): This amendment is of a textual nature.

Subclause (b): UST is not payable in respect of a change in beneficial ownership in securities if such beneficial ownership is acquired by a person in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). This exemption was extended in 2002, in line with those applying in respect of marketable securities tax and stamp duty, to an acquisition of beneficial ownership in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of the market value of the asset exchanged for those securities. The proposed changes align the wording of the exemption in respect of unbundling transactions with that applying in respect of company formations, share-for-share and other corporate transactions. It is also proposed that the exemption be extended to the acquisition of beneficial ownership in securities in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules regardless of whether those securities are acquired as capital assets or trading stock. These proposals are in line with those proposed in respect of the equivalent marketable securities tax and stamp duty exemptions - see the notes on *CLAUSE 2 subclause (a)*.

CLAUSE 191

Uncertificated Securities Tax: Insertion of section 11A in the Uncertificated Securities Tax Act, 1998

The UST Act lacks the agency provision that is present in many of the modern tax Acts. The lack of such a provision has impeded the collection of taxes. Such agency appointments (provisions) are usually a last resort attempt to against defaulting taxpayers. The UST Act has not kept pace with the other Acts in combating recalcitrant taxpayers who simply don’t pay their taxes that are due. This amendment inserts a new subsection to achieve this goal. This power to appoint provision roughly mirrors that contained in the VAT Act.

CLAUSE 192

Uncertificated Securities Tax: Amendment of section 13 of the Uncertificated Securities Tax Act, 1998

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 193

Uncertificated Securities Tax: Insertion of section 14A in the Uncertificated Securities Tax Act, 1998

Under current law it is unclear who is responsible for the retention of records and for how long these records need to be kept. The lack of such a provision has impeded the collection of taxes. This amendment aligns the UST Act to provisions that are present in many of the modern tax Acts. The issuer / member (stock broker) / participant will have to retain for a period of five years all records pertaining to the trade in securities traded through that issuer / member (stock broker) / participant business.

CLAUSE 194

Skills Development Levies: Amendment of section 4 of the Skills Development Levies Act, 1999

This amendment is of a textual nature.

CLAUSE 195

Skills Development Levies: Amendment of section 12 of the Skills Development Levies Act, 1999

The amendment proposes that if an employer fails to pay the skills levy timeously and the Commissioner, the chief executive officer of the SETA or its approved body, as the case may be, is satisfied that the employer's failure was due to an intent to postpone or evade his or her obligations under the Act, a penalty of 200 per cent of the outstanding levy may be imposed on the employer. In any other case the penalty is as at present 10 per cent of the unpaid amount.

CLAUSE 196

Income Tax: Amendment of section 21 of the Taxation Laws Amendment Act, 2000

This amendment grants a further year to entities contemplated in section 10(1)*(d)*(iii) or (iv) (e.g. trade unions, chambers of commerce, sport clubs and professional bodies) to apply for exemption under that section. This would enable SARS and National Treasury to finalise the criteria to be applied to qualify for exemption and regulations to be issued in terms of that section.

CLAUSE 197

Customs and Excise: Amendment of section 113 of the Second Revenue Laws Amendment Act, 2001

A number of sections which would have come into operation on a date fixed by the President by proclamation in the Gazette is being repealed or amended. The sections provide for the licensing of wharfs, container terminals and transit sheds and degrouping depots.

The various provisions contemplated controlled movement of imported goods between those licensed premises until delivery after due entry. However, it has been found necessary to introduce licensing requirements for degrouping depots before any of the other activities concerned reached the implementation stage. As the introduction of the licensing requirements on a piecemeal basis could lead to numerous amendments of the existing legislation awaiting implementation, the provisions are repealed in the meantime. Enabling provisions will again be created when the necessary procedures have been fully developed. In consequence the relevant provisions are amended, deleted or repealed.

CLAUSE 198

Customs and Excise: Amendment of section 116 of the Second Revenue Laws Amendment Act, 2001

This section is amended for the reasons stated in *CLAUSE 197.*

CLAUSE 199

Customs and Excise: Repeal of section 117 and 118 of the Second Revenue Laws Amendment Act, 2001

These sections are repealed for the reasons stated in respect of *CLAUSE 197*.

CLAUSE 200

Customs and Excise: Amendment of section 121 of the Second Revenue Laws Amendment Act, 2001

This section which inserted section 21 A in the Customs and Excise Act, 1964, provides for Industrial Development Zones and must come into operation on a date fixed by the President by proclamation in the Gazette.

Section 21A(1)*(a)* is amended to provide for an amendment of the regulations published by the Minister of trade and Industry under section 10(1) of the Manufacturing Development Act, 1993 (Act No. 187 of 1993) published in Government Notice R.1224 of 1 December 2000.

Section 21A(2)*(a)*(i) is amended to provide that the customs secured area (CSA) of an industrial development zone must be deemed to be a special customs and excise warehouse contemplated in section 21, notwithstanding anything to the contrary contained in the Act or a regulation, but subject to the provisions of the section, any Schedule or any exception or adaptation as the Commissioner may prescribe by rule. Greater flexibility in the application of the provisions of section 21 is accordingly created.

In section 21A(1)*(d)* the IDZ enterprise is also made jointly and severally liable for the duty on goods brought into the CSA. Subsections (1)*(d)*(i)*(ee)* and (5)*(e)* are textually amended.

CLAUSE 201

Customs and Excise: Repealed of section 125 of the Second Revenue Laws Amendment Act, 2001

This section is repealed for the reasons stated in respect of *CLAUSE 197.*

CLAUSE 202

Customs and Excise: Amendment of section 135 of the Second Revenue Laws Amendment Act, 2001

This section is repealed. It inserted section 95A, which would have come into operation on a date fixed by the President by proclamation, but a new Chapter XA which provides for internal administrative appeals and alternative dispute resolution is now proposed.

CLAUSE 203

Customs and Excise: Repeal of section 137 of the Second Revenue Laws Amendment Act, 2001

This section is repealed for the reasons stated in respect of *CLAUSE 197*.

CLAUSE 204

Short Title: Amendment of section 190 of the Second Revenue Laws Amendment Act, 2001

Subsection (2) of this section is deleted in view of the repeal of section 125 of the Second Revenue Laws Amendment Act, 2001.

CLAUSE 205

Unemployment Insurance Contributions: Amendment of section 1 of the Unemployment Insurance Contributions Act, 2002

This amendment brings the Contribution Act in line with the amendments to the Unemployment Insurance Act which is currently before Parliament.

CLAUSE 206

Unemployment Insurance Contributions: Amendment of section 4 of the Unemployment Insurance Contributions Act, 2002

This amendment brings the Contribution Act in line with the amendments to the Unemployment Insurance Act which is currently before Parliament.

CLAUSE 207

Unemployment Insurance Contributions: Amendment of section 7 of the Unemployment Insurance Contributions Act, 2002

Employers are required to withhold and pay over UIF. Unfortunately, many scrupulous parties withhold these funds only to expend these funds for their own use, thereby misusing Government proceeds. It is accordingly proposed that disbursing agents and other responsible persons become directly liable if they have direct or indirect authority over withheld funds. International experience reveals that personal liability contributes to reducing misuse of tax and social security funds.

CLAUSE 208

Customs and Excise: Repeal of section 73 of the Taxation Laws Amendment Act, 2002

This section is repealed for the reasons stated in *CLAUSE 197.*

CLAUSE 209

Customs and Excise: Amendment of section 76 of the Taxation Laws Amendment Act, 2002

This section is repealed for the reasons stated in respect of *CLAUSE 197.*

CLAUSE 210

Income Tax: Amendment of section 33 of the Revenue Laws Amendment Act, 2002

Section 38 of the Income Tax Act, 1962, was amended by the Revenue Laws Amendment Act, 2002 and it is proposed that that amendment come into operation when the Collective Investment Schemes Control Act.2002, comes into operation.

CLAUSE 211

Income Tax: Amendment of section 36 of the Revenue Laws Amendment Act, 2002

The substitution of the definition of “intermediate company” in section (1)*(b)* of the Revenue Laws Amendment Act,2002, was incorrect as the definition of a “group of companies had been introduced an it is proposed that that subsection be deleted with effect from 13 December 2002 when it came into operation.

CLAUSE 212

Stamp Duty: Amendment of section 113 of the Revenue Laws Amendment Act, 2002

Section 113 of the Revenue Laws Amendment Act, 2002 extended the stamp duty exemption in respect of the registration of transfer of any marketable security acquired in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). Similar amendments were effected to the equivalent marketable securities tax and uncertificated securities tax exemptions. The proposed amendment aligns the effective date of these amendments.

CLAUSE 213

Uncertificated Securities Tax: Amendment of section 122 of the Revenue Laws Amendment Act, 2002

Section 122 of the Revenue Laws Amendment Act, 2002 extended the uncertificated securities tax exemption in respect of the acquisition of beneficial ownership in any marketable security in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). Similar amendments were effected to the equivalent marketable securities tax and stamp duty exemptions. The proposed amendment aligns the effective date of these amendments.

CLAUSE 214

Customs and Excise: Repeal of section 128 of the Revenue Laws Amendment Act, 2002

This section is repealed for the reasons stated in respect of *CLAUSE 197.*

CLAUSE 215

Income Tax: Amendment of section 1 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003

This amendment is of a textual nature and corrects an incorrect cross reference.

CLAUSE 216

Transitional provisions relating to gold bullion and shares acquired from funds transferred to Republic

Transitional relief is granted to the company holding gold mining shares, whose tax exemption is withdrawn, in order to enable the company to restructure its affairs in a tax neutral manner.

CLAUSE 217

Short title and commencement

This clause provides for the short title of the Bill.