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

It would be appreciated if comments on the draft legislation could be furnished by **Wednesday, 21 September 2005**. Due to time constraints, it will not be possible to respond individually to comments received. However, receipt of comments will be acknowledged and fully considered by the National Treasury and SARS. A further opportunity to comment on the draft legislation will be available when the legislation is before the Parliamentary Committees early in October 2005.

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DRAFT REVENUE LAWS AMENDMENT BILL, 2005

BATCH FOUR

Amendment of section 1 of Act 45 of 1955

1. Section 1 of the Estate Duty Act, 1955, is hereby amended—

(a) by the substitution in subsection (1) for the definition of "fair market value" of the following definition:

"**'fair market value',** means—

(a) the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm's length in an open market; or

(b) in relation to immovable property on which a *bona fide* farming undertaking is being carried on in the Republic, the productive value of that property;"; and

(b) by the insertion in subsection (1) after the definition of "Master" of the following definition:

"**'productive value'** in relation to immovable property on which a *bona fide* farming undertaking is being carried on in the Republic means the amount determined by reducing the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm's length in an open market by 30 per cent;";

(b) by the deletion of subsection (2).

In terms of the definition of "fair market value" in the Estate Duty Act and the Income Tax Act as far as it relates to donations tax and capital gains tax, persons carrying on bona fide farming operations can elect to value their immovable property at its fair market value or fair agricultural or pastoral value.

The Land Bank Act read with the Estate Duty Act provided for the appointment of land bank valuators, the method of determining the agricultural or pastoral value and an appeal process for taxpayers dissatisfied with the valuation to the Land Bank Board. Applications for valuations were to be made with the magistrate of the district in which a property is situated. The Land Bank Act was replaced by the Land and Agricultural Development Bank Act of 2002, which no longer requires the involvement of a magistrate of the district in which a property is situated. From an administrative point of view it has, therefore, become impossible to administer these provisions.

It is proposed that the so called land bank valuation be replaced with the valuation applicable to all other property, namely, the price that could be obtained between a willing buyer and willing seller dealing at arm's length

in an open market but must be reduced by 30 per cent in recognition of the fact that land bank valuation were lower than the fair market value. The reason, therefore, being that the land bank value represented the production value of the property and not the open market value.

Amendment of section 8 of Act 45 of 1955

2. Section 8 of the Estate Duty Act, 1955, is hereby amended by the substitution for subsection (1) of the following subsection:

"(1) If the Commissioner on receipt of any return referred to in section **[*seven*]** 7 —

(*a*) is dissatisfied with any value at which any property **[other than property whereof the fair market value has been determined in accordance with the provisions of subsection (2) of section *one*]** is shown in any such return; or

(*b*) is of the opinion that the amount claimed to represent the dutiable amount as disclosed in the return does not represent the correct dutiable amount,

he or she shall adjust such value or amount and determine the dutiable amount accordingly.".

This amendment is consequential upon the amendment to section 1 above.

Amendment of section 1 of Act 58 of 1962

3. Section 1 of the Income Tax Act, 1962, is hereby amended by the insertion after the definition of **"foreign equity instrument"** of the following definition:

"**'government grant'** means an appropriation, grant in aid, subsidy or contribution, in cash or kind, paid by a department listed in Schedule 1 to the Public Service Act, 1994 (Proclamation No. 103 of 1994), (other than a provincial administration), but does not include any amount paid in respect of the supply of any goods or services to that department;".

Government has introduced a uniform system of dealing with value-added tax on government grants to public entities and private parties. It was announced in the

Budget that the first steps would be taken to introduce a uniform system for income tax.

It is proposed that a definition of "government grant" be introduced and that an enabling provision be introduced which gives the Minister of Finance the power to approve the different government grants as being exempt from tax in terms of a notice in the Gazette if they meet the requirements of the section. The requirements are that the schemes in term of which the grants are paid meet government policy priorities and objectives in defined areas. The Minister must have regard to the financial implications for the Government and whether the tax implications have been taken into account in designing the scheme.

Amendment of section 8B of Act 58 of 1962

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

(a) by the insertion after subsection (2) of the following subsection:

"(2A) If a person acquires any equity share by virtue of any qualifying equity share held by that person, that other equity share so acquired is deemed to be a qualifying equity share which was acquired by that person on the date of grant of the qualifying equity share so held by that person.".

As a result of corporate actions such as unbundling or issue of capitalisation shares additional shares may be acquired by the person because he or she owns qualifying equity shares. It is proposed that they be deemed to have been acquired on the same date as the qualifying equity shares. The effect would be that if they are sold before the period of five years from the date of acquisition of the original qualifying equity they will be subject to tax. It is proposed that they be included in the ambit of the provisions of section 8B as the unbundling or issue of capitalisation shares will reduce the value of the shares held by the taxpayer.

(b) by the substitution in subsection (3) for the definition of "qualifying equity share" of the following definition:

"**'qualifying equity share"** in relation to a person means an equity share acquired in a year of assessment in terms of a broad-based employee share plan, where the market value of all equity shares (as determined on the relevant date of grant of each equity share and excluding the market value of any qualifying equity share acquired in the circumstances contemplated in subsection (2A)), which were acquired by that person in terms of that plan in that year and the two immediately

preceding years of assessment, does not in aggregate exceed R9 000.”.

There is a limit on the value of qualifying equity share that an employee may receive in terms of a broad based employee share plan. It is proposed that the value of shares acquired by an employee as a result of a corporate re-organisation as contemplated in the proposed section 8B(2A) be excluded from the limit.

Amendment of section 8C of Act 58 of 1962

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

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

“(*a*) Notwithstanding section 9B and section 23(*m*), a taxpayer must include in or deduct from his or her income for a year of assessment any gain or loss determined in terms of subsection (2) in respect of the vesting during that year of any equity instrument, if that equity instrument was acquired by that taxpayer—

(i) by virtue of his or her employment or office of director of any company or from any person by arrangement with the taxpayer’s employer; or

(ii) by virtue of any other restricted equity instrument held by that taxpayer in respect of which this section will apply upon vesting thereof.”.

As a result of corporate actions such as unbundling or issue of capitalisation shares, additional equity instruments may be acquired by the person because he or she owns restricted equity instruments. It is proposed that they be included in the ambit of the provisions of section 8C as the unbundling or issue of capitalisation shares will reduce the value of the shares held by the taxpayer.

(b) by the substitution in subsection (2) for item (ii) of subparagraph (a) of the following item:

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

(*aa*)] the amount by which the market value of the equity instrument determined **[on the date on which]** at the time that it vests in that taxpayer exceeds the sum of any consideration in respect of that equity instrument; **[and**

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

As the amount determined in subsection (4)(b) is deemed to be a gain and included in the income of the taxpayer in terms of that subsection it is not necessary to include it in income again in terms of this subsection.

(c) by the substitution for subsection (4) of the following subsection:

"(4)(*a*) If a taxpayer disposes of a restricted equity instrument which was acquired in the manner contemplated in subsection (1) for **[a consideration]** an amount which consists of or includes any other restricted equity instrument which is acquired from the employer, associated institution or other person by arrangement with the employer, that other restricted equity instrument acquired in exchange is deemed to be acquired by that taxpayer by virtue of his or her employment or office of director of any company.

(*b*) If the **[consideration contemplated in subsection (*a*) includes an amount other than restricted equity instruments and that amount exceeds the consideration]** amount received or accrued in respect of the restricted equity instrument which is disposed of as contemplated in paragraph (*a*) includes any payment in a form other than restricted equity instruments, **[the excess]** that payment less any consideration attributable to that payment must be deemed to be a gain or loss which must be included in or deducted from the income of the taxpayer in the year of assessment during which that restricted equity instrument is so disposed of.":

Subsection (4) deals with the situation where an employee exchanges a restricted equity instrument with his employer or associated institution for another restricted equity instrument. This normally happens as a result of some corporate restructuring. A roll-over relief is provided and the new instrument is deemed to have been acquired as a result of employment and is, therefore, taxable.

There are situations where in addition to the exchange of shares the employer pays the employee cash to balance the exchange of instruments. To the extent that the employee receives money he or she has cashed out and the gain made should be taxed. The provisions currently provide that to the extent that the employee receives cash, the full amount is subject to tax. This results in an inequitable situation where the employee is in an overall loss position in relation to the instrument and he or she receives a cash payment which will be fully subject to tax. It is proposed that a portion of the consideration that the employee paid for the original instrument be attributable to the amount which is subject to tax. The employee will be taxed on the cash received less the consideration attributable to the cash received and so the

actual gain will be taxed or the actual loss will be allowed when the amount of cash is received. The gain or loss made on the vesting of the instrument will be taxed when this event occurs.

(d) by the substitution in the definition of "consideration" for paragraph *(b)* of the following paragraph:

"(*b*) by the taxpayer in respect of any other restricted equity instrument which had been disposed of by that taxpayer in exchange for that equity instrument, reduced by any amount **[received or accrued in respect of that disposal which consisted of something other than that equity instrument to the extent that it has not been included in the income of the taxpayer]** attributable to the gain or loss determined in terms of subsection (4)*(b)*; and".

The amendment to this subsection is consequential on the amendment to subsection (4)

Amendment of section 10 of Act 58 of 1962

6. Section 10 of the Income Tax Act, 1962, is hereby amended by the insertion in subsection (1) after paragraph *(x)* of the following paragraph:

"*(y)* any government grant received by or accrued to or in favour of a person which has been approved in terms of the national annual budget process and has been identified by the Minister by notice in the *Gazette* for purposes of this paragraph, having regard to—

(i) whether the purpose of that grant meets government policy priorities and objectives with respect to—

(aa) the encouragement of economic growth and investment;

(bb) the promotion of employment creation;

(cc) the development of public infrastructure and transport;

(dd) the promotion of public health;

(ee) the development of innovation and technology;

(ff) the provision of housing and basic services; or

(gg) the provision of relief in the case of natural disasters;

(ii) the financial implications for government should the government grant be exempt from tax; and

(iii) whether the tax implications were taken into account in determining the amount of the grant;".

Government has introduced a uniform system of dealing with value-added tax on government grants to public entities and private parties. It was announced in the Budget that the first steps would be taken to introduce a uniform system for income tax.

It is proposed that a definition of "government grant" be introduced and that an enabling provision be introduced which gives the Minister of Finance the power to approve the different government grants as being exempt from tax in terms of a notice in the Gazette if they meet the requirements of the section. The requirements are that the grants paid must meet government policy priorities and objectives in defined areas. The Minister must have regard to the financial implications for the Government and whether the tax implications have been taken into account in determining the amount of the grant.

Amendment of section 15 of Act 58 of 1962

7. Section 15 of the Income Tax Act, 1962, is hereby amended by the substitution for paragraph *(a)* of the following paragraph:

"*(a)* an amount to be ascertained under the provisions of section 36, in lieu of the allowances in section 11(*e*), (*f*), (*g*A), (*g*C) and (*o*);".

This amendment is consequential upon the introduction of section 11(gC) in 2003.

Amendment of section 23 of Act 58 of 1962

8. Section 23 of the Income Tax Act, 1962, is hereby amended by the addition of the following paragraph:

"*(o)* any expenditure incurred—

(i) where the payment of that expenditure or undertaking to make that payment constitutes an activity contemplated in Chapter 2 of the Prevention and Combating of Corrupt Activities Act (Act No. 12 of 2004); or

(ii) which constitutes a fine charged or penalty imposed as a result of an unlawful activity carried out in the Republic or in any other country if that activity would be unlawful had it been carried out in the Republic.”.

Currently, tax legislation does not specifically address the deductibility of bribes, fines or penalties. As announced in the Budget, the tax treatment of bribes should be addressed as a matter of good governance and to reinforce South Africa's anti-corruption drive. From a policy perspective the deduction of fines and penalties for tax purposes cannot be justified where those payments relate to unlawful activities. The granting of a deduction for fines and penalties would reduce the burden of the penalty or fine and be contrary to the rationale of the law in terms of which it is imposed. It is proposed that a payment should not be deductible for tax purposes if:

- *the payment or undertaking to make that payment constitutes an activity contemplated in Chapter 2 of the Prevention and Combating of Corrupt Activities Act, 2004; or*
- *the payment is a fine charged or penalty levied as a result of carrying out an unlawful activity in the Republic or in another country where the activity would be unlawful if it was carried out in the Republic.*

Amendment of section 23D of Act 58 of 1962

9. Section 23D of the Income Tax Act, 1962, is hereby amended—

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

“*(a*A*)* any invention, patent, design, trade mark, copyright, or any other property which is of a similar nature, contemplated in section 11*(g*A*)* or 11*(g*C*)*;”;

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

“and a deduction was previously granted to such lessee, such connected person or such sublessee under section 11(*e*), 11(*g*A), 11*(g*C*)*, 12B, 12C, 13, 14 or 14*bis* or section 12 prior to the repeal thereof by section 16 of the Income Tax Act, 1991 (Act No. 129 of 1991), or section 27(2)(*d*) prior to the

deletion thereof by section 28(*b*) of that Act, whether in the current or any previous year of assessment, any deduction or allowance claimed by such lessor in respect of such asset in terms of section 11(*e*), (*g*A), (*g*C) or (*o*), 12C, 13, 14 or 14*bis* shall be calculated on an amount not exceeding the lesser of the cost or adjustable cost, as the case may be, of such asset to such lessee, such connected person or such sublessee or the market value thereof as determined on the date upon which the asset was acquired by the taxpayer.”.

This amendment is consequential upon the introduction of section 11(gC) in 2003.

Amendment of section 23G of Act 58 of 1962

10. Section 23G of the Income Tax Act, 1962, is hereby amended by the substitution in subsection (2) for paragraph *(b)* of the following paragraph:

“such lessor shall, notwithstanding the provisions of this Act, not be entitled to any deduction in terms of section 11(*e*), (*f*) or (*g*A), (*g*C), 12B, 12C or 13 in respect of an asset which is the subject matter of such sale and leaseback arrangement.”.

This amendment is consequential upon the introduction of section 11(gC) in 2003.

Amendment of section 24F of Act 58 of 1962

11. Section 24F of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution for the heading of the following heading:

“**Allowance in respect of films**”;

The heading of the section is amended to more accurately reflect the purpose of the section, which is the granting of a film allowance.

(b) by the substitution in subsection (1) for the definition of “completion date” of the following definition:

“‘completion date’, in relation to—

(a) the production of a film, means the date on which **[the cut master negative and conforming sound track of the film are married in an answer print, or, where such film is not a cinematographic film, the date on which the film is completed to an equivalent production stage]** it is first in a form in which it can be regarded as ready for copies of it to be made and distributed, for presentation to the general public; or

(b) the acquisition of a film, means the date it was acquired;"

(c) by the deletion in subsection (1) of the definitions of "export", "export country", "film manufacturer", "marketing expenditure" and "South African export film";

(d) by the addition in subsection (1) of the following proviso to the definition of "production cost":

"Provided that where a film owner acquired the film directly or indirectly from a connected person the total expenditure incurred by the film owner in respect of the acquisition of the film must be limited to the total expenditure incurred by the connected person in respect of the acquisition or production cost for the production of the film;";

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

"*(a)* There must be allowed as a deduction from the income of any film owner—

(i) the total amount of all production costs or post-production costs actually incurred by that film owner in connection with any film used by that film owner in the production of income, if at least 75 per cent of the total amount of those production costs and post-production costs is incurred and paid or payable in the Republic in respect of services rendered or goods supplied in the Republic; or

(ii) in any other case, so much of any production costs or post-production costs actually incurred by that film owner in the Republic in connection with any film used by that film owner in the production of income, as is or will be paid by that film owner

in the Republic in respect of services rendered or goods supplied in the Republic.";

(*b*) The film allowance which may be granted in respect of any film **[shall]** may not in the aggregate exceed the production cost and post-production cost thereof and shall be in lieu of any deduction or allowance in respect of such production cost or postproduction cost which may otherwise be allowable in terms of the provisions of this Act.";

(f) by the substitution in subsection (3) for the words preceding paragraph *(a)* of the following words:

"(3) Subject to the provisions of subsection (4), the amount of the film allowance which may be granted in respect of any one film **[shall be]** is the sum of—";

(g) by the substitution in subsection (4) for the words preceding paragraph *(a)* and paragraph *(a)* of the following words and paragraph:

"(4) The film allowance which may be granted in respect of any one film in any year of assessment **[shall]** must, together with the total film allowances granted in respect of that film in any preceding years of assessment, not exceed the sum of—

(*a*) the amounts of production cost and post-production cost in respect of the film which have been paid by the film owner: Provided that where any loan or credit has been used by **[him]** the film owner for the payment or financing of the whole or any portion of such production cost or post-production cost and any portion of such loan or credit is owed by **[him]** the film owner on the last day of the year of assessment, the amount which may be taken into account under this paragraph **[shall]** must be reduced by any portion of such loan or credit so owed by **[him]** the film owner for which the film owner is not under the provisions of subsection (8) deemed to be at risk on the last day of the year of assessment; and";

The amendments to subsections (3) and (4) are of a textual nature.

(h) by the insertion of the following subsection after subsection (4):

"(5) An amount incurred in respect of production or post-production costs of a film shall not be allowed as a deduction in terms of this section unless there is a binding, unconditional obligation to pay that amount within a period of 18 months from the completion date of that film.";

(i) by the deletion of subsection (7); and

(j) by the substitution for subsection (8) of the following subsection:

"(8) For the purposes of **[subsections]** subsection (4) **[and (7)]**, a film owner shall be deemed to be at risk to the extent that the payment of the production cost or post-production cost**[, print cost or marketing expenditure]** incurred by **[him]** the film owner, or the repayment of any loan or credit used by **[him]** the film owner for the payment or financing of any such production cost or post-production cost**[, print cost or marketing expenditure,]** would (having regard to any transaction, agreement, arrangement, understanding or scheme entered into before or after such production cost or post-production cost**[, print cost or marketing expenditure]** is incurred) result in an economic loss to **[him]** the film owner were no income to be received by or accrue to **[him]** the film owner in future years from the exploitation by **[him]** the film owner of the film: Provided that where the full amount of the loan or credit is not repayable within a period of ten years from the completion date, the film owner is deemed not to be at risk for purposes of this section to the extent the loan or credit is not repayable within a period of ten years from the completion date of the film.".

Section 24F (which deals with film allowances) was introduced in 1987 to provide special rules to determine the amount and timing of deductions allowable to film owners for tax purposes.

The film industry is an important industry and has shown great potential and growth over the last few years. The film industry, however, also presents difficulties from a tax point of view as it has been the worldwide experience of revenue authorities that special allowances and other tax incentives have been the subject of abuse by promoters and investors in films. This was the South African experience in the 1980s and a tendency in that direction is now being experienced again.

Bearing in mind the need to balance the above considerations the following limited interventions are proposed:

- ***In order to encourage the production of South African films, the film allowance will be targeted at expenses incurred and paid/payable in South Africa***

The provisions of the current film allowance do not draw a distinction between foreign and locally produced films. This means that local film owners may benefit from the film allowance for films produced outside South Africa. As was announced in the 2005 Budget Review the tax incentives for films must be refined to achieve their intended goal. The view is held that South African tax expenditure in the form of the film allowance should be focused on South African film productions in order to grow and support the local film industry.

It is, therefore, proposed that the production and post-production costs which may be allowed to a film owner who is using a film in the production of income be limited to expenditure incurred and paid or payable in South Africa to persons who are subject to tax in the Republic on the amount of those costs. In order to allow for co-productions and the use of foreign talent and expertise the total amount of all production costs or post-production costs actually incurred in connection with a film may be deductible if at least 75 per cent of the total amount of those production costs and post-production costs is incurred and paid or payable in the Republic to persons who are subject to tax in the Republic on those amounts.

- ***Address the artificial increase of the cost of the acquisition of films from connected persons***

Currently the cost of acquisition of a film is included under the definition of "production cost" and qualifies for the accelerated write-off under section 24F. It has become clear that this allowance is used by some persons who are involved in transactions with connected persons to artificially increase the value claimed for tax purposes. In order to limit the potential for abuse of the film allowance it is proposed that the acquisition cost of a film acquired directly or indirectly from a connected person be limited to the cost of acquisition of the film by the connected person or the production cost incurred by the connected person in producing the film.

- ***Introduction of a time limit on the payment of production and post-production costs***

There is currently no time limit to the period during which the expenditure in respect of production or post-production costs of a film needs to be paid to qualify for an allowance in terms of section 24F. The intention is not to provide a film allowance for expenditure which constitutes a disguised distribution of profit or deferred expenditure. It is proposed that production or post-production expenditure only be allowed as a deduction under section 24F where a binding, unconditional obligation exists to pay the amount of the expenditure within a period of 18 months from the completion date of the film.

- ***Treat film owners not to be at risk for loans and credit not payable within 10 years from date of completion of a film***

The effect of the accelerated allowance in terms of section 24F is that a film owner gets the benefit of a tax deduction before the related income from the exploitation of the film is taxed. In order to limit the deduction of expenditure to closer reflect the economic cost to film owners the concept of an at risk rule was introduced.

It has become clear that in a limited number of cases film owners are extending the period within which a loan or credit which is used to finance production or post-production costs of a film is repayable for as long as possible. This has the effect of creating an unacceptable long period between the tax year the expenditure is deducted and the date of settlement of the loan or credit. Internationally limits are imposed in different forms on the tax deferral by investors in films. In New Zealand a deferred deduction is achieved with reference to the concept of a limited recourse loan, which is a loan where the borrower is not required to make repayments for at least 10 years. Before a new tax credit system for the film industry was introduced in Canada in 1995, deductible cost was limited for film tax shelter investments financed by way of limited-recourse debt. One of the criteria for determining limited-recourse debt was whether the debt and interest thereon would be repayable within 10 years. A proposed limitation of expenditure incurred on films in the United Kingdom applies where guaranteed income in respect of a film will arise more than 15 years after the agreement was entered into.

Although the bulk of the income from a film should be generated during the first five years after completion date and logically most of the expenditure incurred to produce the film should be settled within that five year period, internationally a longer period is allowed for tax purposes. It is proposed that the film owner be treated not to be at risk for purposes of the film allowance to the extent a loan or credit used to finance production or post-production cost is not repayable within a period of 10 years from the completion date of the film.

- ***Review of other definitions used in section 24F***

The current definition of "completion date" was introduced in 1987 and does not specifically deal with films other than cinematographic films or with the acquisition of a film. It is proposed that a generic definition of "completion date" be introduced which defines completion date with reference to the stage when a film can be copied for distribution to the general public. In the case of the acquisition of a film the completion date is the date of acquisition thereof.

The definitions of "export", "export country", "film manufacturer", "marketing expenditure" and "South African export film"; which have become obsolete are deleted. These definitions were introduced at the time the exporter's allowance in terms of the now repealed section 11bis was granted in addition to the general deduction of expenditure.

The proposed deletion of section 24F(7) is consequential upon the deletion of the definition of "marketing expenditure" and will grant relief in respect of printing costs. The deletion of this subsection will have the effect that the provisions of the Income Tax Act, other than section 24F, will apply to printing costs in relation to a film and that marketing expenditure will no longer be subject to the at risk rule.

Amendment of section 24I of Act 58 of 1962

12. Section 24I of the Income Tax Act, 1962, is hereby amended by the substitution in subsection (7) for subparagraph (ii) of paragraph *(a)* of the following subparagraph:

"(ii) the devising, developing, creation, production, acquisition or restoration of any invention, patent, design, trade mark, copyright or other similar property or knowledge contemplated in section 11(*g*A) or *(g*C*)*, as the case may be;".

This amendment is consequential upon the introduction of section 11(gC) in 2003.

Amendment of section 35A of Act 58 of 1962

13. (1) Section 35A of the Income Tax Act, 1962, is hereby amended by the substitution for subsection (10) of the following subsection:

"(10)*(a)* The Commissioner may having regard to the circumstances of the case remit the whole or any part of the penalty imposed under subsection (9)*(b)*.

(b) Any decision by the Commissioner under paragraph *(a)* shall be subject to objection and appeal.".

(2) Subsection (1) shall come into operation on the date that section 35A of the Income Tax Act, 1962, comes into operation.

Section 35A was introduced in 2004 to provide for a withholding tax on foreign sellers of immoveable property in the Republic. This section will only come into operation on a date to be fixed by the President by proclamation in the Gazette. Section 35A, however, does not allow a taxpayer to objection and appeal against any decision by the Commissioner not to remit any penalty imposed in terms of this section if the tax was not paid within the prescribed period. It is, therefore, proposed that a provision be inserted to allow objection and appeal.

Amendment of section 44 of Act 58 of 1962

14. Section 44 of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution for subsection (6) of the following subsection:

"(6)*(a)* Subject to subsection (7), this subsection applies where a person—

(i) disposes of any equity share in an amalgamated company in return for equity shares in the resultant company as part of an amalgamation transaction in respect of which subsection (2) or

(3) applied, which equity shares in the resultant company are acquired—

(*aa*) either as capital assets or trading stock, in the case where that share in the amalgamated company is disposed of as a capital asset; or

(*bb*) trading stock in the case where that share in the amalgamated company is disposed of as trading stock; and

(ii) at the end of the day during which that disposal is effected, holds a qualifying interest in that resultant company.

(b) The person contemplated in paragraph *(a)* is deemed to have—

(i) disposed of the equity share in that amalgamated company for an amount equal to the expenditure incurred by that person in respect of that equity share which is or was allowable in terms of paragraph 20 of the Eighth Schedule or taken into account in terms of section 11(*a*) or 22(1) or (2), as the case may be;

(ii) acquired the equity shares in the resultant company on the date on which that person acquired the equity share in the amalgamated company for a cost equal to the expenditure incurred by that person as contemplated in subparagraph (i); and

(iii) to have incurred the cost contemplated in subparagraph (ii) on the date on which that person incurred the expenditure in respect of the equity share in the amalgamated company, which cost must be treated as—

(aa) an expenditure actually incurred and paid by that person in respect of those equity shares for the purposes of paragraph 20 of the Eighth Schedule, if those equity shares in the resultant company are acquired as capital assets; or

(bb) the amount to be taken into account by that person in respect of those equity shares for the purposes of section 11(*a*) or 22(1) or (2), if those equity shares in the resultant company are acquired as trading stock.

(c) Any valuation of the equity share in the amalgamated company which was done by the person contemplated in paragraph *(a)* within the period contemplated in paragraph 29(4) of the Eighth Schedule, is deemed to have been done by that person in respect of the equity shares in the resultant company.".

Currently, where an amalgamation transaction is entered into, roll-over relief is provided to the shareholder of the amalgamated company for shares in a amalgamated company which are disposed of in return for shares in the company which acquires all the assets of the amalgamated company. This relief is only available where the market value of the shares in the amalgamated company exceeds the tax value of the shares in the hands of the shareholder.

This limitation does not serve to protect the tax base as an amalgamation transaction does not result in the potential duplication of losses as in the case of a company formation transaction. The company formation transactions exclude the roll-over of unrealised loss assets in order to prevent the creation of an unrealised loss in the shares acquired in the formation company by the person who transferred the unrealised loss assets.

It is, therefore, proposed that these provisions be reworded to allow the roll-over to apply to the shares held by the shareholder of the amalgamated company irrespective of whether the market value of the shares exceeds the tax value of the shares or not.

Amendment of section 55 of Act 58 of 1962

15. Section 55 of the Income Tax Act, 1962, is hereby amended—

(a) by the substitution in subsection (1) for the definition of "fair market value" of the following definition:

"**'fair market value',** means—

(a) the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm's length in an open market; or

(b) in relation to immovable property on which a *bona fide* farming undertaking is being carried on in the Republic, the productive value of that property;"; and

(b) by the insertion in subsection (1) after the definition of "property" of the following definition:

"**'productive value'** in relation to immovable property on which a *bona fide* farming undertaking is being carried on in the

Republic means the amount determined by reducing the price which could be obtained upon a sale of the property between a willing buyer and a willing seller dealing at arm's length in an open market by 30 per cent;";

(b) by the deletion of subsection (2).

In terms of the definition of "fair market value" in the Estate Duty Act and the Income Tax Act as far as it relates to donations tax and capital gains tax, persons carrying on bona fide farming operations can elect to value their immovable property at its fair market value or fair agricultural or pastoral value.

The Land Bank Act read with the Estate Duty Act provided for the appointment of land bank valuators, the method of determining the agricultural or pastoral value and an appeal process for taxpayers dissatisfied with the valuation to the Land Bank Board. Applications for valuations were to be made with the magistrate of the district in which a property is situated. The Land Bank Act was replaced by the Land and Agricultural Development Bank Act of 2002, which no longer requires the involvement of a magistrate of the district in which a property is situated. From an administrative point of view it has, therefore, become impossible to administer these provisions.

It is proposed that the so called land bank valuation be replaced with the valuation applicable to all other property, namely, the price that could be obtained between a willing buyer and willing seller dealing at arm's length in an open market but must be reduced by 30 per cent in recognition of the fact that land bank valuation were lower than the fair market value. The reason for the lower value being that the land bank value represented the production value of the property and not the open market value.

Amendment of section 62 of Act 58 of 1962

16. Section 62 of the Income Tax Act, 1962, is hereby amended by the substitution for subsection (4) of the following subsection:

"(4) If the Commissioner is of the opinion that the amount shown in any return as the fair market value of any property **[other than property whereof the fair market value has been determined in accordance with the provisions of subsection (2) of section *fifty-five*,]** is less than the fair market value of **[such]** that property, he or she may fix the fair market value of that property, and the value so fixed **[shall]** is, subject to the provisions of section **[*sixty-three*]** 63, **[be]** deemed for the purposes of this Part to be the fair market value of such property.".

Consequential upon the amendment in clause 15.

Amendment of section 64C of Act 58 of 1962

17. Section 64C of the Income Tax Act, 1962, is hereby amended—

(a) by the deletion in subsection (2) of the word "or" at the end of paragraphs *(f)* and *(g)* and the addition of the word "or" at the end of paragraph *(h)*;

(b) by the addition to subsection (2) of the following paragraph:

"*(i)* any share is distributed by that company to or for the benefit of that shareholder or any connected person in relation to that shareholder, if—

(i) that share was acquired by that company (or any other company in the same group of companies as that company) in exchange for the disposal by that company (or any other company in that group) of any interest in equity share capital of a foreign company; and

(ii) the capital gain determined in respect of the disposal of that interest was disregarded in terms of paragraph 64B of the Eighth Schedule;";

(b) by the substitution in subsection (4) for the words in paragraph *(c)* preceding the proviso of the following words:

"*(c)* to so much of any amount (other than an amount contemplated in subsection (2)*(e)* or *(i)*) as exceeds the company's profits and reserves which are available for distribution, including any amount deemed in terms of the definition of 'dividend' in section 1 to be a profit available for distribution:";

(c) by the insertion in subsection (4) after paragraph *(c)* of the following paragraph:

"*(c*A*)* to so much of the value of the share distributed as contemplated in subsection (2)*(i)*, as exceeds the amount of the capital gain which was disregarded as contemplated in subsection (2)*(i)*(ii);".

Residents and controlled foreign companies are able to benefit from a participation exemption on the sale of interests in the equity share capital of foreign companies. This means any capital gain or capital loss on disposal of those interests is disregarded. The exemption was introduced on the assumption that consideration would accrue to the resident or controlled foreign company. However, it has become clear that it would be possible for taxpayers to benefit from the participation exemption and subsequently distribute the consideration received (in the form of shares) to shareholders on a tax free basis. This is contrary to the purpose for which the participation exemption was introduced.

It is proposed that the gain disregarded as a result of the participation exemption be treated as a deemed dividend for STC purposes where a share was acquired by a company in exchange for the disposal by that company of any interest in equity share capital of a foreign company and the share is distributed by that company.

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

18. Paragraph 20 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in subparagraph (1) for subitem (ix) of item *(c)* of the following subitem:

"(ix) if that asset was acquired or disposed of by the exercise of an option or an equity instrument contemplated in section 8C which constitutes an option (other than the exercise of an option contemplated in item *(f)*), the expenditure actually incurred in respect of the acquisition of **[the]** that option, including expenditure contemplated in item *(h)*(i);".

Paragraph 20 contains the rules for determining the base cost of an asset for capital gains tax purposes. Item (c)(ix) provides that when an asset is acquired or disposed of by the exercise of an option acquired after valuation date, the expenditure incurred in respect of the acquisition of the option must be included in the base cost of that asset.

As a result of the introduction of section 8C, gains on equity instruments (options), as contemplated in that section, will in certain circumstances be subject to tax as income. When the option is exercised it terminates and is replaced by the contract of sale and In terms of paragraph 58 of the Eighth Schedule any capital gain or loss made as a result of that termination must be disregarded.

The effect of these provisions is that gains on the vesting of options will be taxed as income in terms of 8C without an increase in the base cost of the shares being allowed for capital gains tax purposes. This will result in double taxation. It is proposed that the gains on options that are taxed as income be allowed as part of the base cost for capital gains tax purposes.

Amendment of paragraph 38 of the Eighth Schedule to Act 58 of 1962

19. Paragraph 38 of the Eighth Schedule to the Income Tax Act, 1962, is hereby amended by the substitution in subparagraph (2) for item *(d)* of the following item:

"*(d)* an equity instrument contemplated in section 8C **[in respect of which that section applies and which]** to an employee or a director, where that equity instrument had not yet vested as contemplated in that section, in that employee or director at the time of that disposal; or".

Paragraph 38 provides that where an asset is disposed of by way of a donation, for a consideration not measurable in money or to a connected person for a consideration which is not at arm's length, the transaction is deemed to have taken place at market value. Certain transactions are excluded from the provisions of the paragraph to prevent the imposition of both CGT and tax on income.

There is concern that exclusion of transactions relating to share options is not specific enough and that they may be subject to double tax.

It is proposed that the wording be amended to make the exclusion more specific.

Amendment of section 1 of Act 38 of 1996

20. Section 1 of the Tax on Retirement Funds Act, 1996, is hereby amended by the substitution in the definition of "rental income" for paragraph *(d)* of the following paragraph:

"*(d)* any consideration payable by a borrower to the lender in respect of any "lending arrangement" as defined in section **[23 (1) of the Stamp Duties Act, 1968 (Act No. 77 of 1968)]**1 of the Uncertificated Securities Tax Act, 1998 (Act No. 31 of 1998), as consideration for the use of any **[marketable]** security, in so far as such amount is not included in paragraph *(a)* of the definition of "interest";

This amendment is consequential upon the substitution of the definition of "lending arrangement" in the Uncertificated Securities Tax Act in 2003.