REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

TAXATION LAWS AMENDMENT BILL, 2005

[W.P. 1 —'05]

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INTRODUCTION

The Taxation Laws Amendment Bill, 2005, introduces amendments to the Transfer Duty Act, 1949, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Uncertificated Securities Tax Act, 1998, the Skills Development Act, 1999, the Value-Added Tax Act, 1991, and the Taxation Laws Amendment Act, 2004.

CLAUSE 1

Transfer duty: Amendment of section 2 of the Transfer Duty Act, 1949

Transfer duty is levied in terms of section 2 of the Transfer Duty Act on the acquisition of fixed property in South Africa. Currently, the rates for property acquired by natural persons are—

- 0% on the first R150 000 of the value of the property;
- 5% on the value between R150 001 up to R320 000; and
- 8% on the value above 320 000.

Given the steep increases in property prices during the last few years, the Minister of Finance has proposed that the exempt (zero-rated) threshold for transfer duty be increased to R190 000 and that the second threshold up to where the 5% rate applies be increased to R330 000. The new graduated rate structure will be as follows:

- 0% on the first R190 000 of the value of the property;
- 5% on values between R190 001 up to R330 000; and
- 8% on values above R330 000.

The new rate structure will apply in respect of acquisitions of property on or after 1 March 2005.

CLAUSE 2

Fixing of rates of normal tax

Income Tax: Rates of normal tax

Rates of normal tax payable by all persons are enacted by *clause 2* and Schedule 1 to the Bill.

Persons other than companies

The rates for persons (other than companies) apply in respect of the year of assessment ending on 28 February 2006 and are provided for in paragraph 1 of Schedule 1. More specifically, the rates for—

- persons (other than companies) and special trusts are provided for in paragraph 1*(a)* of Schedule 1; and

- trusts (other than special trusts) are provided for in paragraph 1*(b)* of Schedule 1.

The rates for paragraph 1*(a)* persons consist of a progressive rate structure ranging between 18 per cent on the lowest portion of taxable income (amounts up to R80 000) and 40 per cent which is reached on the portion of taxable income above R300 000. The rates for paragraph 1*(b)* persons are fixed at a single rate of 40 per cent on all taxable income.

Companies

The rates for companies apply in respect of years of assessment, i.e. the financial year of the company concerned, ending during the 12-month period from 1 April 2005 to 31 March 2006, and are provided for in paragraphs 2*(a)* to *(h)* inclusive, of Schedule 1.

Those rates are as follows:

(a) Taxable income derived otherwise than—
  (i) by a small business corporation or an employment company;
  (ii) from gold mining;
  (iii) from long-term insurance business;
  (iv) by a non-resident through a branch or agency in the Republic; or
  (v) by a qualifying company enjoying tax holiday status:
  29 cents per R1. However, in the case of a company which mines for gold and which is exempt from secondary tax on companies in terms of an option exercised by it, 37 cents per R1 of its non-gold mining taxable income (paragraph 2*(a)* of Schedule 1).

(b) Taxable income derived by a company which qualifies as a small business corporation as defined in section 12E:
  (i) 0 cents in respect of taxable income up to R35 000
  (ii) 10 cents per R1 of taxable income exceeding R35 000, but up to R250 000, and
  (iii) 29 cents per R1 of taxable income exceeding R250 000
  (paragraph 2*(b)* of Schedule 1).

(c) Taxable income derived by an employment company as defined in section 12E: 34 cents per R1 of taxable income (paragraph 2*(c)* of Schedule 1).

(d) Taxable income derived by a company from gold mining: an amount determined in accordance with one of the following formulae—

  (i) where such company is not exempt from secondary tax on companies:

$$y = 35 - \frac{175}{x} \text{ ; or}$$

(ii) where such company is exempt from secondary tax on companies:

$$y = 45 - \frac{225}{x},$$

as provided for in paragraph 2*(d)* of Schedule 1.

(e) Taxable income in the form of "recoupments" of capital expenditure accruing to companies which are or have been gold mining companies: the average rate of tax, determined as provided, or 29 cents per R1, whichever is the higher (paragraph 2*(e)* of Schedule 1).

(f) Taxable income derived from long-term insurance business:
(i) 30 cents per R1 in respect of the insurer's individual policyholder fund; and
(ii) 29 cents per R1 in respect of the insurer's its company policyholder fund and corporate fund
(paragraph 2*(f)* of Schedule 1).

(g) Taxable income (excluding from gold mining, long-term insurance business, or a qualifying project enjoying tax holiday status, or derived by a small business corporation or an employment company) derived by a non-resident which carries on trade through a branch or an agency within the Republic: 34 cents per R1 (paragraph 2*(g)* of Schedule 1).

Example 1:

Facts. Company is incorporated in South Africa but maintains its place of effective management in Foreign Country. Company generates R100 000 of taxable income through a retail sales branch located in South Africa. No treaty for the avoidance of double taxation exists between South Africa and Foreign Country.

Result. Even though Company maintains its effective place of management outside South Africa, the 34 per cent rate described in paragraph 2*(g)* does not apply to the R100 000 of taxable income because Company is a South African resident for income tax purposes by virtue of its South African incorporation.

Example 2:

Facts. The facts are the same as Example 1, except that South Africa and Foreign Country have entered into a treaty for the avoidance of double taxation. The treaty determines the residence of a company based on the location of that company's place of effective management.

Result. Company does not qualify as a South Africa resident for income tax purposes because the treaty views Company as a resident of Foreign Country. The 34 per cent rate described in paragraph 2*(g)* applies to the R100 000 of taxable income because Company is a non-resident for income tax purposes and that income is derived through a South African branch.

(h) Taxable income derived by a qualifying company which has been granted tax holiday status in terms of section 37H of the Income Tax Act, 1962: zero cents per R1 (paragraph 2*(h)* of Schedule 1).

For purposes of paragraph 2 of Schedule 1, income derived from mining for gold shall include any income derived from silver, osmiridium, uranium, pyrites or other minerals which may be won in the course of mining for gold, and any other income which results directly from mining for gold.

CLAUSE 3

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

This clause increases the primary rebate from R5 800 to R6 300 and the secondary rebate for persons 65 years and older from R3 200 to R4 500. These changes mean that the tax threshold for individuals under age 65 is increased to R35 000 and for individuals at least 65 years of age is increased to R60 000.

CLAUSE 4

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

Section 8 of the Income Tax Act, 1962, determines the taxable portion of an allowance or advance paid by a principal to a recipient. This taxable portion, however, does not include any allowance or advance to the extent that it was actually expended by the recipient on *inter alia* traveling on business. Section 8 contains a deeming provision relating to the distance traveled by a taxpayer to avoid the need to maintain exact details of business travel in the form of a logbook. In terms of this deeming provision the first 14 000 kilometres traveled by a person in a year is deemed to be private travel and it is only the kilometres in excess of the 14 000 (but limited to a total of 32 000 kilometres) that are deemed to constitute business travel. The rate per kilometre applied to determine the amount expended on business travel is based on a cost table fixed by the Minister in respect of different categories of vehicles.

The deduction of deemed business expenses against a motor vehicle allowance has increased substantially over the years. As mentioned by the Minister of Finance in his Budget Review this year, this generous allowance in the current formula creates an unfair bias in the structuring of salary packages with undue benefits accruing especially to higher income earners. As part of the package of reform in this area, the Minister proposed that the deemed private kilometers be increased from 14 000 to 16 000 and this amendment gives effect to that proposal.

CLAUSE 5

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

The interest and dividend exemption is currently fixed at R11 000 for taxpayers under 65 years of age and R16 000 for taxpayers aged 65 years and older. The Minister of Finance proposed in his Budget Review this year that the interest and dividend income exemption be raised with effect from 1 March 2005 to R15 000 for taxpayers under the age of 65 and to R22 000 for taxpayers age 65 and over. Up to R1 000 of

this exemption may currently be applied to interest and dividends from foreign sources and the balance applies in respect of domestic interest. The Minister further proposed that this amount be increased to R2 000.

CLAUSE 6

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

As was mentioned in the Budget Review this year, it has come to Government's attention that certain taxpayers are attempting to rely on a hyper-technical argument to claim depreciation on certain assets, even though the taxpayer is not the owner. This argument is inconsistent with generally accepted and longstanding interpretation. An amendment is proposed to place beyond doubt that taxpayers claiming the depreciation allowance must be the owner. This amendment gives effect to this proposal.

A further amendment is proposed to exclude assets from the application of section 11*(e)* if those assets qualify for a deduction under section 12E. This amendment is consequential upon the proposal to allow a 50:30:20 depreciation allowance on depreciable assets of a small business corporation.

CLAUSE 7

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

As was mentioned in the Budget Review this year, it has come to Government's attention that certain taxpayers are attempting to rely on a hyper-technical argument to claim depreciation on certain assets, even though the taxpayer is not the owner. This argument is inconsistent with generally accepted and longstanding interpretation. An amendment is proposed to place beyond doubt that taxpayers claiming the depreciation allowance must be the owner. This amendment gives effect to this proposal.

A further amendment is proposed to exclude assets from the application of section 11*(e)* if those assets qualify for a deduction under section 12E. This amendment is consequential upon the proposal to allow a 50:30:20 depreciation allowance on depreciable assets of a small business corporation.

CLAUSE 8

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

As was mentioned in the Budget Review this year, it has come to Government's attention that certain taxpayers are attempting to rely on a hyper-technical argument to claim depreciation on certain assets, even though the taxpayer is not the owner. This argument is inconsistent with generally accepted and longstanding interpretation. An amendment is proposed to place beyond doubt that taxpayers claiming the depreciation allowance must be the owner. This amendment gives effect to this proposal.

A further amendment is proposed to exclude assets from the application of section 11*(e)* if those assets qualify for a deduction under section 12E. This amendment is

consequential upon the proposal to allow a 50:30:20 depreciation allowance on depreciable assets of a small business corporation.

CLAUSE 9

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

Currently, small business corporations enjoy certain tax benefits, i.e. a beneficial rate structure and an immediate 100 per cent write off in respect of manufacturing assets. A small business corporation is defined in section 12E of the Income Tax Act, 1962, to mean a company or a close corporation where—

- the gross income for the relevant year of assessment does not exceed R5 million;
- the shareholders do not hold any share or interest in another company (with the exception of certain holdings in listed companies, collective investment schemes, etc.); and
- not more than 20 per cent of the total receipts and accruals of the company or close corporation consists of investment income and income from rendering a personal service.

Personal service includes the rendering of certain services listed in section 12E which are performed personally by a person who holds an interest in the company or close corporation (i.e. a shareholder or member).

The Minister of Finance announced in his Budget Review this year that the categories of companies that should qualify for the small business relief will be greatly expanded to also cover the services sector in recognition of their prominence as an engine of growth within the wider small business sector. Small business corporations which are primarily engaged in the provision of personal services will now become eligible for the relief if the company or close corporation maintains at least four full-time employees for the core operations of the business. Furthermore, the turnover limit for small business corporations will also be increased from R5 million to R6 million.

In addition to other tax relief proposed in the 2005 Budget, such as extending the scope of small business corporations and introducing a beneficial rate structure, the Minister also proposed a simplified and enhanced depreciation regime to encourage fixed capital formation. Small business corporations will now be eligible for a deprecation write-off at a 50:30:20 per cent rate over a three-year period for all depreciable assets (other than manufacturing assets, which retain their immediate 100% write-off). This amendment gives effect to this proposal.

Bearing in mind the rate adjustments which apply in respect of years of assessment which end on or after 1 April 2005, the Minister also proposed that the R20 000 double deduction of start up expenses be removed. These amendments give effect to these proposals.

CLAUSE 10

Customs and Excise: Amendment of section 21 of the Customs and Excise Act, 1964

The paragraph is restructured to clarify its provisions.

CLAUSE 11

Customs and Excise: Amendment of section 21A of the Customs and Excise Act, 1964

Subclause (a) and (b): Reference to section 10 is removed as it is not the only provision in the Manufacturing Development Act, 1933 empowering the Minister of Trade and Industry to regulate matters in terms of the said Act by publication of a notice or a regulation.

Subclause (c) and (d): These amendments are of a textual nature.

CLAUSE 12

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

Section 44 of the Customs and Excise Act, 1964, provides that there is no liability for an underpayment of duty, if the underpayment is found during the course of an investigation which commenced more than two years after the date on which underpayment occurred.

The wording of the legislation appears to be somewhat ambiguous in this regard and it is proposed that it be clarified.

CLAUSE 13

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

When section 47(8)*(a)* was amended in 2001, the amendment was inadvertently enacted as a substitution of the whole of subsection (8), with the result that paragraphs *(b)* and *(c)* no longer formed part of the subsection.

It is proposed that paragraphs *(b)* and *(c)* be reinstated with effect from the date on which they were incorrectly deleted, i.e. 12 December 2001.

CLAUSE 14

Air Passenger Departure Tax: Amendment of section 47B of the Customs and Excise Act, 1964

The air passenger departure tax was last adjusted for inflation in 2003. The Minister of Finance has therefore proposed an increase in the air passenger tax from R55 to R60 in respect of international departing passengers traveling to Botswana, Lesotho, Namibia and Swaziland, and from R110 to R120 for all other international flight destinations.

The rate changes for Botswana, Lesotho, Namibia and Swaziland will be published by way of notice in the *Gazette*, and the rate change from R110 to R120 for other countries is contained in the Bill.

These changes will generally come into operation for flights commencing on or after 1 August 2005. The new rates will however not apply for flight tickets purchased and issued before this Bill is promulgated.

CLAUSE 15

Customs and Excise: Amendment of Schedule No. 1 to Act 91 of 1964

This clause provides for the amendment of Schedule No. 1 to the Customs and Excise Act, 1964. These amendments are reflected in Schedule 2 to this Bill. These amendments give effect to the taxation proposals which were tabled by the Minister of Finance during his Budget Speech this year and contain the rates of duty in respect of alcoholic and tobacco products.

CLAUSE 16

Customs and Excise: Continuation of certain amendments of Schedules Nos. 1 to 6 and 10 to Act 91 of 1964

This clause provides for the continuation of the amendments to the Schedules to the Customs and Excise Act, 1964, which were effected by the Minister of Finance during the 2004 calendar year.

CLAUSE 17

Stamp Duties: Amendment of section 1 of the Stamp Duties Act, 1968

*Subclause (1)(a):*This amendment is consequential upon the abolition of stamp duties in respect of instalment credit agreements.

Subclause (1)(b): This amendment is consequential upon the abolition of stamp duties in respect of debit entries.

CLAUSE 18

Stamp Duties: Amendment of section 6 of the Stamp Duties Act, 1968

This amendment is consequential upon the removal of stamp duties on debit entries.

CLAUSE 19

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

This amendment is consequential upon the repeal of the abolition of stamp duties on debit entries with effect from 1 March 2005.

CLAUSE 20

Stamp Duties: Amendment of section 19 of the Stamp Duties Act, 1968

This amendment is consequential upon the repeal of the abolition of stamp duties on debit entries.

CLAUSE 21

Stamp Duties: Repeal of item 6 of the Stamp Duties Act, 1968

As was announced by the Minister of Finance in his Budget Review this year, Government and the public alike have become increasingly concerned about the high cost of banking charges in South Africa. These charges have a disproportionate impact on low-income individuals as well as small businesses. Government has accordingly decided to play its role in reducing these charges by eliminating stamp duties on all debit entries with effect from 1 March 2005 and this amendment gives effect to this proposal.

CLAUSE 22

Stamp Duties: Repeal of item 13A of the Stamp Duties Act, 1968

As was announced by the Minister of Finance in his Budget Speech this year, stamp duties on instalment credit agreements are removed with effect from 1 March 2005. This amendment gives effect to that proposal.

CLAUSE 23

Value-Added Tax: Amendment of section 1 of the Value-Added Tax Act, 1991

The definition of “consideration” in section 1 of the Value-Added Tax Act, 1991, was amended last year to replace the reference to unconditional gift with a reference to a donation. With this amendment, the proviso to the definition was inadvertently deleted which was not the intention. The proviso ensures that a deposit given in respect of a supply of goods or services must not be considered as payment made for the supply unless and until the supplier applies the deposit as consideration or the deposit is forfeited. It is proposed that this proviso be reinserted.

CLAUSE 24

Value-Added Tax: Amendment of section 11 of the Value-Added Tax Act, 1991

Prior amendments to the Act in terms of Acts 45 of 2003 and 32 of 2004 respectively had the unintended effect that SETA grants payable to designated entities did not qualify for the application of the zero rate of VAT as is the case for other vendors. The proposed amendment will allow a designated entity to account for output tax at the zero rate where the payment is a training grant which is paid in terms of section 10(1)*(f)* of the Skills Development Act, 1998 by a SETA for the purposes of training the employees of the designated entity.

CLAUSE 25

Value-Added Tax: Amendment of section 25 of the Value-Added Tax Act, 1991

This amendment is consequential upon the introduction of the proposal that VAT returns be submitted every four months in respect of certain vendors who fall within the new proposed Category F which is introduced in section 27 of the VAT Act.

CLAUSE 26

Value-Added Tax: Amendment of section 27 of the Value-Added Tax Act, 1991

Small businesses regard the filing of VAT returns as a substantial part of their compliance costs. This is partially due to the requirement to file and partially due to the need to maintain accurate and up-to-date accounting records in order to complete the return.

The Minister of Finance announced in his Budget Review this year that as a further measure to keep the VAT compliance costs of small businesses to a minimum and to assist with the cash flow, small businesses with an annual turnover of less than R1 million need only file a VAT return every four months. Registered VAT vendors may however elect to remain on the two-monthly return cycle if so desired. This amendment gives effect to that proposal and comes into operation on 1 August 2005.

CLAUSE 27

Value-Added Tax: Amendment of section 39 of the Value-Added Tax Act, 1991

The proposed amendment is to allow for the payment of penalty and interest where a person fails to pay VAT on an environmental levy in terms of section 7(3)*(a).* The sum of the environmental levy and the VAT constitutes the total environmental charge which is equal to the cost of environmental degradation.

CLAUSE 28

Value-Added Tax: Amendment of section 40A of the Value-Added Tax Act, 1991

The proposed amendment will allow the Commissioner to write-off certain outstanding amounts of tax, penalty and interest due by vendors which are public entities. This is to minimise the circular flow of funds within government. The provision applies to any public entity listed in Schedule 1 or Part A or C of Schedule 3 to the Public Finance Management Act, 1999 (Act No. 1 of 1999), which is registered as a vendor on 31 March 2005 and which will cease to be a vendor as a result of the new VAT dispensation applying to these entities.

The tax write-off relates to instances where an assessment has been raised in respect of an actual supply of goods or services by one of the entities concerned to a public authority and has been incorrectly treated as a zero-rated deemed supply in terms of section 8(5) and 11(2)(p) of the Act.

CLAUSE 29

Value-Added Tax: Renumbering of section 54A of the Value-Added Tax Act, 1991

This amendment is of a textual nature and it intended to position the provisions relating to advance tax rulings with the provisions relating to VAT rulings made by SARS.

CLAUSE 30

Skills Development Levies: Amendment of section 4 of the Skills Development Levies Act, 1999

Currently, a business with a payroll of less than R250 000 per annum and which does not have any employees who are liable for PAYE, is exempt from the payment of skills levy. As part of the initiative to provide relief for small businesses and to reduce their compliance costs, the Minister of Finance proposed in his Budget Review this year that the threshold for the exemption from the skills development levy be increased to R500 000. The requirement of not having any employees liable for PAYE will also be deleted.

CLAUSE 31

Transitional Mineral and Petroleum Provisions: Amendment of paragraph 3 of Schedule 3 of the Taxation Laws Amendment Act, 2004

In 2004, transitional mineral and petroleum provisions were introduced to provide for the continuation of certain lease, royalty or similar payments to the State which applied before a mining right, production right, mining permit or a prospecting right with a permission to remove and dispose of minerals was converted in terms of the Mineral and Petroleum Resources Development Act, 2002.

Paragraph 3 of the transitional provisions currently provides that the Minister of Minerals and Energy has the authority and responsibility to collect these payments. It is proposed that these functions be shifted to the South African Revenue Service (SARS) as a matter of overall efficiency. These amendments give effect to this proposal and enable SARS to collect these amounts.

CLAUSE 32

Short title and commencement

This clause provides the short title and commencement date of the Bill.