C

Summary of tax proposals

Direct tax proposals

Personal income tax rate and bracket structure

It is proposed to retain the single rate scale for individuals. The primary rebate is increased to R6 300 a year for all individuals. The secondary rebate is increased to R4 500 a year for individuals age 65 and over. The rates of tax in respect of the 2004/05 tax year and those proposed for the 2005/06 tax year are set out in Table C.1.

Table C.1 Personal income tax rate and bracket adjustments

2004/05		2005/06	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 74 000	18% of each R1	0 – 80 000	18% of each R1
74 001 – 115 000	R13 320 + 25% of the amount above R74 000	80 001 – 130 000	R14 400 + 25% of the amount above R80 000
115 001 – 155 000	R23 570 + 30% of the amount above R115 000	130 001 – 180 000	R26 900 + 30% of the amount above R130 000
155 001 – 195 000	R35 570 + 35% of the amount above R155 000	180 001 – 230 000	R41 900 + 35% of the amount above R180 000
195 001 – 270 000	R49 570 + 38% of the amount above R195 000	230 001 – 300 000	R59 400 + 38% of the amount above R230 000
270 001 and above	R78 070 + 40% of the amount above R270 000	300 001 and above	R86 000 + 40% of the amount above R300 000
Rebates		**Rebates**	
Primary	R5 800	Primary	R6 300
Secondary	R3 200	Secondary	R4 500
Tax threshold		**Tax threshold**	
Below age 65	R32 222	Below age 65	R35 000
Age 65 and over	R50 000	Age 65 and over	R60 000

The proposed tax schedule eliminates the effects of inflation on income tax liabilities and results in a reduced tax liability for taxpayers at all income levels. These tax reductions are set out in tables C2 and C3.

The average tax rates (tax as a percentage of taxable income) for individuals are illustrated in figures C1 and C2. Average tax rates decline for all income groups under the proposed tax rate structure, as illustrated in figure C3.

Table C.2 Income tax payable, 2005/06 (taxpayers younger than 65)

Taxable income (R)	2004 rates (R)	Proposed rates (R)	Tax reductions (R)	% change
35 000	500	–	500	100,0
40 000	1 400	900	500	35,7
45 000	2 300	1 800	500	21,7
50 000	3 200	2 700	500	15,6
55 000	4 100	3 600	500	12,2
60 000	5 000	4 500	500	10,0
65 000	5 900	5 400	500	8,5
70 000	6 800	6 300	500	7,4
75 000	7 770	7 200	570	7,3
80 000	9 020	8 100	920	10,2
85 000	10 270	9 350	920	9,0
90 000	11 520	10 600	920	8,0
100 000	14 020	13 100	920	6,6
120 000	19 270	18 100	1 170	6,1
150 000	28 270	26 600	1 670	5,9
200 000	45 670	42 600	3 070	6,7
250 000	64 670	60 700	3 970	6,1
300 000	84 270	79 700	4 570	5,4
400 000	124 270	119 700	4 570	3,7
500 000	164 270	159 700	4 570	2,8
1 000 000	364 270	359 700	4 570	1,3

Table C.3 Income tax payable, 2005/06 (taxpayers age 65 and older)

Taxable income (R)	2004 rates (R)	Proposed rates (R)	Tax reductions (R)	% change
55 000	900	–	900	100,0
60 000	1 800	–	1 800	100,0
65 000	2 700	900	1 800	66,7
70 000	3 600	1 800	1 800	50,0
75 000	4 570	2 700	1 870	40,9
80 000	5 820	3 600	2 220	38,1
85 000	7 070	4 850	2 220	31,4
90 000	8 320	6 100	2 220	26,7
95 000	9 570	7 350	2 220	23,2
100 000	10 820	8 600	2 220	20,5
120 000	16 070	13 600	2 470	15,4
150 000	25 070	22 100	2 970	11,8
200 000	42 470	38 100	4 370	10,3
250 000	61 470	56 200	5 270	8,6
300 000	81 070	75 200	5 870	7,2
500 000	161 070	155 200	5 870	3,6
1 000 000	361 070	355 200	5 870	1,6

Figure C1: Average tax rates under age 65

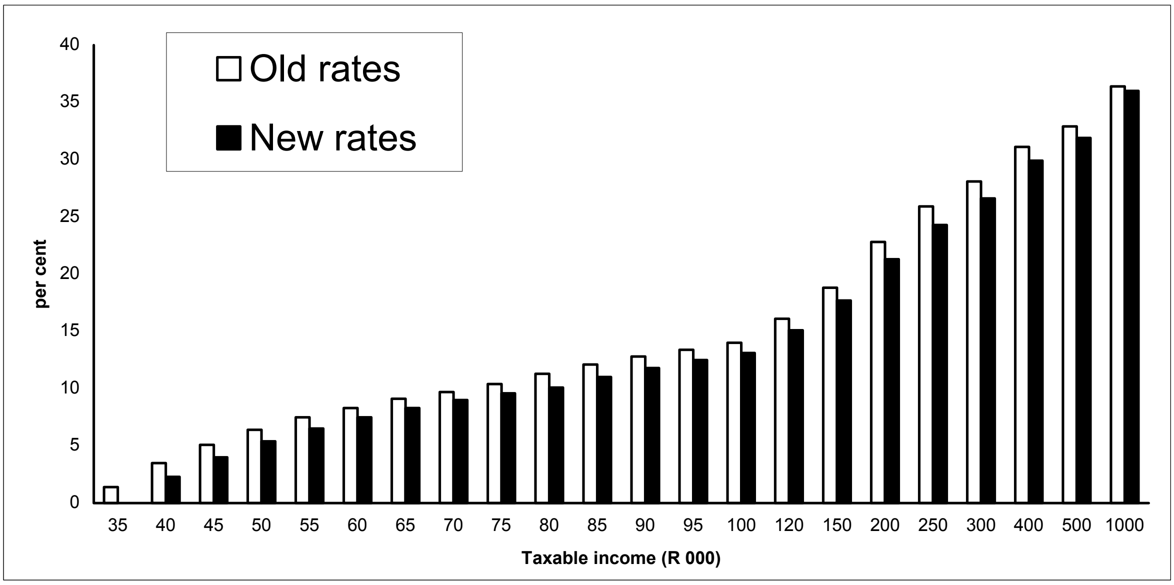


Figure C2: Average tax rates age 65 and over

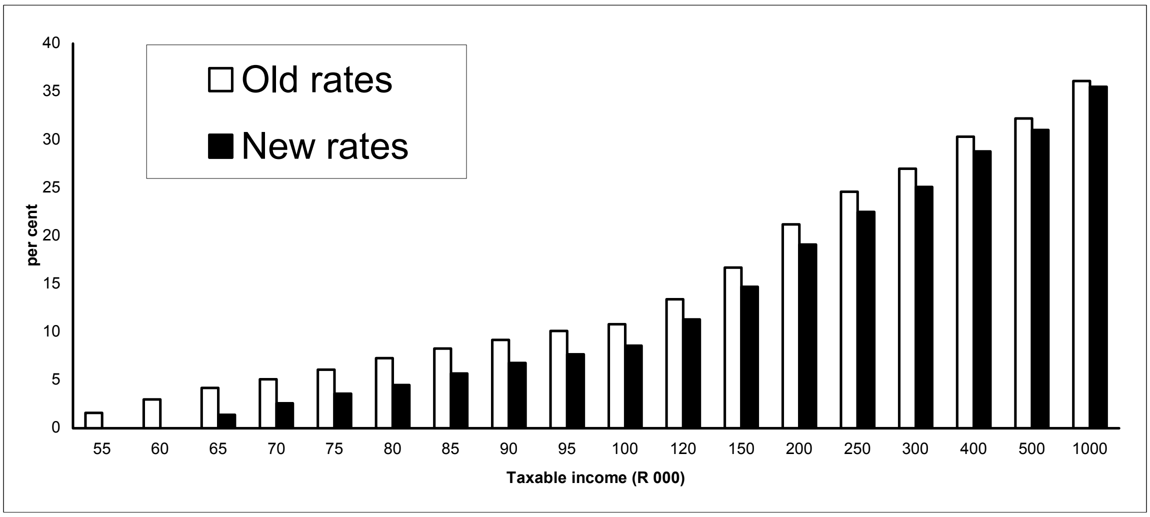
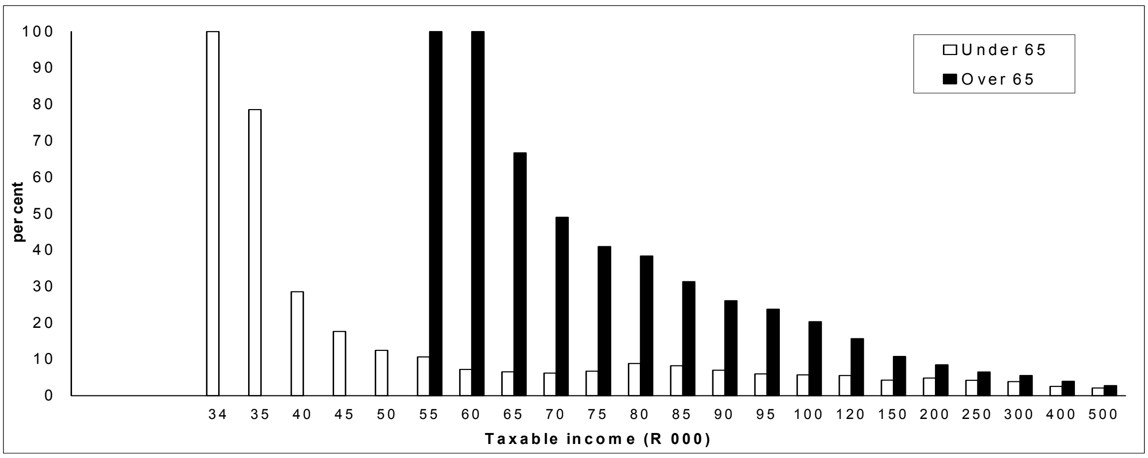


Figure C3: Nominal declines in average tax rates



International tax agreements

International tax agreements are important for encouraging investment and trade flows between countries.

In the 2004/05 fiscal year, considerable progress was once again made in reaching agreements with other countries for the avoidance of double taxation and prevention of fiscal evasion. The present position is as follows:

- Comprehensive agreements (56) are in force with Algeria, Australia, Austria, Bulgaria, Belarus, Belgium, Botswana, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Korea, Lesotho, Luxembourg, Malawi, Malta, Mauritius, Namibia, New, Zealand, the Netherlands, Norway, Oman, Pakistan, the People's Republic of China, Poland, Romania, the Russian Federation, the Seychelles, Singapore, the Slovak Republic, Swaziland, Sweden, Switzerland, Taiwan, Thailand, Tunisia, Uganda, Ukraine, the United Kingdom, the United States of America, Zambia and Zimbabwe. An older agreement with the United Kingdom (1946) applies also to Grenada and Sierra Leone.
- New comprehensive agreements (26) are in the process of negotiation or being finalised with Bangladesh, Brazil (ratified by South Africa), Chile, Cuba, Democratic Republic of Congo, Estonia, Ethiopia (ratified by South Africa), Gabon, Ghana, Kuwait (ratified by South Africa), Latvia, Lithuania, Malaysia, Morocco, Mozambique, Nigeria (ratified by South Africa), Portugal, Qatar, Rwanda (ratified by South Africa), Saudi Arabia, Serbia and Montenegro, Spain, Sri Lanka, Tanzania, Turkey, and the United Arab Emirates.
- Old comprehensive agreements (7) are in the process of renegotiation or being finalised with Germany, Malawi, Namibia, the Netherlands, Swaziland (ratified by South Africa), Zambia and Zimbabwe. Where agreements are being renegotiated, the existing agreements remain effective until new agreements are entered into force.
- Limited sea and air transport agreements (3) are in force with Brazil, Portugal and Spain.

Agreements for mutual administrative assistance between customs administrations

Agreements covering all aspects of assistance, including exchange of information, technical assistance, surveillance, investigations and visits by officials are as follows:

- Agreements (4) are in force with France, the Netherlands, the United Kingdom and the United States of America.
- New agreements (15) are in the process of negotiation or being finalised with Algeria (ratified by South Africa), Angola, Brazil, Israel, Iran, Malawi, Mozambique (ratified by South Africa), Nigeria, Norway, the Democratic Republic of Congo, the Czech Republic (ratified by South Africa) Tanzania, Turkey, Zambia (ratified by South Africa) and Zimbabwe.

Agreements for mutual and technical assistance in respect of VAT

- New agreements (5) with Botswana, Lesotho, Namibia, Swaziland and Zimbabwe are in the process of negotiation or being finalised.

Indirect tax proposals

Specific excise duties

It is proposed that the customs and excise duties in Section A of Part 2 of Schedule No.1 of the Customs and Excise Act, No. 91 of 1964, be amended with effect from 23 February 2005 to the extent shown in Table C4.

Table C.4 Specific excise duties

Tariff item	Tariff heading	Description	Present rate of duty 2004/05		Proposed rate of duty 2005/06	
			Excise	Customs	Excise	Customs
104.00		Prepared foodstuffs; beverages, spirits and vinegar; tobacco				
104.01	19.01	Malt extract; food preparations of flour, groats, meal starch or malt extract, not containing cocoa or containing less than 40 per cent by mass of cocoa calculated on a totally defatted basis, not elsewhere specified or included; food preparations of goods of headings 04.01 to 04.04, not containing cocoa or containing less than 5 per cent by mass of cocoa calculated on a totally defatted basis not elsewhere specified or included not elsewhere specified or included:				
.10		Traditional African beer powder as defined in Additional Note 1 to Chapter 19	34.7 c/kg	34.7 c/kg	34.7 c/kg	34.7 c/kg
104.10	22.03	Beer made from malt				
.10		Traditional African beer as defined in Additional Note 1 to Chapter 22	7.82 c/l	7.82 c/l	7.82 c/l	7.82 c/l
.20		Other	3 073.04 c/l of absolute alcohol	3 073.04 c/l of absolute alcohol	3 364.98 c/l of absolute alcohol	3 364.98 c/l of absolute alcohol
104.15	22.04	Wine of fresh grapes, including fortified wines; grape must, other than that of heading no. 20.09				
	22.05	Vermouths and other wine of fresh grapes flavoured with plants or aromatic substances				
.02		Sparkling wine	323.32 c/l	323.32 c/l	387.99 c/l	387.99 c/l
.04		Unfortified wine	117.10 c/l	117.10 c/l	140.52 c/l	140.52 c/l
.06		Fortified wine	232.87 c/l	232.87 c/l	263.14 c/l	263.14 c/l
104.17	22.06	Other fermented beverages, (for example, cider, perry and mead); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included:				
.05		Traditional African beer as defined in Additional Note 1 to Chapter 22	7.82 c/l	7.82 c/l	7.82 c/l	7.82 c/l
.15		Other fermented beverages, unfortified	153.74 c/l	153.74 c/l	168.24 c/l	168.24 c/l
.17		Other fermented beverages, fortified	295.27 c/l	295.27 c/l	333.65 c/l	333.65 c/l
.22		Mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages	153.74 c/l	153.74 c/l	168.24 c/l	168.24 c/l
.90		Other	295.27 c/l	295.27 c/l	333.65 c/l	333.65 c/l

Table C.4 Specific excise duties

Tariff item	Tariff heading	Description	Present rate of duty 2004/05		Proposed rate of duty 2005/06	
			Excise	Customs	Excise	Customs
104.20	22.07	Undenatured ethyl alcohol of an alcoholic strength by volume of 80 per cent volume or higher; ethyl alcohol and other spirits, denatured, of any strength				
	22.08	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 per cent volume; spirits, liqueurs and other spirituous beverages:				
.10		Wine spirits, manufactured by the distillation of wine	4 583.65 c/l of absolute alcohol	4 487.65 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	4 945.88 c/l of absolute alcohol
.15		Spirits, manufactured by the distillation of any sugar cane product	4 583.65 c/l of absolute alcohol	4 569.65 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 028.11 c/l of absolute alcohol
.25		Spirits, manufactured by the distillation of any grain product	4 583.65 c/l of absolute alcohol	4 537.65 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	4 996.01 c/l of absolute alcohol
.29		Other spirits	4 583.65 c/l of absolute alcohol	4 583.65 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol
.40		Liqueurs and other spirituous beverages	4 583.65 c/l of absolute alcohol	4 583.65 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol
104.30	24.02	Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes				
.10		Cigars, cheroots, and cigarillos, of tobacco or of tobacco substitutes	123 304 c/kg net	123 304 c/kg net	141 676.55 c/kg net	141 676.55 c/kg net
.20		Cigarettes, of tobacco or of tobacco substitutes	226.40 c/10 cigarettes	226.40 c/10 cigarettes	252.43 c/10 cigarettes	252.43 c/10 cigarettes
104.35	24.03	Other manufactured tobacco and manufactured tobacco substitutes; “homogenised” or “reconstituted” tobacco; tobacco extracts and essences:				
.10		Cigarette tobacco and substitutes thereof	13 903 c/kg	13 903 c/kg	14 946.05 c/kg	14 946.05 c/kg
.20		Pipe tobacco and substitutes thereof	6 832 c/kg net	6 832 c/kg net	7 624.01 c/kg net	7 624.01 c/kg net

Miscellaneous amendments

In addition to the Budget Proposals described in Chapter 4 of this Budget Review, the 2005 legislation will contain a number of miscellaneous amendments to the various tax acts. These amendments stem from various problem areas identified in the current legislation as detected over the course of the year through internal review and public comment. Some of these amendments eliminate perceived loopholes while others ensure that tax legislation does not inadvertently hinder legitimate non-tax motivated transactions. These amendments are expected to have only a small revenue impact for the fiscus and are accordingly not listed in Chapter 4. This full listing of lesser amendments provides taxpayers with additional certainty in terms of expected legislative changes for the upcoming year.

Miscellaneous amendments to the Income Tax Act

- *Discretionary trust interests*: Current law is unclear as to when the holder of a discretionary interest in a trust qualifies as a trust beneficiary. The Income Tax Act will accordingly be clarified in this regard with a definition that possibly varies depending on the context.
- *Individual home office expenses*: The tax system has a long history of allowing individuals to deduct certain portions of their home as a business expense under certain limited circumstances. In 2003 however, Government limited the types of miscellaneous deductible business expenses that salaried employees may claim. This limitation now has the unintended impact of denying certain legitimate home office expenses if employees are forced by their employers to bear the cost of maintaining a home office as their central business location (versus operating at a site provided by the employer). The rules will be changed to allow employees to fully deduct these legitimate expenses.
- *Providing certainty for deductible donations*: Under current law, a donor may lose the benefit of a deduction for a donation if the donee organisation fails to satisfy its objects, even though this failure falls outside the donor's control. This result is unfair for the donor so it is proposed that the violating organisation incur an additional tax charge rather than the donor.
- *Disability pensions*: Certain individuals receiving a disability pension as a result of a pre-1 March 1994 injury do not qualify for tax exemption; whereas, these same disability pensions would be exempt if the injury occurred at a later date. It is proposed that the exemption apply to all these disability pensions regardless of the date.
- *Shifting government pension arrangements:* Certain categories of Government employees may be eligible to shift from one pension arrangement to another upon their election. These shifts raise certain collateral tax consequences that may have to be considered or alternatively necessitate a direct allocation.
- *Whole year learnership allowances for part-year learnerships*: Anomalies have arisen with respect to the learnership allowance. In particular, certain employers are artificially attempting to obtain a full-year allowance for part-year learnerships. This tax avoidance strategy could possibly create overall tax reductions that far exceed any benefits offered by the program. This strategy will be terminated by ensuring that part-year programmes receive only part-year tax benefits.
- *Connected persons in relation to companies*: The anti-avoidance rules for "connected persons" may be inadvertently interfering with company reorganisations, especially with respect to the definition as it relates to persons connected to a company. This aspect of the definition includes two sets of persons having a 20 per cent interest (i.e., company shareholders and non-company shareholders), both of which differ from one another and may simply have too low a threshold. It is proposed that these definitions should be revised. Consideration will also be given to treating all persons not acting at arm's length as "connected persons" regardless of their formal relationship.
- *Conversion of local non-proprietary exchanges and other tax-exempt entities*: In 2004, Government announced its intent to withdraw the tax exemption for non-proprietary exchanges. Legislation will be required to address the tax consequences of their conversion to proprietary status. This legislative initiative may also cover comparable issues involving the conversion of other tax-exempt entities to taxable status.

- *Doubtful debts*: Taxpayers may only claim bad debts as a deduction if the underlying claim relating to that debt initially gave rise to income. However, this requirement appears to be missing from the doubtful debt provisions, thereby triggering the need for legislative change.
- *Leasehold improvements*: Leasehold improvements continue to generate uncertainty in terms of the capital gains tax due because these improvements automatically affix to the underlying land of the landlord. Further clarification of these tax consequences will accordingly be considered.
- *Ownership requirement for accelerated depreciation*: It has come to Government's attention that certain taxpayers are attempting to rely on a hyper-technical argument to claim accelerated depreciation on certain assets, even though the taxpayer is not the owner. This argument is inconsistent with generally accepted and longstanding interpretation. An amendment will be proposed to place beyond doubt that taxpayers claiming this accelerated depreciation must be the owner.
- *Capital gains and debt cancellation, reduction or repayment*: Debt cancellations, reductions and repayments of principal give rise to unintended anomalies in terms of calculating capital gains and losses. For instance, the cancellation or reduction of debt generates capital gain, thereby preventing the liquidation of certain shell companies. While this matter has been addressed in the context of liquidating shell companies within a group, this matter remains unresolved outside the group context. Also of concern is the mere repayment of principal on debt, which may inadvertently give rise to capital gain or loss if the market value of the debt changes over time. These issues will be addressed to the extent time permits.
- *Capital loss transfers between insurance four-funds*: The transfer of assets between the four funds of an insurance company generates certain unintended results in terms of the capital gains tax. Of special concern is the rollover of built-in loss assets (i.e., assets with a base cost in excess of value) in contrast with the rules for clogging losses of the transferor fund in the case of transactions between connected persons.
- *Capital gains tax and the 1 October 2001 implementation date*: Problems continue to arise around the 1 October implementation date for calculating capital gains or losses. Of special concern are the calculations involving the time-apportionment base cost. These problems will continue to be addressed as they arise.
- *Foreign ownership of South African immovable property companies*: Foreigners are subject to South African tax on the disposal of certain South African companies containing significant holdings of South African real estate. This tax, however, becomes problematic when it applies to the disposal of certain foreign companies indirectly owning these South African real estate interests, especially when the South African real estate is a relatively small part of the overall structure. Consideration will be given to removing these anomalies and adjusting the tax so that its operation is more akin to similar transactions involving the Transfer Duty.
- *Foreign tax credits and provisional tax payments*: Although taxpayers can generally claim foreign tax credits for foreign taxes paid against their final domestic income tax calculations, the provisional tax payment system fails to account for these credits in the case of companies. This failure to allow for provisional credits in the case of companies makes little sense, especially because individuals can claim these credits on their provisional tax payments. It is accordingly proposed that the provisional tax system for companies be properly aligned to allow for provisional tax credits.
- *Foreign tax credits and the sale of foreign shares*: The South African sale of foreign shares is generally deemed to have a South African source because few countries impose tax on this form of capital gain generated by outsiders (especially after tax treaties are taken into account). However, this deemed South African source treatment is problematic if the foreign country does, in fact, tax this form of sale. This latter form of sale will therefore be treated as foreign

source income, thereby providing South Africans with appropriate foreign tax credits for foreign taxes proved to be payable.

- *Participation rights in controlled foreign companies*: Taxation of controlled foreign company income depends on ownership of participation rights (e.g., shares) in that company. These tests are currently measured solely in terms of value. Consideration is being given towards additionally measuring these rights in terms of voting power so that the regime more closely resembles the permissible range of foreign investments allowed in terms of the Exchange Control dispensation. The impact of participation rights may also be clarified in situations involving preferred shares and certain hybrid instruments.
- *Namibian insurance policy claims*: South African controlled foreign companies cover certain Namibian insurance policy holders. However, it has come to Government's attention that profits may be subject to tax in the South African company's hands even though all these profits will eventually be paid to Namibian policy holders wholly outside the South African tax net. This tax on profits attributable to foreign policy holders will be eliminated.
- *Integration of controlled foreign company income and deemed imputation*: Tainted (e.g., passive) controlled foreign company income is first calculated according to South African principles and then imputed to South African shareholders. However, the exclusion of certain forms of controlled foreign company activities (attributable to a business establishment) does not properly integrate with the overall regime, thereby possibly giving rise to overall losses without matching income. This failure of integration will be remedied.
- *Intragroup controlled foreign company loans*: Controlled foreign companies within a single group held by South African shareholders often make loans to each other (or with the South African shareholders). The tax system generally ignores both payments and receipts in terms of these loans. However, situations arise that trigger a mismatch (with one leg falling within the tax system and the other leg falling outside). Intragroup loans may also give rise to other possible anomalies, such as the denial of tax credits, capitals gain on cancellation, and miscalculations of the foreign passive investment company threshold. These issues will be addressed as time permits.
- *The participation exemption for foreign share gains and dividends*: The participation exemption for foreign share gains and dividends needs to be re-examined. How this exemption works in combination with the overall capital gains tax and the controlled foreign company regimes needs further consideration. Special concerns exist that these rules can be used to shift funds offshore free of tax. It is accordingly proposed that the participation exemption be modified to account for these concerns.
- *Foreign currency translations*: Rapid collateral changes were made to the rules involving the translation of foreign currency when Government adopted a worldwide tax system and the taxation of capital gains. These structural changes require certain ongoing technical clarifications. One important change is to again allow for the full use of the spot rate. Under the new rules, foreign trading stock and non-financial assets will be translated at spot in all cases. Financial assets (such as portfolio bonds) can fall under either the spot or average exchange rate system with appropriate anti-avoidance rules to prevent artificial switching. Other foreign currency anomalies will be addressed to the extent time permits.

Miscellaneous amendments to the Donations Tax and Estate Duty

- *Shifting the Donations Tax to a worldwide basis*: In 2001, Government shifted from a sourced-based system of taxation to a worldwide system. However, this shift was not fully reflected in the Donations Tax. As a result, certain foreign located assets inadvertently remain outside the Donations Tax net. It is accordingly proposed that the Donations Tax be amended to include these assets.

- *Obsolescence of Land Bank values*: Both the Donations Tax and the Estate Duty (as well as the capital gains tax) currently rely on Land Bank valuators as one method of real estate valuation. However, the underlying law underpinning the Land Bank valuating system has since been repealed and little property valuation capacity remains. It is accordingly proposed that the tax system for land valuations be adjusted to account for these developments.
- *Closing Donations Tax/Estate Duty Loophole*: Certain schemes have emerged that arguably allow taxpayers to transfer property without triggering either the Donations Tax or the Estate Duty. These schemes appear to involve the transfer of property that benefits the donee only upon the donor's death, seemingly avoiding the Donations Tax while acting as a deduction against the donor's estate on death for purposes of the Estate Duty. It is accordingly proposed that the use of these schemes be closed.
- *Nominated beneficiaries and the Estate Duty*: The Estate Duty does not clearly address how assets assigned to a nominated beneficiary will be treated (e.g., as property or deemed property). It is proposed that the Estate Duty be clarified in this respect.

Miscellaneous amendments to the Value-Added Tax (VAT) Act

- *Application of the Customs and Excise Tax Act*: The rules for importing goods make reference to the Customs and Excise Act. This reference appears to be overly broad because it enacts the entire Customs and Excise Act into the VAT Act, thereby necessitating a review for potential limits to the reference's overall scope.
- *Booking of local tours by foreign agents*: Consumption of South African holiday packages (e.g., meals and hotel accommodation) are fully subject to VAT at the standard rate. However, when local tour operators offer these holiday packages through foreign tour operators, these packages often become zero rated even though the benefits fully remain within South Africa. These issues will be addressed to ensure that all these South African holiday packages are properly subject to VAT at the standard rate, even if offered by foreign tour operators.
- *Schemes to obtain input credits for ultimately exempt supplies*: No input tax credit is allowed for purchases if ultimately acquired for an exempt supply (e.g., education). Some developers have devised schemes to retain these inputs even though the buildings are ultimately constructed for a provider of exempt supplies. Typically, input credits are claimed in the construction phase and output VAT is only recovered over time or when the property is directly or indirectly transferred to the exempt supplier. This practice will be curtailed.
- *Reversal of input credits on purchased goods that are ultimately never paid*: Purchasers must recoup any input VAT previously claimed if an invoice remains unpaid for 12 months. This 12-month prescription limit can be problematic in terms of enforcement if a vendor liquidates or if parties enter into schemes of arrangement to avoid the 12-month period. These failures to recoup will be remedied.
- *Reconsideration of the* de minimis *rule for* pro rata *allocations of input taxes*: A vendor making both taxable and exempt supplies must generally claim proportional input credits subject to a 5 per cent *de minimis* rule. Intrinsically, the percentage rule has no monetary limit, thereby resulting in substantial mismatches. This mismatch will be reviewed as well as the integration between the definition of "input tax" and the system of VAT adjustments.
- *Removing mismatches of inputs and outputs caused by business restructurings*: When selling a VAT registered business, a standard or zero rate of VAT applies to the entire consideration, even if the business makes both taxable and exempt supplies. Different rules for the seller and buyer exist to account for the exempt supply portion of the business. Unfortunately, these rules are not fully integrated resulting in inconsistency between buyer and seller. This inconsistency leads to potential underpayments and overpayments, which will therefore be reviewed.

- *Zero rating of foreign donor funds offered with the assistance of the South African government as a party*: Supplies by a vendor to a third party can be zero rated if consideration for that supply is from foreign donor funds made under the umbrella of an international agreement, when the South African Government is a party to the transaction. The main difficulty relates to the tracing procedures for documents to substantiate the zero rating, resulting in administrative difficulties for vendors. Consideration will be given to remedy this situation.
- *Motorcars and entertainment offered as prizes*: Input credits are generally disallowed for motorcars and entertainment even if used in the course of business (in order to prevent disguised private use). However, concerns about private use of motorcars and entertainment for business-related prizes simply do not exist. The VAT Act will accordingly account for these special circumstances.
- *Criminal treatment for non-vendors charging VAT*: Non-vendors illegally charging VAT must pay over any VAT charged pursuant to an assessment issued by SARS. However, this provision carries no criminal sanction. The proposal is to add criminal sanctions for this serious violation.
- *Loop supplies into South Africa through a foreign intermediary utilising South African supplies*: Generally, transactions directly between a South African purchaser and South African supplier involving South African supplies results in matching inputs and outputs. However, when a foreign intermediary is interposed between the South African parties (e.g., where a foreign intermediary agrees to supply goods or services to a South African purchaser by making use of a South African supplier) the benefit of the input tax credit may be lost to the South African purchaser. This lost credit becomes a cost to the foreign intermediary who will pass the cost along to the South African purchaser. Consideration will be given to providing relief in these circumstances.
- *Industrial Development Zones*: Government introduced a revised set of enabling legislation for Industrial Development Zones in 2003. Because of its gradual implementation, certain amendments were made in 2004 with the expectation that further legislative changes would follow.
- *Limitation periods for refunds*: Input tax credits can only be claimed if a vendor is in possession of a tax invoice. If possession of a tax invoice is delayed, a 5-year limit exists to cater for the late receipt of the tax invoice. However, a loophole exists that effectively breaches the 5-year limitation that can lead to abusive practices. It is proposed to limit the input tax claim to the 5-year limitation period as originally intended.
- *Public authorities/entities*: SARS raised assessments against many public authorities and entities due to ongoing confusion about the VAT implications of transfer payments. In 2003 and 2004, Government introduced a whole new set of VAT legislation to eliminate this confusion. In order to bring full finality to this matter, Government will write off outstanding assessments raised against public authorities and entities to the extent these assessments stem from this longstanding confusion.
- *Additional assessments*: Government is gradually attempting to unify all the administrative provisions of the various tax acts as practicalities will allow. The proposal is to align the VAT Act with the Income Tax Act in terms of raising additional assessments.

Miscellaneous amendments to the Customs and Excise Act

- *State warehouse rent*: An amendment is proposed that would authorise the Commissioner to provide by rule the date on which any amendment of State warehouse rental rates will have effect.
- *Removal of goods in bond*: If goods are removed in bond for export, it has become necessary to clarify the time when these goods must be exported and to determine when they will be

regarded as having been diverted for purposes of applying any penalty provisions of the Customs and Excise Act.

- *Registration of producers*: For the purpose of preferential trade agreements such as the SADC and EU Free Trade Agreements and in order to effectively enforce the rules of origin contained in these agreements, it is proposed to extend registration to the chain of producers and/or manufacturers of goods that qualify for this preferential treatment.
- *Delivery of notices*: In the event of any intended legal action against the Commissioner, it is proposed to refine the administrative procedures regarding the delivery of notices to the office of the Commissioner.
- *Counterfeit goods*: SARS and the DTI are exploring improved procedures to effectively enforce provisions of the Counterfeit Goods Act, 1997. SARS is also considering adopting the World Customs Organization's model legislation on counterfeit goods.
- *Order of discharge of money collected*: The order of discharging of money collected against a debt consisting of penalties, interest and duties or taxes under different provisions of the Customs and Excise Act needs to be aligned.
- *Removal of goods that were attached*: The removal of goods attached in terms of the Customs and Excise Act for security and goods attached under a warrant of execution will be changed to one premise for safekeeping.
- *Goods subject to a lien*: Changes will be made so that the onus falls on the debtor to prove that goods do not belong to him / her when these goods are subject to a lien. This onus will fully account for any constitutional limits.
- *Rebates of excise duties*: SARS and the National Treasury have undertaken a review of the rebate provision as contained in the Customs and Excise Act, including Schedule 6. A revised draft Schedule 6 was published for comment in late 2004, and the revisions of the rebates would require legislative amendments regarding the losses allowed for bulk spirits.
- *To amend the definition of 'circumvention'*: Currently the definition of circumvention applicable to the non-reciprocal preferential tariff treatment of goods exported from the Republic refers to the WTO Agreement of Textiles and Clothing. The said WTO agreement was terminated and as a result consequential amendments are required to the definition.

Miscellaneous amendments to the Unemployment Insurance Contributions Act

- *Clarifying the interaction between the Unemployment Insurance Contributions Act and the Unemployment Insurance Act*: In 2004, Government recognised that certain anomalies existed between the contributions charge and the main act. These anomalies unfortunately could not be resolved. It is proposed that further efforts be made to properly align the Unemployment Insurance Contributions Act with the Unemployment Insurance Act in order to ensure that all parties paying into the system will receive full benefits.

Miscellaneous amendments to the Transfer Duty Act

- *Property splits*: Certain taxpayers are entering into sophisticated transactions to transfer artificially divided property, thereby undervaluing the whole property transferred and multiplying the various rate thresholds. It is proposed to terminate any potential benefits created by these schemes.
- *Refunds*: In prior years, Government has aligned the administrative provisions of the Transfer Duty and other financial transaction taxes to more closely align with the Value-added Tax. The

Transfer Duty refund provisions inadvertently fell outside this alignment and will be appropriately modified.

Miscellaneous amendments to the diesel fuel tax refund system

- *Diesel fuel tax*: The diesel fuel tax refund system was introduced to provide partial relief from fuel taxes to certain primary produces, especially agriculture, mining, fishing and forestry. The rules regarding the diesel refund system will be reviewed to eliminate potential abuses that have been identified and to ensure that the system supports intended beneficiaries.

Technical corrections

In addition to the miscellaneous amendments above, the 2005 legislation will contain ongoing technical corrections. These technical corrections will address typing and grammatical issues, incorrect or misleading headings, misplaced cross-references, differences between the English and Afrikaans text, obsolete provisions (e.g., updating tax acts in light of other non-tax legislative changes), cross references incorporating regulations into law and problems relating to effective dates. These technical corrections may also occasionally include legislation clearly at odds with legislative intent as well as obvious ambiguities and omissions, especially in terms of legislation promulgated since 2004 (e.g., broad-based employee shares, executive equity schemes and public-private partnerships and transfer payments by Government). These changes are not intended to have any meaningful policy or revenue impact. Technical corrections will be made during the upcoming year only as time permits.

SARS collections

- *Collection of current State mineral royalties*: Government has a significant number of longstanding mineral rights that generate annual lease and/or royalty payments. These payments have historically been audited and collected as national revenue by the Department of Minerals and Energy. Consideration is now being given to shifting some or all of these functions to SARS as a matter of overall efficiency. This changeover may begin as early as 1 April 2005.
- *Collection of the Road Accident Fund Levy*: SARS will collect the Road Accident Fund Levy as a matter of overall efficiency. It is envisaged that this levy will apply on a duty at source basis.

Tax expenditures in South Africa

South Africa has introduced a basic tax expenditure statement with further development towards a comprehensive quantitative statement on revenues foregone once the information management systems at SARS are fully developed.

Tax expenditures can be defined as any tax preference, including exemptions that exclude income from the tax base or allowances that are deductible from gross income or a reduction in a rate of tax or tax deferrals that delay the payment of tax. The statement covers all national government taxes. The detail of the main tax expenditures with the policy rationale and intended beneficiaries is provided in Tables C5 to C8.

Table C.5 Tax expenditures - Personal income tax expenditures

Source	Rationale for tax expenditure and intended beneficiaries
• Rating formula on lump sum benefits. • Exemption of R30 000 on certain lump sum payments. • Exemption of war pensions. • Exemption of disability pensions. • Exemption of capital portion of certain annuity payments.	Providing relief for retirement.
• Exemption of compensations paid in terms of the Workmen's Compensation Act or the Compensation for Occupational Injuries and Diseases Act. • Exemption of allowances payable in terms of the Unemployment Insurance Act.	Providing relief to taxpayers receiving payments due to detrimental work-related circumstances.
• R15 000/R22 000 exemption on interest income.	Incentivising the propensity to save and to provide tax relief for pensions receiving fixed interest income.
• Broad based employee equity participation.	Incentivising initiatives to empower employees.
• Exemption of certain foreign dividends.	Encouraging the repatriation of dividends.
• Exemption for employees working abroad. • Introducing withhold tax on payments to visiting entertainers and sports people. • Partially relaxing capital gains tax rules for visiting skilled expatriates.	Aligning tax treatment of South African nationals working abroad and foreign nationals working temporarily in South Africa.
• Exemption of a *bona fide* scholarship or bursary.	Incentivising education initiatives.
• Deductions for donations to Public Benefit Organisations ("PBO"). • Tax exemption for certain PBO's. • Simplified qualifying criteria for small PBO's.	Assisting non-profit organisations to obtain funding.
• Deductions for pension fund and retirement annuity fund contributions.	Encouraging saving for retirement, thereby reducing the need for State assistance.
• Individual taxpayers pay capital gains tax only at an effective rate of up to 10 per cent.	Low effective capital gains tax rate for individuals to prevent lock-in effect.
• Adjusting the deemed method for calculating business travel. • Curtailing subsistence allowance as a salary sacrifice.	Broadening the base by reducing or eliminating tax deductions for salaried employees.

Table C.6 Tax expenditures - Corporate income tax expenditures

Source	Rationale for tax expenditure and intended beneficiaries
• Companies declaring a dividend pay a 12,5 per cent secondary tax on companies.	Low tax rate on dividends to mitigate company double tax.
• Exemption for real property body corporates and similar associations.	Eliminating the tax burden for entities formed solely for purposes of managing the collective interests common to all its members.
• Deduction of premiums paid on key-man insurance policies.	Promoting initiatives to ensure long term continuance of businesses.
• Deduction for strategic industrial projects.	Incentive package to stimulate industrial investment by granting additional allowances (available to both domestic and foreign investors).
• Deduction for research and development capital expenditure. • Accelerated depreciation for research and development buildings.	Incentivising research and development undertaken in South Africa.
• Accelerated depreciation for Urban Development Zones.	Countering urban decay.
• Exempt infrastructure government grants to Public Private Partnerships ("PPP").	Eliminating tax burden for corporate expenditure on government property.
• Special rules for small businesses.	Incentivising the growth and development of the small business sector.
• Reduction of corporate income tax rate. • Business reinvestment deferral.	Providing cash flow benefit to businesses to encourage investment.
• Corporates pay capital gains tax only at an effective rate of 15 per cent.	Low effective capital gains tax rate for corporates to prevent lock-in effect.
• Deduction for learnership agreements.	Encouraging job creation by lowering the cost of hiring new employees.
• 100% deduction for mining extraction operations.	Incentivising mining extraction operations.
• Gold mining formula (including STC exemption)	Incentivising gold mining extraction operations.
• Encouraging investment in renewable energy. • Exemption for specially formed mining rehabilitation trusts. • Introducing tax relief for rehabilitation reserve funds.	Protecting and rehabilitating South Africa's natural resources.
• Expanding anti-avoidance provisions.	Protecting South Africa's tax base.
• Introducing a tonnage tax.	Promoting investment in the South African shipping industry.

Table C.7 Tax expenditures - Estate duty and donation tax

Source	Rationale for tax expenditure and intended beneficiaries
Estate duty: • Deduction of R1,5 million of the dutiable value of an estate for individuals.	Alleviating the overall tax burden of estate duty.
Donation tax: • Tax exemption for individual and annual donations.	Concession to assist taxpayers when making small donations and protecting the income tax base.

Table C.8 Tax expenditures - Value-added tax expenditures

Source	Rationale for tax expenditure and intended beneficiaries
Exempt supplies includes: • The supply of financial services. • The supply of residential accommodation. • The supply of road transport. • The supply of rail transport. • Trade union subscriptions. • The sale or letting of land outside the Republic. • The supply of services to members in the course of management of a sectional title body corporate, a share block company and any housing development scheme for the aged. • The supply of educational services by approved educational institutions. • The supply of crèche or after-school for children. • The supply by an association not for gain or certain donated goods. • The letting of land for the purpose of constructing a residential dwelling.	No input credit can be claimed on exempt supplies. Persons delivering only exempt supplies are deemed not to be carrying on an enterprise and cannot register as a vendor for VAT purposes. Educational services and public transport are exempted to provide some relief, as well as for administrative considerations. Exemptions from VAT are generally applied to non-fee based financial services as it is difficult to determine the value added. The exclusion of the vendor from the VAT regime (although costs including VAT are passed on to the consumer), is a solution in balancing the needs of the under privileged (by not charging VAT on the service) against revenue considerations.
Zero-rated supplies of services include: • The transport of passengers and goods to and from an export country. • Certain services rendered to non-residents who are outside the country. • The insuring of passengers and goods. • The arranging of international transport. • Services rendered outside the Republic to a user in the Republic – excluding telecommunication services. • Welfare activities, such as the provision of food, meals, board, lodging, clothing, or other necessaries, comforts or amenities to aged or indigent persons, children, or physically or mentally handicapped persons.	An enterprise that makes only zero-rate supplies may register as a VAT vendor and may reclaim VAT on input costs (supplies received).
Zero-rated supplies of goods: • The supply of animal feed, animal remedy, fertilizer, pesticide, plants and seed for farming purposes. • The supply of basic foodstuffs: brown bread, maize meal, samp, mealie rice, dried mealies, dried beans, lentils, pilchards or sardinella, milk powder, rice, vegetables, fruit, vegetable oil, cultured milk, brown wheaten meal, eggs, edible legumes. • The supply of illuminating paraffin. • The supply of petrol and diesel fuel. • The supply of goods that are exported.	The zero-rating of primary agriculture supply is to assist farmers. The zero-rating of basic foodstuffs and illuminating paraffin is intended to provide relief to the poor. Petrol and diesel fuel are subject to fuel levies. The zero-rating of exports is in line with international practice of the "destination principle" – where VAT is intended to be levied in the jurisdiction where consumption occurs.