C

Summary of tax proposals

Direct tax proposals

Personal income tax rate and bracket structure

The primary rebate is increased to R7 200 a year for all individuals. The secondary rebate remains at R4 500 a year for individuals age 65 and over. The rates of tax in respect of the 2005/06 tax year and those proposed for the 2006/07 tax year are set out in Table C.1.

Table C.1 Personal income tax rate and bracket adjustments

	2005/06		2006/07
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 80 000	18% of each R1	0 – 100 000	18% of each R1
80 001 – 130 000	R14 400 + 25% of the amount above R80 000	100 001 – 160 000	R18 000 + 25% of the amount above R100 000
130 001 – 180 000	R26 900 + 30% of the amount above R130 000	160 001 – 220 000	R33 000 + 30% of the amount above R160 000
180 001 – 230 000	R41 900 + 35% of the amount above R180 000	220 001 – 300 000	R51 000 + 35% of the amount above R220 000
230 001 – 300 000	R59 400 + 38% of the amount above R230 000	300 001 – 400 000	R79 000 + 38% of the amount above R300 000
300 001 and above	R86 000 + 40% of the amount above R300 000	400 001 and above	R117 000 + 40% of the amount above R400 000
Rebates		**Rebates**	
Primary	R6 300	Primary	R7 200
Secondary	R4 500	Secondary	R4 500
Tax threshold		**Tax threshold**	
Below age 65	R35 000	Below age 65	R40 000
Age 65 and over	R60 000	Age 65 and over	R65 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 C.2 and C.3.

The average tax rates (tax as a percentage of taxable income) for individuals are illustrated in Figures C.1 and C.2.

Table C.2 Income tax payable, 2006/07 (taxpayers younger than 65)

Taxable income (R)	2005 rates (R)	Proposed rates (R)	Tax reductions (R)	% change
40 000	900	–	900	100,0
45 000	1 800	900	900	50,0
50 000	2 700	1 800	900	33,3
55 000	3 600	2 700	900	25,0
60 000	4 500	3 600	900	20,0
65 000	5 400	4 500	900	16,7
70 000	6 300	5 400	900	14,3
75 000	7 200	6 300	900	12,5
80 000	8 100	7 200	900	11,1
85 000	9 350	8 100	1 250	13,4
90 000	10 600	9 000	1 600	15,1
100 000	13 100	10 800	2 300	17,6
120 000	18 100	15 800	2 300	12,7
150 000	26 600	23 300	3 300	12,4
200 000	42 600	37 800	4 800	11,3
250 000	60 700	54 300	6 400	10,5
300 000	79 700	71 800	7 900	9,9
400 000	119 700	109 800	9 900	8,3
500 000	159 700	149 800	9 900	6,2
1 000 000	359 700	349 800	9 900	2,8

Table C.3 Income tax payable, 2006/07 (taxpayers older than 65)

Taxable income (R)	2005 rates (R)	Proposed rates (R)	Tax reductions (R)	% change
65 000	900	–	900	100,0
70 000	1 800	900	900	50,0
75 000	2 700	1 800	900	33,3
80 000	3 600	2 700	900	25,0
85 000	4 850	3 600	1 250	25,8
90 000	6 100	4 500	1 600	26,2
95 000	7 350	5 400	1 950	26,5
100 000	8 600	6 300	2 300	26,7
120 000	13 600	11 300	2 300	16,9
150 000	22 100	18 800	3 300	14,9
200 000	38 100	33 300	4 800	12,6
250 000	56 200	49 800	6 400	11,4
300 000	75 200	67 300	7 900	10,5
500 000	155 200	145 300	9 900	6,4
1 000 000	355 200	345 300	9 900	2,8

Figure C.1 Average tax rates for people under age 65

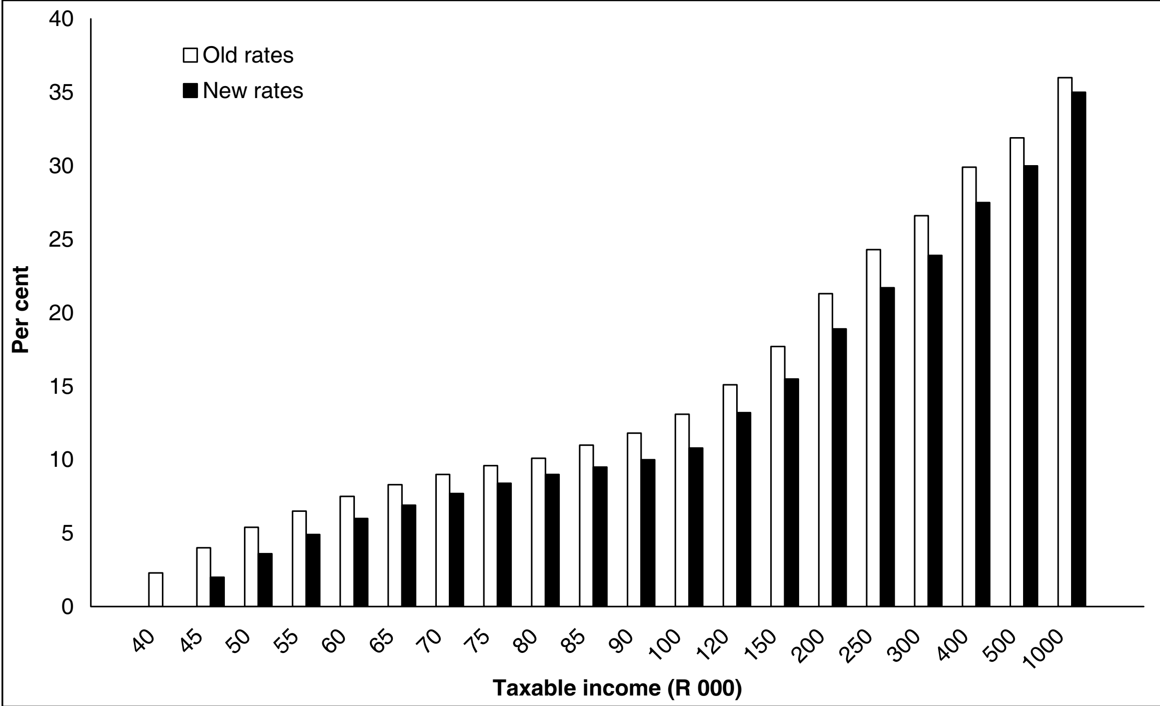
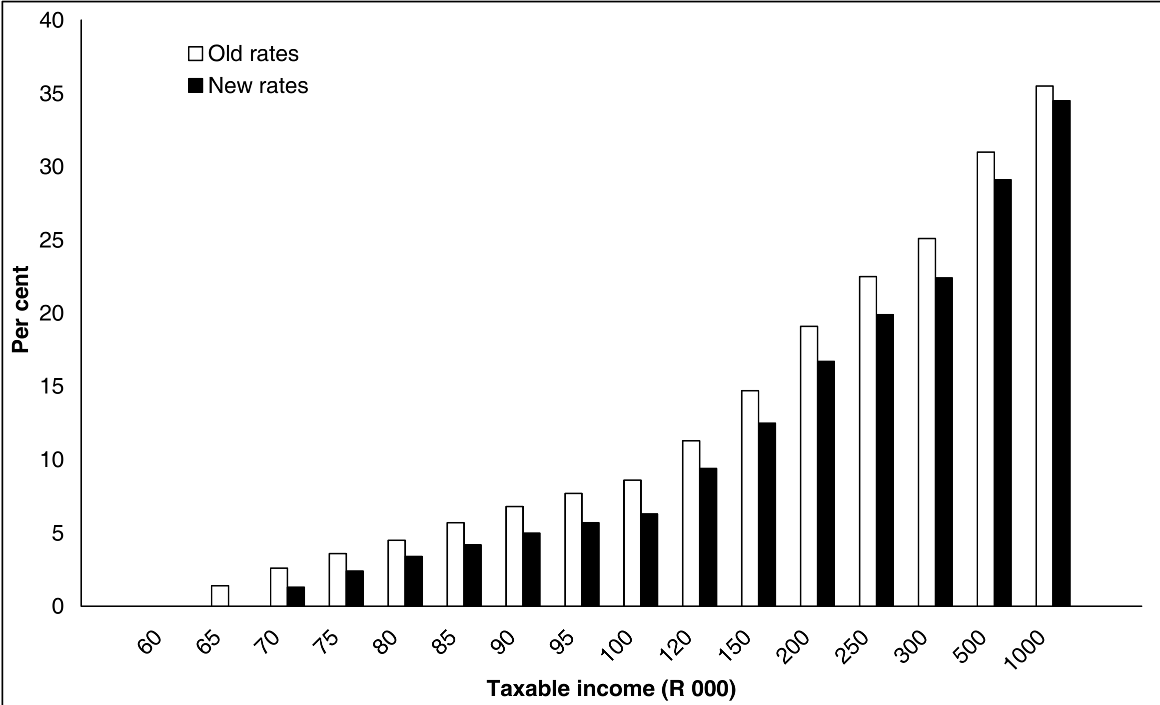


Figure C.2 Average tax rates for people age 65 and over



International tax agreements

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

In 2005/06, considerable progress was once again made in reaching agreements with other countries for the avoidance of double taxation and the prevention of fiscal evasion. The present position is as follows:

- Comprehensive agreements (57) are in force with Algeria, Australia, Austria, Belarus, Belgium, Botswana, Bulgaria, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Ethiopia, Finland, France, Germany, Greece, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Korea, Lesotho, Luxembourg, Malawi, Malta, Mauritius, Namibia, the Netherlands, New Zealand, 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.
- Comprehensive agreements (9) have been ratified with Brazil, the Democratic Republic of Congo, Gabon, Ghana, Kuwait, Malaysia, Nigeria, Rwanda and Turkey.
- Comprehensive agreements (2) have been signed but not ratified with the Netherlands (renegotiated) and Tanzania.
- New comprehensive agreements (16) are in the process of negotiation or are being finalised with Bangladesh, Chile, Cuba, Estonia, Latvia, Lithuania, Morocco, Mozambique, Portugal, Qatar, Saudi Arabia, Serbia and Montenegro, Spain, Sri Lanka, the United Arab Emirates and Vietnam.
- Old comprehensive agreements (6) are in the process of renegotiation, signing or ratification with Germany, Malawi, Namibia, Switzerland, Zambia and Zimbabwe. Where agreements are being renegotiated, the existing agreements remain effective until the new agreements enter into force.
- Limited sea and air transport agreements (3) are in force with Brazil, Portugal and Spain.

Further information on the status of the agreements is available on the SARS website (www.sars.gov.za) under Income Tax/International Treaties.

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 (6) are in force with Algeria, France, Mozambique, the Netherlands, the United Kingdom and the United States of America.
- Agreements (2) have been ratified by South Africa with the Czech Republic and Zambia.
- Agreements (3) have been signed but not ratified with the Democratic Republic of Congo, Norway and Turkey.
- Agreements (9) are in the process of negotiation or are being finalised with Angola, Brazil, Iran, Israel, Malawi, Nigeria, Tanzania, Uganda and Zimbabwe.

Agreements for mutual and technical assistance in respect of value-added tax

- Agreements (6) are in the process of negotiation or are being finalised with Botswana, Lesotho, Malawi, Namibia, Swaziland and Zimbabwe.

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 15 February 2006 to the extent shown in Table C.4.

Table C.4 Specific excise duties

Tariff item	Tariff heading	Description	2005/06 Present rate of duty Excise	Customs	2006/07 Proposed rate of duty 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:				
.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	3 364.98 c/l of absolute alcohol	3 364.98 c/l of absolute alcohol	3 667.82 c/l of absolute alcohol	3 667.82 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	Vermouth and other wine of fresh grapes flavoured with plants or aromatic substances				
.02		Sparkling wine	387.99 c/l	387.99 c/l	465.58 c/l	465.58 c/l
.04		Unfortified wine	140.52 c/l	140.52 c/l	158.09 c/l	158.09 c/l
.06		Fortified wine	263.14 c/l	263.14 c/l	287.88 c/l	287.88 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	168.24 c/l	168.24 c/l	183.38 c/l	183.38 c/l
.17		Other fermented beverages, fortified	333.65 c/l	333.65 c/l	365.35 c/l	365.35 c/l
.22		Mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages	168.24 c/l	168.24 c/l	183.38 c/l	183.38 c/l
.90		Other	333.65 c/l	333.65 c/l	365.35 c/l	365.35 c/l
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:				

Table C.4 Specific excise duties

Tariff item	Tariff heading	Description	2005/06 Present rate of duty		2006/07 Proposed rate of duty	
			Excise	Customs	Excise	Customs
.10		Wine spirits, manufactured by the distillation of wine	5 042.01 c/l of absolute alcohol	4 945.88 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.15		Spirits, manufactured by the distillation of any sugar cane product	5 042.01 c/l of absolute alcohol	5 028.11 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.25		Spirits, manufactured by the distillation of any grain product	5 042.01 c/l of absolute alcohol	4 996.01 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.29		Other spirits	5 042.01 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.40		Liqueurs and other spirituous beverages	5 042.01 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00c/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	141 676.55 c/kg net	141 676.55 c/kg net	148 515.70 c/kg net	148 515.70 c/kg net
.20		Cigarettes, of tobacco or of tobacco substitutes	252.22 c/10 cigarettes	252.22 c/10 cigarettes	278.04 c/10 cigarettes	278.04 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	14 946.05 c/kg net	14 946.05 c/kg net	15 649.41 c/kg net	15 649.41 c/kg net
.20		Pipe tobacco and substitutes thereof	7 624.01 c/kg net	7 624.01 c/kg net	8 261.93 c/kg net	8 261.93 c/kg net

Ad valorem excise duties

It is proposed that the relevant sections in Section B of Part 2 of Schedule No.1 of the Customs and Excise Act, No. 91 of 1964, be deleted with effect from 1 April 2006 to the extent shown in Table C.5.

Table C.5 Ad valorem excise duties to be abolished

Tariff item	Tariff heading	Description
118.10	3301.90.10	Aqueous distillates and aqueous solutions of essential oils
124.35	8476.00	Automatic goods vending machines
124.37	8517.21	Facsimile machines
124.37	8517.90	Parts of facsimile transmission apparartus
126.01	8701.20	Road tractors

Miscellaneous amendments

In addition to the proposals described in Chapter 4, the 2006 legislation will contain miscellaneous amendments to the various tax acts. These amendments stem from problems identified in the current legislation as detected over the course of the year through internal review and public comments. 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 a limited impact on revenue for the fiscus.

Miscellaneous amendments to the Income Tax Act (1962)

The list of income tax amendments provided below is divided into two categories. The first category represents proposed changes for which there is a firm commitment. The second category represents changes that will depend on the underlying facts provided by taxpayers and other interested parties. Public comments will generally be solicited with respect to the latter category.

Proposed changes

Individual

- *Foreign inherited assets:* No rules exist for determining the base cost of foreign-located assets received as an inheritance from a foreign estate. Foreign assets received in this manner should generally enter the South African tax jurisdiction at market value.
- *Fringe benefit taxation of employee-residential accommodation:* Employees receiving free or discounted residential accommodation are subject to fringe benefit taxation. This form of fringe benefit taxation is based on a formula, which is partly based on prior-year salary less R20 000. The R20 000 amount will be doubled to R40 000.
- *Travel benefits for employees engaged in the transport business:* Cross-border travel benefits up to R500 for transport business employees are not subject to fringe benefit taxation. This R500 monetary cap rule will be deleted as obsolete.
- *Bursaries for employee relatives:* Under current law, low-income employees can receive an annual tax-free bursary of up to R2 000 for their relatives. It is questionable whether this form of bursary operates as an effective means for subsidising lower-income education, thereby requiring reconsideration or adjustment.
- *Subsistence expenditure for foreign travel:* Employees who travel abroad on business may receive a subsistence allowance to cover meals and incidental expenses. In order to reduce record keeping in calculating the taxable portion of the allowance, provision is made for an amount which is deemed to have been spent for each day during which the employee is away from his or her usual place of residence. This amount is not a fair reflection of the actual expenses likely to be incurred in all countries, especially neighbouring countries. Consideration will be given to fixing amounts per country that are more closely aligned with the actual costs likely to be incurred for the 2006/07 tax year.

Business

- *Vesting of amounts by trust:* Depreciable assets are subject to potential capital gain treatment and recoupment of the prior depreciation benefit when sold. However, some have argued that the current rules create a possible mismatch between the granting of depreciation and recoupment on disposal by a trust. This potential anomaly will be rectified.
- *Collective investment scheme unit/share buy-backs:* The tax system treats certain gains as a dividend when a company enters into a buy-back of its own shares. While this tax principle is fundamentally sound for standard companies, dividend treatment could under certain circumstances be inappropriate with respect to collective investment schemes (i.e. deemed companies for tax purposes). It is proposed that dividend treatment be clarified by way of legislative amendment or interpretation.

- *Dividend-interest swaps involving collective investment schemes:* The act contains anti-avoidance rules to prevent the swap of tax-free dividends and other taxable income. It has come to the attention of SARS that certain collective investment schemes are designing yet another set of arrangements that allow for the conversion of taxable income in favour of tax-free dividends for investors. Legislation will be proposed to ensure that the current anti-avoidance rules effectively encompass these arrangements.
- *Grant funds used to purchase depreciable property:* In 2005, Government enacted a regulatory framework for exempting Government grants from income tax. At issue is the next step – the use of tax-free Government grants. Proposed legislation will address the entitlement to depreciation for depreciable assets acquired with tax-free grants.
- *Instalment sales involving mining property:* Taxpayers disposing of mining property must treat the disposal as occurring at an "effective value" determined by the Department of Minerals and Energy. It is uncertain how this rule applies when the consideration received on sale is payable in instalments that cannot be quantified with any real certainty (e.g. dependent on future profits), especially in light of the new rules that defer taxation of unquantifiable payments. This uncertainty will be clarified.
- *Leasehold improvements:* The deductibility of leasehold improvements on Government land was previously addressed in the context of public-private partnerships. This issue is now creating difficulties in terms of other Government-sponsored projects, thereby requiring remedial legislation.
- *Artificial repurchase transactions:* Repurchase schemes have been identified that attempt to deduct amounts that economically represent loan capital. These schemes are based on the spurious argument that the payments at issue are "manufactured interest" (as opposed to interest) and that a rule against double deduction or inclusion exists only for the latter (although both are taken into account in determining the accrual of interest). It is accordingly proposed that the tax rules for repurchase schemes be revisited to eliminate any of these arguments.
- *SETA grants:* Under present law, taxpayers are arguably eligible for a double tax benefit under the SETA regime. While taxpayers should be able to deduct the initial payment for SETA participation, payout of the SETA funds to a taxpayer should be a tax-neutral event (be included as income when the payout is received, and amounts incurred in respect of employee training should be deductible). This potential anomaly will be rectified.
- *Removal of allowance for general employee housing:* The act has historically allowed for special depreciation allowances for employee housing. While a case can be made for the continued use of employee housing allowances in terms of mining and farming employees, special depreciation allowances for other forms of employee housing should be deleted to the extent these allowances are no longer of practical use.
- *Company formations:* A taxpayer that disposes of shares shortly after receiving those shares in a tax-free company formation may be forced to treat the gain on those shares as ordinary revenue if the taxpayer transferred mainly ordinary revenue assets to the company pursuant to the tax-free company formation. While this treatment is designed to prevent taxpayers from artificially converting ordinary revenue assets into capital shares, the level of gain triggered on the disposal of the shares may be excessive given the overall construct of the corporate reorganisation regime. It is proposed that this gain be limited to the gain existing at the time of company formation.
- *Share-for-share acquisitions:* Share-for-share company acquisitions can be tax-free under certain conditions. One condition is that the acquiring company must obtain meaningful ownership over the target company's shares. In the case of listed target companies, this acquisition of meaningful ownership can occur over 90 days, whereas unlisted companies must

satisfy this level of ownership on the day of acquisition. It is proposed that the 90-day period should be made available for unlisted company acquisitions as well.

- *Reduction of base cost to prevent double benefits:* Taxpayers generally receive base cost for expenditure incurred with respect to an asset unless that expenditure was already accounted for (e.g. already deducted). This exception properly prevents any double counting for expenditure incurred. However, it appears that this rule against double counting applies even if the prior benefit was denied (e.g. as reduction of assessed loss upon creditor cancellation of debt). This anomaly will be rectified.
- *Denial of double deductions:* Taxpayers cannot claim double deductions for the same underlying expenditure or loss. It is argued by some that this rule against double deductions does not apply if the deductions claimed occur in different years. The law will accordingly be clarified to the extent necessary.
- *Recoupments for dividends and donations:* Disposals of depreciable assets trigger recoupment, including the disposal of these assets by way of a dividend or donation. However, in the case of a dividend or donation, the rules often do not trigger appropriate results. For instance, the recoupment equals the market value of the asset donated or distributed, not just the portion representing prior depreciation. Transfers for consideration below market value should also be treated as donations to the extent of the discount, even if not viewed as donations under case law.
- *Foreign companies and the "connected person" test:* The act contains a number of anti-avoidance rules to prevent schemes between connected persons. In some circumstances, the term "connected person" arguably is only determined with reference to domestic companies. This situation will be corrected.

Changes dependent upon available facts

Individuals

- *Medical adjustments:* The revised tax system for medical scheme contributions and other medical expenses will take effect as of 1 March 2006. Operational implementation of this new system may generate the need for ongoing adjustments to ensure a smooth transition. Consideration will also be given to introducing a higher cap for adult dependants and a lower cap for child dependants instead of the current caps.
- *Share options:* In 2004, Government substantially revised the tax treatment of share options to prevent executives and other high-income employees from receiving tax preferences for consideration that effectively represents deferred salary. The myriad of share option schemes continues to generate issues that require ongoing minor legislative adjustments. One form of share option scheme already identified involves unlisted companies with a repurchase price based on a formula using weighted average earnings rather than market value.
- *Redistribution agreements:* Assets transferred upon death trigger capital gains tax unless the assets are transferred to a spouse. Potential unfairness arises when a spouse enters into a redistribution agreement that swaps unwanted inherited assets with those inherited by another family member. The problem is that the capital gains tax is typically triggered on the swap, even though no gain would have arisen had the spouse received the desired asset directly as an inheritance.

Business

- *Post-retirement medical coverage:* Many employers provide post-retirement medical coverage to former employees that must be fully reflected for financial reporting purposes as a future

financial liability. Corporations are accordingly exploring options that will limit this impact. The viability of some options may require regulatory and ancillary tax changes.

- *Controlled foreign companies (CFCs):* In 1997, Government enacted the CFC regime for South African-controlled foreign companies as a necessary adjunct to the relaxation of exchange controls, and expanded it with the move to worldwide taxation for South African residents. These rules require a careful balance between capital export neutrality (i.e. equal tax treatment for all South African-owned operations) and the opposing need for international competitiveness. While a number of adjustments have already taken place since the introduction of the CFC regime to account for practical realities, it appears that some anomalies remain. Any changes envisioned will not deviate from the core philosophy of the CFC rules developed over the past few years. The list of issues requiring possible further examination includes:
  - Treatment of certain CFC mobile businesses as qualifying business establishments
  - Treatment of royalties that are central to core active CFC business operations
  - Offshore business operations that are subject to the CFC diversionary rules even though the CFC's activities represent no threat to the South African tax base
  - Taxation of a CFC business operating in multiple countries within a single economic market
  - Clarification of the "country of residence" concept.
- *CFC currency anomaly:* A longstanding policy position has been taken to tax liquid portfolio currency gains regardless of whether those gains exist in the hands of a South African resident or a CFC. It appears that a technical problem may exist that prevents this desired taxation of CFC liquid portfolio currency gains. This technical problem will be corrected as necessary.
- *Financial instrument holding companies:* Preferential tax treatment is unavailable for the restructuring of companies owning mainly financial instruments. For purposes of this test, financial instruments with a tax cost equal to market value are ignored because these assets do not contain any built-in gain or loss that could benefit from the preferential tax treatment of the company restructuring rules. Concerns have been raised that other financial instruments posing little threat to the fiscus count against a tax preferred company restructuring.
- *Cross-issues:* If a company issues shares in exchange for assets, the company is not subject to capital gains tax and normally obtains a base cost in the assets received equal to their market value. However, current law specifically provides for a zero base cost result if two companies issue their own shares in exchange for one another. A similar zero base cost result exists for debt. While sound reasons exist for the zero base cost approach, some have questioned whether this approach is too rigid, especially given the need for cross-issues as a means of satisfying other Government regulatory requirements.
- *Minority shares:* Share-for-share transactions, amalgamations and other company acquisitions sometimes create situations in which minority shareholders are forced to exchange their shares. This forced exchange may trigger tax if the minority shareholders fail to satisfy certain technical requirements (i.e. the requirement to hold a 20 per cent share interest in the acquiring company). Consideration will be given to relaxing these requirements in limited circumstances, depending in part on whether this relaxation can be achieved without violating the integrity of the overall corporate restructuring regime.
- *Capital gains tax implementation date issues:* Problems may continue to arise around the 1 October implementation date for calculating capital gains and losses. As in prior years, these issues will be addressed based on the strength of the underlying facts presented.
- *Secondary tax on companies (STC) anti-avoidance:* Corporate distributions to shareholders are subject to a 12,5 per cent STC charge when those distributions represent underlying profits. Corporate distributions that fail to represent profits can be distributed free of STC. In 2005, Government identified schemes seeking to avoid the STC by artificially separating distributions

from profits. This separation typically was achieved through the corporate restructuring rules, especially the rules allowing for the tax-free transfer of assets within a group of companies. These schemes were most acute in terms of distributions involving foreign shares that also benefited from the participation exemption from the capital gains tax. While Government sought to close the latter set of schemes, additional legislation may be required to overcome further attempts to circumvent the STC. Otherwise, more comprehensive changes to the STC will be held back until finalisation of corporate law reform undertaken by the Department of Trade and Industry.

- *Subsidiary distributions of parent company shares:* In 2005, Government introduced a rule to neutralise transactions that sought to avoid STC by having a subsidiary distribute the shares of its parent company as a dividend. It appears that this anti-avoidance rule did not cover all eventualities, thereby requiring further possible legislation.

Miscellaneous amendments to the Value-Added Tax Act (1991)

- *Credits for excess consideration:* Taxpayers fail to account for VAT on amounts received that are in excess of invoice value. Consideration will be given to clarifying the imposition of VAT on the excess received as well as allowing input credits when the excess is refunded.
- *Irrecoverable debts:* Vendors who purchase goods or services must reverse any input credits claimed if the vendor ultimately fails to make payment within a 12-month period. In order to ensure that output tax is properly accounted for, provision must be made to shorten the period of reversal if vendors deregister within the 12-month period.
- *Bare dominium financing structures:* Vendors may not claim inputs for exempt supplies. However, certain taxpayers are entering into bare dominium structures designed to disguise actual financial services as rental payments, thereby misusing the statutory exception to the financial services definition. As a result, input credits are claimed even though no subsequent taxable supply is made. The VAT implications will accordingly be clarified either by legislative amendment or interpretation.
- *Industrial Development Zones (IDZs):* Government created IDZs to encourage the development of trade as well as to stimulate foreign and local investment in particular areas. Consistent with this philosophy, current VAT legislation generally provides that the supply of goods and services into a Customs Controlled Area (CCA) within an IDZ will be zero-rated. However, this zero-rating needs to be limited so that it does not apply to goods or services artificially routed through the CCA or to goods or services that are not economically used, consumed or transformed in the CCA.
- *Entertainment for independent contractors:* Vendors cannot claim inputs for entertainment expenses, except in limited circumstances (such as personal subsistence in the case of overnight business travel for employees). Certain taxpayers are putting forth a case for expanding these exceptions to include comparable expenses for independent contractors. Consideration of expanding relief to this form of entertainment will depend on the facts presented.
- *Imported services:* Imported services are subject to VAT at the standard rate. The relevant imported services provisions will be reviewed so that this policy is fully maintained.
- *Documentary evidence for zero-rated exports:* Vendors receive zero-rated treatment for exports only upon documentary proof acceptable to the Commissioner. This requirement will be upgraded to permit the Commissioner to prescribe the documentary proof required.
- *Documentary proof for deemed inputs:* Vendors must be in possession of prescribed documents to claim input credits. However, as a practical matter, vendors cannot be in possession of these documents if the supply giving rise to the credits is a legislatively “deemed supply”. The provisions relating to these documentary requirements will be remedied.

- *Additional assessments:* The VAT Act provides SARS with the authority to issue one assessment. It is proposed that SARS be given the authority to issue additional assessments to the extent that further controversies subsequently arise. This authority to issue additional assessments will be akin to the authority SARS currently has in issuing additional assessments in terms of the Income Tax Act.

Miscellaneous amendments to the Customs and Excise Act (1964)

- *General duties and powers of officers:* As part of its effort to promote information sharing, SARS is seeking to enhance its exchange of information with other customs administrations, especially in terms of mutual assistance agreements. This enhancement will require a refinement of the relevant sections.
- *Biodiesel:* Operational implementation of the biodiesel fuel rebate may need further adjustments to ensure smooth operation. Amendments will be made accordingly to the extent required.
- *Security seals:* SARS officials may under general provisions apply security seals. In order to facilitate compliance and service delivery, consideration will be given to introducing specific provisions for the application of seals by SARS and by other parties (e.g. external economic and logistic operators in the safeguarding of goods in transit).
- *Licensing:* Legislative changes will be made to provide for the licensing of all port, terminal and similar operations (whether private or public) to achieve more effective customs control.
- *International agreements:* South Africa has acceded to certain annexures of the Convention on Temporary Admission (Istanbul Convention) with possible further accessions to follow. This accession will require conforming amendments under domestic law. Other conforming amendments will be required under domestic law in light of the International Trade Administration Act (2002) as well as certain standards contained in the Marrakesh Agreement.
- *Rebates of excise duties:* Legal changes may be required as the review of Schedule No. 6 is now complete.
- *Record keeping:* The act is outmoded in terms of its private record keeping requirements. The act will accordingly be aligned with other tax acts, all of which provide for a five-year retention period for records.
- *Service of notices:* The act is outmoded in terms of its administrative processes for the service of notice requirements. Consideration will accordingly be given to alignment of the act with the Income Tax Act and the Admiralty Jurisdiction Regulation Act (1983).
- *Large-scale scanner*: The first mobile, state-of-the-art, large-scale scanner is likely to be commissioned in the third quarter of 2006 with further scanners to follow. Legislative amendments to support the effective use of such scanners will be required.
- *Electronic communication*: Large clearing and forwarding houses, importers, carriers and other supply chain participants will be required to communicate electronically with SARS to facilitate risk management, reduce error rates and speed up processing.

Miscellaneous amendments to other taxes, duties and charges

- *Uncertificated securities tax imposed on listed collective investment schemes:* Listed collective investment schemes (e.g. index funds) potentially face double charges in terms of the uncertificated securities tax – one at the collective investment scheme level and another at the level of the holders of participatory interests (unit holders). This potential double charge is

inconsistent with the treatment of unlisted collective investment schemes, which are subject to only one level of comparable charges at the collective investment scheme level.

- *Transfer duty upon divorce:* The transfer of real estate upon divorce is subject to transfer duty unless the marriage was in community of property. Transfer duty relief should in principle be extended to transfers arising from all types of unions.
- *Collecting estate duty on property falling outside the formal estate process:* According to a recent court decision, SARS may not collect estate duty from an executor in respect of property subject to estate duty but not directly under the control of the executor. This decision puts SARS at a severe disadvantage in terms of collecting estate duty for property of this kind. Legislation will be enacted to provide SARS with the right to appoint collecting agents for property of this kind.
- *Unemployment insurance contributions:* Government has been working to resolve certain anomalies between the Unemployment Insurance Contributions Act (2002) and the Unemployment Insurance Act (2001) for over two years. Of concern is the fact that certain parties are seemingly required to contribute even though they lack the potential of fully receiving benefits. Given recent progress, this matter should be resolved within the coming fiscal year.

SARS general administration

- *De minimis payments and refunds:* The payment of small amounts of tax or payout of small refunds often costs taxpayers or SARS more in administration costs than the actual amount paid or refunded. The rules for dealing with these *de minimis* payments or refunds vary among the different tax acts. It is proposed that these *de minimis* rules be aligned and that the SARS Commissioner be given authority to set and adjust the numerical *de minimis* thresholds as required.
- *SARS power to collect third party income tax data:* In addition to some general powers, the Income Tax Act contains a variety of specific provisions allowing for certain types of third party data requests. This use of specific provisions is antiquated and the SARS Commissioner should instead be given the freedom of more general powers to request relevant third party data as needed.
- *Reportable arrangements:* Government previously introduced an enhanced reporting regime for transactions that are likely to entail a high-risk of tax avoidance. This regime is intended to act as a supplement to the general anti-avoidance rule highlighted in Chapter 4 but has unfortunately not generated the desired level of reporting. This regime will accordingly be adjusted to achieve its objective.
- *National Treasury access to public entity data:* The National Treasury currently has access to taxpayer data for tax policy design and revenue estimation. This limited access is insufficient in the case of public entities given National Treasury's role in appropriating funds. The National Treasury should accordingly be given access to individual taxpayer data to the extent the taxpayer involved is subject to the Public Finance Management Act (1999) and the Municipal Finance Management Act (2003).

Technical corrections

In addition to the miscellaneous amendments above, the 2006 legislation will contain technical corrections. These technical corrections will address typing and grammatical issues, incorrect or misleading headings or definitions, 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), incorporation of regulations into law and problems relating to effective dates. These technical corrections may also occasionally include changes to legislation clearly at odds with legislative intent as well as obvious ambiguities and omissions, especially in terms of legislation promulgated since 2005. These changes are not intended to have any meaningful revenue impact or represent any change in policy. Technical corrections will be made during the upcoming year only as time permits.

Tax expenditures in South Africa

An International Monetary Fund delegation visited South Africa in March 2002 and issued the *Observance of Standards and Codes: Fiscal Transparency Report*. In terms of this review process, South Africa has given an undertaking to introduce 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.

This statement covers tax expenditures at the national government level. The detail of the main tax expenditures with the policy rationale and intended beneficiaries is provided in Tables C.6 to C.10.

Table C.6 Tax expenditures – Personal income tax expenditures

Source	Rationale for tax expenditure and intended beneficiaries
Rating formula on lump sum benefits	Providing relief for retirement
Exemption of R30 000 on certain lump sum payments	
Exemption of war pensions	
Exemption of disability pensions	
Exemption of compensations paid in terms of the Workmen's Compensation Act or the Compensation for Occupational Injuries and Diseases Act	Providing relief to taxpayers receiving payments due to detrimental work-related circumstances
Exemption of allowances payable in terms of the Unemployment Insurance Act	
Exemption on interest income - R16 500 for persons under the age of 65 and R24 500 for persons age 65 and over	Incentivising the propensity to save and to provide tax relief for pensioners 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	Aligning tax treatment of South African nationals working abroad and foreign nationals working temporarily in South Africa
Partially relaxing capital gains tax rules for visiting skilled expatriates	
Exemption of a bona fide scholarship or bursary	Incentivising education initiatives
Deductions for donations to public benefit organisations	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
Exemption of medical contributions up to certain limits	Encouraging taxpayers to obtain medical scheme cover

Table C.7 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	Lower tax rate on dividends distributed 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
Additional deduction for certain research and development expenditure Accelerated depreciation for research and development buildings	Incentivising certain research and development undertaken in South Africa
Accelerated depreciation for urban development zones	Countering urban decay
Exemption for certain government grants and infrastructure government grants to public private partnerships	Reducing the circular flow of money between government and the private sector and eliminating the tax burden for corporate expenditure on government property
Special rules for small businesses: reduced tax rate and accelerated depreciation on certain assets	Incentivising the growth and development of the small business sector
Business reinvestment deferral	Providing cash-flow benefit to businesses to encourage re-investment growth
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
Additional 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
Three-year accelerated depreciation write-off for biofuels industries	Encouraging investments 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
Introducing a tonnage tax	Promoting investment in the South African shipping industry
Partial taxation for certain public benefit organisations	Assisting entities that help meet government objectives

Table C.8 Tax expenditures – Estate duty and donation tax

Source	Rationale for tax expenditure and intended beneficiaries
Estate duty: • Deduction of R2,5 million of the dutiable value of an estate for individuals.	Alleviating the overall tax burden of estate duty.
Donation tax: • An annual tax exemption for individual donations of less than R50 000.	Concession to assist taxpayers when making small donations.

Table C.9 Tax expenditures – Fuel taxes

Source	Rationale for tax expenditure and intended beneficiaries
Fuel taxes • 40 per cent rebate of the general fuel levy on bio-diesel	To promote the bio-diesel industry and account for its environmental and socioeconomic advantages
• Varying rates of refunds of the general fuel levy and/or Road Accident Fund levy on diesel	To improve the international competitiveness of those sectors that rely heavily on diesel inputs To exclude certain off-road diesel users from the Road Accident Fund levy

Table C.10 Tax expenditures – Value-added tax expenditures

Source	Rationale for tax expenditure and intended beneficiaries
VAT registration threshold of R300 000 of taxable supplies per annum	Incentivising the growth and development of the small business sector
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 scheme for the aged • 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 Exemptions from VAT are generally applied to non-fee based financial services as it is difficult to determine the value-added Educational services and public transport are exempted to provide some relief, as well as for administrative considerations 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