C

Summary of tax proposals

Direct tax proposals

Personal income tax rate and bracket structure

The primary rebate is increased to R7 740 a year for all individuals. The secondary rebate is increased to R4 680 a year for individuals age 65 and over. The rates of tax in respect of the 2006/07 tax year and those proposed for 2007/08 are set out in Table C.1.

Table C.1 Personal income tax rate and bracket adjustments

2006/07		2007/08	
Taxable income (R)	**Rates of tax**	**Taxable income (R)**	**Rates of tax**
0 – 100 000	18% of each R1	0 – 112 500	18% of each R1
100 001 – 160 000	R18 000 + 25% of the amount above R100 000	112 501 – 180 000	R20 250 + 25% of the amount above R112 500
160 001 – 220 000	R33 000 + 30% of the amount above R160 000	180 001 – 250 000	R37 125 + 30% of the amount above R180 000
220 001 – 300 000	R51 000 + 35% of the amount above R220 000	250 001 – 350 000	R58 125 + 35% of the amount above R250 000
300 001 – 400 000	R79 000 + 38% of the amount above R300 000	350 001 – 450 000	R93 125 + 38% of the amount above R350 000
400 001 and above	R117 000 + 40% of the amount above R400 000	450 001 and above	R131 125 + 40% of the amount above R450 000
Rebates		**Rebates**	
Primary	R7 200	Primary	R7 740
Secondary	R4 500	Secondary	R4 680
Tax threshold		**Tax threshold**	
Below age 65	R40 000	Below age 65	R43 000
Age 65 and over	R65 000	Age 65 and over	R69 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, 2007/08 (taxpayers younger than 65)

Taxable income (R)	2006 rates (R)	Proposed rates (R)	Tax reductions (R)	% change
43 000	540	–	540	100,0
45 000	900	360	540	60,0
50 000	1 800	1 260	540	30,0
55 000	2 700	2 160	540	20,0
60 000	3 600	3 060	540	15,0
65 000	4 500	3 960	540	12,0
70 000	5 400	4 860	540	10,0
75 000	6 300	5 760	540	8,6
80 000	7 200	6 660	540	7,5
85 000	8 100	7 560	540	6,7
90 000	9 000	8 460	540	6,0
100 000	10 800	10 260	540	5,0
120 000	15 800	14 385	1 415	9,0
150 000	23 300	21 885	1 415	6,1
200 000	37 800	35 385	2 415	6,4
250 000	54 300	50 385	3 915	7,2
300 000	71 800	67 885	3 915	5,5
400 000	109 800	104 385	5 415	4,9
500 000	149 800	143 385	6 415	4,3
1 000 000	349 800	343 385	6 415	1,8

Table C.3 Income tax payable, 2007/08 (taxpayers older than 65)

Taxable income (R)	2006 rates (R)	Proposed rates (R)	Tax reductions (R)	% change
69 000	720	–	720	100,0
70 000	900	180	720	80,0
75 000	1 800	1 080	720	40,0
80 000	2 700	1 980	720	26,7
85 000	3 600	2 880	720	20,0
90 000	4 500	3 780	720	16,0
95 000	5 400	4 680	720	13,3
100 000	6 300	5 580	720	11,4
120 000	11 300	9 705	1 595	14,1
150 000	18 800	17 205	1 595	8,5
200 000	33 300	30 705	2 595	7,8
250 000	49 800	45 705	4 095	8,2
300 000	67 300	63 205	4 095	6,1
500 000	145 300	138 705	6 595	4,5
1 000 000	345 300	338 705	6 595	1,9

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

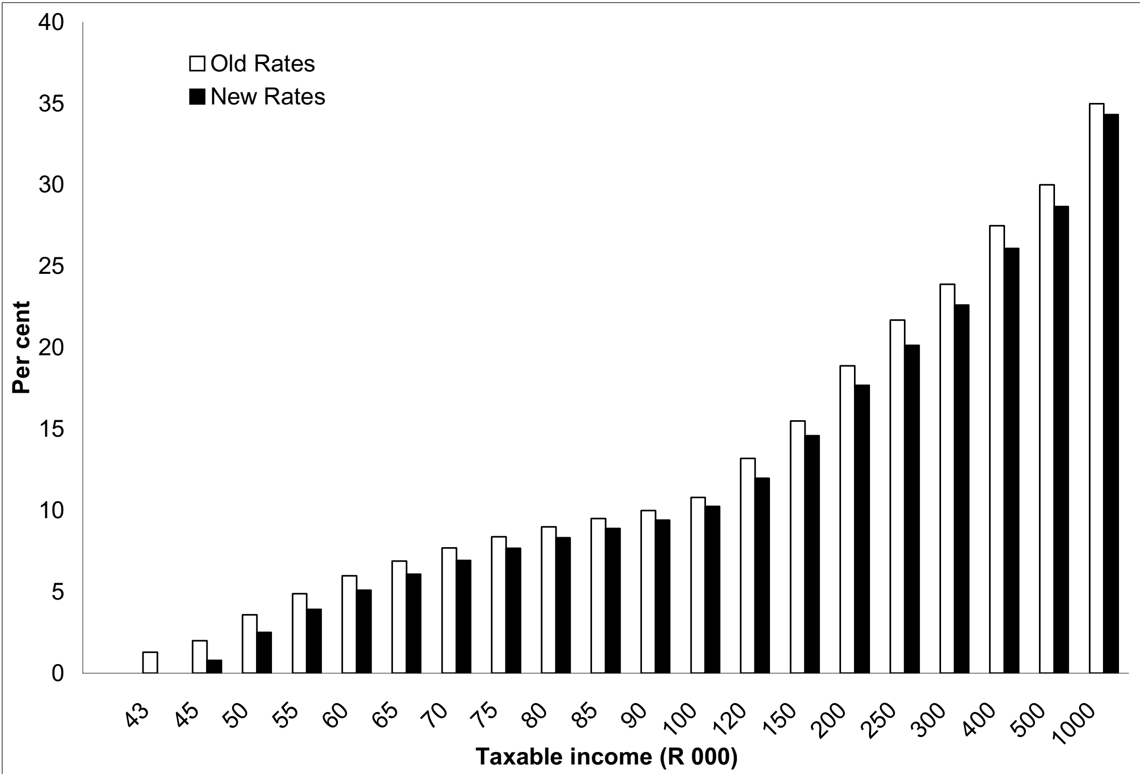
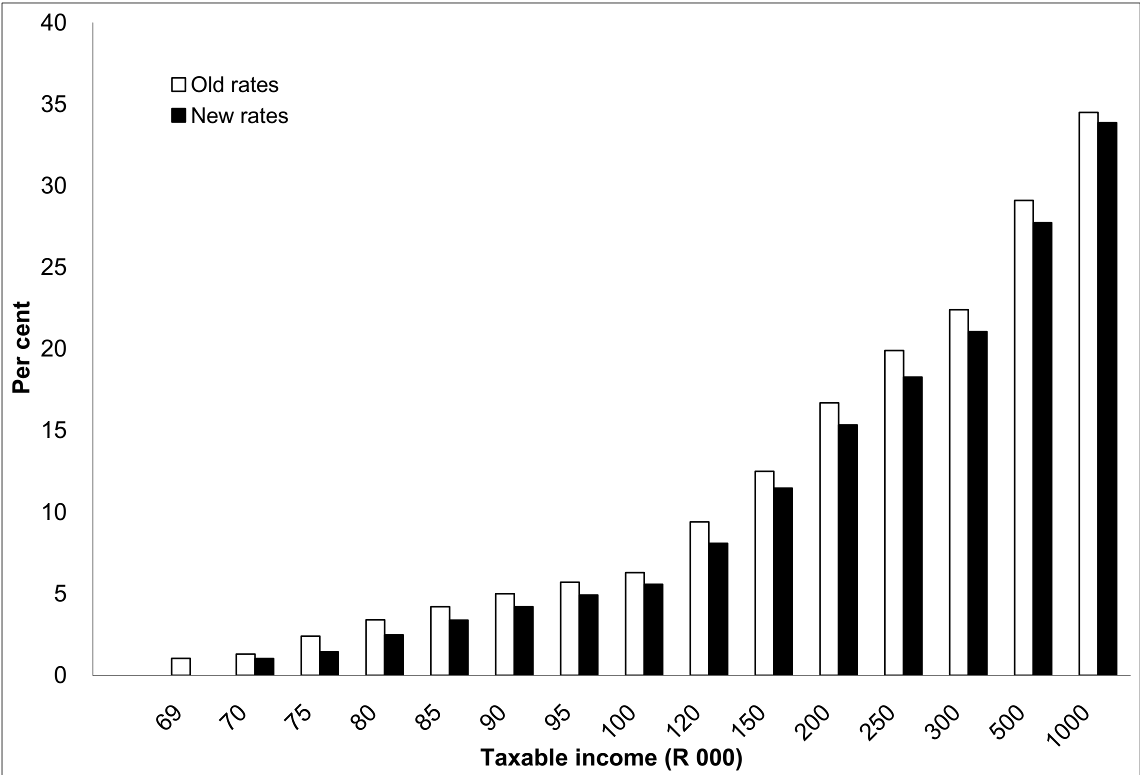


Figure C.2 Average tax rates for people age 65 and over



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 21 February 2007 to the extent shown in Table C.4.

Table C.4 Specific excise duties

Tariff item	Tariff heading	Description	2006/07 Present rate of duty		2007/08 Proposed rate of duty	
			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:				
.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	3 667.82 c/l absolute alcohol	3 667.82 c/l absolute alcohol	3 961.25 c/l absolute alcohol	3 961.25 c/l absolute alcohol
104.15	22.04	Wine of fresh grapes, including fortified wines; grape must (excluding that of heading 20.09)				
	22.05	Vermouth and other wine of fresh grapes flavoured with plants or aromatic substances				
.02		Sparkling wine	465.58 c/l	465.58 c/l	512.14 c/l	512.14 c/l
.04		Unfortified wine	158.09 c/l	158.09 c/l	171.53 c/l	171.53 c/l
.06		Fortified wine	287.88 c/l	287.88 c/l	316.67 c/l	316.67 c/l

Table C.4 Specific excise duties

Tariff item	Tariff heading	Description	2006/07 Present rate of duty		2007/08 Proposed rate of duty	
			Excise	Customs	Excise	Customs
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	183.38 c/l	183.38 c/l	198.05 c/l	198.05 c/l
.17		Other fermented beverages, fortified	365.35 c/l	365.35 c/l	401.88 c/l	401.88 c/l
.22		Mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages	183.38 c/l	183.38 c/l	198.05 c/l	198.05 c/l
.90		Other	365.35 c/l	365.35 c/l	401.88 c/l	401.88 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:				
.10		Wine spirits, manufactured by the distillation of wine	5 521.00 c/l absolute alcohol	5 521.00 c/l absolute alcohol	6 100.71 c/l absolute alcohol	6 100.71 c/l absolute alcohol
.15		Spirits, manufactured by the distillation of any sugar cane product	5 521.00 c/l absolute alcohol	5 521.00 c/l absolute alcohol	6 100.71 c/l absolute alcohol	6 100.71 c/l absolute alcohol
.25		Spirits, manufactured by the distillation of any grain product	5 521.00 c/l absolute alcohol	5 521.00 c/l absolute alcohol	6 100.71 c/l absolute alcohol	6 100.71 c/l absolute alcohol
.29		Other spirits	5 521.00 c/l absolute alcohol	5 521.00 c/l absolute alcohol	6 100.71 c/l absolute alcohol	6 100.71 c/l absolute alcohol
.40		Liqueurs and other spirituous beverages	5 521.00 c/l absolute alcohol	5 521.00c/l absolute alcohol	6 100.71 c/l absolute alcohol	6 100.71 c/l 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	148 515.70 c/kg net	148 515.70 c/kg net	164 057.97 c/kg net	164 057.97 c/kg net
.20		Cigarettes, of tobacco or of tobacco substitutes	278.04 c/10 cigarettes	278.04 c/10 cigarettes	307.82 c/10 cigarettes	307.82 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	15 649.41 c/kg	15 649.41 c/kg	16 483.51 c/kg	16 483.51 c/kg
.20		Pipe tobacco and substitutes thereof	8 261.93 c/kg net	8 261.93 c/kg net	8 738.60 c/kg net	8 738.60 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 Customs and Excise Act, No.91 of 1964, be deleted with effect from 1 April 2007 to the extent shown in Table C.5.

Table C.5 Ad valorem excise duties to be abolished

Tariff item	Tariff heading	Description
124.05	8415.20	Air conditioning machines installed in motor vehicles
124.08	8422.11	Domestic dish washing machines
128.1	9002.00	Camera lenses
128.15	9004.10	Sunglasses
128.2	9005.10	Binoculars
128.2	9005.80	Telescopes
128.25	9006.40	Instant print cameras
128.25	9006.50	Other photographic cameras
128.25	9006.69	Flashlights and flashbulbs
128.3	9007.11	Cinematographic cameras
128.3	9007.20	Cinematographic projectors
128.35	9008.10	Slide projectors
128.35	9008.30	Image projectors

Detailed explanation of corporate reorganisation and BEE proposal

As discussed in Chapter 4, amendments to the Income Tax Act are proposed to ensure that corporate reorganisations and black economic empowerment (BEE) restructurings do not face additional tax costs that could undermine necessary financing. Discussions with key role players have revealed the following six areas of concern:

- *Anti-avoidance financial instrument company provisions:* While the company rollover rules have gradually changed to accommodate ongoing transactions, recurring problems exist in respect of anti-avoidance rules for companies that mainly contain financial instruments. These anti-avoidance rules were designed to ensure that company restructurings were limited to active companies. However, the calculations required are often excessively burdensome and often add little value in preventing real avoidance. It is proposed that the financial instrument rules be deleted to the extent possible and/or be mitigated in favour of a simpler anti-avoidance mechanism.
- *Intra-group transfers:* The company restructuring rules allow for the tax-free rollover of assets within a single group of companies as if the group were a single entity. However, this rollover treatment comes at the price of the de-grouping charge. The de-grouping charge essentially triggers tax on transferred intra-group assets once companies within the group become separated. While the need for the de-grouping charge is accepted, taxpayers have long sought to obtain time limits on its use. It is accordingly proposed that the de-grouping charge apply only if the group break-up occurs within six years after the intra-group asset transfer (in line with the system in the United Kingdom). This proposal will also require re-evaluation of the general company group definition because certain transactions are giving rise to avoidance through artificial temporary arrangements. As a final matter, ongoing legislative relief is required for various intra-group anomalies (such as an alleged dual charge on transferred mining assets) and avoidance loopholes.
- *Share cross-issues:* Many BEE structures involve the cross-issue of shares. In these structures, the operating company issues ordinary shares to the BEE entity. In return, the BEE entity issues

preference shares (which operate as a quasi-loan) to the operating company. If the ordinary shares reach a predetermined value, the BEE entity sells a portion of the ordinary shares for cash and redeems the BEE preference shares. Rules are required to ensure that the ultimate dual dispositions do not give rise to unwarranted gain while simultaneously ensuring that the proposed structure does not trigger artificial losses.

- *Share buybacks of listed shares:* BEE restructurings of listed shares frequently involve a two-step transaction. Shares are first purchased from the public before transfer to BEE partners pursuant to a forced sale via section 311 of the Companies Act (1973). Many of those parties forced to sell their listed shares (especially management) then repurchase identical listed shares on the market from non-BEE participants. At issue is the tax triggered on the forced sale for those parties who simply use sale proceeds to repurchase identical shares. It is proposed that these parties be free from tax to the extent that timely repurchases leave them in the same economic position as before.
- *Connected person sales of depreciable property:* As a practical matter, the majority of BEE transactions involve BEE entities that obtain a 26-30 per cent shareholding with the pre-existing company shareholder retaining a 70-74 per cent shareholding. These situations largely receive relief through the intra-group rules discussed above. At issue are situations where BEE partners (especially with assistance of outsider investors) obtain ownership levels nearing 50 per cent. In these situations, the transfer of depreciable assets to the BEE entity often becomes subject to certain anti-avoidance rules that prevent the BEE entity from depreciating newly obtained assets at currently existing market values. While the general need for these avoidance rules is accepted, it is proposed that these anti-avoidance rules accommodate situations where avoidance is unlikely to be the driver.
- *Broad-based share incentive schemes:* In 2004, government introduced a tax incentive to facilitate broad-based share employee ownership. As a result, employees can now receive up to R9 000 worth of shares tax-free over a three year period (with companies eligible for up to R3 000 of deductions per annum). This incentive was partly driven by the need to have more broad-based schemes that would include rank-and-file employees. Unfortunately, usage of the incentive appears to be minimal. This incentive will accordingly be reviewed for possible change.

In addition to the relief discussed above, a number of potential avoidance schemes involving corporate reorganisation rules have been identified. As mentioned in Chapter 4, immediate anti-avoidance provisions relating to the secondary tax on companies are to be proposed with effect from 21 February 2007. Other potential concerns involving corporate reorganisation rules have been identified and additional measures may be proposed.

Miscellaneous amendments

In addition to the major tax proposals previously described, it is proposed that the 2007 legislation 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 proposed amendments eliminate perceived loopholes while others ensure that tax legislation does not inadvertently hinder legitimate non-tax motivated transactions. These proposed amendments are expected to have a limited revenue impact for the fiscus.

Miscellaneous amendments to the Income Tax Act (1962)

- *Residential accommodation fringe benefits*: Residential accommodation provided by an employer to an employee is a fringe benefit unless provided to an employee when the employee

is away from the employee's usual place of residence. This "place of residence" test is wrongfully being applied on a basis similar to the concept of "country of residence." As a result, foreign residents are arguing that accommodation provided by employers to foreign residents for their entire stay within South Africa is not a taxable fringe benefit even if those foreign residents regularly work at a single South African location. The law will be amended to eliminate this interpretation.

- *Exemption for South Africans working abroad:* South African residents working abroad for more than 183 days over a 12-month period are exempt from income tax on remuneration for services rendered while abroad. However, if a person has rendered services during a 12-month period that meets the requirements (i.e. more than 183 days abroad of which 60 days are for a continuous period) but the remuneration for these services accrues or is received in a later year of assessment during which the 12-month period does not commence or end, the remuneration will not be exempt. This mismatch typically arises in the case of share incentive schemes. The current exemption will be amended to correct these inconsistencies.
- *Streamlining the medical regime:* The tax regime for medical deductions (especially contributions to medical schemes) was fundamentally changed in 2006. One key aspect of this change was a shift from the two-thirds deduction formula to monthly ceilings, thereby enhancing the equity aspects of this concession. While this change was fundamentally sound, administrative and compliance hurdles continue to arise that may require legislative intervention.
- *Eliminating the employer-deduction for dependants of ex-employees/partners:* Employers (and partnerships) can deduct annuity payments to ex-employees (and ex-partners) as well as to their dependants. However, the corresponding deduction for annuity payments to dependants of ex-employees (and ex-partners) is limited to R2 500. This limited deduction has essentially been phased out over time and will accordingly be withdrawn.
- *Taxable income of short-term insurance businesses:* Short-term insurers may deduct reserves when determining taxable income. The rules relating to this determination have not been updated in a long time. The terminology will be updated to reflect current practice in the industry.
- *Allowing short-term insurance companies to partake in reorganisation relief*: Companies can reorganise their assets tax-free (e.g. as part of an amalgamation, liquidation or unbundling). However, it has come to government's attention that provision has not been made for the tax-free rollover of reserves of short-term insurers. This oversight will be corrected.
- *Requiring long-term insurers to match the tax status of their four funds as a precondition for reorganisation relief:* Asset transfers between the four funds of a single long-term insurer trigger deemed gain or loss as if the transfer were between different (but connected) taxable persons. At issue is how the four funds regime works in conjunction with the tax-free reorganisation provisions. The law will be clarified to ensure that long-term insurers receive tax-free reorganisation relief only if assets remain subject to the same tax treatment both before and after the reorganisation.
- *Reorganisations of collective investment schemes held by long-term insurers:* Long-term insurers frequently restructure their controlled collective investment schemes. These restructurings were not envisioned when the reorganisation rules were developed. Consideration will accordingly be given to clarify issues involving these forms of restructurings depending on the facts available.
- *Incorporation of professional partnerships involving part-time members:* In order for audit firms to comply with recent regulatory legislation, certain audit firms need to incorporate their consulting and advisory activities. However, it has come to government's attention that tax may stand as a barrier to some of these incorporations. Under present law, some incorporations may

be ineligible for tax-free rollover relief because certain partners will neither hold the requisite 20 per cent shareholding nor participate on a full-time basis in the business of the newly created company. Legislative amendments may be undertaken.

- *Permissible use of buildings benefiting from the urban development zone incentive:* In 2003, government introduced a tax incentive to encourage the development and renovation of selected urban centres. This incentive is available for buildings that are used for trade, not for personal use. The question has arisen as to impact of the incentive if an urban development zone building was used for purposes other than trade before renovation occurred. The law will be clarified in this regard.
- *Schemes to avoid the reduction of assessed losses upon indirect debt compromises or concessions:* Special provisions exist to reduce company assessed losses to the extent that a company's debts are relieved via compromises or concessions from the lender. Certain taxpayers argue that this reduction of assessed loss can be avoided through indirect means. The law will accordingly be clarified to eliminate this argument.
- *Foreign companies with South African activities:* Foreign companies are subject to different rates of South African tax, depending on the level of their South African activity. Foreign companies with South African sourced income are subject to the standard 29 per cent tax rate, but a higher tax rate applies (34 per cent) if the foreign company generates the income through a South African branch or agency. This higher rate (acting as a substitute for the secondary tax on companies) should apply regardless of whether the foreign company maintains a local branch or agency.
- *Foreign taxpayers receiving passive South African interest and/or royalties:* Foreign taxpayers with passive South African interest income are exempt from tax while passive South African royalties are subject to a flat 12 per cent withholding charge. However, the two tests for distinguishing passive versus active status differ. It is accordingly proposed that both tests be harmonised.
- *Loans made in respect of emigrating South African residents:* To protect the South African tax base against erosion through the use of loans to South African residents by foreign residents, the tax system disallows the deduction of interest on excessive loans of this nature. However, this anti-avoidance rule may not apply if a loan is made by a South African resident who becomes a foreign resident immediately after the loan is made. This and similar loopholes will be closed.
- *Changing status of controlled foreign companies:* Special rules apply when foreign companies acquire or lose controlled foreign company (CFC) status (such as the deemed disposal treatment for capital gains tax purposes). Technical anomalies continue to arise in this area, especially when a chain of foreign companies gain or lose CFC status simultaneously (thereby creating conflicting deemed sale dates for the different foreign companies in the chain). Clarification in this area is required.
- *Deductibility of foreign taxes:* South African controlled foreign activities are often subject to foreign tax in addition to South African tax. The South African tax system provides clear guidelines for obtaining foreign tax credits, but the law is less clear whether South Africans can deduct foreign taxes if no credit is available (or if a deduction is preferred). It is proposed to freely allow deductions for foreign taxes in lieu of credits.
- *Ambiguous foreign currency cross-references:* Two sets of corresponding rules exist for the taxation of currency gains and losses – one for ordinary gain/loss and the other for capital gain/loss. Upon review, it appears that the technical wording of the capital gain/loss currency rules generates confusion due to reliance on cross-references to the ordinary gain/loss currency provisions. This use of cross-references will be removed in favour of more explicit rules.

- *Foreign currency hedges on exempt connected-party foreign loans:* Certain cross border (and wholly foreign) loans between connected persons (including intra-group members) are exempt from the mark-to-market gain/loss rules. However, hedges on these loans do not benefit from this exemption, thereby causing a mismatch (i.e. with the loan falling outside the tax net while the hedge potentially remains within the tax net). Hedges on exempt loans will accordingly receive the same exempt treatment so that all aspects of the same economic activity remain on par.
- *Tax relationship within and between the three spheres of government:* The tax system contains anti-avoidance rules for transactions between connected persons. However, the tax system does not provide clarity on how the three spheres of government relate to one another (and within each sphere). Consideration will be given to clarifying the extent to which entities within government are viewed as connected persons.
- *Obsolete cross-border submarine cable and wireless business provisions:* The Income Tax Act provides a special deeming of taxable income for cross-border submarine cable and wireless business (which is waived for businesses that render accounts with satisfactory disclosure). This deeming provision no longer makes sense in light of South Africa's adoption of a worldwide tax system and in light of technological progress. This special provision will be deleted as obsolete.
- *Obsolete value-added process incentive:* Many years ago, special income tax incentives existed for committee-approved value-added processes. This incentive regime contained transferable negotiable tax credit certificates. The actual incentive was phased out long ago, but tax credit certificates continue to exist for a very small number of taxpayers. All aspects of this incentive will be formally removed, but taxpayers still holding these credit certificates will be given a final opportunity to use these certificates until 29 February 2008.
- *Obsolete tax-redemption certificates:* Many years ago, government utilised a system of tax-redemption certificates as a mode of financing, all of which were tax-exempt. This outmoded form of financing is no longer in use with the exception of certain nominal amounts still outstanding. The exemption for these unclaimed certificates will be removed as obsolete (with holders given a final opportunity to use the exemption until 29 February 2008).
- *Contributions to the Financial Consumer Education Foundation:* As part of its statutory mandate to facilitate consumer education in the financial sector, the Financial Services Board (FSB) has formed a tax-exempt public benefit trust to promote financial literacy and consumer education about financial products and services. The FSB has contributed seed capital, but the rest of the funds will come from voluntary private sector and donor agency contributions. These rules will be clarified to ensure that contributions are treated as deductible payments.
- *Simplifying the averaging formula for individual farmers:* The income-averaging formula for farmers is complex, especially for newly commencing operations. It is proposed to simplify the thresholds within the commencing formula as a first step toward greater simplification.
- *General anti-avoidance rule:* A wholly revised general anti-avoidance rule was approved by Parliament in 2006. Initial indications are that the new rule has already discouraged impermissible tax-avoidance arrangements. However, it would also appear that the new rule is under intense scrutiny by some in an effort to circumvent it. The practical operation of the general anti-avoidance rule will be monitored with appropriate amendments to ensure its effectiveness.
- *Provisional payment system:* The provisional tax system is problematic in terms of enforcement and compliance ease. Effective provisional tax systems should be simple and require minimal audit intervention. Amendments to the provisional tax system will be considered in order to add certainty, minimise compliance and administrative burdens, and to ensure a coherent penalty/interest structure. Any legislative amendments will become effective only after

sufficient time is permitted for taxpayers and South African Revenue Service (SARS) computer system changes.

- *Refund payments:* Refunds of overpaid taxes by cheque result in delays, continue to be subject to fraudulent negotiation and impose significant costs on SARS. In view of the Mzansi initiative to provide bank accounts for low-income earners and the fact that fewer than 2 500 refunds in 2006 were to taxpayers who did not have access to a bank account, consideration will be given to requiring that refunds be made directly into taxpayers' bank accounts on a similar basis to refunds in terms of the Value-Added Tax Act (1991).
- *Employee 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. Share-option schemes continue to generate issues that require minor legislative adjustment.
- *Capital gains tax implementation date issues*: Problems continue to arise around the 1 October 2001 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.

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

- *E-commerce downloads:* The VAT system operates on a destination basis, thereby taxing goods and services consumed within South Africa. This principle theoretically requires South African users of e-commerce downloads to pay VAT and for foreign providers to register for VAT. There is a growing international trend to require foreign e-commerce suppliers of services to register as VAT vendors in countries in which they supply services. The practical implications of requiring these suppliers of services to register within South Africa will be considered with regard to international practice.
- *Nominal or passive foreign-controlled local activities:* The VAT Act prescribes that persons must register as vendors if those persons conduct enterprises and make taxable supplies that exceed or are likely to exceed R300 000 in a 12-month period. This prescription applies equally to domestic and foreign persons. That said, VAT registration for nominal or certain wholly passive activities of foreign persons is impractical when the supply is made to domestic VAT vendors. It is therefore proposed that scope be provided to allow relief in order not to discourage foreign investment and trade.
- *Dried maize:* The supply of dried maize for human consumption, animal feed or as seeds is zero-rated. On the other hand, the supply of dried maize from one vendor to another for resale is standard-rated unless it is a zero-rated supply. The tax treatment by the supplying vendor depends on the ultimate consumption of the recipient, which is often outside the vendor's control and probable knowledge. In order to simplify matters, it is proposed that all supplies of dried maize be eligible for zero-rating regardless of the recipient's intended consumption.
- *Streamlining business reorganisations:* The Income Tax Act provides extensive relief for company reorganisations (mergers, intra-group transfers and liquidations, etc). The VAT rules indirectly provide relief but further clarification is required. It is proposed that the VAT rules be fully examined in relation to all forms of company reorganisations sanctioned by the Income Tax Act, thereby legislatively remedying any inconsistencies between the two tax systems.
- *Insurance versus financial services:* Short-term insurance products are generally subject to VAT, whereas long-term insurance products are regarded as financial services that are exempt. At issue is the uncertainty in terms of modern financial practices, especially given the fact that many financial services (such as guarantees) are designed to guard against risk much like insurance products. It is proposed that this distinction be legislatively clarified.

- *Bare dominium financing structures:* It was mentioned in last year's Budget that certain taxpayers were 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 supplies are made. The investigation has now been completed and the VAT implications will be clarified by legislative amendment.
- *Transfer among rental pool members:* A rental pool administrator acts as a VAT representative for the unit owners and is accordingly conducting an enterprise on their behalf. At issue is the VAT treatment of the transfer of units between rental pool members where the unit remains in the rental pool. Theoretically, these transfers should be regarded as going concerns and hence zero-rated. However, due to the current provisions of the VAT Act, the supply of the unit does not qualify as a going concern. It is proposed that legislation be enacted to this effect.
- *Horse-racing industry*: In the horse-racing industry, a number of persons typically have joint ownership of one horse. The financial affairs of the racehorse owners are managed by an administrator. For the sake of administrative simplicity, consideration will be given to treating racehorse administrators as a VAT representative on behalf of the racehorse owners, much like the situation for rental pooling arrangements. Due to difficulties in establishing the tax status of each racehorse owner, the winnings paid by racing operators to racehorse owners are regarded as a single supply. As such, consideration will also be given to zero-rating such supply.
- *Game-viewing clarification:* It has always been intended that game-viewing drives should be treated as a taxable supply at the standard rate. However, some practitioners are taking positions that undermine this intent due to possible weakness in the technical language. Legislative clarity will be provided to ensure that the supply of game viewing is fully subject to VAT.
- *Foreign diplomat resale of local purchased vehicles:* Foreign diplomats receive VAT refunds in respect of locally purchased vehicles and are exempt from tax on importation of imported vehicles. If the foreign diplomats dispose of these vehicles within two years of purchase or importation, rules exist that require partial or full recoupment of the VAT under certain circumstances. This recoupment ensures that foreign diplomats do not receive unfair benefits. The law will be amended to ensure that the rules for the recoupment of VAT on locally purchased vehicles mirror those for imported vehicles. Rules will also be required to ensure that local VAT vendors do not receive notional input credits on these vehicles to the extent foreign diplomats benefit from unrecouped VAT refunds.
- *Change of use adjustments of fixed property:* VAT-registered property developers acquiring fixed property for resale claim VAT input credits on purchase and levy VAT on the subsequent sale of the property. On the other hand, residential leasing is an exempt activity and therefore no VAT input credits are allowed for fixed property acquired for residential rental purposes. While this rule is fundamentally sound, problems arise when developers change the use for which the property was originally acquired, i.e. from resale to rental. The change of intent should result in a VAT adjustment.
- *Improper use of turnover apportionment method:* Circumstances often arise when a VAT vendor makes mixed supplies of goods or services (some subject to VAT, others exempt). In these situations, questions often arise as to the nature of input credits for purchases to the extent that those purchases cannot be directly allocated to a specific output (i.e. general overheads). Current law provides for a general written ruling prescribing the turnover-based method as being the default method of apportionment. Vendors may, however, use another method if the turnover method does not give an equitable result. Consideration will be given to similarly allow the SARS Commissioner to prescribe another method of apportionment if the turnover-based method does not give an equitable result.

- *Government capital contributions or bailouts to public entities:* Ongoing issues exist when government makes large capital contributions or bailouts to its public entities. In particular, the distinction between an exempt contribution and a transfer subject to VAT appears to be driven more by form than by substance. Possible refinements will be considered depending on the impact that these issues have on public expenditure allocations.
- *Duty-free shops:* Under current administrative practice, South African and foreign travellers benefit from zero-rating when purchasing goods at South African duty-free shops on the basis that these goods are being exported. Although this result is consistent with the destination principle for VAT, legislation is required to support this practice. The VAT Act will be amended accordingly.
- *Clarifying payment dates:* VAT requires different payment dates depending on the means of payment (e.g. cash or electronic transfer). However, lack of legislative clarity exists as to the payment dates for the different electronic payments. It is accordingly proposed that the VAT Act be amended to eliminate this confusion.
- *Documentary evidence for input tax:* Supporting documentation when claiming input credits is a critical element of a sustainable VAT system. While legislation generally requires this documentation, there are legislative ambiguities in the case of deemed supplies. The VAT Act will be amended to ensure that full documentation requirements exist in terms of deemed supplies (e.g. requiring proof of the claimed amount and the reasons of entitlement) as well as limiting such entitlement to the prescribed five-year period.
- *Documentary evidence for zero-rated exports:* Under current administrative practice, VAT vendors must provide proper documentation within a three-month period in order to receive zero-rating for exports. Lack of timely documentation results in subsequent standard rating, but VAT vendors may subsequently claim the VAT as input tax if the documentation follows within another nine-month period. Current practice will be clarified in legislation with some possible refinements depending on comments received.
- *Electronic storage of cheques, bank deposit slips and other documents*: Modern technology increasingly allows for the effective electronic storage of information. While the tax law generally accounts for this shift, certain relics remain. One relic is the ongoing VAT requirement to maintain paper originals of cheques for a five-year period. This paper requirement is costly for the vendors and inefficient in terms of data searches. It is accordingly proposed to allow for the destruction of paper cheques if digital images (or microfilm) are maintained for the same five-year period (similar to the income tax).
- *VAT rulings:* The issuing of VAT rulings came into effect on 1 January 2007. The current provisions for VAT class and other rulings will be reviewed to eliminate unanticipated operational concerns.

Miscellaneous amendments to other legislation

- *Reciprocal tax relief for sportspersons:* From July 2006, income earned by foreign visiting entertainers or sportspersons performing within South Africa became subject to South African withholding tax. While this form of taxation is consistent with international norms, some countries provide various forms of reciprocal relief in the case of international tournaments (i.e. involving teams from multiple countries). These countries legislatively elect not to tax foreign visiting sportspersons playing in their countries on condition that the foreign home country provides a similar exemption on the other side. Restated, source taxation is waived in favour of residency country taxation as long as that waiver is reciprocal. Legislation may be considered so that South African sportspersons can benefit from this reciprocity principle.

- *Public benefit organisations and the skills development levy:* The skills development levy is payable by employers to help develop employee skills (subject to an exemption for small businesses). Public benefit organisations (PBOs) do not fully participate in this developmental facility. The scope of this levy will be extended to place PBOs on par with other employers for skills development.
- *Counterfeit goods:* SARS and the Department of Trade and Industry are exploring improved procedures to effectively enforce provisions of the Counterfeit Goods Act (1997). SARS is also considering adopting model legislation of the World Customs Organisation on counterfeit goods.
- *Small business amnesty as applied to trusts:* Some technical issues have risen regarding the application of the small business tax amnesty in respect of certain types of trusts. These issues may have to be clarified by legislative amendment depending on the facts.
- *Repeal of the Fifth Schedule:* The Fifth Schedule of the Income Tax Act provides the Minister of Finance with the authority to impose a loan levy that essentially forces taxpayers to lend sums to government. This type of forced loan (last utilised in the early 1980s) is outdated, especially given government's growing ability to issue bonds on domestic and global markets. The Fifth Schedule will be repealed.
- *Collection of air passenger tax:* The air passenger tax falls on passengers but is effectively collectible only from operators. Changes will be made to clarify that operators will be liable as withholding agents for the tax with a right to reclaim any tax liability from passengers.
- *Optional exemption for bargaining councils:* Employee benefit funds are exempt from Income Tax. These benefit funds include friendly societies that are regulated by the FSB, but do not include bargaining councils outside FSB regulation. It has come to our attention that certain bargaining councils are willing to accept the price of FSB regulation to obtain income tax exemption. Bargaining councils will accordingly be given the option to register as friendly societies under the FSB in order to obtain tax exemption.

Miscellaneous amendments to the Pensions Act (1956)

- *Forced early withdrawals from retirement funds*: Retirement fund members may be forced to surrender all or part of their retirement fund interests while still being a member of the fund. These forced surrenders may stem from a variety of events, such as housing loan payments and defaults as well as divorce and maintenance orders. Lack of clarity in the law often means that the forced surrender is effectively deferred until a member's final retirement or withdrawal from the fund. This delayed surrender gives rise to unnecessary tax complications. The Pensions Act will be amended to clarify that the forced withdrawal triggers an immediate severance from the fund (as opposed to a delayed severance upon retirement or withdrawal). Corresponding changes will also be made to the Income Tax Act.
- *Defining annuity payments*: While the term "annuity" has legal meaning in case law, the term "annuity" lacks precise statutory definition. This definition is critical for determining the tax impact of guaranteed and living annuities and requires clarification.
- *Living annuity drawdowns*: Currently, living annuities allow pensioners to withdraw retirement funds at an accelerated rate. This rate varies between a 5 per cent minimum to a 20 per cent maximum. However, accelerated withdrawals of this nature often leave pensioners with insufficient funds. In order to limit drawdowns in line with market factors, it is proposed that the permissible drawdowns be shifted from a low of 2,5 per cent to a high of 17,5 per cent.
- *Preserving tax-free pre-1998 pension build ups for public servants:* Public servants previously had the benefit of tax-free pensions until 1998. A special formula (formula C) was introduced to preserve the portion attributable to the tax-free pre-1998 pension (including the subsequent

build-up). It appears that this benefit is now completely lost when a public servant transfers to a private retirement savings fund. Amendments will be considered to retain the tax-free pre-1998 pension build-up in these circumstances.

Technical corrections

In addition to the miscellaneous amendments above, the 2007 legislation will contain technical corrections. These technical corrections will address typing and grammatical errors, incorrect or misleading headings or definitions, misplaced cross-references, differences between the English and Afrikaans text, obsolete provisions (e.g. updating tax acts in the 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 introduced since 2006. These changes are not intended to have any meaningful revenue impact or represent any change in policy, and they will be made as time permits.

Tax legislative holdovers

Below are several outstanding tax issues related to last year's budget cycle. Resolution of these issues will depend on the quality of information obtained during the course of the year.

Mineral and Petroleum Resources Royalty Bill

In 2003 government released the initial proposal to impose a royalty on the sale of domestically extracted mineral and petroleum resources. This royalty is ancillary to the Mineral and Petroleum Resources Development Act (2002), which introduces a new regulatory regime for mineral and petroleum operations. After extensive comments, the revised Royalty Bill was released in October 2006. This most recent version of the bill retains a gross *ad valorem* charge (as in the initial version), but introduces a split rate – one for refined minerals and the other for unrefined minerals. Further public consultation will be conducted with the expectation that the final bill will be introduced before Parliament during the latter half of 2007 (for implementation in 2009).

Employee tax relief for sole proprietors

In 2006, government acknowledged that the anti-avoidance rules safeguarding employee withholding taxes may have introduced excessive rigidities for small business operators. The 2006 legislative relief involved the removal of the automatic "deemed employee" triggers, such as: (i) client control or supervision over hours of service performance and over the manner in which duties are performed and (ii) regular payments. However, the above sets of relief applied solely to small businesses operating as trusts and companies. Comparable relief was inadvertently omitted for small businesses operating as sole proprietors. This oversight will be corrected.

Cooperatives

As proposed, government made initial changes to the tax system in light of the new Cooperatives Act. These changes allow cooperatives to fully participate in small business tax incentives. Other legislative changes will be required to modernise the tax system as the Cooperatives Act (2005) is implemented and to take into account the proposed Cooperatives Banks Bill. Tax changes for cooperative banks may necessitate changes to the tax exemption for mutual loan associations (a pre-existing form of member-owner financial institution).

Oil and gas incentives

Government has renewed income tax incentives for oil and gas exploration and production operations. The tax legislation adopted also contains a fiscal guarantee so that investors have legal assurance that these incentives will remain in effect throughout the life of their investment. While this guarantee received support, technical issues remain in terms of practical application. The fiscal guarantee will receive attention as information is provided by the industry.

Mining environmental rehabilitation

In 2006, government revised the tax regime for environmental rehabilitation trusts used by the mining industry. The revised regime ensures that incentives exist only for funds destined for rehabilitation while simplifying administration. Financial provision for mining environmental rehabilitation consists of various permutations, such as bank guarantees, insurance coverage and direct payments by companies. These issues will be reviewed in line with recent proposed amendments to the Mineral and Petroleum Resources Development Act by the Department of Minerals and Energy. Tax legislation may be adjusted accordingly depending on the outcome of this review.

Public entities

In 2006, government announced its intent to review the income-tax treatment of public entities (following recent changes in this area for VAT). It was hoped that comprehensive revisions could occur, but time pressures prevented this outcome. A full-scale effort to revise income-tax treatment of provincial and municipal entities will be taken forward. Collateral changes may also be required for certain indirect taxes (e.g. the New Securities Tax).

Regulating tax practitioners

Many taxpayers receive advice and assistance from tax advisers and consultants. These practitioners play an important role in the administration of fiscal legislation but bear limited responsibility for the advice and assistance they provide. Following a discussion paper in 2002 and subsequent consultations with stakeholders, a decision was taken to implement the regulation of tax practitioners in two phases. The first phase involved the registration of tax practitioners with SARS by 30 June 2005. The second phase envisages the establishment of an independent regulatory board for tax practitioners. Draft legislation for this second phase has been released for public comment and should be tabled later in the year.

International cooperation for enhanced cross-border enforcement

South Africa has an extensive network of treaties for the avoidance of double taxation, which include provisions for the exchange of information and assistance in the collection of taxes. In a regional context, the number of South African businesses active in neighbouring jurisdictions (and vice versa) has highlighted the need for improved mechanisms for implementation of these treaty enforcement provisions. SARS will therefore explore memoranda of understanding with neighbouring jurisdictions in order to achieve more efficient outcomes. This increased level of administrative cooperation will assist in countering avoidance and abuse in respect of the region's tax systems (such as artificial dual residence, transfer pricing and non-declaration of foreign income). This increased level of administrative cooperation will also accelerate resolution of differences in the interpretation and application of tax treaties as they arise.