REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

REVENUE LAWS AMENDMENT BILL, 2002

[W.P. 2 —’02]
## EXPLANATORY MEMORANDUM ON THE REVENUE LAWS AMENDMENT BILL, 2002

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INTRODUCTION


RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES

As mentioned in the Budget Review this year, a number of far-reaching tax changes were implemented during 2000 and 2001, and there are a number of areas where technical corrections are required to these provisions. The purpose of the technical corrections is to refine wording, remove inconsistencies, address ambiguities, introduce consequential amendments and provide clarity with regard to the legislation in respect of areas where there may be uncertainty.

One of the areas where a number of technical corrections are required is the residence basis i.e. worldwide system of taxation. The residence-basis of taxation was introduced in 2000 and deals with the taxation of income of residents from foreign sources. The introduction of this system also involved new rules for the taxation of South African owned foreign subsidiaries (“controlled foreign entities” (CFE’s)), the taxation of foreign dividends and credits for foreign taxes paid. The new system of worldwide taxation also included the introduction of various forms of foreign currency rules. The technical corrections proposed in this Bill refine all these changes, especially with regard to foreign currency.

Income from foreign sources

Definition of “resident”

A person is a resident for the purposes of the Income Tax Act, 1962, if that person is either ordinarily resident in the Republic, or that person was physically present in the Republic for a period exceeding—

- 91 days in aggregate during the relevant year of assessment;
- 91 days in aggregate during each of the three preceding years of assessment; and
- 549 days in aggregate during those three preceding years.

For purposes of determining the period that a person is present in the Republic, a day includes a part of a day. The issue has been raised whether persons in transit through the Republic should be treated as being physically present in the Republic for any day during which that person is in transit between two places outside the Republic. The issue has also been raised whether a day should include travel across the border into South Africa for a few hours, where if the person who so travels maintains his or her home and business, or place of employment outside the border (e.g. in Botswana, Mozambique, Zimbabwe, or Namibia).

In this regard it is proposed that these issues be clarified and that the definition of “resident” be amended to specifically exclude days that—

- a person is in transit through the Republic between two places outside the
Republic, where that person does not formally enter the Republic through a port of entry; or

- a regular commuter to and from the Republic, who has his or her main dwelling outside the Republic and is also not employed nor carries on business in the Republic, commutes to or from the Republic.

**Translation of foreign sourced income into Rands**

Residents are taxed on their income derived from foreign sources. Currently, the general rule is that if the income derived by the resident from a source outside the Republic is attributable to a permanent establishment of the resident outside the Republic, the taxable income is determined in the currency of the country where the permanent establishment is situated. The amount of taxable income so determined is then translated to Rand on the last day of the relevant year of assessment by using the ruling exchange rate on that date. The Commissioner may, however, approve another exchange rate taking into account the ruling exchange rates during the year of assessment. The taxable income which is not so attributable to a permanent establishment of the resident outside the Republic, is currently determined in Rand. All income, received or accrued, and all expenses incurred must, therefore, be determined separately in Rand by translating the relevant income received or accrued or expenditure incurred in foreign currency to Rand by applying the ruling exchange rate at the time that the income is received or accrued or when the expense is incurred. Effectively, all currency gains and losses are, therefore, picked up in the calculation and included in taxable income.

It is proposed that for purposes of determining the amount of income derived from foreign sources, the application of the ruling exchange rate be replaced by an average exchange rate for the relevant year of assessment of the resident. If an average exchange rate for a year is used, all income received by or accrued to a resident from a foreign source and all expenditure incurred will be determined in the relevant foreign currency before the amount of taxable income is translated into Rand. In this regard, it is proposed that where the income—

- is attributable to a permanent establishment of the resident, the calculation of the amount of taxable income must be done in the currency used by the permanent establishment for purposes of financial reporting; or
- is not attributable to a permanent establishment, the calculation must be done in the currency in which the relevant income or expenditure is denominated.

The amount of taxable income so determined, must then be translated to Rand by using the average exchange rate for the relevant year of assessment. The average exchange rate in relation to a year of assessment of a resident means—

- the time-based average rate based on the spot rate for each day of the year of assessment; or
- the weighted average of the spot rate for each day on which income is received or accrued or expenditure is incurred, which average must be based on the net amount of receipts, accruals and expenditure on each such day, excluding those of a capital nature, and the capital gain or capital loss determined in respect of any disposal of an asset on the relevant day.

By using the average exchange rate for a year of assessment, most currency gains or losses that arise during the relevant year are not taken into account.
Individuals: Exemption

Currently, individuals who are outside the Republic for a specified period are exempt from tax in respect of income earned offshore. This exemption, however, applies only in respect of income received or accrued in respect of services rendered outside the Republic during that period. The purpose of this exemption was to provide relief to persons who are outside the Republic for an extended period and who earn an income offshore during that period, for example, a student living overseas for a year. South Africans who, therefore, work abroad for more than 183 days during any year (of which more than 60 days must be for a continuous period) are exempt from tax on their remuneration. The issue has been raised regarding the scope of the exemption and whether it, for example, includes pension income.

The proposed legislation, therefore, serves to clarify that the exemption applies to, “remuneration” as defined in the Fourth Schedule and that such remuneration must have been received or accrued during that period that person was abroad. Other benefits which stem from that period of service, such as pensions do, however, not qualify for the exemption. This latter limitation is required as a matter of administration, as complex tracing rules would be required to determine which portions of a pension are attributable to local service and which part is attributable to foreign service.

It is, therefore, proposed that the provision of section 10(1)(o) of the Income Tax Act, 1962, be amended to clarify that it applies only in respect of remuneration received or accrued in the year of assessment during which that person was outside the Republic.

Source rules

The question whether income arises from a South African or foreign source remains important despite the introduction of the worldwide basis of taxation. Although South African residents may be subject to tax on a worldwide basis, only foreign source income is eligible for a section 6 rebate. In addition, non-residents remain subject to South African tax only to the extent of their income is from a South African source.

Source of Capital Gains

There are currently no rules in the Act which determine the source of capital gains or losses. In terms of the Eighth Schedule, the capital gains tax provisions apply in respect of all assets of residents and the following assets of non-residents which are situated in the Republic—

• immovable property held by the non-resident or any interest or right of that person to or in immovable property; and
• any asset of a permanent establishment of that person through which a trade is carried on in the Republic during the relevant year of assessment.

The proposed rules accordingly introduce source rules for capital gains. Under these rules, the source of the capital gain or loss on the sale of immovable property will be determined according to where the immovable property is situated. In the case of movable property, if the property forms part of the business property of a permanent establishment, the source of the capital gain or loss on the sale of that property will be where the permanent establishment is situated. If the movable property is not attributable to a permanent establishment, the source of the capital gain or loss on
the sale of that property will be determined according to the residence of the seller. These rules are not in conflict with the approach adopted in the OECD Model Convention with regard to the right of taxation of capital gains.

Currency gains and losses from assets located in the Republic

Currently, currency gains or losses determined in respect of assets which are acquired or disposed of in any foreign currency are excluded for purposes of determining the capital gain or loss from the disposal of that asset. This, however, does not apply in respect of foreign equity instruments, in which case the currency gains and losses are taken into account and are subject to capital gains tax under paragraph 43(4) of the Eighth Schedule. Where the foreign equity instruments constitute trading stock, the currency gains or losses determined in respect of those instruments are taxed under section 9G in order to fully tax currency gains and losses.

It is proposed that paragraph 43 of the Eighth Schedule, which deals with capital assets which are acquired or disposed of in foreign currency, be extended to also take into account currency gains and losses, where the asset is—

• acquired or disposed of in Rands;
• immovable property situated in the Republic;
• a movable asset of a resident which is not attributable to a permanent establishment outside the Republic; or
• movable asset of a non-resident, which is attributable to a permanent establishment in the Republic.

In the case of any other assets which is acquired in one foreign currency and disposed of in another foreign currency, only the currency gain or loss determined between the two foreign currencies will be taken into account and the Rand currency gain or loss with regard to that asset will be ignored. Furthermore, no foreign currency gain or loss will be determined in respect of the disposal of an asset acquired in any foreign currency which is disposed of in the same foreign currency, provided that the capital gains or losses on the disposal of that asset are not from a source in the Republic or the asset does not constitute a foreign equity instrument.

Assets acquired or disposed of in local currency

Where an asset was acquired in local currency and is disposed of in any foreign currency, the currency of disposal must be translated to local currency and at the average exchange rate for the year of assessment during which the asset is disposed of.

Where, on the other hand, an asset was acquired in a foreign currency and is disposed of in local currency, the currency of expenditure must be translated to local currency at the average exchange rate for the year of assessment during which that expenditure was incurred. This will effectively result therein that the currency gain or loss will be taken into account in determining the capital gain or loss from the disposition of that asset.

Foreign equity instruments and assets sourced in the Republic

In the case of foreign equity instruments and assets which are deemed to be sourced in the Republic, the full currency gain or loss determined on disposal will be taxable.
The expenditure will be translated to Rand at the average exchange rate for the year during which the expenditure was incurred and the proceeds will be translated to Rand at the average exchange rate for the year during which the asset is disposed of.

**Pre-valuation date assets**

In the case of pre-valuation date assets for which a valuation has been obtained on 1 October 2001, which have been valued, the market value must be determined in the currency of expenditure of that asset and must be translated to the currency of disposal at the ruling exchange on valuation date. Provision has also been made for the translation of any currency that has in the meantime been replaced by the Euro. In that case, the old currency must be translated at the last available exchange rate for that currency.

**Controlled foreign companies**

South African residents are subject to tax under section 9D on a current basis on income generated by their controlled foreign companies. In terms of the current provisions, these controlled foreign companies are referred to as “controlled foreign entities” or “CFEs.” The proposed legislation includes a number of technical changes to the CFE provisions, almost all of which are in favour of the taxpayer.

**CFE Definition**

The term CFE will be reclassified as Controlled Foreign Company (“CFC”). This change will clarify that only foreign entities that qualify as companies as defined in section 1 of the Act, will be subject to section 9D. The purpose of the original definition was to also include trusts. Trust avoidance techniques have, however, subsequently been addressed in a different manner. Trusts were also removed from the application of section 9D in terms of previous legislation. The new CFC description is also more consistent with the international description used by the OECD.

**Business Establishment**

The CFC regime strikes a balance between competitiveness and international tax neutrality. Under this balance, passive income and diversionary income (tax schemes artificially shifting income offshore) are subject to immediate taxation in the hands of a resident who holds a participation right in the CFC. Active income of CFCs are, however, exempt under section 9D(9) in order to ensure that foreign businesses remain competitive with local businesses in the foreign country from a tax point of view. This active income includes income attributable to a business establishment, unless it is passive or diversionary. The proposed legislation contains some adjustments to the definition of a “business establishment”.

- The definition is amended to clarify that farming and fishing operations located abroad are covered by the business establishment exemption.
- Mines, construction sites, farms, and fishing operations are all deemed to be business establishments *per se* without satisfaction of other anti-avoidance tests (i.e. “suitably equipped” requirement and used for *bona fide* purposes other than tax avoidance). The reason for this is that fixed businesses of these kinds are virtually impossible to fabricate for tax planning purposes.
Changes in Ownership

The current provisions of section 9D do not clearly define how to attribute CFC income if share ownership changes during the foreign tax year. For instance, if a resident shareholder sells all the CFC shares to another resident shareholder, the net income of the CFC generated during the foreign tax year is attributable to the last-mentioned shareholder. The proposed legislation clarifies this in a manner that favours ease of SARS administration and taxpayer compliance.

Transfer Pricing

Taxpayer avoidance of CFC income through transfer pricing poses the same risk to the tax base as other forms of cross-border transfer pricing. The proposed legislation explicitly states that CFC’s are fully subject to transfer pricing enforcement under section 31 in addition to the anti-diversionary rules. This merely clarifies existing law.

Tax Reporting

Under current law, the failure by a resident to properly report on any participation rights in a CFC may jeopardise certain exemptions under section 9D, such as the exemption for active business establishment income. The proposed legislation provides that the failure to report on participation rights may compromise all CFC exemptions which would otherwise have been available under section 9D, other than the exemption relating to amounts which have been subject to tax at a rate of at least 27 per cent or 13,5% in the case of capital gains of the CFC.

Textual changes

The proposed legislation also includes a number of textual changes. These changes eliminate duplication of certain exemptions, clarify and simplify the exemptions for intra-group CFC transactions, address the calculation of base cost adjustments in the case of multi-tier CFC structures and impose tax on a CFC’s that earn South African income which receives South African tax treaty benefits.

Foreign dividends

Dividends from foreign companies have been subject to tax in full since 23 February 2000.

Less than 10 Percent Shareholders

As a general rule, only shareholders who hold 10 per cent or more of a foreign subsidiary are entitled to indirect tax credits on dividends. Where a dividend is received in these cases, the amount of the underlying profit from which the dividend is distributed (grossed up by the amount of foreign taxes paid in respect of those profits) is included in the gross income as a foreign dividend. The underlying taxes are then allowed as a credit against the South African tax payable on those dividends. In the case of a shareholder that is a company, the 10% is determined taking into account ownership held by other group companies, while persons other than companies must hold 10% without taking into account any connected persons. This threshold was introduced for administrative convenience as portfolio shareholders are not able to track the level of taxes paid by the distributing foreign company.

The proposed legislation softens the rule slightly to include all shareholders who own
10 per cent directly or together with connected persons. This test matches the 10 per cent test used for income inclusions under section 9D. It is believed that both tests should be the same as both thresholds are based on the same administrative convenience principle.

**Stacking Rule**

Foreign dividends attract, differently, levels of tax depending on the profits from which the dividend is distributed. Some profits result in tax-free dividends, some are fully taxable with a 6quat rebate, and other are fully taxable without offset of foreign taxes. This determination requires taxpayers to trace dividends to profits. It is proposed that the wording be amended to clarify that dividends must come out of profits from the most recent year which are available for distribution. Taxpayers can, however, choose to use profits from a different year if they so elect, either by way of a vote in a directors’ or general shareholders’ meeting.

**Designated Country Exception**

Certain foreign dividends and foreign income is exempt from tax if derived from designated countries. The designated country exception language appears in several places in the Act. The proposed legislation attempts to clarify the exception to ensure that it applies consistently throughout the Act. The proposed legislation also extends the Minister’s regulatory powers with respect to the designated country exception. The new regulatory power allows the Minister to exclude certain portions of income from designated country exception.

**Foreign tax rebate**

Taxpayers who are subject to tax on their foreign income may receive a rebate (i.e., tax credit) for foreign taxes paid. This rebate is a key component in any worldwide tax system.

**Section 6quat**

Section 6quat provides for a foreign tax credit to be granted against South African tax payable on any income where a resident is taxed in another country on that same income. This applies in respect of income which is derived from a foreign source and which is not deemed to be from a source in the Republic. In certain instances, where it is deemed to be from a South African source, the credit is also granted. This includes income derived inter alia by virtue of—

- any contract for the disposal of minerals (including natural oil) won by a person in the course of mining operations carried on under any mining authorisation granted under the Minerals Act, 1991 (Act No. 50 of 1991); and
- any services rendered or work or labour done upon, beneath or above the continental shelf referred to in section 8 of the Maritime Zones Act, 1994 (Act 15 of 1994), in the course of or connected with, operations carried on under any prospecting permit or mining authorisation issued under the Minerals Act, 1991, or any prospecting or mining lease granted under the Mining Rights Act, 1967.

A rebate determined in accordance with section 6quat shall be deducted from the normal tax payable by any resident in whose taxable income there is included any taxable gain contemplated in section 26A, which is derived from a source outside the Republic which is not deemed to be from a source in the Republic.
It is proposed that no foreign tax credit be allowed in these instances, as it is effectively income attributable to the Republic’s mining rights or services in respect of which the Republic has the first right to tax.

Source of capital gains

As mentioned above, changes are being proposed to limit the foreign tax credits in respect of capital gains only to those gains derived from sources outside the Republic.

Foreign Government Royalties

Many countries impose royalties on the right to extract minerals or oil based on the net income generated. The proposed legislation clarifies that no rebates may be claimed for government imposed royalty charges on minerals and natural oil, as tax rebates in respect of the income system should only offset comparable income taxes. This rule is consistent with international treaties, none of which provide exemption for government royalties.

Foreign Provincial and Local Taxes

The proposed legislation clarifies that rebates are available for income taxes paid at any level of government i.e. also those imposed on the provincial and local level. This treatment assists in putting South African taxpayers on a level playing field with local taxpayers who are subject to a myriad of income taxes at different levels as opposed to a single larger level imposed at the National level.

Less than 10 per cent shareholders

As mentioned above, it is proposed that section 9E be amended to provide that all persons who, together with connected persons, hold at least 10% of the equity share capital must include the underlying profits to which a foreign dividend relates (grossed up by the foreign taxes payable in respect thereof) in their income. The foreign taxes are then allowed as a foreign tax credit against the South African tax payable in respect of the dividend. Section 6quat is, therefore, also amended to allow for the foreign tax credits in these instances.

Section 24I and foreign currency pool

Section 24I provides for the mark to market taxation of gains and losses on foreign exchange items and applies in respect of companies, trading trusts and individuals who hold exchange items for purposes of trade. All other exchange items must be dealt with in terms of the regulations which must be issued in terms of paragraph 84 of the Eighth Schedule. No regulations have, however, to date been issued under paragraph 84 and these currency gains and losses have, therefore, up to now been exempt from tax. New provisions contained in paragraphs 84 to 96 of the Eighth Schedule are, however, being proposed, which will apply to all foreign currency assets of individuals. These provisions only apply where the provisions of section 24I do not apply to the individual or trust.

Currently, an exchange item of an individual which is held for purposes of trade taints all other exchange items held by that person and section 24I will, however, apply to all exchange items of that person. This “for purposes of trade” test in section 24I
effectively means that a person could move in and out of the provisions of section 24I. For example, a foreign debt owed by or to that person which relates to his or her trade, brings that person into the ambit of section 24I. Once the debt is paid off, that person is no longer subject to section 24I and the provisions of the Eighth Schedule become applicable in respect of that person’s foreign currency assets.

In this regard, it is proposed that section 24I be amended to provide that it only applies in respect of natural persons who hold exchange items as trading stock as opposed to the current requirement for purposes of trade.

There is some interaction between section 24I and the provisions of the Eighth Schedule, as the Eighth Schedule becomes applicable once section 24I ceases to apply. Currently, section 24I does not contain any deemed acquisition and disposal provisions in respect of exchange items held at the time that the provisions of section 24I become applicable or cease to apply.

It is, therefore, proposed that specific provisions be inserted to provide that when an individual at any time acquires any exchange item as trading stock, all other exchange items held by that person at the time must be deemed to be acquired for purposes of section 24I. The reason for this is that section 24I then also applies in respect of those other non-trading stock exchange items. Furthermore, where that individual disposes of all trading stock exchange items and the provisions of section 24I, therefore, cease to apply, that individual must at that stage be deemed to have disposed of all other exchange items for purposes of that section 24I.

Where section 24I does not apply and that person holds any foreign currency assets (which include non trading stock exchange items) paragraphs 84 to 96 of the Eighth Schedule will apply in respect of those foreign currency assets. In terms of these provisions a person must maintain a separate foreign currency pool for each foreign currency in which any foreign currency assets of that person are denominated. All foreign currency assets (which includes cash and cash equivalents) must be included in the pool at the average exchange rate for the year of assessment during which that foreign currency asset is acquired. A weighted average base cost for all foreign currency assets held in the relevant foreign currency is determined.

Where that person disposes of any foreign currency asset which is included in the foreign currency pool (i.e. disposes of cash or converts to another currency), the foreign currency gain or loss is determined as the difference between the foreign currency value of the asset translated to Rand at the average exchange rate for the year during which it is disposed of, and the weighted average base cost of that foreign currency asset.

For reasons of simplicity, it is proposed that all cash held for personal use (i.e. for purposes of traveling and subsistence) and one bank account in which a person does the most personal transactions, be excluded from the pool, which means that no currency gains or losses will be determined on these amounts.

**Textual changes**

A number of textual changes are also proposed in order to simplify the current wording of the provisions relating to income from foreign sources and controlled foreign companies.
CORPORATE RESTRUCTURING RULES

Group relief measures were introduced from 1 October 2001 to facilitate transactions between group companies on a tax neutral basis. A number of amendments are proposed in order to refine the measures, to simplify the application thereof and to ensure that the provisions clearly reflect the underlying guiding principles. New provisions are proposed which provide for the amalgamation, conversion, merger or similar schemes between two resident companies.

Corporate rules subject to election

An important proposed change is the result of a number of representations that the rollover relief in respect of the corporate rules should be voluntary and elective and not mandatory as at present.

Provision will be made to allow a transferor and a transferee to make a joint election on a transaction-by-transaction basis to be subject to a company formation transaction, amalgamation transaction or liquidation distribution. A person who, for example, acquires an asset under a company formation transaction at its full market value where that market value exceeds its base cost, will no longer be subject to a mandatory rollover of that asset’s lower base cost. The proposed treatment is consistent with that currently applying in respect of an intra-group transaction.

Transferor and transferee deemed to be one and the same with respect to the transfer of assets

The proposed amendments clarify the effect on the transferee. The transferee steps into the shoes of the transferor regarding the date of acquisition of the asset, the amount and date of any expenditure incurred in respect of the acquisition of that asset by the transferor, and any valuation of a pre-valuation date asset effected by the transferor within the period contemplated in paragraph 29(4) of the Eighth Schedule. A transferee who acquires a pre-valuation date asset as a capital asset in terms of a transaction under this Part effected after the expiry of the period contemplated in paragraph 29(4) of the Eighth Schedule will, therefore, be entitled, subject to the normal loss limitation rules, to adopt the market value determined by the transferor within that period as the asset’s valuation date value.

The cost and holding period rollover rule also applies if the transferee acquires the asset as trading stock, for example for purposes of section 9B. The effect of the rollover rule on the transferee company is that it steps into the transferor’s shoes regarding the transferor’s date of acquisition of the trading stock and the cost of that stock in the transferor’s hands under section 22(1) or (2). This is consistent with the position in respect of assets acquired as capital assets.

This rule should be applicable to formation transactions, share-for-share transactions, amalgamation transactions, intra-group transactions and liquidation distributions.

Allowance Assets

The proposed reformulation of the provisions dealing with the treatment of assets in respect of which deductions or allowances are claimable is aimed at clarifying and simplifying the rule that the transferee steps into the shoes of the transferor. The two parties are deemed to be one and the same for purposes of determining any allowance to which the transferee may be entitled or in respect of amounts recovered.
or recouped. This is the case where certain assets or obligations are transferred in terms of a formation transaction, amalgamation transaction, intra-group transaction or liquidation distribution. The provisions are only applicable where the asset constitutes an allowance asset in the hands of both the transferor and the transferee. It, therefore, gives effect to the principle in terms of which rollover treatment is extended to any allowances that may be recouped by the transferor or that may be included in the transferor’s income upon the disposal of a capital asset or of a liability under a company formation transaction. The potential recoupment of allowances enjoyed by the transferor or their inclusion in the transferor’s income is, therefore, shifted into the transferee company. All remaining unutilised capital allowances associated with the transferred assets or liabilities also shift to that company in whose hands they continue to be deducted as if that company had held those assets all along.

**Example**

**Facts:** Individual forms Newco. Individual transfers machinery for all 100 shares of Newco. Individual initially purchased the machinery for R250 000. At the time of the transfer, the machinery has a market value of R115 000 and a base cost of R100 000 after capital allowances of R150 000 (at R50 000 per year) were allowed. The machinery has a remaining useful life of two years.

**Result:** The formation is tax-free (i.e., does not trigger any capital gain or any recoupment). Newco receives a carryover cost of R100 000 in the machinery with a R150 000 potential recoupment. Newco can continue to take further capital allowances on the machinery for an additional two years at R50 000 per year.

**Ring-fenced capital gains and taxable income from sale of trading stock or allowance assets**

The corporate rules contain anti-avoidance provisions to prevent the shifting of built-in gain assets into a company transferee through the mechanism of a company formation transaction, share-for-share transaction, intra-group transaction and liquidation distribution. It is proposed that amalgamation transactions also be subject to these provisions. Without these anti-avoidance rules, taxpayers could use the rollover mechanism to shift built-in gain assets into a transferee company with excess losses. Transferee companies could then immediately sell their transferred assets and setoff any gain against their own tax situation.

Further proposed amendments clarify the operation of the anti-avoidance rule to prevent this form of stuffing by providing for the ring-fencing of capital gains from capital assets disposed of within 18 months and impose a similar rule in respect of trading stock or allowance assets acquired under the abovementioned transactions that is disposed of within the 18 month period. This ensures the consistent treatment of capital assets, allowance assets and trading stock in this regard. In specific terms, a company transferee that disposes of a capital asset within 18 months after receipt in the abovementioned transactions is subject to restrictions on any gain stemming from that disposal. If the capital asset disposed of generates a gain, the company transferee cannot use any of its losses (i.e., any assessed loss, any balance of assessed loss, any capital loss, or any assessed capital loss) against the gain generated from that disposal. Likewise, in the case of the sale of trading stock or an allowance asset within the 18 month period the taxable income arising from that sale is ring-fenced and cannot be set off against an assessed loss or balance of assessed loss.
It is proposed that where a formation transaction or a share-for-share transaction is followed by an involuntary disposal under paragraph 65 of the Eighth Schedule, a disposal by way of an intra-group transaction or a liquidation distribution within 18 months, that disposal should not be subject to the anti-avoidance provisions. Furthermore, where an intra-group transaction is followed by an involuntary disposal, amalgamation transaction, intra-group transaction or liquidation distribution within 18 months, that disposal should not be subject to the anti-avoidance provisions.

Example of application of capital gain ring-fencing rule

**Facts:** On 5 April 2004, Company X owns all the shares of Company Y, both of which have been in existence for many years. Company Y has assessed capital losses of R200 000. Company X transfers land with a R180 000 value and a R20 000 base cost in exchange for additional Company Y shares as part of a valid section 42 rollover. On 20 September 2004, Company Y sells the land for R190 000.

**Result:** Company Y has R170 000 of gain on the land sale. This gain cannot be taken into account when determining the company’s net capital gain or assessed capital loss for the relevant tax year. It cannot, therefore, be set off against any capital loss or taken into account when determining an assessed capital loss (or, in the case of a natural person, qualify for the annual exclusion). The ring-fenced gain is subject to the provisions of paragraph 10 of the Eighth Schedule for the purpose of determining the taxable capital gain derived from the affected disposal. Company Y’s taxable capital gain of R85 000 so determined cannot be set off against any assessed loss or balance of assessed loss incurred by it and is therefore taxed in its hands as taxable income whatever the results, for tax purposes, of its other activities and disposals.

Example of application of ring-fencing rule in respect of trading stock

**Facts:** On 5 April 2004, Company X owns all the shares of Company Y, both of which have been in existence for many years. Company Y has a balance of assessed loss of R200 000 brought forward from the previous tax year. Company X transfers trading stock with a R180 000 value and a R30 000 cost, for purposes of section 22, in exchange for additional Company Y shares as part of a valid section 42 rollover. On 20 September 2004, Company Y sells the trading stock for R190 000.

**Result:** The sale of the affected trading stock must be treated as a disposal in the course of a separate trade carried on by Company Y. The taxable income derived from that trade is, therefore, determined with reference to the amount received or accrued in respect of that disposal and the amount taken into account under section 22 in respect of that stock. The resulting taxable income of R160 000 derived by Company Y from the disposal of the affected trading stock is ring-fenced in its hands, as it cannot be set off against any assessed loss or balance of assessed loss incurred by it. It is therefore taxed in its hands as taxable income whatever the results of its other activities and disposals.

**Multi-tier rollovers**

To allow multi-tier rollovers, all of which occur simultaneously or within a short-time frame, would enable transferors to use these rollovers as a mechanism to dilute the nexus in the assets transferred below any meaningful level (thereby resulting in an indirect cash-out). For instance, a transferor could transfer assets to an unlisted newco company in exchange for a 30 per cent equity share interest in that unlisted company, and that unlisted newco company could then retransfer those same assets
to a second unlisted newco company in exchange for a 30 per cent equity share interest in that second company. This result would leave the initial transferor with only a 1/9th effective interest in the assets transferred (far below the more than 25 per cent minimum threshold), a situation where the initial transferor’s interest in the assets transferred becomes too remote.

In order to prevent multi-tier transactions of the kind just described, company formation rollover relief does not apply to a company transferring assets if that company acquired those assets in a company formation transaction within the previous 18-months. Likewise share-for-share rollover relief does not apply to a company transferring equity shares if that company acquired those shares in a share-for-share transaction within the previous 18-months.

However, the initial transferors will not suffer any penalty for the subsequent transaction. The initial transferor should not be held hostage to the subsequent actions of the transferee company because the activities of the transferee company are often outside the initial transferor’s practical control.

**Determination of total equity share capital**

Currently, in determining total equity share capital on a specific date for purposes of the definition of controlling company, the company formation transactions, share-for-share transactions, intra-group transactions and liquidation distributions regard must be had to any agreement in terms of which any person is entitled to acquire equity share capital in the relevant company at no or nominal cost. In order to simplify the application of the corporate rules it is proposed that this requirement be deleted.

**Loss rollovers**

It is proposed that the anti-avoidance rules which were aimed at preventing rollovers of a capital loss where an asset, the market value of which is lower than its base cost, is transferred under a company formation transaction or a share-for-share transaction be deleted. Theoretically, it should be impossible for a taxpayer to shift built-in loss assets into a transferee company because rollover treatment under those transactions applies only to built-in gain assets. As a result, all losses stemming from built-in loss assets transferred should be triggered. These rules are complex and administratively unworkable. Similarly, the rules providing for the disregarding of capital losses in respect of the disposal of capital assets within a period of 18 months from the date of a formation transaction, share-for-share transaction, intra-group transaction or liquidation distribution are complex, could be regarded as unfair and should also be deleted. The deletion of these provisions will also result in a marked simplification of the corporate rules.

**Anti-avoidance**

In section 41(2) it is specifically stated that the provisions of Part III must apply notwithstanding any provision to the contrary contained in the Income Tax Act. However, section 103 may still be applied to address schemes for the avoidance of tax.

Provision is made in the Act for regulations to be issued by the Minister to prescribe the circumstances under which prior approval of the Commissioner must be obtained as a pre-requisite for the application of the provisions. The issuing of these regulations is, however, optional at the instance of the Minister. It is not the intention that any such regulations which may be issued will apply with retroactive effect.
COLLECTIVE INVESTMENT SCHEMES CONTROL ACT

The Collective Investment Schemes Control Act, 2002, which was introduced this year, replaces two existing Acts, namely, the Unit Trusts Control Act, 1981, and the Participation Bonds Act, 1981. The new Act provides a comprehensive modern legislative framework to regulate and supervise the collective investment industry which includes equity unit trusts, property unit trusts and participation mortgage bond schemes. The provisions of the Act are based on internationally accepted principles and best practices.

There are a number of references in the Income Tax Act, 1962, to the two Acts that have been repealed and a number of consequential amendments are, therefore, being proposed to the Income Tax Act, 1962, and other revenue laws to bring them in line with the new dispensation. The changes proposed merely maintain the status quo and do not provide for special rules for new vehicles catered for in the Collective Investment Schemes Control Act, 2002.

CLAUSE 1

Marketable Securities: Amendment of section 3 of the Marketable Securities Tax Act, 1948

This amendment is consequential upon the amendment to the corporate restructuring rules contained in sections 41 to 47 of the Income Tax Act, 1962.

CLAUSE 2

Transfer Duty: Amendment of section 1 of the Transfer Duty Act, 1949

Currently, transfer duty on the acquisition of immovable property is avoided by placing the property in a company. Persons who so hold their immovable property through a company dispose of the shares in the company to the person who wishes to acquire the property. As there is no registration of transfer in the Deeds Registry, no transfer duty is payable as the property remains registered in the name of the company. Similarly, immovable property is placed in a trust and which the “owner” is the beneficiary. When the person wishes to dispose of the property, there is merely a substitution of beneficiaries and there is no registration of transfer of the immovable property. New provisions are, therefore, being inserted in the Transfer Duty Act, 1949, to address this abuse.

Sub-clause (a): A new definition of “acquired” is inserted to make it clear that the acquisition of a contingent right in a trust that holds either a residential property or share in a property owning company, will be subjected to transfer duty.

Sub-clause (b): The definition of “fair value” has been extended to cover the abnormal situation created by these schemes. Normally a contingent right has no value and shares are valued on the basis of a net asset value. To overcome this all liabilities are disregarded. Another anti avoidance measure is to prevent the current shareholder from issuing new shares to the “buyer of the house” for a nominal value where the buyer introduces the full consideration for the house as a loan, later on, a buy back of the shares of the seller takes place. Normally the fair value is arrived at by subtracting the liabilities (R500 000 loan) from assets (R500 000 house) and duty
will be paid on a negligible amount (R1 share issued). In the case of residential property entities the amendment disregards any debt (R500 000 loan) and financial instruments in determining the amount on which the duty is to be payable.

**Sub-clause (c):** Shares held in a company or members interest in a close corporation is deemed to be property. Therefore the disposition thereof attracts duty.

**Sub-clause (d):** A new definition “residential property company” was inserted to single out close corporations and companies where the only asset or the majority of the assets in value, consist of a house, thereby avoiding duty on the sale of the shares or members interest. This includes where more the one company is owned outside of a group structure such as where a holiday home or a speculation house are held in two CC’s.

The definition goes further to include passive land holding if it is zoned residential. The intention is to exclude all business enterprises and is achieved by two tests. The first deals with non VAT registered vendors and the other with VAT vendors. The first test applies to apartments, hotels, motels and any business to the extent it is a business enterprise or has the markings of a business enterprise. Indicators of this would be:

- It is a scheme of profit making as opposed to incidental income earned from the letting of the holiday home for a few months in the year.
- Existence of income flow from holding the asset.
- Frequency of transactions.
- Existence of plausible benefits as to why the property should be held in this form other than for tax reasons.
- Not occupied by the shareholder or trustee/beneficiary or any connected person.
- The stated business in the Articles and Memorandum of Association or the Founding Statement.

The second test applies to the same set of people, however, the business must be registered for Value Added Tax (VAT) where the property forms an indivisible part of the business activity, for example, a law practice in a residential suburb where the land, improvements and the business are VAT registered. Such a business is excluded from these amendments because on the sale of the enterprise VAT will be charged, or should the enterprise cease trading, VAT output must be accounted for on all assets held by that enterprise, including the land and improvements.

To overcome the problem with connected parties a 50% test is inserted. It is the underlying asset held by the company that is under scrutiny and not the shareholding in the company. The test is at fair market value (at the date of acquisition of shares or substitution of trustee/beneficiaries) thus preventing the company from artificially inflating the assets by introducing financial instruments or introducing several but insignificant assets to break the test.

It also caters for multiple shareholder since the duty is triggered by the sale or any similar transaction of any shareholders interest in such company, the proportional duty is then payable.

**Sub-clause (e):** Discretionary trusts are contractually constructed in such a way that until the beneficiary accepts, he is not supposed to have any rights at all. The founder may reserve the right to vary the trust or confer that right to the trustees. The trust deed can be varied by agreement between the donor and trustee so as to
revoke benefits to a third party, provided the beneficiary has not accepted the benefits thereunder.

Therefore, a trustee is at liberty to agree with the donor to amend or vary the trust deed so as to remove or substitute those beneficiaries who have not acquired vested rights or have not yet accepted benefits even if they acquired vested rights despite the fact that named beneficiaries who have not yet had rights conferred on them may be prejudiced thereby.

To avoid the complexities of the above, the amendments simply deem an acquisition of the property when any or all of the trustees and/or contingent beneficiaries are substituted in a trust.

Because the specific naming of a contingent beneficiary will trigger duty, it was necessary to insert an exception for natural persons who are named contingent beneficiaries of the trust for reasons that are not related to any scheme for the avoidance of duty. Situations like the births, adoptions or extending the family due to a second marriage should not trigger duty.

**CLAUSE 3**

*Transfer Duty: Amendment of section 3 of the Transfer Duty Act, 1949*

As described above, the special and artificial nature of the transactions require that the person liable for the transfer duty be expanded.

An interest in a company or close corporation is property as defined, therefore, the buyer of the interest is liable for the duty. The amendments extend the liability to the public officer or seller who will be jointly and severally liable for the transfer duty should the buyer fail to pay. Similarly, the newly named beneficiaries of a trust will be liable for duty. However, should they fail to pay the duty, the trust and former and current trustees will be jointly and severally liable for the duty.

**CLAUSE 4**

*Transfer Duty: Amendment of section 9 of the Transfer Duty Act, 1949*

This amendment is consequential upon the amendment to corporate restructuring rules in sections 41 to 47 of the Income Tax Act, 1962.

**CLAUSE 5**

*Estate Duty: Amendment of section 4 of the Estate Duty Act, 1955*

Section 4(h) of the Estate Duty Act, 1955, provides for a deduction from the net value of an estate for estate duty purposes, of the value of any property included in the estate which accures or accrued to a public benefit organisation, the State, a local authority or certain institutions, boards or bodies established by law.

Section 4(h) was amended by the Taxation Laws Amendment Act, 2002, (Act No. 30 of 2002 to provide that the property must accrue to the relevant entity “by way of bequest”. The words “by way of bequest”, however, have unintended consequences
as they do not, for example, include property transferred during the lifetime of the deceased in terms of a donation mortis causa to an entity contemplated in section 4(h), but which is included in the deceased’s estate before being transferred to the relevant entity.

It is, therefore, proposed that these words be deleted.

CLAUSE 6


Subclause (a): See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

Subclause (b) and (e): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (c), (d) and (j): A number of definitions which are contained in specific sections are used in other provisions throughout the Act. These include the definitions of “controlled group company”, “controlling group company”, “group of companies”, “controlled foreign company” and “designated country”. It is, therefore, proposed that these definitions be moved to section 1 and be of general application.

Subclause (f): At present the portion of a dividend declared out of profits of a capital nature on liquidation is not regarded as a dividend for tax purposes and, therefore, not subject to STC. As was announced by the Minister of Finance in the Budget Review this year, the definition of “dividend” is to be amended to include profits of a capital nature for liquidation distributions. It is proposed that these provisions must apply in respect of dividends declared on or after 1 January 2003 from any profits which are attributable to any gain that accrued on or after 1 October 2001.

Subclause (g): The term “financial instrument” is used in a number of provisions throughout the Act, including section 9D and Part III of Chapter II which contains the corporate restructuring rules. There is, however, no definition of “financial instrument” in the Act other than the definition contained in the Eighth Schedule to the Act for purposes of the CGT provisions. It is proposed that the definition be moved to section 1 of the Act to also apply in respect of the provisions of the main body of the Act.

Subclause (h): A foreign equity instrument includes a share listed on any recognised exchange outside the Republic. The Act does, however, not contain any definition of a “recognised exchange” other than the definition contained in the Eighth Schedule for purposes of CGT. It is proposed that the reference to “recognised exchange” in the definition of “foreign equity instrument” be deleted and that the definition be extended to include any foreign stock exchange which is similar to a South African stock exchange or any of the other stock exchange which has been recognised by the Minister of Finance for the purposes of the Eighth Schedule. It would be also include any regional or local exchange and any interdealer quotation system that regularly publishes or releases firm buy or sell quotation.

The amendment to paragraph (b) of the definition of “foreign equity instrument” is consequential upon the introduction of the Collective Investment Schemes Control Act, 2002.
Subclause (k): A number of provisions in the Act contain a reference to companies listed on a stock exchange. As it is, in fact, the shares of the company, as opposed to the company itself, which is so listed, it is proposed that all these provisions be amended to reflect this. For this purpose, it is proposed that a definition of “listed company” be inserted in section 1. A listed company is defined as a company, the shares of which are listed on—

(a) a stock exchange as defined in section 1 of the Stock Exchanges Control Act, 1985 (Act No. 1 of 1985); or

(b) a stock exchange in a country other than the Republic, which is similar to a South African stock exchange, which has been recognised by the Minister of Finance for purposes of the Eighth Schedule.

Subclause (l): Employees of local authorities have traditionally been members of retirement funds that were treated for tax purposes on the same basis as public service retirement funds. With the establishment of so-called municipal entities (local authority-controlled private companies taking over some of the functions of local authorities, like the provision of sanitary services), the services of some of the local authority employees were transferred to the municipal entities. These employees, however, wanted to remain members of the local authority retirement fund. Prior to 2001, the Income Tax Act, 1962, did not recognise the fact that a local authority retirement fund could have members other than employees of a local authority. The Income Tax Act was amended in 2001, to recognise the existence of a local authority fund with members who are employees of a municipal entity, if the fund was established before 14 November 2000. This meant that the accrued public sector rights of these employees continued to be protected under cover of the rules of the local authority retirement fund. This is the current position.

Subsequent to the amendment, a new umbrella local authority retirement fund was established, and the members of the local authority retirement fund who are employed by the municipal entities now want to become members of the new fund. However, if they do, they will forfeit their “public sector tax protection” under the existing fund. To accommodate them, it is proposed that the Income Tax Act, 1962, be amended to recognise the existence of this type of a retirement fund, on condition that the fund complies with the requirements for tax approval that applies to private sector retirement funds. This would mean that the tax benefits of the members of the fund who were members prior to 1 March 1998 (when the “public sector tax benefits” started being phased out) will continue to be protected in the newly established funds even though the funds would for all other members be treated on the same basis as private sector funds.

Subclause (m): Currently, the rate of interest applicable in respect of outstanding taxes and refunds are determined by the Minister of Finance for purposes of the Income Tax Act, 1962. Section 80 of the Public Finance Management Act, 1999 (PFM Act), however, also provides that the Minister of Finance must determine a uniform rate of interest in respect of debts due to the State which must be paid into a revenue fund. This includes taxes, duties and levies payable in terms of any revenue Act, as they are debts due to the State and must be paid into the National Revenue Fund. It is, therefore, proposed that the definition of “prescribed rate” in section 1 of the Income Tax Act, 1962, be amended to link the rate of interest on outstanding taxes to the rate determined by the Minister of Finance in terms of the PFM Act. The interest rate in respect of refunds of provisional tax will be linked to four percentage points below this rate.

Subclause (n): See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.
Subclause (o): Deletion of a reference to an obsolete provision.

Subclause (p): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (q): Currently, the definition of “taxpayer” refers to any person who is chargeable with any tax leviable under the Act, and includes for purposes of any provision in the Act relating to returns, every person who is required by the Act to furnish a return. It is proposed that the wording be amended to provide that a person who must submit a return must be regarded as a taxpayer for all provisions of the Act.

The definition also includes a reference to Part IV of Chapter III of the Act which has been repealed and it is proposed that the reference to the obsolete provisions be deleted.

Subclause (r): The definition of “trading stock” includes inter alia—
- anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf; or
- the proceeds from the disposal of which forms or will form part of his gross income.

The intention with the wording was not to include assets, where the proceeds from the disposal of that asset is of a capital nature, but where the recovery or recoupment of any amount deduction previously allowed to that person as a deduction in respect of that asset is included in his or her gross income. It is, therefore, proposed that the definition be amended to clarify this.

CLAUSE 7


Section 3(4) refers to the discretionary provisions in the Act which are subject to objection and appeal. It is proposed that the provisions which allow for objection and appeal in respect of the exercise by the Commissioner of his or her discretion in terms of section 9E and 30 be moved to section 3(4).

CLAUSE 8


Subclause (a): Section 4 was amended last year to provide that the Commissioner may provide information to the National Police Commissioner and National Director of Public Prosecutions in the case where the Commissioner obtains information that a serious crime has been committed or that there is a public safety or environmental risk. Section 4 states that the National Police Commissioner and National Director of Public Prosecution may only use the information obtained in terms of section 4 for purposes of any investigation or prosecution of an offence. It is proposed that the provisions be extended to also provide that the information may be used to combat any public safety or environmental risk.

Subclause (b): In terms of section 4 the Commissioner may provide information to
the Statistician-General, Director-General of National Treasury, National Police Commissioner or National Director of Public Prosecution under certain circumstances. This information may be used by them only for purposes prescribed by the Act. There is, however, no sanction contained in section 4 in the case where these officials do not comply with this provision. It is, therefore, proposed that section 4 be amended to provide that it will constitute an offence where the Statistician-General, Director-General of National Treasury, National Police Commissioner or National Director of Public Prosecution discloses information obtained in terms of section 4, otherwise than as provided for in that section.

CLAUSE 9


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 10


The amendment of section 7 is consequent upon the change of the reference in section 9D from "controlled foreign entity" to "controlled foreign company".

CLAUSE 11


Subclause (a): It is proposed that allowances or advances received by or accrued to a person stationed outside the Republic and employed by any national or provincial public entity, which is substantially funded by Parliament, not be included in taxable income if they are attributable to that official’s services rendered outside the Republic.

Subclause (b): It is proposed that the deemed daily expenses in respect of meals and incidental costs be restructured with a view to providing more specific guidance in respect of foreign travel and to increase the amounts available in respect of domestic travel. These amounts will be set by the Minister of Finance by way of notice in the Gazette in respect of each year of assessment.

Subclause (c): As section 8(4)(k)(ii) presently reads, it deems an amount to have been recovered or recouped by a person in respect of an allowance previously allowed in respect of an asset, where that asset is distributed as a dividend. One of the deficiencies of the present provision is that an asset can be transferred to a shareholder by means other than a dividend as defined. Examples include capital profits distributed during winding-up and reductions in share capital. In such circumstances it might not be possible to recoup an allowance previously allowed in respect of such an asset.

It is, therefore, proposed that the reference to the distribution of a dividend be deleted and replaced by a reference to the transfer of an asset to a shareholder in whatever manner or form. This is a much wider concept that will ensure that all methods of distribution of assets to a shareholder are covered.
CLAUSE 12


Subclause (a): This amendment is consequential upon the amendments in CLAUSE 11(a).

Subclause (b): See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES, specifically the subheading dealing with source rules.

CLAUSE 13


The provisions relating to blocked funds, i.e. amounts which may not be remitted to the Republic as a result of the currency restrictions or limitations of the country where the amounts arose, were previously contained in section 9F. As these provisions relate to all funds, including amounts imputed to residents in terms of section 9D, it is proposed that a separate section be inserted to specifically deal with blocked funds.

CLAUSE 14


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 15


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 16


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.
CLAUSE 17


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 18

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

Subclauses (a), (b) and (c): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (d): Currently, section 10(1)(k)(iA) provides for an exemption from tax of any dividend received by or accrued to a unit portfolio. As a general exemption of dividends for all persons already exists in section 10(1)(k)(i) it is proposed that subparagraph (iA) be deleted.

Subclauses (e) and (g): See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

Subclause (f): This amendment is of a textual nature and is consequential upon the amendment of section 10(1)(o)(ii).

Subclause (h): Section 10(1)(t)(xv) provides for an exemption from tax of the receipts and accruals of a recognised company as contemplated in section 2 of the Provision of Special Funds for Tertiary Education Act, 1993 (Act No. 121 of 1993), which has been approved by the Commissioner. The Tertiary Education Fund of South Africa (TEFSA) was approved by the Commissioner in terms of these provisions. This Act was, however, repealed on 19 November 1999 by section 28 of the National Student Financial Aid Scheme Act, 1999 (Act No. 56 of 1999). The transitional provisions of that Act, however, provided that TEFSA continues to perform the functions until a date determined by the Minister of Education by notice in the *Gazette*. That Minister determined 29 July 2000 as the date on which TEFSA ceased to perform its functions (Government Notice No. 777 published in *Gazette* No. 21444 of 2 August 2000). It is, therefore, proposed that the specific exemption contained in section 10(1)(t)(xv) be withdrawn.

Subclauses (i) and (j): These amendments are consequential upon the repeal of section 11bis.

CLAUSE 19


Subclause (a): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (b): This amendment deletes a reference to an obsolete provision.
CLAUSE 20

**Income Tax: Repeal of section 11bis of the Income Tax Act, 1962**

Section 11bis provided for a marketing allowance for exporters. This provision is, however, no longer in use and it is, therefore, proposed that section 11bis be repealed.

CLAUSE 21

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

*Subclause (a):* This amendment is consequential upon the insertion of a definition of “listed company” in section 1 of the Income Tax Act, 1962, and the introduction of the Collective Investment Schemes Control Act, 2002.

CLAUSE 22

**Income Tax: Amendment of section 12G of the Income Tax Act, 1962**

*Subclause (a):* The provisions of section 12G grants an additional industrial investment allowance in respect of industrial assets which are contracted for or acquired on or after the date of approval of a strategic industrial project. The concern was raised that foreign companies who wish to invest in the Republic may already have contracted for or acquired the relevant assets while considering in which country they plan to invest. It is proposed that the application of this section be extended to also apply in respect of assets acquired before the date of approval but which are brought into the Republic on or after the date of approval.

*Subclauses (b), (c), (f) and (g):* Currently, the provisions of section 12G require that the industrial asset in respect of which the section applies must be brought into use within three years of the date of approval of the strategic investment project. It is proposed that this period be extended to four years as the concern has been raised that the three year period is unrealistic.

*Subclause (d):* An industrial project for purposes of section 12G includes the manufacturing of certain products, goods, articles or other things which are classified under “Major Division 3: Manufacturing” in the most recent Standard Industrial Classification (SIC) issued by Statistics South Africa. The concern has been raised that the new projects may intend to manufacture goods which are for some reason not yet classified under any SIC code. It is, therefore, proposed that the definition be extended to also cater for instances where the adjudication committee is of the view that the manufacturing of those goods will be so classified once the project is in operation.

*Subclause (e):* This amendment is of a textual nature.
CLAUSE 23

*Income Tax: Amendment of section 20 of the Income Tax Act, 1962*

This amendment is of a textual nature and deletes a reference to an obsolete provision.

CLAUSE 24

*Income Tax: Amendment of section 22 of the Income Tax Act, 1962*

Paragraph (jA) was inserted in the definition of “gross income” last year, to include any amount received or accrued from the disposal of any asset manufactured by a person, which is similar to any trading stock manufactured by the person, but which is used for purposes other than the sale thereof. An example is the sale of company cars manufactured by a car manufacturer, but which are used by its employees. The fact that the amount derived on disposal must be included in “gross income” means that the asset constitutes trading stock with the result that the provisions of section 22 apply thereto. In order to address an anomaly which has resulted from the fact that capital assets now become trading stock and to avoid potential double taxation, it is proposed that section 22(8) be amended to provide that section 22(8)(b)(iv) does not apply to these assets.

CLAUSE 25


These amendments are consequential upon the repeal of section 11*bis*. Section 24F contains a number of references to certain definitions contained in section 11*bis*. As section 11*bis* is now being repealed, it is proposed that the relevant provisions to which section 24F refers, be reworded for that purpose and be included in section 24F.

CLAUSE 26


This amendment is consequential upon the repeal of section 11*bis*.

CLAUSE 27


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.
CLAUSE 28


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 29


This amendment is consequential upon the repeal of section 11bis.

CLAUSE 30

*Income Tax: Amendment of section 29A of the Income Tax Act, 1962*

This amendment is consequential upon the introduction of the residence basis of taxation.

CLAUSE 31

*Income Tax: Amendment of section 30 of the Income Tax Act, 1962*

*Subclause (a):* This amendment is consequential upon the amendment of the definition of “public benefit activity” by section 22 of the Taxation Laws Amendment Act, 2002 (Act No. 30 of 2002), which came into effect on 5 August 2002.

*Subclause (b):* Subsection (10) empowers the Commissioner to request any person to furnish information or to answer questions relating to a public benefit organisation. It is proposed that this subsection be deleted as the Commissioner already has these powers by virtue of the information gathering provisions contained in sections 74 to 74D. Subsection (11), furthermore, provides that certain decisions of the Commissioner shall be subject to objection and appeal. It is proposed that this provision be deleted and that section 3(4) which contains a reference to all the provisions which are subject to objection and appeal, be amended to include a reference to section 30.

CLAUSE 32


Section 35 proposes a final withholding tax on certain royalties paid by a resident to any non-resident. It is proposed that this final withholding tax should not apply in respect of royalties paid to any controlled foreign company as the amount of the royalty must be taken into account in the net income of the CFC to be included in the income of the resident shareholder in terms of section 9D.
CLAUSE 33

*Income Tax: Amendment of section 38 of the Income Tax Act, 1962*

See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

CLAUSE 34


Special rules relating to company formations, share-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distributions

Section 41 - General

Definitions

The definitions of “asset”, “base cost” and “disposal” have been inserted as they are used in various instances in the corporate rules embodied in Part III.

The concept of a “depreciable asset” has been replaced with the concept of an “allowance asset”: The corporate rules extend rollover treatment to any asset of a person if that asset qualifies for a deduction or allowance under the Act that must be included in the income of that person in the year following that, in which it is allowed or that is subject to recoupment in the hands of that person. The inclusion or potential recoupment associated with an asset transferred in terms of a company formation transaction shifts to the transferee company. All the remaining allowances or deductions associated with that asset also shift to the transferee company as if that company held those assets all along. This proposed amendment replaces the concept of a “depreciable asset” with the wider concept of an “allowance asset” and deletes a superfluous qualification of that concept that has the unintended effect of excluding farming assets falling under the First Schedule from this relief.

A definition of “domestic financial instrument holding company” is introduced which replaces and significantly relaxes the current limitation on the transfer of financial instruments. The definition and the criteria built into the definition are applied throughout Part III to limit company formation transactions, share-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distributions transactions. As a general rule the transfer of financial instruments or of a company, where more than 50 per cent of the market value or actual cost of all the assets of that company together with any controlled company in relation to that company is attributable to financial instruments, is unacceptable. However, an exception is made for debts in respect of goods sold or services rendered by that company or transferor where the amount of the transaction was included in the income of that entity and the debt is an integral part of a business conducted by that entity as a going concern. An important further exception is made for financial instruments of, or financial instruments transferred to certain regulated financial institutions, e.g. banks, insurance companies and collective investment schemes.

In the case where financial instruments as a percentage of all assets of a group of companies in relation to a company is determined shares held in controlled group companies as well as loans, advances or debts between companies which form part
of that group of companies are disregarded.

The definition of “equity share” has been amended. A company, as defined in section 1, includes a close corporation. The definition of “equity share” does not extend, however, to a member’s interest in a close corporation. This amendment is aimed at remedying this omission.

The amendment to the definition of “listed company” is consequential upon the insertion of a definition of ‘listed company’ in section 1 of the Act. See CLAUSE 6.

In order to clarify what would qualify as “equity shares held” in the context of the corporate rules the concepts “held” and “shareholder” are defined. The registered shareholder of an equity share is the holder of an equity share unless another person is entitled to all or part of the benefit of the rights of participation in the profits or income attaching to that equity share. In that case the other person will be deemed to be the shareholder. This ensures that the beneficial owner of an equity share would qualify as the holder of the share and not an entity in whose name the equity share is registered in its capacity as nominee on behalf of the beneficial owner.

It is proposed that a new definition of “qualifying interest” be introduced. It means equity shares held by a person in a company which—

• is a listed company;
• will become a listed company within 12 months; or
• constitutes more than 25 per cent of the equity shares in any other company.

This concept is used to determine a qualifying interest for company formations and amalgamation transactions. The rule in respect of a company which will become listed within 12 months replaces the current provision requiring the company to be listed within a period of six months or such further period, not exceeding six months, which is subject to the discretion of the Commissioner.

Section 42 – Company formations

Subsection (1): The definition of “company formation transaction” has been amended.

The proposed change is aimed at clarifying the position where a person acquires a qualifying interest as a result of a number of transactions effected on the same date. The question whether such a transaction can qualify as a company formation transaction will, therefore, depend on the extent of that person’s interest in the equity share of that company at the end of that day, and not on the extent of such interest after each of those transactions.

Currently, rollover relief does not apply to capital assets, the base cost of which exceeds their market value at the time of transfer to the company, i.e., assets, the disposal of which gives rise to a capital loss. It is proposed that a similar qualification be inserted in respect of trading stock qualifying for rollover relief.

Subsection (2): Provision is made for the transferee company to acquire an asset held by the transferor as a capital asset as either a capital asset or as trading stock. However, an asset which was held by the transferor as trading stock may only be acquired by the transferee as trading stock and not as a capital asset. This limitation is introduced to avoid gains on disposal of the asset being subject to a lesser tax
burden. The transferor may hold the equity shares received in terms of the formation transaction as either capital assets or trading stock irrespective of the nature of the formation asset.

Subsection (3): See notes on CORPORATE RESTRUCTURING RULES.

Subsection (4): Where an asset is disposed of to a company under a company formation transaction for a consideration consisting partly of something other than equity shares issued by that company, the disposal to that company is treated partly as a sale of that asset and partly as a company formation transaction eligible for rollover relief. The proposed amendment clarifies the rules regarding the determination of the portion of the base cost in the case of a capital asset, allowances allowed in the case of an allowance asset or amount in the case of trading stock to be taken into account in the transferor’s hands as the part of the asset disposed of which does not qualify for rollover relief.

Subsection (5): Taxpayers can transfer allowance assets and/or trading stock for company transferee shares pursuant to a section 42 rollover, followed by a capital gain sale of the company transferee shares initially received. This subsection accordingly contains anti-avoidance rules that prevent transactions mainly designed to exploit this possibility. Under these anti-avoidance rules, company transferee shares, received in exchange for section 42 rollover assets, will be treated as having been disposed of as trading stock if:

(a) more than 50 per cent of the assets (in terms of fair market value) transferred by the transferor to the company transferee under a company formation transaction consist of allowance assets and/or trading stock; and

(b) the transferor subsequently disposes of those shares within 18 months after their acquisition under a company formation transaction (unless the disposal stems from death of the transferor, an involuntary disposal, intra-group transaction, unbundling transaction or liquidation distribution).

The character of shares in a transferee company falling outside these rules is determined in terms of the general principles as modified by certain statutory rules (such as section 9B).

The proposed amendment makes it clear that the 50% test that is applied every time a person disposes of a share acquired under a corporate formation transaction takes into account all transfers of assets by that person to the relevant company under a company formation transaction effected at any time prior to the disposal of that share.

Subsection (6): Transferors involved in a company formation transaction with an unlisted company must hold a qualifying interest in that company for at least 18 months after that transaction. Failure to maintain this interest for the required period is treated as a disposal event in respect of all the shares acquired by the transferor under the formation transaction. Where the transferor’s interest is reduced due to an actual disposal of some of the shares, the transferor is deemed to have disposed of any shares still retained at a price equal to their market value at the time they were originally acquired under the company formation transaction. The gain in the transferor’s hands initially deferred under the company formation transaction is therefore crystallised, while the base cost of the retained shares is also adjusted to their market value at the time of their acquisition under the formation transaction.

Shares actually disposed of are deemed to have been disposed of at the higher of actual proceeds or their market value at the time of that disposal. The latter rule is inconsistent with some of the other rules applying to actual disposals and is
considered to be superfluous in view of the anti-avoidance provisions of the Eighth Schedule regarding non-arm’s length transactions. It is, therefore, proposed that it be deleted in order to simplify the provisions. It is also proposed that disposals in terms of an intra-group transaction, an unbundling transaction or a liquidation distribution or as a result of an involuntary disposal or death of the transferor be excluded from the rule in order to bring it into line with similar rules applying in respect of other corporate transactions.

Subsection (7): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (8): Taxpayers may transfer property subject to previously existing debt, thereby creating debt relief for the transferor. In the case of a company formation, any such debt relief for the transferor is economically akin to the receipt of consideration other than equity shares of the transferee company.

As a general rule, this form of debt relief should trigger part-disposal treatment under subsection 4. However, pure part-disposal treatment for this form of debt relief is problematic in practical terms because company formations regularly involve non-tax motivated transfers of property secured by debt. Business assets such as land, plant and equipment are customarily debt financed. Theoretical purity triggering part-sale treatment would thereby undo the main intent of making company formations tax-free.

In order to eliminate this practical concern, the transfer of certain categories of debt-secured capital assets is exempt from part-sale treatment under subsection 4. These categories of exempted debt assumptions involve situations that typically arise in company formations. These categories do not cover situations where a transferor borrows against property immediately before a company formation in order to achieve a disguised tax-free partial cash-out. These exempt categories of debt-secured asset transfers include the transfer of any capital asset secured by debt if that debt was incurred more than 18 months before the company formation. The transfer of any asset secured by refinanced debt incurred within 18 months before the company formation, is also excluded, if that refinanced debt was incurred at the same time as that asset was acquired.

Transfers of debt secured property subject to exemption receive full rollover treatment. The transferor has no gain on the transfer, and the transferee company receives a base cost in the transferred asset equal to the base cost of that asset in the hands of the transferor. However, tax-free treatment in this circumstance comes with a price. The transferor receives a base cost in the equity shares of the transferee company equal to the base cost of the asset or business undertaking transferred, but must add the face value of the debt to proceeds or the amount to be included in the transferor’s income when that transferor disposes of the equity shares of the transferee company.

Example

Facts: On 10 January 2004, Individual transferred mortgaged land to Newco in exchange for all 100 Newco ordinary shares. Individual has owned the land for 10 years along with the corresponding mortgage. The land has a R500 000 value and a R200 000 base cost. The mortgage equals R70 000 at the time of the transfer and the bank agrees to the substitution of debtors.

Result: The transfer of mortgaged land is tax-free because the mortgage has been in existence more than 18-months before the transfer. Individual receives a base cost of R200 000 in the Newco shares. Newco receives a R200 000 base cost in the land.
Individual will have to add R70 000 to the proceeds from the disposal of the equity shares. Individual will in effect be deemed to have received an additional R70 000 of proceeds upon any subsequent sale of the Newco shares.

The proposed amendments clarify this rule and extend it to trading stock to ensure the consistent treatment of trading stock and capital assets acquired under company formation transactions. They also provide for the application of the rule in spite of the fact that the transferor may be liable as a surety for the payment of the debt delegated to the transferee company as part of the company formation transaction.

Subsection (9): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (10): See notes under CORPORATE RESTRUCTURING RULES.

Section 43 – Share-for share transactions

Subsection (1): It is proposed that the definition of “share-for-share transaction” be amended to provide that a share-for-share transaction only applies to shares where the market value exceeds the base cost of the shares held as capital assets or the amounts taken into account in terms of sections 11(a), 22(1) or 22(2) in the case of assets held as trading stock.

Currently, any share-for-share transaction entered into in terms of an offer made on the same terms as the transaction and which is accepted within a period of 45 days before or after that transaction is taken into account to determine whether the acquiring company holds the required direct interest in the target company. It is proposed that the period be changed to take into account any other share-for-share transaction entered into within a period of 90 days after the first transaction.

It is not clear when the transferor of the target shares must hold the required interest in the equity share capital of the acquiring company. The reworded provision now provides that the qualifying interest must be held at the close of day during which the share-for-share transaction is effected.

Subsection (2): The person who disposes of the shares in the target company, in terms of a share-for-share transaction, may acquire the shares in the acquiring company as either capital assets or as trading stock where the shares in the target company were held as capital assets and acquired as trading stock where the shares in the target company were held as trading stock, at the same tax values as the shares disposed of.

Provision is made for an acquiring company to acquire target company shares as either capital assets or as trading stock at the tax value to the person who disposed of the shares irrespective of whether the shares were held as capital assets or trading stock in the hands of that person. However, where the target company is a listed company the acquiring company is in certain instances deemed to have acquired the shares at market value.

See “Transferor and transferee deemed to be one and the same with respect to the transfer of assets” under CORPORATE RESTRUCTURING RULES.

Subsection (3): The part-disposal rules are similar to those contained in section 42(4).

Subsection (4): The requirement, that an interest of more than 50 per cent be held for
a period of 18 months in the acquiring company by the person who disposed of the target shares, is similar to the rule contained in section 42(6). Where the qualifying interest is not so held, the roll-over gain at the time of the share-for-share transaction is triggered. See explanation under section 42(6).

Subsection (5): It is proposed that where an acquiring company ceases to hold the required interest in the target company within a period of 18 months from the date of the share-for-share transaction, the roll-over gain at the time of the share-for-share transaction is triggered. Provision is made for exceptions to these rules for subsequent involuntary disposals, intra-group, unbundling and liquidation transactions.

Subsection (6): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (7): See notes under CORPORATE RESTRUCTURING RULES. In addition to the limitation where the target company constitutes a domestic financial instrument holding company, a foreign financial instrument company as defined in section 9D will also not qualify as a target company.

Subsection (8): See notes under CORPORATE RESTRUCTURING RULES.

Section 44 – Amalgamation transactions

Subsection (1): The scope of the current corporate rules does not include the merger or amalgamation of companies. It is therefore proposed that specific rules be introduced to provide relief for amalgamation transactions. An amalgamation transaction means any transaction—

• in terms of which a company (amalgamated company) which is a resident, disposes of all its assets and transfers all of its obligations to another company (resultant company) which is a resident, by means of an amalgamation, conversion, merger or similar scheme;
• as a result of which that amalgamated company’s existence will be terminated; and
• in respect of which that amalgamated company and that resultant company have jointly elected that this section applies.

In order to enable collective schemes in equities (which are referred to in paragraph (e)(i) of the definition of “company”) to also qualify for the amalgamation relief, the definitions of “equity share” and “qualifying interest” have been extended to include those companies.

Subsection (2): See “Transferor and transferee deemed to be one and the same with respect to the transfer of assets” under CORPORATE RESTRUCTURING RULES.

Subsection (3): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (4): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (5): Where the shareholder (other than a trust which is not a special trust) of the amalgamated company disposes of equity shares, that shareholder will qualify for roll-over relief if the market value of the shares exceeds the base cost or the amount for trading stock purposes, as the case may be. The shareholder can acquire the shares in the resultant company as either capital assets or as trading
stock. This principle is similar to that applied in respect of share-for-share transactions.

Subsection (6): The part-disposal rules are similar to those contained in section 42(4).

Subsection (7): The person who disposed of the shares in the amalgamated company and acquired shares in the resultant company in terms of an amalgamation transaction is required to hold a qualifying interest in the resultant company for a period of 18 months. If the interest is not so held, the roll-over gain is triggered. See explanation under section 42(6).

Subsection (8): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (9): The roll-over relief will only be available to the resultant company if the amalgamated company has within a period of six months after the date of the amalgamation transaction taken the steps, as contemplated in section 41(4), to terminate its existence.

Section 45 – Intra-group transactions

Subsection (1): An inter-group transaction is a transaction between two resident companies where both companies form part of the same group of companies. The view is held that the transferor company need not be a resident of the Republic. Although the test relating to the same group of companies will be retained, it is proposed that the requirement that the transferor company needs to be a resident be deleted.

In order to clarify the application of the section the definition of intra-group transaction is extended to provide that the transferee must hold an asset as a capital asset where the transferor held it as a capital asset and that the transferee must hold an asset as trading stock where the transferor held it as trading stock.

Subsection (2): See “Transferor and transferee deemed to be one and the same with respect to the transfer of assets” under CORPORATE RESTRUCTURING RULES.

Subsection (3): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (4): Currently the transferee company is deemed to have disposed of the asset acquired in terms of an intra-group asset at market value on the date the transferee and transferor companies cease to form part of the same group of companies. This rule is not in accordance with the methodology followed to trigger a gain in terms of sections 42 and 43 where a qualifying interest is no longer held. It is proposed that the intra-group asset rather be deemed to have been disposed of for an amount equal to the market value of the asset on the date on which it was acquired in terms of the intra-group transaction.

Subsection (5): See notes under CORPORATE RESTRUCTURING RULES. In addition thereto a capital loss determined on disposal of a capital asset within 18 months after it was acquired in terms of an intra-group transaction must be disregarded. In order to soften the impact of the capital loss being disregarded, it is proposed that the capital loss may be deducted from the amount of any capital gain determined in respect of the disposal during that year or any subsequent year of assessment of any other asset acquired by the transferee company from the transferor company in terms of an intra-group transaction.
Subsection (6): See notes under CORPORATE RESTRUCTURING RULES.

Section 46 – Unbundling transactions

Subsection (1): The definition of “unbundling transaction” has been reformulated by combining the contents of the definitions of “distributable shares”, “holding company”, “qualifying shareholder”, “unbundled company”, “unbundling company” and “unbundling transaction”.

In terms of the current provisions, the qualifying interest of the unbundling company in the unbundled company can be 25 per cent in the absence of any other shareholder with an equal or greater interest or 35 per cent, if the unbundled company will become a listed company within the prescribed period of time. It is not considered to be justifiable to allow this lower percentage, compared to the normal, more than 50 per cent interest in an unlisted company. This distinction should be removed and a 50 per cent requirement introduced in respect of all companies which are unlisted on the date of the unbundling transaction.

It is, furthermore, proposed that shares acquired by an unbundling company terms of a substitution (as contemplated in paragraph 78(2) of the Eighth Schedule) of equity shares acquired—
- not less than 18 months before the unbundling transaction;
- in terms of a transaction contemplated in this Part; or
- in terms of an unbundling transaction contemplated in section 60 of the Income tax Act, 1993 or a rationalisation scheme contemplated in section 39 of the Taxation Laws Amendment Act, 1994,
qualify as unbundled shares.

A discretion of the Commissioner to extend the period within which shares unbundled by a listed unbundling company are to be listed has been deleted on the same basis as was done in the definition of “qualifying interest” under Definitions.

Subsection (2): It is made clear that the subsection deals with the disposal by the unbundling company of equity shares held as either capital assets or as trading stock.

It is proposed that the base cost or the cost to the shareholder of the equity shares, held in the unbundling company immediately prior to the unbundling transaction, be split between those previously held shares and the unbundled equity shares acquired on the basis of the market values of the shares at the close of day after the unbundling transaction. This attribution of the cost must only be done if the nature of the unbundling shares acquired, is the same as the previously held shares, e.g. if the previously held shares were capital assets and the unbundling shares are acquired as capital assets. The current rule is that the market value of the shares should be determined on the date on which the shareholders become entitled to acquire distributable shares. The utilisation of this market value, which may be determined prior to the distribution of the unbundling shares, may result in an anomalous split of the cost or base cost.

Subsection (3): The provisions regulating the tax treatment of shares held in the unbundling company as a result of the exercise of a right contemplated in section 8A remain unchanged.

Subsection (4): The provisions regulating the tax treatment of dividends for purposes
of secondary tax on companies remain unchanged.

Subsection (5): The provisions of this subsection in respect of the distribution, first out of the share premium account and then from undistributed profits remained unchanged.

Subsection (6): See notes under CORPORATE RESTRUCTURING RULES.

Section 47 – Transactions relating to liquidation, winding-up and deregistration

Subsection (1): The definition of “liquidation distribution” has been reformulated by combining the definitions of “holding company”, “liquidating company” and “liquidation distribution”.

Provision is made for the liquidating company and its holding company to jointly elect that this section applies in respect of all the assets disposed of by the liquidating company to the holding company.

Subsection (2): See “Transferor and transferee deemed to be one and the same with respect to the transfer of assets” under CORPORATE RESTRUCTURING RULES.

Subsection (3): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (4): See notes under CORPORATE RESTRUCTURING RULES.

Subsection (5): Where a holding company disposes of an asset held, as either a capital asset or as trading stock as a result of the liquidation of the liquidating company, provision is made for a tax neutral disposal by the holding company.

Subsection (6): See notes under CORPORATE RESTRUCTURING RULES.

CLAUSE 35


This amendment is consequential upon the changes to corporate reorganisation rules in section 41 to 47 of the Income Tax Act.

CLAUSE 36


Subclauses (a), (b) and (e): The corporate reorganisation rules, which were introduced last year, contain references to a controlling company and a controlled company. These references are being changed to controlled group company and controlling group company. The shareholding requirements of 100 per cent in section 64B were also reduced at the time of the introduction of the corporate reorganisation rules to 75 per cent to bring the requirements in line with the corporate rules. It is proposed that, for consistency, the reference in section 64B to “holding company” and “affected company” be amended to also refer to “controlled group company” and “controlling group company”. Consequential amendments are also required to the exemption contained in section 64B(5)(f) in respect of dividends.
declared to certain holding companies to accommodate the reduced shareholding requirement.

Subclause (c): As was announced by the Minister of Finance in the Budget Review this year, the capital profits distributed on liquidation will be included in the definition of "dividend". In giving effect to this proposal, the definition of ‘dividend’ in section 1 is being amended to include capital profits distributed upon liquidation. It is, however, proposed that STC should only be imposed in respect of dividends declared on or after 1 January 2003 from capital profits in anticipation of liquidation or deregistration, that accrued on or after 1 October 2001. Furthermore, section 64B(5)(c) also, currently, provides that the exemption from STC shall not apply where the company has not taken such steps as the Minister may prescribe to liquidate the company within a period prescribed by the Minister. As new provisions are being inserted in section 41(4) to prescribe the relevant steps for liquidation, it is proposed that section 64B also be amended to refer to those steps.

Subclause (d): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (f): This amendment is consequential upon the insertion in section 1 of a definition of “listed company”.

CLAUSE 37


Subclause (a): It is proposed that a definition of “share incentive scheme” be inserted in section 64C. The definition was previously contained in section 64B, but it was deleted in 2001.

Subclause (b) and (c): The provisions have been reworded to provide that the amount deemed to have been distributed shall be deemed to have been declared to the shareholders in order to enable them to obtain an exemption under section 64B(5)(f).

(d): This amendment is consequential upon the change in section 64B of the reference to “affected company” and “holding company” to controlling group company and controlled group company.

CLAUSE 38


Subclause (a): This amendment is of a textual nature.

Subclause (b): This amendment is consequential upon the insertion in section 78(3) of a definition of “foreign currency”.

Subclauses (c), (d) and (e): These amendments are consequential upon the amendments introduced by the Taxation Laws Amendment Act, 2002 (Act No. 30 of 2002) that certain farmers, fishers and diamond diggers being brought into the standard arrangement as far as their year-end and provisional tax is concerned. These amendments apply in respect of years of assessment commencing on or after
1 July 2002.

CLAUSE 39


This amendment is consequential upon the amendment of the definition of “taxpayer” in section 1 of the Income Tax Act, 1962.

CLAUSE 40


See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

CLAUSE 41


The Electronic Communications and Transactions Act, 2002, provides that where any other Act requires a person to retain certain information, that person will be deemed to have complied with the provisions of that other Act if that person keeps the information in the electronic format prescribed by the abovementioned Act, unless the other Act regulates such retention. A taxpayer will, therefore, be deemed to have complied with the tax Acts, if he or she retains information in the format prescribed by the Electoral Communications and Transactions Act, 2002. The format prescribed therein is, however, not sufficient for purposes of the tax Acts and it is proposed that the relevant tax Acts specifically provide for the storage of information in such electronic format as the Commissioner may direct.

CLAUSE 42


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 43


Subclause (a): Section 73A currently provides that a person whose gross income consists of amounts other than salary, wages or other similar compensation for personal service, must retain records for four years. It is proposed that this provision be amended to apply to all persons who are required to render a return or persons who, despite the fact that they are not so required have rendered any return. It is also proposed that the four year period be extended to five years in order to align all record keeping provisions in the Act.

Subclause (b): The Electronic Communications and Transactions Act, 2002,
provides that where any other Act requires a person to retain certain information, that person will be deemed to have complied with the provisions of that other Act if that person keeps the information in the electronic format prescribed by the abovementioned Act, unless the other Act regulates such retention. A taxpayer will, therefore, be deemed to have complied with the tax Acts, if he or she retains information in the format prescribed by the Electoral Communications and Transactions Act, 2002. The format prescribed therein is, however, not sufficient for purposes of the tax Acts and it is proposed that the relevant tax Acts specifically provide for the storage of information in such electronic format as the Commissioner may direct.

CLAUSE 44


Subclause (a): section 73B provides that a person must retain all records required to determine a taxable capital gain or assessed capital loss for a period of four years. It is proposed that this period be extended to five years in order to align all periods of record keeping in the Act.

Subclause (b): The Electronic Communications and Transactions Act, 2002, provides that where any other Act requires a person to retain certain information, that person will be deemed to have complied with the provisions of that other Act if that person keeps the information in the electronic format prescribed by the abovementioned Act, unless the other Act regulates such retention. A taxpayer will, therefore, be deemed to have complied with the tax Acts, if he or she retains information in the format prescribed by the Electoral Communications and Transactions Act, 2002. The format prescribed therein is, however, not sufficient for purposes of the tax Acts and it is proposed that the relevant tax Acts specifically provide for the storage of information in such electronic format as the Commissioner may direct.

CLAUSE 45


It is proposed that the period of imprisonment be increased from 12 months to 60 months to bring it in line with similar offences contained in the Value-Added Tax Act, 1991.

CLAUSE 46


Subclause (a): This amendment is of a textual nature.

Subclause (b): This amendment is consequential upon the amendment of the objection and appeal procedures by the Second Revenue Laws Amendment Act, 2001 (Act No. 60 of 2001).
CLAUSE 47

*Income Tax: Amendment of section 78 of the Income Tax Act, 1962*

*Subclause (a):* This amendment clarifies that the rate to be used by the Commissioner for purposes of determining an amount of deemed foreign income in terms of section 78 is the rate as determined in paragraph (a) of the “official rate of interest”.

*Subclause (b):* This amendment is of a textual nature.

*Subclause (c):* A definition of “foreign currency” is inserted in subsection (3) to clarify that it means any currency other than currency of the Republic and that the currency used by any permanent establishment will not be taken into account.

CLAUSE 48


The Income Tax Act, 1962, currently provides for the issue of additional assessments and reduced assessments, but does not specifically provide for the withdrawal of an assessment. It is, therefore, proposed that a new section 79B be inserted to provide that the Commissioner may withdraw an assessment under certain circumstances.

CLAUSE 49

*Income Tax: Amendment of section 89quat of the Income Tax Act, 1962*

These amendments are of a textual nature.

CLAUSE 50


See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

CLAUSE 51


Section 105 provides for the jurisdiction of criminal courts and provides that, notwithstanding anything contained in any other law, a person may be tried in respect of an offence by a court having jurisdiction in an area where that person resides or carries on business. In terms of the criminal law provisions, a court in the area where the offence was committed has jurisdiction to hear a matter. It is proposed that it be clarified that the provisions of section 105 apply in addition to other jurisdictions and is not intended to limit the jurisdiction provided for in other legislation.
CLAUSE 52


See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

CLAUSE 53


This amendment is consequential upon the amendment to paragraph 31 of the Eighth Schedule to the Income Tax Act, 1962.

CLAUSE 54

Income Tax: Amendment of paragraph 5 of First Schedule to the Income Tax Act, 1962

This amendment is of a textual nature and deletes a reference to an obsolete provision.

CLAUSE 55


The provisions relating to remuneration of employees were amended earlier this year to give effect to the Budget proposal that the deductions by employees be limited. Certain allowances such as entertainment allowances are now included in the definition of "remuneration" and is, therefore, subject to employees’ tax. In terms of the current wording of the Act, these amounts are, however, excluded from the SITE system with the result that any employee who receives such an allowance is not subject to the final deduction system of SITE. It is proposed that the exclusion of these amounts from the definition of "net remuneration" for SITE purposes, be deleted.

CLAUSE 56


The Electronic Communications and Transactions Act, 2002, provides that where any other Act requires a person to retain certain information, that person will be deemed to have complied with the provisions of that other Act if that person keeps the information in the electronic format prescribed by the abovementioned Act, unless the other Act regulates such retention. A taxpayer will, therefore, be deemed to have complied with the tax Acts, if he or she retains information in the format prescribed by the Electoral Communications and Transactions Act, 2002. The format prescribed therein is, however, not sufficient for purposes of the tax Acts and it is proposed that the relevant tax Acts specifically provide for the storage of information in such electronic format as the Commissioner may direct.
CLAUSE 57


This amendment is consequential upon the amendments introduced by the Taxation Laws Amendment Act, 2002 (Act No. 30 of 2002) to provide that certain farmers, fishers and diamond diggers being brought into the standard arrangement as far as their year-end and provisional tax is concerned.

CLAUSE 58


This amendment is consequential upon the amendments introduced by the Taxation Laws Amendment Act, 2002 (Act No. 30 of 2002) to provide that certain farmers, fishers and diamond diggers being brought into the standard arrangement as far as their year-end and provisional tax is concerned.

CLAUSE 59


This amendment is consequential upon the amendments introduced by the Taxation Laws Amendment Act, 2002 (Act No. 30 of 2002) to provide that certain farmers, fishers and diamond diggers being brought into the standard arrangement as far as their year-end and provisional tax is concerned.

This amendment will apply in respect of years of assessment commencing on or after 1 July 2002.

CLAUSE 60

Income Tax: Amendment of paragraph 1 of Seventh Schedule to the Income Tax Act, 1962

Subclause (a): This amendment ensures that the provisions of paragraph (b) of the definition of “official rate of interest” applies in respect of loans denounced in any currency other than the currency of the Republic and is consequential upon the insertion in section 1 of the definition of “foreign currency”.

Subclause (b): It is proposed that no tax be imposed in respect of allowances, benefits and privileges received by or accrued to a person stationed outside the Republic and employed by any national or provincial public entity, which is substantially funded by Parliament, if they are attributable to that official’s services rendered outside the Republic.
CLAUSE 61

Income Tax: Amendment of paragraph 1 of Eighth Schedule to the Income Tax Act, 1962

Subclause (a): In terms of paragraph 57 a concession is granted to small business persons, subject to certain limitations, who on their retirement dispose of “active business assets” which are defined in paragraph 1. The definition requires that the active business assets be used wholly and exclusively for business purposes. This restriction precludes any small business person from enjoying any concession on immovable property used for business purposes on which that person resides. It is proposed that this limitation in the definition be relaxed and the gain on the property to the extent that the person uses the property for business qualify for the concession. As the definition is only used in paragraph 57, it is proposed that the definition be moved to that paragraph.

Subclause (b) and (c): These amendments are consequential upon the insertion in section 1 of the definition of “financial instrument” and “foreign equity instrument”.

Subclause (d): The definition in section 1 was amended by the inclusion of certain testamentary trusts. Previously special trusts were restricted to trusts created solely for the benefit of a person who suffers from a mentally illness or serious physical disability. In the Eighth Schedule these special trusts were treated as the alter ego of the person suffering from the illness or disability. As the testamentary trusts now included can have many beneficiaries it is not possible to treat them on the same basis as the previous trusts. It is proposed that for the purposes of the Eighth Schedule only the special trusts referred to in paragraph (a) of the definition be recognised as special trusts for the purposes of the Eighth Schedule. See, however, CLAUSE 64 in which it is proposed that the inclusion rate of all special trusts be 25% of their net capital gain.

It is proposed that the amendment in subclause (a) come into operation on 1 October 2001 and the amendment in subclause (b) come into operation from the commencement of years of assessment ending on or after 1 January 2003.

CLAUSE 62

Income Tax: Amendment of paragraph 2 of Eighth Schedule to the Income Tax Act, 1962

See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 63

Income Tax: Amendment of paragraph 4 of Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature and it is proposed that it be deemed to come into operation on 1 October 2001
CLAUSE 64

Income Tax: Amendment of paragraph 10 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 10 prescribes what portion of the net capital gain of a person is that person's taxable capital gain. Although, for the purposes of the Eighth Schedule only "special trusts" referred to in paragraph (a) of that definition are regarded as special trusts, it is proposed that only 25% of the net capital gain of all special trusts be the taxable capital gains of these trusts.

CLAUSE 65


Subclause (a): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (b): The purpose of item (e) of subparagraph (2) was to exclude from the concept of disposal the distribution of an asset by a trustee to a beneficiary in whom that asset had vested. The reason for this is that the vesting of the asset in a beneficiary is already a disposal. There is concern that the wording could possibly allow manipulation. For example, if a beneficiary held a usufruct in immovable property it could be argued that if the bare dominium is distributed to the beneficiary it will not be a disposal. It is proposed that the wording of the item be clarified.

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

CLAUSE 66

Income Tax: Amendment of paragraph 12 of Eighth Schedule to the Income Tax Act, 1962

The purpose of paragraph 12(5) is to ensure that where a debtor is relieved of the obligation to pay any portion of the amount owing, that debtor will be subject to CGT on a capital gain equal to the amount discharged. Such reductions may result from donations or offers of compromise.

In this regard paragraph 12(5) refers to a debt being discharged without ‘full consideration’ being given. The term ‘full consideration’ is not defined but would seem to refer to a market related consideration. As a result where a debtor renegotiates the repayment terms that debtor may end up settling the debt for a full consideration which is less than the face value of the debt. This would result in the debtor escaping CGT on the amount discharged, whilst the creditor would be able to claim a capital loss in respect of the same amount. It is proposed to rectify this mismatch by amending paragraph 12(5) to ensure that the difference between the amount of the debt so reduced and the amount of the consideration for the reduction or discharge is treated as a capital gain.
Example – Discounting of debt

A owes B R100 payable in 5 years’ time. B agrees to accept R70 on condition that A settles the debt after 1 year. Had B discounted the debt with a bank he would have received R70. As the law stands A has settled the debt for full consideration and would not have a capital gain. In terms of the proposed amendment to paragraph 12(5), R30 will now be treated as a capital gain in A’s hands. Note that B would have a capital loss of R30 (proceeds R70 less base cost R100).

It is also proposed that where the amount of the debt reduction is in excess of the consideration and it has been taken into account in determining the debtor’s assessed loss in terms of section 20(1)/(a)/(ii) paragraph 12(5) should not apply.

Paragraph 67 allows rollover relief for assets transferred between spouses and in order to place it beyond doubt that paragraph 67 takes precedent over paragraph 12(5), an amendment of the paragraph is proposed.

CLAUSE 67

Income Tax: Amendment of paragraph 13 of Eighth Schedule to the Income Tax Act, 1962

It was always the intention that the time of disposal be when the agreement for disposal was entered into except when the agreement is subject to a suspensive condition. As it became clear that certain persons were interpreting the provisions in a different manner, it is proposed that the wording of the provisions be clarified.

Where an agreement which is not subject to a suspensive condition is entered into but delivery of the asset take place at a later date, the time of disposal will be the date the agreement was entered into. It is proposed that the amendments come into operation on 1 October 2001.

CLAUSE 68


Paragraph 14 of the Eighth Schedule deals with the disposal of “property” by a spouse married in community of property. It is proposed that the paragraph be amended by substituting the defined word “asset” for the undefined word “property”.

CLAUSE 69

Income Tax: Amendment of paragraph 20 of Eighth Schedule to the Income Tax Act, 1962

Subclause (a): This amendment is of a textual nature.

Subclauses (b) and (c): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclause (d): Paragraph 20(1)/(h) deals with the inclusion in base cost of various amounts that were included in the person’s income upon acquisition of the relevant
asset. Examples include—

- shares acquired as a result of exercising an option granted to an employee in terms of section 8A,
- assets acquired from an employer at less than fair market value which have been taxed as fringe benefits
- an asset acquired by a lessee from a lessor at less than fair market value which has been taxed in terms of section 8(5).

It is proposed to add a further asset to this category.

*Improvements effected by lessee in terms of a lease agreement*

Where a lessee is compelled to effect improvements to the land or buildings of a lessor in terms of a lease agreement, the value of those improvements is included in the lessor’s gross income in terms of paragraph (h) of the definition of “gross income”. The lessor may qualify for an allowance in terms of section 11(h) in respect of these improvements. It is proposed that the net amount on which the lessor has been taxed be added to the base cost of the land and buildings - in other words the amount included in gross income less the allowance in terms of section 11(h).

As far as the amendment to paragraph 20(1)(h)(iii) is concerned, see notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

**CLAUSE 70**

*Income Tax: Amendment of paragraph 24 of Eighth Schedule to the Income Tax Act, 1962*

Paragraph 24 prescribes the CGT treatment of immigrants disposing of assets acquired before they became residents, other than those assets contemplated in paragraphs 2(1)(b)(i) and (ii) (immovable property in the Republic and assets of a permanent establishment situated in the Republic) after they become residents. The paragraph as it is worded prescribes what must be done with the expenditure that forms the base cost of assets incurred before and after the date the immigrants became South African residents, but does not deal with expenditure incurred on the date they became resident. It is proposed that this shortcoming be rectified with effect from 1 October 2001.

**CLAUSE 71**


Paragraph 25 provides that the base cost of pre-valuation date assets is the value on valuation date and expenditure allowable in terms of paragraph 20 incurred after valuation date.

The paragraph does not prescribe what must be done with expenditure incurred on valuation date. It is proposed that this shortcoming be rectified with effect from 1 October 2001.
CLAUSE 72

Income Tax: Amendment of paragraph 26 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 26 prescribes the method to determine the valuation date value of an asset where?
- the asset was acquired before valuation date;
- proceeds exceed expenditure, allowable in terms of paragraph 20, incurred before and after the valuation date.

The paragraph does not prescribe what must be done with expenditure incurred on valuation date. It is proposed that this shortcoming be rectified with effect from 1 October 2001.

CLAUSE 73

Income Tax: Amendment of paragraph 27 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 27 prescribes the method to determine the valuation date value of an asset where?
- the asset was acquired before valuation date;
- proceeds do not exceed expenditure, allowable in terms of paragraph 20, incurred before and after the valuation date.

The paragraph does not prescribe what must be done with expenditure incurred on valuation date. It is proposed that this shortcoming be rectified with effect from 1 October 2001.

CLAUSE 74


Subclause (a): This amendment is of a textual nature.

Subclause (b): This amendment is consequential upon the proposed introduction of item (c) in subparagraph (4).

Subclause (c): Where a person acquires an asset from his/her spouse, paragraph 67 provides for a CGT-free roll over of the asset between the spouses, the purpose being to trigger the gain or loss only when the transferee spouse disposes of the asset. It may, however, happen that the transferee spouse wishes to adopt market value as the valuation date value of the asset. As the law stands that spouse would be precluded from doing so unless the transfer took place prior to 30 September 2003. It is proposed that the transferee spouse be treated as having adopted or determined the same market value as the transferor spouse if the transferor spouse had adopted or determined a market value in compliance with this paragraph.

Subclause (d): Subparagraph (6) presently requires that a person must submit proof of valuation with the return covering the year of assessment in which an asset was
disposed of. It is proposed that the subparagraph be amended to require that the proof be in the form prescribed by the Commissioner. This proposal will bring the wording in line with subparagraph (5), which contains the earlier submission requirements for certain high value assets. The intention is that the same form, presently available on the SARS website (http://www.sars.gov.za) under CGT/Forms, be used for both subparagraph (5) and (6) assets.

It is proposed that these amendments be deemed to come into operation on 1 October 2001.

**CLAUSE 75**


Paragraph 30 specifies how the time based apportionment base cost (TAB) of an asset is to be determined. The following amendments are proposed to the paragraph:

**Subclause (a):** Subparagraph (1) contains the formula for determining the valuation date value of an asset using the time based apportionment method and it is proposed that it be subject to the proposed subparagraph (3).

**Subclause (b):** The symbol ‘P’ in the formula in subparagraph (1) is defined as representing ‘the proceeds as determined in terms of paragraph 35, in consequence of the disposal of that asset...’. It is proposed that the word ‘consequence’ be replaced by the word ‘respect’. The purpose of this amendment is to bring this paragraph into line with the wording used in paragraph 35. The word ‘respect’ makes it clear that all proceeds must be accounted for, including any amounts received or accrued in a previous year of assessment.

**Subclause (c):** Subparagraph (2) contains a proceeds formula that applies when expenditure is incurred in more than one year of assessment before and after the valuation date. The present wording has the unintended consequence of making the formula applicable where expenditure was only incurred in more than one year of assessment prior to valuation date. It is therefore proposed that the proceeds formula only be applicable when a portion of the expenditure is incurred on or after the valuation date.

It is further proposed that subparagraph (2) be made subject to a new subparagraph (3) which proposes the conditions under which a special formula for determining TAB in respect of certain depreciable assets will apply. This is discussed in more detail below.

The symbol “T” in the proceeds formula represents the total amount of proceeds as determined in terms of paragraph 35 in consequence of the disposal of the pre-valuation date asset. It is proposed that this symbol be replaced with the symbol “R”. The purpose of this amendment is to prevent confusion with the symbol “T” which is also used in the main formula where “T” represents the number of years after valuation date.

**Subclause (d):** In determining TAB, proceeds are reduced by the amount of any recoupments in terms of paragraph 35(3)(a) and expenditure is reduced in accordance with paragraph 20(3)(a) by the amount of any capital allowances.
Where expenditure has been incurred both before, and on or after the valuation date, and the asset qualifies for capital allowances, the portion of the capital gain to be allocated to the post-CGT period can be influenced by the speed with which the expenditure has been written off against income. As a result, for example, where the entire amount of the expenditure incurred before valuation date has been written off against income, the entire gain will be thrown into the post-CGT period. This results in an inequitable apportionment of the gain. To rectify this problem it is proposed that the apportionment of the gain be determined by excluding recoupments and capital allowances from certain variables in the TAB formula. The proposed subparagraph (3) sets out the conditions under which the ‘depreciable asset formula’ will be applicable. Three conditions must be met:

- Ignoring capital allowances, expenditure must have been incurred both before, and on or after the valuation date;
- The asset must be a depreciable asset in respect of which capital allowances were claimed;
- The proceeds (not reduced by recoupments) must exceed the expenditure (not reduced by capital allowances) – in other words the asset must have been disposed of at an overall capital profit.

The proposed formula is set out in subparagraph (4). It contains a two step process for determining the gain applicable to the pre-CGT period. First, the portion of the ‘receipts’ (proceeds not reduced by recoupments) generated by the expenditure incurred before valuation date is determined. This is done by multiplying those ‘receipts’ by the costs incurred before valuation date, divided by the total cost of the asset. Note that the costs used in this calculation are not reduced by capital allowances. Next, the gain generated by those pre-CGT expenses is apportioned between the pre- and post-CGT periods on a time basis. This gives the gain applicable to the pre-CGT period which is then added to ‘B’ in the formula (pre-valuation date expenditure reduced by capital allowances) to give the time apportionment base cost of the asset. The provisions of paragraph 25 are then applied in the normal way in determining a capital gain, taking recoupments and capital allowances into account. The example below illustrates the application of the formula.

**Example – Determination of TAB using the depreciable asset formula**

Assume the following details regarding an asset subject to capital allowances:

<table>
<thead>
<tr>
<th></th>
<th>Pre 1.10.01</th>
<th>Post 1.10.01</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost</td>
<td>100</td>
<td>200</td>
<td>300</td>
</tr>
<tr>
<td>Capital allowances</td>
<td>100</td>
<td>20</td>
<td>120</td>
</tr>
<tr>
<td>Expenditure i.t.o. para 20</td>
<td>0</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Period (years)</td>
<td>10</td>
<td>5</td>
<td>15</td>
</tr>
<tr>
<td>Received on disposal</td>
<td>321</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recouped ito s 8(4)(a)</td>
<td>120</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds ito para 35</td>
<td></td>
<td>201</td>
<td></td>
</tr>
</tbody>
</table>
The capital gain will be determined as follows:

**Step 1 – Determine whether the depreciable asset formula is applicable**

The asset in the example meets all the necessary requirements:
- Expenditure before 1.10.01 = 100; and on or after 1.10.01 = 200;
- Capital allowances of 100 were claimed;
- There is an overall profit of 321 – 300 = 21

**Step 2 – Determine the receipts generated by pre-CGT costs**

\[ P_1 = R_1 \times \frac{B_1}{(A_1 + B_1)} \]

\[ = 321 \times 100/(100 + 200) \]

\[ = 321 \times 100/300 \]

\[ = 107 \]

**Step 3 – Apply the depreciable asset TAB formula**

\[ Y = B + \frac{[(P_1 - B_1) \times N]}{T + N} \]

\[ = 0 + [(107 – 100) \times 10/(10 + 5)] \]

\[ = 0 + 7 \times 10/15 \]

\[ = 4.6667 \]

**Step 3 – Determine the capital gain**

Capital gain = Proceeds – [TAB + expenditure incurred on or after 1.10.01)

\[ = 201 – (4.6667 + 180) \]

\[ = 201 – 184.6667 \]

\[ = 16.3333 \]

Note that the normal rules are applied under step 3 proceeds so proceeds are reduced by recoupments and expenditure on or after 1.10.01 is reduced by capital allowances.

In summary, had the gain been worked out under the main formula, the entire gain would have been allocated to the post-valuation date period and the person would have paid CGT on a gain of 21. The depreciable asset formula therefore gives a far more equitable spread of the gain.

It is proposed that that the amendment be deemed to come into operation on 1 October 2001.

**CLAUSE 76**

*Income Tax: Amendment of paragraph 31 of Eighth Schedule to the Income Tax Act, 1962*

Paragraph 31 prescribes how the market value of an asset must be determined.
Subclause (a): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

Subclauses (b) and (c): It is proposed that the undefined word and phrase ‘property’ and ‘fair market value’ be replaced with the defined words “asset” and “market value”.

In terms of the paragraph the market value of a fiduciary, usufructuary or other similar interests the market value is determined over the life expectancy of the person entitled to the asset or to the period of enjoyment if it is less than the life expectancy. To determine the bare dominium of an asset the market value of the asset is reduced by the value of the fiduciary, usufructuary or other similar interest. The Minister of Finance may in terms of section 107 make regulations prescribing the method of valuation of these interests. It is proposed that the power of the Minister to make regulations be withdrawn and that the Tables A and B of the regulations issued in terms of section 29 of the Estate Duty Act be used for the purpose of the calculations for CGT. The paragraph does not, however, prescribe over what period the market value must be determined in the case of persons who are not natural persons. It is proposed that the period should be fifty years as is the case with donations tax and estate duty.

It is proposed that the amendment come into operation on 1 October 2001.

CLAUSE 77

Income Tax: Amendment of paragraph 32 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 32 provides the rules for the determination of the base cost of “identical assets”. Identical assets are a group of similar assets which may only be distinguishable by their identifying numbers. Examples are shares, gold coins and units in a unit trust.

Subclauses (a), (c) and (d): The weighted average method of determining the base cost of identical assets may only be used for three classes of identical assets, namely, financial instruments listed on a recognised stock exchange, units in a unit trust scheme registered or approved by the Registrar of Collective Investment Schemes and coins made mainly from gold and platinum. Included in the first class of assets with listed shares are listed interest-bearing arrangements such as stocks, bonds, debentures and similar assets. In order to give taxpayers more flexibility it is proposed that the first class of identical assets be split into two and the interest bearing instruments which are listed on a recognised exchange be treated in a separate class. It is proposed that this amendment be deemed to have come into operation on 1 October 2001.

Subclause (b): See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

CLAUSE 78

Income Tax: Amendment of paragraph 33 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 33 provides rules for determining the base cost of an asset when part of
the asset is disposed of. It provides that part of the total base cost of the asset must be allocated to the part disposed of and this is done in most cases in the same ratio of the market value of the part disposed of to the total market value of the asset.

Where a person grants, varies or cedes the right of use or occupation of an asset, he or she is disposing of an asset, the base cost of which can be determined in terms of subparagraphs (1) and (2). The consideration the person receives for the use or occupation of the asset is normally rental or a lease premium which forms part of the person’s gross income and, therefore, does not constitute “proceeds” for capital gains purposes. The effect will be that the person has base cost but no proceeds and this will create an artificial capital loss. The amount of the base cost claimed in these circumstances will reduce the base cost of the asset and if the asset is subsequently disposed of only a reduced amount of base cost will be deductible from the proceeds on disposal. It is, therefore, proposed that in the case of the granting, variation or cession of the right or use of an asset the disposal not be treated as a part-disposal and no portion of the base cost be attributed to the part-disposal. The full base cost will be allowed when the whole asset is disposed of.

Where however proceeds are received or accrue in these circumstances it is proposed that that portion of the base cost which relates to the proceeds should be brought to account.

**Example 1 - Granting of a lease not a part-disposal where no proceeds**

A company, XYZ (Pty) Ltd acquired a warehouse on 1 October 2001 at a cost of R100 000. It immediately advertised for tenants, and on 1 November 2002 entered into a 5-year lease agreement with another company. The agreement provided for a rental of R1000 payable monthly in advance. It is estimated that the present value of the rental contract is R40 000. Immediately prior to signing the lease, the property had a market value of R120 000.

In terms of para 11(1)(a) the act of granting of a lease over the property is a disposal and the portion of the base cost disposed of would have to be determined in terms of para 33. The market value of the part disposed of is R40 000. Therefore under the existing para 33 the portion of the base cost disposed of is:

\[
\text{R40 000/R120 000 x R100 000 = R33 333.}
\]

Since the future rental income will be included in gross income, it will be excluded from proceeds in terms of para 35(3)(a). The result is a capital loss of R33 333. In terms of the proposed amendment the act of entering into the lease will not be regarded as a part-disposal and as a result no gain or loss will result. The base cost of R100 000 will remain intact and available for use when the full property is disposed of.

**Example 2 – Part-disposal where lease granted and proceeds received**

Errol purchased “Speedy Boy”, a racehorse for R100 000 on 1 October 2001. On 31 August 2002 after Speedy Boy had won a number of races, Errol agreed to lease the steed to Andrew for a market related rental of R50 000 per annum for five years. Immediately prior to entering into the lease the market value of the racehorse was R200 000. Since Andrew was desperate to impress his friends and reverse his flagging fortunes on the race track he agreed to pay Errol an up front premium of R25 000 for the right of use of Speedy Boy. This was in addition to, and over and above the market related rental that Errol could have obtained from other interested lessees. For the purposes of this example it is assumed that Errol did not claim
depreciation on Speedy Boy.

In terms of the proposed amendment to para 33, since Errol has received proceeds of R25,000, he will have triggered a part-disposal. The base cost of the part disposed of will be determined as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base cost</td>
<td>R100,000</td>
</tr>
<tr>
<td>Proceeds (lease premium)</td>
<td>R25,000</td>
</tr>
<tr>
<td>Market value of Speedy Boy</td>
<td>R200,000</td>
</tr>
</tbody>
</table>

Part of base cost disposed of = $\frac{25,000}{200,000} \times 100,000 = R12,500$

Capital gain = R25,000 – R12,500 = R12,500

**CLAUSE 79**

*Income Tax: Amendment of paragraph 38 of Eighth Schedule to the Income Tax Act, 1962*

Paragraph 38 in simple terms provides that transactions between connected persons at a non-arm’s length price must be treated as taking place at market value. Ostensibly this provision is at odds with paragraph 12(5) which deals with the waiver or cancellation of debt. Paragraph 12(5) provides that the debtor benefiting from the waiver of debt is deemed to have acquired the debt at a base cost of nil and to have immediately disposed of it at market value, thereby triggering a capital gain in the debtor’s hands. On the face of it, therefore, paragraph 38 is at odds with paragraph 12(5). In terms of the principle of interpretation *generalia specialibus non derogant*, general provisions do not override specific provisions. Whilst the view is held that the specific provisions of paragraph 12(5) override the general provisions of paragraph 38, it is proposed for the purposes of clarity that paragraph 38 be made subject to paragraph 12(5).

**CLAUSE 80**

*Income Tax: Amendment of paragraph 40 of Eighth Schedule to the Income Tax Act, 1962*

Subclauses (a) and (b): These amendments are of a textual nature.

Subclause (c): Paragraph 40 provides rules for the determination of capital gains and losses in the hands of the deceased, the estate and provides that assets that pass through to heirs and legatees do so at the base cost of the assets to the estate which is market value. Ostensibly this provision is at odds with paragraph 12(5) which deals with the waiver or cancellation of debt. Paragraph 12(5) provides that the debtor benefiting from the waiver of debt is deemed to have acquired the debt at a base cost of nil and to have immediately disposed of it at market value, thereby triggering a capital gain in the debtor’s hands. For the purpose of clarity it is proposed that it be made clear that the provisions of paragraph 40 are subject to paragraph 12(5).
CLAUSE 81

Income Tax: Amendment of paragraph 41 of Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 82


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 83

Income Tax: Amendment of paragraph 51 of Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 84


In terms of paragraph 53 the capital gains and losses on the disposal of personal-use assets by natural persons and special trusts are disregarded.

Subclause (a): This amendment is of a textual nature.

Subclause (b): Certain personal-use assets such as financial instruments, gold and platinum coins, fixed property, etc are excluded and the capital gains and losses on these assets are taken into account for CGT purposes. It is proposed that long-term insurance policies be added to this list and policies and capital gains which do not fall within the exclusion of paragraph 55 will be taken into account for CGT purposes.

Subclause (c): It is also proposed that short-term insurance policies to the extent they relate to assets which are not a personal-use asset also be taken into account for capital gains tax purposes.

It is proposed that the amendment be deemed to have come into operation on 1 October 2001

CLAUSE 85


Paragraph 55 provides that capital gains or losses arising from an amount received
in respect of an insurance policy in certain circumstances must be disregarded.

Subclause (a): Capital gains or losses arising from policies taken out on the life of an employee or director contemplated in section 11(w) are excluded. Questions arose as to whether the policy must be an approved section 11(w) policy and once the policy was such a policy, would it still qualify to be disregarded if it was sold to any other person or persons. It is proposed that the matter be clarified and that it be made clear that the policy must be an approved section 11(w) policy and for the gain or loss to be disregarded, it must accrue to the employee or director whose life was insured.

Subclause (b): The so-called “buy and sell arrangements” are arrangements where partners and shareholders take out insurance on the life of their partners and shareholders take our insurance on the life of their partners or fellow shareholders so that if their partners or fellow shareholders should die, they can buy out that partner or shareholder’s interest in the partnership or company. When the business comes to an end, there is no purpose for the policies and they are often ceded to the person whose life was insured in terms of the policy. It was the intention that capital gains or losses arising from these policies in the hands of these persons should be disregarded, but the wording of the paragraph did not achieve this. It is proposed that this wording be amended to achieve this objective.

CLAUSE 86
Income Tax: Amendment of paragraph 56 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 56 provides that where a creditor disposes of a claim owed by a connected person in relation to the creditor, that creditor must disregard any capital loss arising as a consequence of that disposal unless the capital gain arising in the connected person’s hands is taxed. An unintended consequence of the paragraph is that should the creditor, for example, discount the debt with a bank, the creditor must disregard the capital loss because the debtor is not taxed on the capital gain in terms of paragraph 12(5). In addition, if the amount is included in the debtor’s gross income or income or taken into account in the determination of his or her assessed loss, the creditor may not claim the loss. A further uncertainty is whether the provisions of paragraph which “clog” the losses arising between connected parties applies or does this paragraph apply. It is proposed that it be clarified that this paragraph takes precedence.

Example

A owes B R100 payable in 5 years’ time. A and B are connected persons. B discounts the debt with the bank and receives R70 in respect of the disposal. B would have a capital loss of R30. As the law stands B cannot claim the loss because A has not had to account for a capital gain in his hands. The bank has, however, acquired the claim for R70 and will receive R100 after 5 years. It will pay income tax on the gain of R30 in terms of s 24J.
**Debtor and creditor connected**

- Debtor Liability = 100
- Payment = 70
- Capital gain = 30

Debtor taxed on gain (para 12(5)). Where the debt is discounted, debtor is not taxed as he is still liable for face value of debt.

**Debtor and creditor not connected**

- Debtor taxed on gain (para 12(5))
- Where debt discounted, debtor not taxed (full consideration paid)

**Creditor**

- Asset = 100
- Proceeds = 70
- Capital loss = 30

Loss allowed if debtor accounts for gain under 12(5). Loss not allowed where debt discounted (para 56(2)). However new creditor will have to account for gain. This results in a mismatch – hence proposed amendment to 56.

Loss allowed regardless of whether debtor accounts for gain under 12(5). Where debt discounted, new creditor should account for gain. Proceeds 100 - Asset 70 = Gain 30

This would offset the loss claimed by the first creditor. Where debtor renegotiates terms with creditor leading to early payment at a discount, debtor has no gain but creditor has a loss. That loss should be disallowed. But easier to tax debtor in terms of 12(5).

It is proposed that these anomalies be rectified with effect from 1 October 2001

**CLAUSE 87**

**Income Tax: Amendment of paragraph 57 of Eighth Schedule to the Income Tax Act, 1962**

This paragraph deals with a concession for small businesses and as mentioned in **CLAUSE 61**, it is proposed that the definition of “active business asset” be amended and moved to this paragraph.

**CLAUSE 88**

**Income Tax: Substitution of paragraph 61 of Eighth Schedule to the Income Tax Act, 1962**

See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

**CLAUSE 89**

**Income Tax: Substitution of paragraph 63 of Eighth Schedule to the Income Tax Act, 1962**

Paragraph 63 seeks to disregard all capital gains and losses in respect of disposals by persons that are exempt from tax in terms of section 10 of the Act. In order to ensure that the provision achieves it purpose it has been reworded. The amendment
is deemed to have come into operation on 1 October 2001

**CLAUSE 90**

*Income Tax: Insertion of paragraph 64A of Eighth Schedule to the Income Tax Act, 1962*

Currently, an award in terms of the Restitution of Land Rights Act, 1994, may be subject to CGT, as a person who has put in a claim for land restitution effectively disposes of his or claim for the amount of the award or compensation received. It is, therefore, proposed that a specific exclusion be incorporated in the Eighth Schedule.

**CLAUSE 91**


See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

**CLAUSE 92**

*Income Tax: Amendment of paragraph 72 of Eighth Schedule to the Income Tax Act, 1962*

See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

**CLAUSE 93**

*Income Tax: Amendment of paragraph 74 of Eighth Schedule to the Income Tax Act, 1962*

See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

**CLAUSE 94**

*Income Tax: Amendment of paragraph 76 of Eighth Schedule to the Income Tax Act, 1962*

Paragraph 76 deals with the shareholder level consequences of capital distributions. This provision provides that such capital distributions must first be applied in reduction of the base cost of the share. Should the base cost turn negative, any excess must be added to the proceeds on disposal of the share. A similar rule contained in subparagraph (4) applies where time based apportionment is used in determining the valuation date value of a share, except that it is the expenditure that is reduced, not the base cost.

*Subclause (a): Market value of capital distribution*

Presently subparagraph (1) refers to the ‘amount’ of a capital distribution. The word
‘amount’ has received judicial consideration in various court decisions dealing with the gross income definition and it has been held in that context to mean market value. The same meaning was intended to be conferred on the word in paragraph 76. Some taxpayers have questioned whether the word ‘amount’ refers to the nominal value of any capital distribution. Whilst it is considered that this is not the position under the current law, for clarity it is proposed that the word ‘amount’ be replaced with the words ‘market value’. For example, a company in liquidation distributes an asset with a cost of R50 and a market value of R100. The company has revenue reserves of R10 and capital reserves of R40 from which the dividend is declared. Is the capital distribution R40 (nominal value) or R100 x 40/50 = 80? The proposed amendment makes it clear that the capital distribution is R80.

**Unintended consequences arising from reduction in base cost by capital distributions**

A number of unintended consequences (illustrated below) have resulted from this formulation and it is therefore proposed that all capital distributions instead be treated as proceeds on disposal, except where the weighted average method is used. This is also more consistent with the method used for determining capital gains and losses on assets other than shares, where the proceeds received prior to disposal of an asset are gathered up and accounted for on disposal.

As a consequence of the proposed amendment subparagraph (2) has been replaced (see clause (b) below) and subparagraph (4) has been deleted.

**Example 1 - Unintended consequence involving TAB**

A share was acquired on 1.10.92 for R100 and disposed of on 28.03.02 for R250. During 1995 a capital distribution of R30 was received and on 30.11.01 a further capital distribution of R90 was received.

As the law stands the time apportionment base cost of the share will be calculated as follows:

1.10.92 - 30.9.01 = 9 years
1.10.01 - 28.03.02 = 1 year
Total period = 10 years
TAB = (100 - 100) + [(250 + 20 - 0) x 9/10]
= 0 + 270 x 9/10
= 243
Capital gain = 270 - 243 = 27

However, assume the same facts, but selling costs of R1 are incurred on disposal of the share.

The R1 constitutes expenditure after valuation date, and the proceeds formula in paragraph 30 must be applied.

Therefore
P = B/Total costs
P = 0 / 0 = 0
TAB = 0 + [(0 - 0) x 9/10] = 0

By treating all capital distributions as proceeds on disposal instead of first reducing expenditure the correct result is obtained:
Under the first example:
TAB = 100 + [(250 + 120 - 100) x 9/10]
= 100 + [270 x 9/10]
= 100 + 243 = 343
Capital gain = 370 - 343 = 27 (the same result as under the existing law)
Under the second example:
Expenditure before = 100
Expenditure after = 1
Proceeds = 370 x 100/101 = 366.34
TAB = 100 + [(366.34 - 100) x 9/10]
= 100 + 239.71
= 339.71
Capital gain = 370 - (339.71 + 1) = 29.29

Example 2 - Unintended consequence involving paragraph 26 and 27

John purchased 100 shares in Kinky Fashions (Pty) Ltd on 1 July 2000 for R100. On 1 October 2001 the market value of the shares was R350 and the balance sheet of the company appeared as follows:

<table>
<thead>
<tr>
<th>R</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
</tr>
<tr>
<td>Capital reserves</td>
</tr>
<tr>
<td>Revenue reserves</td>
</tr>
<tr>
<td>Capital employed</td>
</tr>
<tr>
<td>Represented by:</td>
</tr>
<tr>
<td>Cash</td>
</tr>
</tbody>
</table>

Between valuation date and 1 July 2002 the balance sheet remained unchanged and the company was liquidated on that date and the cash distributed to John. John elects to use market value as the valuation date value of his shares.

John receives a capital distribution of R150 (share capital and capital reserves). In terms of paragraph 76(2) this is credited against the base cost of the shares (R350). As a consequence, on disposal the shares will have a base cost of R200 and there will be no proceeds.

In this situation the loss limitation rule in paragraph 27(3)(b) applies:

| Cost  | 100 |
| MV   | 350 |
| Proceeds | 0  |

John must use the lower of TAB and MV.

TAB is determined as follows:

B = 100 – 150 = -50 (in terms of paragraph 76(4))
TAB = B + [(P – B) x N/T]
TAB = -50 + [(-50 – (-50)) x 2/3] = -50 + 33 = -17.
Capital gain = 0 – (-17) = 17

If the capital distribution were treated as proceeds the position would be as follows:

| Cost  | 100 |
| MV   | 350 |
| Proceeds | 150 |

In this situation paragraph 26(3) applies and John must use the proceeds as the base cost. This will give no gain, no loss.

Capital distributions to be accounted for in respect of pre-valuation date shares

Paragraph 76 is silent as to whether capital distributions received or accrued prior to valuation date must be accounted for by a shareholder in determining a capital gain or loss. The answer logically depends on the valuation method used but for clarity it is proposed that this be spelt out in subparagraph (1)(b). The table below shows the capital distributions that must be treated as proceeds. The weighted average method is addressed in subclause (b).
Table 1 – Capital distributions to be accounted for under various valuation date value methods

<table>
<thead>
<tr>
<th>Valuation date value method</th>
<th>Paragraph</th>
<th>Capital distributions to be accounted for as proceeds on disposal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Time based apportionment</td>
<td>30</td>
<td>All amounts received or accrued on or after date of acquisition</td>
</tr>
<tr>
<td>Market value</td>
<td>29</td>
<td>All amounts received or accrued on or after valuation date</td>
</tr>
<tr>
<td>20% of proceeds</td>
<td>26(1)(b)</td>
<td></td>
</tr>
</tbody>
</table>

Capital distributions prior to valuation date and TAB

It is proposed that a new item (b) be added to subparagraph (1) to make it clear that where time-based apportionment is adopted, all capital distributions from date of acquisition to date of disposal must be accounted for as proceeds.

Subclause (b): The weighted average method

It is proposed that—
- the existing method of reducing the base cost by any capital distributions received by or accrued to a shareholder be retained for the weighted average method
- only capital distributions received by or accrued to a shareholder on or after the valuation date be accounted for.

The proposed substitution of subparagraph (2) merely entrenches and clarifies the existing treatment applied under the weighted average method. There has, therefore, been no substantive change in the law in this regard.

The base cost reduction method has been retained for the weighted average method in order to simplify record keeping. Had capital distributions been treated as proceeds on disposal, the results would have been the same as the base cost reduction method. However, taxpayers would have had to retain a separate pool of capital distributions, which would have had to be proportionately reduced each time a disposal of an identical asset took place. This would probably have necessitated an amendment to paragraph 32(3A) thereby adding unnecessary complexity. This can be illustrated as follows:

Example – Weighted average: Comparison of base cost reduction and proceeds methods

Proceeds method (not proposed)

<table>
<thead>
<tr>
<th>Date</th>
<th>Units</th>
<th>Base cost</th>
<th>Capital distributions received</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.10.01</td>
<td>100</td>
<td>220</td>
<td>R</td>
</tr>
<tr>
<td>2002</td>
<td>150</td>
<td>300</td>
<td>30</td>
</tr>
<tr>
<td>2003</td>
<td>110</td>
<td>200</td>
<td>60</td>
</tr>
<tr>
<td>Total</td>
<td>360</td>
<td>720</td>
<td>90</td>
</tr>
</tbody>
</table>

Average base cost per unit: R720/360 = R2
Assume that 100 units are disposed of in 2004 at R3/unit = R300.
Proceeds = R300 plus the proportionate share of the pool of capital distributions received (100/360 x 90 = R25) = R325.
Base cost of units disposed of = 100 x R2 = R200
Gain = R325 – 200 = R125

Base cost reduction method (proposed)

<table>
<thead>
<tr>
<th>Date</th>
<th>Units</th>
<th>Base cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.10.01</td>
<td>100</td>
<td>220</td>
</tr>
<tr>
<td>2002 - Purchases</td>
<td>150</td>
<td>300</td>
</tr>
<tr>
<td>Capital dist. received</td>
<td></td>
<td>- 30</td>
</tr>
<tr>
<td>2003 - Purchases</td>
<td>110</td>
<td>200</td>
</tr>
<tr>
<td>Capital dist. received</td>
<td></td>
<td>- 60</td>
</tr>
<tr>
<td>Total</td>
<td>360</td>
<td>630</td>
</tr>
</tbody>
</table>

The base cost of the units disposed of = 100/360 x 630 = R175

Proceeds = R300
Base cost = -175
Gain = R125

Should the base cost become negative under the base cost reduction method, the proportionate amount of the negative base cost disposed of must be added to proceeds instead of subtracted.

It is proposed that the amendments be deemed to have come into operation on 1 October 2001.

**CLAUSE 95**

*Income Tax: Amendment of paragraph 78 of Eighth Schedule to the Income Tax Act, 1962*

*Treatment of pre-valuation date capitalisation shares*

Paragraph 78 presently provides that where a company issues capitalisation shares, those shares must be treated as having a base cost of nil except where the issue of those shares constitute a dividend. An unintended consequence of this amendment is that pre-valuation date capitalisation shares are given a nil base cost. This results in pre-CGT gains being subjected to tax.

**Example**

On 1 October 2001 John held 110 ordinary shares in XYZ Limited. He had purchased 100 of the shares for R100 each in 1998, and received the 10 remaining shares as a capitalisation issue in lieu of dividends. On 1 October 2001 the market value of the shares was R200 per share. Assuming that John elects to use market value to determine the valuation date value of his shares the base cost will be determined as follows:

100 shares @ R200 = R20 000
10 shares null (para 78(1))
Base cost = R20 000
Assuming that he sells his shares on 2 October 2001 for R200 per share he will realise a gain of R2 000:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds</td>
<td>R22 000</td>
</tr>
<tr>
<td>Base cost</td>
<td>20 000</td>
</tr>
<tr>
<td>Capital gain</td>
<td>R2 000</td>
</tr>
</tbody>
</table>

The entire capital gain of R2 000 relates to the pre-CGT period and it should not be subjected to tax.

It is accordingly proposed that paragraph 78(1) be amended to provide that capitalisation shares must be treated as being acquired for expenditure of nil rather than a base cost of nil. This will allow the shareholder the option of using market value as the valuation date value of such shares. If this amendment is accepted the capitalisation shares in the above example will have a base cost of R2 000, and the pre-CGT gain will be eliminated.

**Base cost of capitalisation shares that constitute a dividend**

Paragraph 78 presently provides that where a company issues capitalisation shares, those shares must be treated as having a base cost of nil. Where, however, those capitalisation shares constitute a dividend, this rule does not apply. The paragraph does not state how the base cost of those shares must be determined.

It is proposed that the paragraph be amended to make it clear that such shares will be treated as having been acquired for expenditure equal to the amount of the dividend. The intention is not to trigger CGT as well as STC in respect of such shares.

**Example – Base cost of capitalisation shares constituting a dividend**

Ronen (Pty) Ltd issues 100 000 7% redeemable preference shares of R1 each to its existing ordinary shareholders on the basis of 1 preference share for each ordinary share held. The preference shares are issued out of retained income. Christine holds 1 000 ordinary shares and receives 1 000 preference shares. Her preference shares will have a base cost of R1 000. Ronen (Pty) Ltd will pay STC of 12.5% x R100 000 = R12 500 in respect of the preference share issue as it constitutes a dividend. Christine immediately disposes of her preference shares at the market value of R1/share, making neither a capital gain nor a loss.

Paragraph 78(2) deals with the situation where new shares are issued in substitution of previously held shares in the same company. When this happens, the base cost of the old shares is simply allocated against the new number of shares in issue and no capital gain or loss is triggered.

**Conversion**

Concern has been expressed that the conversion of a company into another type or form of company under the Companies Act 61 of 1973 will trigger a disposal in the hands of the shareholder. The same applies to a close corporation that converts to a company, and a company that converts to a close corporation. It is, therefore, proposed that the paragraph apply where a company or a close corporation convert, as contemplated in section 40A or 40B.
Retention of date of acquisition

The provision does not presently state on what date the new shares must be treated as having been acquired. This has implications where the time based apportionment method is used for determining the valuation date value of pre-valuation date shares. The intention has always been that the new shares should be deemed to have been acquired on the same date that the old shares were acquired. The proposed amendment gives effect to that intention.

It is proposed that these amendments be deemed to have come into operation on 1 October 2001.

CLAUSE 96

Income Tax: Amendment of paragraph 79 of Eighth Schedule to the Income Tax Act, 1962

The amendment proposed is of a textual nature. The erroneous reference to a “section” is replaced with the word “paragraph”.

CLAUSE 97


This amendment is of a textual nature. It is proposed that the erroneous reference to paragraph 38(b) be replaced with the correct reference to paragraph 38(1)(b).

CLAUSE 98


See notes on RESIDENCE BASIS OF TAXATION AND CONTROLLED FOREIGN COMPANIES.

CLAUSE 99


This amendment is consequential upon the substitution for Part XIII of the Eighth Schedule.

CLAUSE 100

Customs and Excise: Amendment of section 18 of the Customs and Excise Act, 1964

This section is restructured and adapted as a result of the introduction of provisions
relating to the licensed remover of goods in bond contemplated in section 64D. In terms of the rules for the section, certain goods removed in bond must, if removed by road, be transported by such licensed remover.

CLAUSE 101

Customs and Excise: Insertion of section 37B of the Customs and Excise Act, 1964

Section 37B provides for the manufacture, storage, distribution and use of biofuel. Biofuel includes biodiesel and ethanol manufactured from vegetable materials.

The proposed section includes enabling provisions for the Minister of Finance to amend the Schedules to the Act in order to prescribe proportions in mixtures of distillate fuel and biofuel and different rates of duty and for the Commissioner to make rules for the administration of the section, including exemptions from licensing.

CLAUSE 102

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

Subsection (13) is inserted to interrupt the running of the period prescribed for the termination of liability when legal proceedings are instituted.

CLAUSE 103

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

Section 47 deals with the payment of duty and the rate of duty applicable and the classification of goods. The proposed amendment includes the convention on the Harmonized Commodity Description and Coding System as one of the instruments to which the interpretation of Part 1 of Schedule 1 shall be subject. This is merely a formal statement of the de facto position.

CLAUSE 104

Customs and Excise: Amendment of section 50 of the Customs and Excise Act, 1964

Section 50 deals with disclosure of information and rendering of mutual assistance in terms of conventions or agreements.

This amendment extends the scope of the section by including also other non-customs and excise related conventions and agreements in respect of which the Commissioner may disclose information which may be in international, regional or national public interest.
CLAUSE 105

Customs and Excise: Insertion of section 50A of the Customs and Excise Act, 1964

Section 50A deals with joint international land border post administration.

This amendment provides for the establishment of joint land border posts and the mutual administration thereof by the Commissioner and the customs authority, of the adjoining state. Such co-operation will follow upon an agreement between the Republic and the adjoining state. This amendment is necessitated by the terms of the SADC Protocol and by practical considerations.

CLAUSE 106

Customs and Excise: Amendment of section 61 of the Customs and Excise Act, 1964

Section 61 deals with customs and excise warehouse licenses.

The proposed amendment provides for the circumstances where various licensees obtain goods from manufacturing warehouses in addition to the existing provision for such a procedure in respect of storage warehouses. It is intended to accommodate activities related to the Duty at Source initiative for the mineral fuel industry.

CLAUSE 107

Customs and Excise: Insertion of section 64F of the Customs and Excise Act, 1964

Section 64F provides for the licensing of distributors of fuels.

This section is necessitated by the Duty at Source initiative and provides for the licensing of certain distributors who are not also licensed manufacturers. It is intended to regulate removals of fuel levy goods to another country in the common customs area and exports on which refunds will be claimed.

CLAUSE 108

Customs and Excise: Amendment of section 75 of the Customs and Excise Act, 1964

The proposed amendment inserts subsection (11A) which is intended to provide for those circumstances where an applicant for a refund of duty in terms of Schedule No. 6 of the Customs and Excise Act, 1964, is unable to prove payment of duty. The Commissioner may allow the refund on production of the evidence stated in the subsection. The necessity for such a provision arises from refund provisions that must be introduced as a result of the Duty at Source initiative.

In the event of a change in the rate of duty and the relevant item in Schedule No. 6 so provides the refund may be calculated at the lowest rate operative during a maximum period of 12 months prior to the date the goods were placed under the
procedure specified in such item.

The amendment is made effective from 1 October 2002 which was the date of implementation of Duty at Source principles for the tobacco industry.

CLAUSE 109

Customs and Excise: Amendment of section 99 of the Customs and Excise Act, 1964

Section 99 deals with the liability of agents for obligations imposed on principals.

This amendment is as a consequence of the Accreditation initiative and the provisions therefor as well as the necessity to state the grounds on which liability must cease more precisely in view of a recent court judgment.

The amendments merely restate the applicable provisions more succinctly and include a provision that mere reliance on the instructions of a principal will not be considered to be reasonable.

Subsection (5) is deleted as it is considered inappropriate to limit such liability under the Act specifically for agents who will now be liable and their liability will cease as provided for their principals.

CLAUSE 110

Customs and Excise: Amendment of section 105 of the Customs and Excise Act, 1964

Section 105 regulates the payment of interest on outstanding amounts. The amendment proposed now links the fixing of the rate at which interest may be changed to the determination of the rate by the Minister of Finance in terms of the Public Finance Management Act, 1999.

CLAUSE 111

Customs and Excise: Amendment of section 114 of the Customs and Excise Act, 1964

Section 114 deals with duty which constitutes a debt to the state.

The provisions of this section were found to be constitutionally invalid by the Constitutional Court to the extent that they provide that goods owned by persons, other than the person liable to the State for the debts described in the section, are subject to a lien, detention and sale. The court also recommended that a provision similar to section 40(2)(a) of the Value-Added Tax Act, 1991 (Act No. 89 of 1991), should be incorporated in the Customs and Excise Act, 1964. It was further found that “this must not be taken to imply that there may not be circumstances when the nexus between the third party and the customs debtor, or that between the goods of the third party and the customs debtor or that between the goods of the third party and the customs debt is such that detention and sale would pass constitutional muster. There may well be such situations and it may be possible to craft a statutory
provision which would limit the detention and sale of the goods of third parties to such circumstances. But that is the task for the legislature and not for this court.”. The section is amended to comply with that judgment”.

Provision is made for a lien on the right, title and interest of the Customs debtor in anything subject to a lien which is the subject of a Credit Agreement.

A distinction is made between goods subject to a credit agreement and other goods.

In respect of an established debt the Commissioner is empowered to obtain a judgment in the Magistrates Court and execution and sale against the goods follow in terms of the Magistrates Court Rules.

Provision is then made for disposal of the amounts recovered in a particular order.

CLAUSE 112

*Stamp Duties: Amendment of item 15 of Schedule 1 of the Stamp Duties Act, 1968*

This amendment is consequential upon the changes to the corporate reorganisation rules in sections 41 to 47 of the Income Tax Act.

CLAUSE 113

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

The amendment to the definition of “enterprise” in section 1 is of a textual nature.

The amendment to the definition of “welfare organisation” in section 1 is of a textual nature.

CLAUSE 114

*Value-Added Tax: Amendment of section 2 of the Value-Added Tax Act, 1991*

See notes on COLLECTIVE INVESTMENT SCHEMES CONTROL ACT.

CLAUSE 115

*Value-Added Tax: Amendment of section 6 of the Value-Added Tax Act, 1991*

The amendment to section 6 is to bring these provisions into line similar provisions in the Income Tax Act.

CLAUSE 116

*Value-Added Tax: Amendment of section 12 of the Value-Added Tax Act, 1991*

The amendment to section 12 is to correct an error in the drafting of the amendment
to sub-section (c) last year.

**CLAUSE 117**

*Value-Added Tax: Amendment of section 28 of the Value-Added Tax Act, 1991*

The amendment to section 28 is to introduce provisions relating to the use of electronic signatures on documents.

**CLAUSE 118**

*Value-Added Tax: Amendment of section 58 of the Value-Added Tax Act, 1991*

The amendment to section 58 introduces an offence for the misuse of electronic communications.

**CLAUSE 119**

*Value-Added Tax: Substitution of section 70 of the Value-Added Tax Act, 1991*

Section 105 provides for the jurisdiction of criminal courts and provides that notwithstanding anything contained in any other law, a person may be tried in respect of an offence by a court having jurisdiction in an area where that person resides or carries on business. In terms of the criminal law provisions, a court in the area where the offence was committed has jurisdiction to hear a matter. It is proposed that it be clarified that the provisions of section 105 apply in addition to other jurisdictions and is not intended to limit the jurisdiction provided for in other legislation.

**CLAUSE 120**

*Value-Added Tax: Amendment of Schedule 1 to Value-Added Tax Act, 1991*

The amendment to item 407.00 is to re-introduce an exemption from VAT in item 407.02/00.00/02.00 in respect of goods to which a flat rate of Customs duty is levied in lieu of VAT and specific Customs duties.

**CLAUSE 121**

*Uncertificated Securities Tax: Amendment of section 6 of the Uncertificated Securities Tax Act, 1998*

These amendments are consequential upon the changes to the corporate reorganisation rules in sections 41 to 47 of the Income Tax Act.
CLAUSE 122

Skills development levy: Substitution of section 11 of the Skills Development Levies Act, 1999

Section 11 of the Skills Development Levies Act, 1999, currently provides that interest is payable by an employer if that employer fails to pay any amount of the levy on the last day for payment thereof. Interest is calculated from the last day for payment to the day that payment is received by the Commissioner, SETA or approved body, as the case may be.

It is proposed that section 11 be amended to provide that interest should only be calculated from the day following the last day for payment and this amendment gives effect to this proposal.

CLAUSE 123

Income Tax: Substitution of section 20A of the Skills Development Levies Act, 1999

Section 105 provides for the jurisdiction of criminal courts and provides that notwithstanding anything contained in any other law, a person may be tried in respect of an offence by a court having jurisdiction in an area where that person resides or carries on business. In terms of the criminal law provisions, a court in the area where the offence was committed has jurisdiction to hear a matter. It is proposed that it be clarified that the provisions of section 105 apply in addition to other jurisdictions and is not intended to limit the jurisdiction provided for in other legislation.

CLAUSE 124

Income Tax: Amendment of section 4 of the Revenue Laws Amendment Act, 2000

An amendment effected by section 4 of the Revenue Laws Amendment Act, 2000, was to withdraw the provision allowing the deduction of excess foreign tax credits from Secondary Tax on Companies which became payable either after the determination of the excess amount or the on the distribution of foreign source income by way of a dividend. The reasons for this amendment were to reduce the complexity of the foreign tax credit provisions and to allow for the mixing of foreign tax credits. As Secondary Tax on Companies is imposed in respect of the declaration of dividends and is not linked to a year of assessment, the deletion of the deduction against STC should have come into operation on the date of promulgation of the Revenue Laws Amendment Act, 2000, i.e., 6 December 2000. This amendment gives effect to the deletion of the deduction against STC with effect from 6 December 2000.

CLAUSE 125

Income Tax: Amendment of section 3 of the Taxation Laws Amendment Act, 2001

A definition of “spouse” was inserted in the Estate Duty Act, 1955, by section 1 of the
Revenue Laws Amendment Act, 2000 (Act No. 59 of 2000), to include customary unions and permanent same-sex partnerships. This was enacted retroactively with effect from 27 April 1994.

This definition was amended by section 3 of the Taxation Laws Amendment Act, 2001 (Act No. 5 of 2001), to also include permanent heterosexual unions. This amendment was, however, not made retroactive to the date of the application of the definition of “spouse”. It is, therefore, proposed that the amendment to the definition should apply with effect from 27 April 1994 and this amendment gives effect to this proposal.

CLAUSE 126

Customs and Excise: Amendment of section 51 of the Revenue Laws Amendment Act, 2001

Section 51(1) of the Revenue Laws Amendment Act, 2001, inserts section 101A in the Customs and Excise Act, 1964. Section 51(2) provides that section 51(1) will come into operation on a date to be determined by the President by proclamation in the Gazette. Subsection (2) was, however, erroneously omitted from the Afrikaans text and it is proposed that section 51 of the Afrikaans text be amended to rectify this.

CLAUSE 127

Customs and Excise: Amendment of section 118 of the Second Revenue Laws Amendment Act, 2001

This section is amended to indicate that except where the Commissioner otherwise prescribes by rule all imported goods landed from a ship, aircraft or other vehicle must be dealt with as provided in the section and not only goods of which due entry had not been made.

CLAUSE 128

Customs and Excise: Amendment of section 134 of the Second Revenue Laws Amendment Act, 2001

Section 134 of Act inserts section 93A of the Customs and Excise Act, 1964 and relates to the settlement of disputes. Section 134(2) is amended to align the provisions with section 71(1) of the Taxation Laws Amendment Act 30 of 2002.

This amendment is of a textual nature.

CLAUSE 129

Short Title and commencement

This clause provides for the short title and the commencement date of the Act.