DRAFT

NATIONAL
TREASURY

REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

REVENUE LAWS AMENDMENT BILL, 2008

[W.P. –- ‘08]

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EXPLANATORY MEMORANDUM
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INTRODUCTION

The Revenue Laws Amendment Bill, 2008, introduces amendments to the Transfer Duty Act, 1949, the Estate Duty Act, 1955, the Pension Funds Act, 1956, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Value-Added Tax Act, 1991, the Restitution of Land Rights Act, 1994, the Revenue Laws Amendment Act, 2006, the Taxation Laws Amendment Act, 2007, the Securities Transfer Tax Act, 2007, the Revenue Laws Amendment Act, 2007, and the Taxation Laws Amendment Act, 2008.

EXPLANATION OF MAIN AMENDMENTS

RETIREMENT ISSUES

TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS

Current Legislation

Withdrawal benefits are benefits payable to retirement fund members when they exit the fund prior to retirement, payments subsequent to their pre-retirement exit from the fund or certain payments from the fund before termination of membership. These benefits are partly tax-free and partly taxable. The tax-free part is generally calculated as follows:

- the first R1,800 of any withdrawal lump sum from a retirement fund (i.e. an annual R1,800 tax exemption); and
- an amount equal to contributions to the fund which did not qualify for a tax deduction when the contribution to the fund was made.

The remaining taxable portion of the lump sum is taxed based on an averaging formula. This averaging formula is based on the highest average annual tax rate for the tax year in which the retirement lump sum is payable or the previous tax year. All taxable amounts are subject to PAYE withholding before payout.

Problem Statement

The problem with the abovementioned regime is two fold. Firstly, the tax-free amount is very low and has not been adjusted for a number of years. Secondly, the averaging formula is complex and is dependant upon information which the retirement fund or retirement fund member cannot easily access or determine. The combination of these issues has prompted the need for change.

Further complexity is created when recurring payments (e.g. ongoing maintenance payable in terms of a court order) need to be made. These benefits are taxed as lump sums when payment is made, but at year-end an additional amount of tax may be payable and the fund member may not have the money to pay the tax.

Proposed Solution

The tax-free withdrawal lump sum will be 50 per cent of the tax threshold (i.e. R23,000 for the 2008/09 tax year although the effective date of this amendment will only be the 2009/10 tax year). This amount will automatically be adjusted annually according to the tax threshold for individuals. It should be noted that the effect of this amendment will be a tax-free amount equal to 50 per cent of the tax threshold but technically, the member will get a tax rebate equal to 50 per cent of the primary rebate. In addition, the existing tax-free amounts upon withdrawals will be retained other than the R1,800.

A retirement fund member will pay tax on the remainder of his withdrawal lump sum in accordance with the personal income tax tables applied separately to this benefit (i.e. as a stand-alone amount separate from other income). No rebate will be granted in addition to the tax-free R23 000. Technically, this amount forms part of “gross income” but a separate rate schedule applies. This amount therefore needs to be “ring-fenced” from gross income in terms of various sections of the income tax act on order for the separate rate schedule to apply correctly to this retirement fund lump sum withdrawal benefit.

Tax on withdrawal benefits (recurring payments)

Section 7(11) was amended during 2007 to recognise payments by retirement funds in terms of maintenance orders for the maintenance of a child. A new section 7(12) was inserted to recognise recurring payments made by retirement funds in terms of all maintenance orders. The wording in the 2nd Schedule was also amended to specifically exclude these recurring payments from being taxed in terms of this schedule. These payments are taxed in the hands of the member (and subject to PAYE) as “remuneration”.

ALLOCATIONS TO SPOUSES ON DIVORCE

Current Legislation

The Divorce Act deems a retirement fund interest to be part of a fund member's estate for purposes of a divorce. This interest can then be divided and a portion may be awarded to the non-member former spouse. The amount awarded to the non-member could previously not be paid prior to the member exiting the fund. The fund administrator was only required to make an endorsement in the records of the fund that a part of the pension benefit should be paid to the non-member upon the member's exit or retirement from that fund.

Amendments to the Pension Funds Act now allow for these orders to be paid prior to the member exiting or retiring from the fund. The non-member can elect to receive this award in cash or to have the amount transferred to his or her own retirement fund.

Problem Statement

The amount awarded to the non-member is deemed to accrue to the fund member and the tax payable must also be released from the fund. The tax to be paid is paid over and above the 'net' amount stipulated in the court order. The Income Tax Act gives the member a right of recovery against the non-member for the tax paid. This tax regime creates a number of problems and is difficult to administer.

Proposed Solution

The amount awarded in terms of a divorce order where the amount accrues to the non-member on or after 1 March 2009 will be taxed in the hands of the non-member's former spouse. This new regime is based on the new stand-alone rate schedule applicable to withdrawal benefits which comes into effect on 1 March 2009. The non-member may also elect to transfer his or her benefit to his or her own retirement fund without triggering any tax.

This new regimes is a simplified regime and should provide fund members and non-member spouses with more certainty around the tax treatment of amounts awarded in terms of divorce orders.

DEFAULT WITHDRAWALS

Current Legislation

In terms of the definitions of pension and provident funds, membership of the fund is dependant upon the employer/employee relationship. Should a member cease to be employed by the employer, an exit event is triggered (in terms of the rules of the fund) and a benefit becomes payable (accrues) normally within 6 months after the termination of the employer/employee relationship.

Tax is automatically levied upon accrual irrespective of whether or not the amount is paid to the member.

Problem Statement

An automatic accrual that triggers tax effectively forces the member to take the cash, rather than preserving the money within the retirement fund industry. The automatic triggering of tax will eliminate the option the member has (when the fund finally finds him and he is requested to make an election to take the cash or transfer to another retirement vehicle) to make the election to preserve his fund interest tax-free within the retirement fund industry.

Proposed Solution

It is proposed that the accrual event be postponed until such time as the member elects to receive the payment in cash.

TRANSFERS FROM PENSION TO PROVIDENT FUNDS

Current Legislation

Employer contributions to either a pension or provident fund are tax deductible for the employer. Only member contributions to pension funds are tax deductible because access to the fund interest upon retirement is limited to 1/3rd of the full value.

Pension and provident funds are approved by SARS on condition that a lump sum benefit may become available to a member upon one of only three exit events, namely resignation, retirement or death. All three of these events trigger an accrual under the provisions of the Second Schedule to the Income Tax Act. Whether the accrual is taxable is a function of the deductions that are determined under the Second Schedule. No deduction is available in the case where a member elects to have his fund interest in a pension fund transferred to a provident fund. This means that these transfers are fully taxable.

Problem Statement

No accrual takes place when a member’s fund interest is transferred from a pension to a provident fund in terms of a Section 14 (of the Pension Funds Act). Because there is no accrual, the Second Schedule is not applicable and no tax is payable upon this transfer. This is contrary to the policy rationale for the tax treatment of contributions to pension and provident funds. Should this transfer continue to be tax-free, fund members effectively get a tax deduction for member contributions to provident funds.

Proposed Solution

It is proposed that transfers from a pension to a provident fund be deemed to accrue to the member and create a lump sum withdrawal benefit in the hands of the member. The amount transferred should be regarded as an after-tax contribution to the provident fund.

EMPLOYERS AND EMPLOYEES

REPAYABLE EMPLOYEE BENEFITS

Current Legislation

Many employers make certain conditional payments to employees. Such payments are made on the basis that the amount paid will accrue to and be received by the employee, but that the employee must meet certain conditions subsequent to receiving the payment, failing which the amount paid will be repayable to the employer. Examples of such payments include retention bonuses and maternity payments.

In terms of current legislation, the amount paid to the employee is fully taxable in the hands of the employee when it is received by the employee, and the payment is subject to PAYE withholding tax.

Problem Statement

Should the employee subsequently be required to repay this amount (due to conditions not being met), the employee will not get a tax deduction of the repaid benefit. This is because section 23(m) of the Income Tax Act limits the types of expenses which an employee may deduct. In addition, the employee will not be entitled to a refund of any PAYE withheld by the employer on this benefit.

Proposed Solution

It is proposed that repaid benefits be allowed as a deduction against taxable income. To the extent that the employee does not have sufficient taxable income to deduct the full amount of the repaid benefit, an assessed loss will be created and carried forward to the following tax year. It is further proposed that a deduction of the repaid benefit be allowed against the amount on which PAYE is required to be calculated.

Example. In terms of Mrs A's employment contract, she is entitled to 4 months of fully paid maternity leave. Should she resign within a 12 month period after the date of returning to work after her maternity leave, she is required to pay back a pro-rated portion of her salary that accrued to her during her maternity leave. Her maternity leave started on 1 November 2008. Her monthly gross salary is R10,000, from which PAYE of R1,200 is deducted. On 1 March 2009, Mrs A informs her employer that she will not return to work. She repays the R40,000 salary that accrued to her during her maternity leave.

Result. Mrs A receives no remuneration in the 2009/2010 year of assessment against which the amount repaid (i.e. R40 000) can be deducted. The amount repaid can also not be deducted against her remuneration for the 2008/2009 year of assessment, since the amount was repaid in the 2009/2010 year of assessment. Mrs A will, however, be entitled to a deduction of the amount repaid against her taxable income on assessment for the 2009/2010 year of assessment.

PERSONAL USE OF BUSINESS CELL-PHONES AND COMPUTERS

Current Legislation

Generally, the private use of employer-provided cellular phones and laptops by employees is a taxable fringe benefit in terms of the Seventh Schedule to the Income Tax Act. Similarly, the private use portion of telephone line rentals and call charges paid for by an employer is taxable in the hands of the employee.

Problem Statement

Employers are increasingly providing employees with cellular telephones and laptops to encourage productivity outside the workplace. However, given the fact that employees are able to use these items outside the office, personal use of these items is ultimately inevitable. From a technical perspective, the incidental private use of cellular phones and laptops should be taxable, but the value of the tax collected does not justify the administrative costs incurred by employers.

Proposal

It is proposed that where certain assets are provided by an employer to an employee mainly for business use, no taxable value be placed on the private use of those assets. These assets will initially be limited to telephones (including cellular telephones) and computers (including laptops).

The same principles will apply to the "private use" portion of telephone line rentals and the cost of private telephone calls from employer-owned telephones, as well as subscriptions for internet access provided by employers.

CONSOLIDATION OF DEEMED EMPLOYEE REGIMES

Current Legislation

Generally, where a relationship of employment exists, a payment made by an employer to an employee as consideration for employment services rendered by the employee is subject to employees' tax, which must be withheld by the employer from the payment made to the employee. Consequently, one of the factors that give rise to the obligation to withhold is the existence of an employment link.

The Income Tax Act contains a number of provisions that are aimed at preventing practices that involve the breaking of the employment link in order to avoid the obligation to withhold tax. For example, payments made to "labour brokers", "personal service companies" and "personal service trusts" are regarded as "remuneration" and therefore subject to withholding tax. In addition, the Income Tax Act limits the tax deductible expenses of these entities in order to prevent individuals from using an entity in order to claim deductions that they would not otherwise be entitled to.

A labour broker is a person (legal or natural) who is in the business of providing its clients with other persons to render services. A labour broker is paid by its clients for the services, and such payments are generally subject to withholding tax. A labour broker may, however, apply for a labour broker exemption certificate if it meets certain criteria. Generally, these criteria would be met where the labour broker is a registered taxpayer, an employer and a stand-alone "real" business. Payments made to a labour broker in possession of a labour broker exemption certificate are not subject to withholding tax.

Personal services companies and trusts are more widely defined than labour brokers. A labour broker will fall within the definition of a personal service company/trust where it is unincorporated and is not a trust.

Problem Statement

The problem with the current regime is that the Income Tax Act recognizes three different types of entities, all of which are effectively engaged in the same type of business. This makes it difficult for businesses to comply with the legislation and is also not conducive to a streamlined compliance and audit process.

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Proposal

In order to promote ease of compliance and to assist SARS in its administration, a streamlined regime in which only one type of entity is recognized is proposed. It is therefore proposed that the definitions of "labour broker", "personal service company" and "personal service trust" be replaced by a single definition of "personal services provider" ("PSP"). Individuals providing services as "independent contractors" are in certain circumstances "deemed employees" of their clients. The definition of "personal services provider" will also include these "deemed employees".

The definition of a PSP should be the same as the definition of "personal services company" except that it should also include any person (including individuals, companies or trusts) who provides clients with people to render services. The people providing the services may be the person contracting with the client or another person.

In order to qualify as a PSP the following criteria must be met (the same criteria as the definition of the old "personal services company"):

- The client must control or supervise the service being provided and the service must be performed at the client's premises; or
- More than 80% of the "service" income should be paid by one client.

Furthermore, even if a person meets the abovementioned criteria, that person may be specifically excluded from being a PSP if that person employs three or more employees on a full-time basis.

A client will also not be required to withhold PAYE on payments to a service provider if the service provider provided the client with a declaration that it does not qualify as a PSP in terms of the abovementioned criteria (other than the first criteria i.e. supervision or control).

DEDUCTIONS IN RESPECT OF LEARNERSHIPS

Current Legislation

In order to encourage job creation, the Income Tax Act currently provides for an additional tax deduction (over and above the normal tax deduction) in respect of certain learnerships.

The deduction applies in respect of (1) learnership agreements that are registered with a SETA, and (2) contracts of apprenticeship registered with the Department of Labour.

The additional tax deduction is determined as follows:

a) Existing employees

Where the employee is employed at the time of entering into the learnership agreement, the employer will be entitled to once off deductions both at the time of entering into the learnership agreement and at the time of completion thereof by the employee.

At the time of entering into the learnership, the deduction will be limited to the lower of:

- 70% of the employee's salary for the duration of the learnership (limited to 12 months); or
- R20,000.

On completion of the learnership by the employee, the deduction will be limited to the lower of:

- The employee's salary for the duration of the learnership (limited to 12 months); or
- R30,000.

b) New employees

Where the employee is not employed at the time of entering into the learnership agreement, the employer will also be entitled to once off deductions both at the time of entering into the learnership agreement and at the time of completion thereof by the employee.

Both of these once off deductions are limited to the lower of:

- the employee's salary for the duration of the learnership (limited to 12 months); or
- R30,000.

Problem Statement

A problem arises with certain apprenticeships where the apprenticeship extends over a number of years and no new contract is entered into each year. In these circumstances, the benefit for the employer is much lower than it would be if a new contract is concluded each year.

The two main types of apprenticeships that do not qualify for the "full" benefit are Time Based Apprenticeships (TBAs) and Competency Based Modular Training (CBMT). The table below illustrates the difference between the deductions the employer is entitled to in respect of these two types of apprenticeships and other learnerships.

Learnerships			Time Based Apprenticeships			CMBT		
Year	**Performance measure**	**Allowance**	**Year**	**Performance measure**	**Allowance**	**Year**	**Performance measure**	**Allowance**
1	NQF1/Contract 1	20,000	1	Contract	20,000	1	Level 1/ Contract	20,000
		30,000		for 4 years			for 4 years	
2	NQF2/Contract 2	20,000	2			2	Level 2	
		30,000						
3	NQF3/Contract 3	20,000	3			3	Level 3	
		30,000						
4	NQF4/Contract 4	20,000	4			4	Level 4	
		30,000			30,000			30,000
		200,000			**50,000**			**50,000**

As is evident from the above, TBAs and CBMT apprenticeships only qualify for the once off deductions once, other learnerships qualify for the once off deductions annually.

Proposed Solution

<u>Replacing the once-off upfront deduction with an equivalent tax deduction for certain apprenticeships</u>

It is proposed that the deduction regime for TBAs and CBMT apprenticeships be modified so that where these apprenticeships extend over a number of years, the employer is entitled to the same tax deduction as if a new contract was concluded each year.

<u>Time Based Apprenticeships</u>

Time Based Apprenticeships are governed by the Manpower Training Act. An apprentice enters into a contract with the employer. The contract stipulates the duration of the apprenticeship (normally the minimum period as prescribed by the Minister of Labour) and that the apprentice should take a trade test. Upon successful fulfillment of these two conditions, the apprentice will be a qualified artisan. Due to the fact that TBAs do not have any interim method for measuring progress during the period of apprenticeship, it is proposed that the “full allowance” be granted upon completion of the trade test. The upfront deduction of R20,000 or R30,000 should still be granted upon entering into the contract. The “full allowance” will be the upfront deduction plus the completion deduction multiplied by the minimum number of years of apprenticeship (as prescribed by the Minister of Labour).

> *Example.* An employer concludes a Time Based Apprenticeship contract with an existing employee. The minimum period of practical training is 4 years. The apprentice’s annual salary is R50,000. The employer will qualify for a R20,000 deduction upon entering into the agreement and a R180,000 (((R20,000 + R30,000) x 4) – R20,000) tax deduction upon the apprentice successfully completing his apprenticeship.

Competency Based Modular Training

CBMT trades were developed under the Motor Industry Training Board and are governed by regulations promulgated in 1996. An apprentice enters into a contract with the employer. The contract stipulates the various levels of the apprenticeship. Successful completion of one level will involve a period of practical apprenticeship and a trade test and will result in the apprentice moving on to the next level.

It is proposed that the upfront allowance and completion allowance be allowed as a deduction for the employer upon successful completion of each level.

> *Example.* An employer concludes a CMBT contract with an existing employee. The contract stipulates that the employee will have to complete 4 levels of the CMBT. Each level consists of one year of practical training and a trade test. The apprentice's annual salary is R50,000. The employer will qualify for a R20,000 upfront deduction every time the employee enters a new level, and a R30,000 completion deduction every time the employee successfully completes a level. The total deduction should amount to R200,000 over the four year period.

The revised deduction regime is illustrated below:

Learnerships			**Time Based Apprenticeships**			**CMBT**		
Year	**Performance measure**	**Allowance**	**Year**	**Performance measure**	**Allowance**	**Year**	**Performance measure**	**Allowance**
1	NQF1/Contract 1	20,000	1	Contract	20,000	1	Level 1/Contract	20,000
		30,000		for 4 years			For 4 years	30,000
2	NQF2/Contract 2	20,000	2			2	Level 2	20,000
		30,000						30,000
3	NQF3/Contract 3	20,000	3			3	Level 3	20,000
		30,000						30,000
4	NQF4/Contract 4	20,000	4			4	Level 4	20,000
		30,000			180,000			30,000
		200,000			**200,000**			**200,000**

PAYROLL GIVING

Some employers operate payroll giving programs that allow their employees to make regular donations to public benefit organisations (PBOs) by way of a deduction from their salaries or wages. At present these employees may only claim the deductions for donations made to PBOs and other entities qualifying under section 18A when they submit their annual tax return.

In order to expand the potential pool of donors, accelerate the tax benefit to employees and reduce the number of refunds on assessment, it is proposed that employers take donations made on behalf of their employees into account for employees' tax purposes. The amount of the donations that may be taken into account for employees' tax purposes is capped at 5% of remuneration since employers will not be aware of other donations made by the employee, the extent to which a car allowance will be utilised, etc. Without such a cap employees may also find themselves with amounts outstanding to SARS when they submit their annual tax return and the overall cap on deductible donations of 10% of taxable income is applied.

Employers will be required to obtain section 18A receipts for the donations made, on at least an annual basis, while employees will be able to rely on their employees' tax certificates to substantiate these donations.

Notes: The 5% of remuneration cap is set to limit donations that end up exceeding the 10% of taxable income cap, which would then require collections action by SARS. This would be undesirable from a SARS perspective since it would require the deployment of collections resources, as well as from a PBO perspective since it would be an unanticipated demand that would be linked to participation in a payroll giving program.

The cap is set to minimise this risk and is equal to the 5% cap that was previously set for deductible donations. It is applied to remuneration since that is an amount that is readily available to the employer. Remuneration will obviously differ from taxable income in that additional non-employment income may be earned, travel allowance claims may differ from the assumptions made in the Fourth Schedule, etc.

The employer acts as the concentration point for donations through a payroll giving programme. From an audit perspective, rather than having to audit individual deductions claimed, SARS' automatic employer/employee data match will take care of that leg of the audit trail. All that will be necessary will be to confirm that the total of the deductions reflected in the employees tax certificates issued by the employer is supported by section 18A receipts issued to the employer.

INDIVIDUALS

DEDUCTIONS IN RESPECT OF DISABILITY EXPENSES

Current Legislation

Natural persons may deduct certain medical-related expenses from taxable income. The extent to which qualifying medical-related expenses are deductible is determined both by the age of the taxpayer and whether the taxpayer or one of his immediate family members are "handicapped". In the case of the latter, all qualifying expenses of the family is tax deductible.

Problem Statement

The use of the term "handicapped" and the definitions "handicapped person" and "handicapped child" are outdated. In addition, there is uncertainty regarding the tax deductibility of expenses incurred by a taxpayer with a "handicap" or with a "handicapped" dependent.

Proposal

It is proposed that the term "handicapped person" be replaced with a more widely accepted and understood term "disabled person". This term is in line with the definition used by other Government departments.

In order to provide more certainty on the tax treatment of expenses incurred relating to a disabled person's disability, the type of tax deductible expenses will be clarified by way of a list of qualifying expenses. This list will be drafted and reviewed regularly in consultation with organisations representing the disabled fraternity.

ESTATE REDISTRIBUTIONS

Current Legislation

Paragraph 40 of the Eighth Schedule to the Income Tax Act deals with disposals to and from deceased estates. In terms of subparagraph (1), the assets of a deceased person (other than certain specified assets) are treated as having been disposed of by the deceased to his or her estate. Subparagraph (2) deals with the disposal of an asset by an estate to an heir, as well as the acquisition of that asset by the heir.

Problem Statement

A problem arises where an heir contributes an asset to the estate for no consideration (for example, in terms of a redistribution agreement or where there is a massed estate). Neither paragraph 40 (which only deals with disposals to an estate by a deceased person) nor paragraph 38 of the Eighth Schedule (which only deals with disposals by way of donations, consideration not measurable in money and transactions between connected persons not dealing at arm's length) deal with this situation.

It may therefore be argued that, where an heir contributes an asset to the estate for no consideration, the heir will have no proceeds in respect of the contributed asset, the estate would acquire the contributed asset at a base cost of nil, and the heir who acquires the contributed asset would do so for a base cost of nil.

Proposed Solution

It is proposed that paragraph 40 be amended to provide for a disposal to an estate by an heir where the disposal takes place as a result of massing or in terms of a redistribution agreement. The disposal should be at the market value of the asset. The subsequent disposal of the asset to another heir should be regarded as a disposal of that asset by the estate at market value and result in an acquisition of the asset at market value by the heir.

Example: Proposed Treatment of Asset Contributed to a Deceased Estate in terms of a Redistribution Agreement

Facts.
In terms of his last will and testament, Mr A, now deceased, bequeathed the following assets to the persons indicated:

Asset A to Spouse A

- Market value on date of death	R150
- Base cost in Mr A's hands	R100

Asset B to Heir B

- Market value on date of death	R200
- Base cost in Mr A's hands	R 50

In terms of a redistribution agreement, spouse A and heir B agree to exchange assets. Spouse A contributes Asset C with a base cost of R10 and a market value of R50 to the estate to make up the shortfall between the value of Asset A (R150) and Asset B (R200).

Result.

The deceased (Mr A)

The deceased realizes a gain of R50 in respect of asset A. There is no gain or loss in respect of Asset B (roll-over relief applies by virtue of paragraph 67(1) of the Eighth Schedule).

Spouse A

Spouse A acquires Asset B at a base cost of R50 (i.e. Spouse A acquires Asset B at Mr A's base cost). Spouse A has a disposal at market value in respect of Asset C which she contributes to the estate. This gives rise to a gain for Spouse A of R40 (i.e. R50 – R10).

Heir B

Heir B acquires Asset A at a base cost of R150. He also acquires Asset C at a base cost of R150.

Deceased estate

The deceased estate acquires Asset A at a base cost of R150 and disposes of it for R150. It acquires Asset C at a base cost of R50 and disposes of it for R50.

BROAD-BASED EMPLOYEE SHARE SCHEMES

Current Legislation

A tax-free broad-based employee share scheme was introduced into the tax legislation with effect from 26 October 2004. In terms of this scheme, an employer may grant/issue shares to employees without a taxable fringe benefit being created in the hands of the employee. This grant will effectively be tax-free in the hands of the employee if the scheme meets a number of stringent criteria.

Problem Statement

Due to the apparent lack of usage of this incentive, the tax policy unit conducted an informal tax survey on broad-based share incentive schemes amongst major SA listed companies in order to identify problem areas to the current tax legislation. Information received from the survey and from consultations with industry representatives indicated that some of the qualifying requirements are too stringent, thereby preventing full utilisation of this incentive.

Proposal

1. *Monetary Cap*

The R9 000 tax-free ceiling is too low. The cost of issuing shares and the administrative burden of these schemes are not justified by such a low amount. It is proposed that the tax-free ceiling be raised to R50 000 over 5 years in order to be more workable. The 5-year rule is proposed because a 5-year time-line exists for employee-holding requirements, so that a 5-year rule creates internal consistency within section 8B. A 5-year time-horizon is also consistent with BEE codes.

2. Participation percentage threshold

In accounting for the 90% threshold, an employee who participates in any other equity scheme offered by the employer is not entitled to participate. It is proposed that the 90 per cent participation be lowered to 80 per cent. A lower percentage is proposed for the following reasons:

- To allow the employer to exclude certain non-performing employees from receiving shares;
- To allow for more flexibility for the employer because it is difficult for the employer to classify each employee (permanent etc), especially due to the time lapse between the classification ('counting' of employees) and granting of shares (scheme implementation);
- It is too costly to include 90% of all employees', the employer should be allowed to exclude middle and senior management from participating in this scheme. It is unlikely that low-income employees will be excluded from participating in the scheme as a result of lowering the % because of the bargaining power of trade unions. While exclusion exists for high-end employees participating in other schemes, many semi-high middle managers must be accounted for in the denominator because these middle-to-high-end employees do not generally receive section 8C shares.

3. Expanding the types of permissible restrictions

The permissible restriction should be further relaxed to allow for the employer to have a right to acquire the shares at any time during a restriction period at the market value of those shares "as at the date of grant." However, this ability to buy back shares at initial market value should be allowed only on grounds of employee misconduct or poor performance.

Example.

Facts.

On 5 January 2007, Y is granted 2 500 section 8B shares in Holdco at a cost of R0.5 per share (minimum required payment in terms of Companies Act). The shares were trading at R2 on the date of grant, and Y is restricted from selling these shares for a period of 5 years from date of grant. In terms of the plan, the employer has a right to acquire the shares at market value in the event of her under performance during the 5 year period. At the end of the 5 year period the shares were trading at R5 each.

Result.

Y under-performed from the date of grant until 4 January 2009. In terms of the plan, the employer can buy her shares back on 5 March 2009 at the market price of R3 each (i.e. at R7 500) under current law. Y will still benefit from the increase in value between the date of grant and the date of the forced sale even though she underperformed during this period. It is proposed that the employer should be able to buy back the shares from at the R2 market value at date of grant.

CORPORATE AND COMMERCIAL ISSUES

STC REFORMS – CONVERSION FROM STC TO A DIVIDEND TAX

Current Legislation and Background

Secondary Tax on Companies ("STC") is a tax that is levied on the "net amount" of dividends declared by a company. Consequently, the liability for STC falls on the company distributing the dividend (as opposed to the shareholder receiving the dividend). STC is not a tax on the dividend declared – it is merely calculated with reference to the amount of the dividend declared.

In February 2007, the Minister of Finance announced a two-phase approach to STC reform.

The first phase entails the reduction of the STC rate, as well as a revision of the tax base (i.e. the definition of dividend) on which the STC relies. The initial elements of this phase were put into effect by the Revenue Laws Amendment Bill, 2007.

The second phase of STC reform announced by the Minister entails the replacement of the STC with a new tax on distributions of companies that is levied at a shareholder level.

Problem Statement

There were two major drivers behind the announcement of the reform of the STC regime.

Firstly, internationally, distributions of dividends by companies are generally taxed at the shareholder (as opposed to company) level. This gives rise to a number of collateral problems, including the following:

- Because the STC charge must be subtracted from the profits of a South African company in determining its profit after tax, South African companies are at a disadvantage to their international counterparts.
- Since the STC is levied at company level, tax treaty limits on dividend rates generally have no effect (unless the relevant treaty makes specific provision for STC).
- Foreign investors are generally unfamiliar with STC and its mechanics. This creates unnecessary confusion in the minds of international investors.

- Arguments have been raised that STC raises the costs of equity financing, and is therefore detrimental to economic growth.

Secondly, there are a number of problems associated with the tax base that STC relies upon. As stated above, STC is levied on the "net amount" of dividends declared by a company. There is a considerable overlap between company law/accounting and tax in the determination of what constitutes a dividend, as well as in determining whether a dividend constitutes a dividend that is subject to STC. The mixture of these (often complex) concepts of accounting, company law and tax has complicated the tax system significantly and, partly because of this complexity, has created opportunities for avoidance.

Proposals

As part of the process of STC reform, the amendments proposed introduce the new Dividend Tax, as well as a new dividend definition (which will serve as the tax base for the Dividend Tax). Regarding the new dividend definition, see the notes on **STC REFORMS – REVISED DIVIDEND DEFINITION** below.

Basics of the Dividend Tax

The new Dividend Tax will, in line with international norms, be levied at a shareholder level. The tax will apply only in respect of dividends declared by South African resident companies, and will be levied at a rate of 10%. The party entitled to the benefit of the dividend will be the party ultimately liable for the tax. However, the beneficial owner will be exempt from the dividend tax if the beneficial owner is:

(a) A South African resident company;
(b) Any sphere of the South African government (i.e. national, provincial and local);
(c) an exempt parastatal;
(d) a pension or benefit fund;
(e) an approved PBO; or
(f) an environmental rehabilitation trust (as contemplated in section 37A).

In terms of timing, the liability of the beneficial owner for the tax is deemed to arise when the dividend is paid by the company payor, irrespective of how long it takes for the dividend to reach the beneficial owner (i.e. where, for example, the dividend is passed through an intermediary or chain of intermediaries).

Transitional Arrangement: STC Credits

In addition to the above exemption for exempt entities, an exemption will exist for dividends previously subject to the STC. For purposes of administrative convenience, STC credits will be exhausted first (i.e. a company will not be entitled to decide whether it is declaring a dividend out of STC credits).

Moreover, dividends eligible for STC credits will be allocated *pro rata* amongst all shareholders within the same class entitled to the dividends, irrespective of whether those shareholders are exempt from the dividend tax.

> *Example. Facts.* Company X has two shareholders (Pension Fund and Individual) that each hold 50% of its shares. Company X has R400 of STC credits (i.e. Company X has received R400 of dividends previously subject to STC). Company X distributes R600 to its shareholders by way of a dividend.
>
> *Result.* Of the R600 dividend, the dividend tax does not apply to the first R400 by virtue of the existing STC credits. Of the remaining R200, R100 is allocated to each shareholder. This means that R100 of the dividend (i.e. that is paid to Pension Fund) will be exempt, and the other R100 (i.e. that is paid to Individual) will be taxed at 10%.

STC credits will work themselves up through a chain of South African resident companies, and will (as they move through the chain) be pro rated amongst each class of shareholder.

> *Example. Facts.* Company X has two shareholders (SA Company and Individual) that each hold 50% of its shares. Company X has R400 of STC credits (i.e. has received R400 of dividends previously subject to STC). Company X distributes R600 to its shareholders by way of a dividend.
>
> *Result.* Of the R600 dividend, the dividend tax does not apply to the first R400 by virtue of the existing STC credits. Of the remaining R200, R100 is allocated to each shareholder (meaning that the R100 paid to SA Company is exempt and the other R100 paid to Individual is taxed at 10%. The R400 of STC credits is similarly split, with SA Company receiving R200 of STC credits and Individual receiving R200 of STC credits (which will be permanently eliminated).

The STC credit regime under the new Dividend Tax will be dependent on reporting by the initial company payor to the payee. The company payor will be required to determine the percentage of the dividend that will be exempt by virtue of STC credits, and this percentage will need to be reported and relied upon through the chain. Failure to transmit this report to the payee will result in the denial of STC credits for the shareholder, while at a company level the STC credit will be reduced. This report will need to be transmitted at time of payment of the dividend by the company payor.

> *Example. Facts.* Company has 5 000 shareholders and distributes a dividend of R40 000. Company has STC credits of R10 000. The distribution is made to both beneficial owners and nominees.
>
> *Result.* Company knows that 25 per cent of the dividend is allocable to STC credits. This percentage is reported through to each payee (practically, nominees will be required to relay this 25% number onward

through the chain). If this percentage is not reported by Company, the STC credits will simply be lost.

All STC credits will disappear on the third anniversary of the date that the dividend tax becomes effective.

Other Transitional Arrangements

In addition to the above STC credit transition regime, another transitional exemption will apply to dividends declared before the date that the new dividend tax becomes effective but that are paid after that date. These dividends will be subject to STC, and will not (despite the fact that they are paid after the effective date) be subject to the dividend tax. This transitional rule will only exist for one year after the effective date.

STC REFORMS – REVISED DIVIDEND DEFINITION

Current Legislation

Basics of STC

As set out above, STC is levied on the net amount of company dividends declared. It is levied on the profits of a company when they are distributed (i.e. it is not a tax on all distributions by companies). The mere distribution by a company will not lead to the STC unless that distribution is classified as a dividend. The determination as to what constitutes a dividend is therefore essential to the determination of STC payable on any given distribution by a company.

Meaning of "Dividend"

A dividend is generally defined in section 1 of the Income Tax Act as "any amount distributed by a company" to its shareholders. The term "amount" is given a wide meaning, and includes not only money, but also the value of every form of property given to a shareholder.

Paragraph (*b*) of the dividend definition in section 1 specifically, by referring to "profits distributed", includes "going-concern" dividends. "Profits" means profits available for distribution – both realised and unrealised. In addition, certain other distributions made by companies are also regarded as dividends for purposes of STC. Such distributions include, for example, the distribution of realized and unrealised profits distributed in the course of, or in anticipation of a liquidation, winding up, deregistration or final termination of a company, redemptions and reductions of share capital, and certain issues of capitalisation shares.

In terms of company law, dividends may freely be distributed only out of current or accumulated profits. Where a dividend is distributed out of contributed share capital, share premium or reserved profits, the articles of association of the company making the distribution typically require a special company resolution.

As is evident from the above discussion, there is considerable overlap between company law/accounting and tax in the determination of what constitutes a dividend, as well as in determining whether a dividend constitutes a dividend that is subject to STC

Problem Statement

The tax base to which STC relates has given rise to two main problems. Firstly, the STC base effectively adopts a blanket reliance on company law and accounting concepts in order to determine what constitutes a dividend. Secondly, it is necessary to reconcile profits for accounting and company law purposes with profits for tax purposes in order to determine what dividends will be subject to STC. The result of these two problems has been unnecessary complexity, further resulting in the creation of opportunities for avoidance.

Proposal

New Definition of “Dividend” (section 1)

For purposes of the new Shareholder Dividends Tax, a new dividend definition will be added to the Act. This new definition will include as a dividend any amount distributed or otherwise paid in respect of a share, unless the distribution is made out of contributed tax capital (“CTC”). Consequently, all operating and liquidating distributions, and all amounts paid in redemption, cancellation or otherwise in exchange for shares surrendered (e.g. through buybacks) will be regarded as a dividend. The amount distributed will consist of money as well as the market value of every other form of property.

New Definition of Contributed Tax Capital (“CTC”) (section 1)

Generally, the Contributed Tax Capital (“CTC”) of a company is a notional amount derived from the value of any contribution made to a company as consideration for the issue of shares by the company. CTC will be reduced by any amount thereof that is allocated in a subsequent transfer back to the shareholder.

As a general rule, the CTC of a company is based on amounts received by or accrued to a company as consideration for the issue of shares by the company. For instance, if an individual contributes an asset worth R100 to a widely held company in an initial offering, R100 is added to CTC.

A special rule applies if the shareholder to which the shares are issued holds more than 20% of the shares of the issuing company after the share issue (paragraph (*a*) of the proviso to the definition of CTC). This rule applies regardless of whether the amount contributed constitutes a capital asset or trading stock. In both circumstances, the starting point for determining the amount of CTC is the tax cost of the asset, adjusted by the amount of tax gain or loss realized by the transferor on the disposal of the asset to the company.

If the amount contributed constitutes trading stock, the amount of CTC will be determined by (1) determining the cost price for the transferor of the trading stock contributed; and (2) adding the amount that is included in the taxable income of the transferor as a result of the disposal of the trading stock to the company. Similarly, where the amount contributed is an asset that is held by the transferor on capital account, the amount of CTC will be determined by (1) determining the base cost of the asset for the transferor; (2) adding the capital gain realized by the transferor on the disposal of the asset to the company; and (3) adding any recoupments triggered by the disposal of the asset to the company.

If the transferor incurs a loss on the disposal of the asset (i.e. where the cost price/base cost of the asset exceeds the amount that is realized by the transferor on the disposal of the asset), the CTC amount will be reduced by the amount of the loss.

> Example. X contributes an asset which he holds on capital account to Company Y in exchange for the issue of 25% of the shares in Company Y. The base cost of the asset in the hands of X is R10. On the date of transfer of the asset to Company Y, the market value of the asset is R100. The capital gain of X in relation to the disposal of the asset to Company Y is R90 (i.e. R100 – R10). The amount of CTC that is contributed to Company Y is calculated as follows:
>
> | | |
> |---|---|
> | Base cost of asset: | R10 |
> | Capital gain: | R90 |
> | CTC contributed: | R100 |

Amendment of definition of trading stock

Under current legislation, trading stock is defined in relation to a taxpayer. Since the contribution of trading stock by a person to a company in exchange for shares will result in the creation of CTC, it is proposed that the definition of "trading stock" be amended so that it is defined in relation to a person.

CTC and Amalgamation Transactions (Section 44)

An amalgamation transaction (as contemplated in section 44) involves the disposal by an "amalgamated" (or target) company of all its assets to a "resultant" (or acquiring) company. The outcome of the transaction is that the existence of the target company is terminated (i.e. the target company is "merged" into the resultant company). As a necessary consequence, the effect of an amalgamation transaction should be that the CTC of the target company should be added to the CTC of the resultant company. Thus, for example, if the CTC in the target company is R150 and the CTC in the acquiring company is R300, the CTC in the newly combined company should be R450.

If, as part of the amalgamation transaction, the target company makes a distribution of CTC to its shareholders, that portion of the CTC that is so distributed will not roll over into the newly merged company. Thus, for example, if the target company has R100 of CTC but makes a distribution of R30 (from CTC) to its shareholders as part of the amalgamation, only R70 of CTC should be rolled over to the acquiring company.

Special considerations exist in circumstances where the acquiring company holds shares in the target company (or *vice versa*) immediately before the amalgamation transaction. In these circumstances, the CTC in the target company cannot simply be added to the CTC in the acquiring company, and the amount of CTC in the target company must be reduced by the percentage shareholding that the acquiring company holds in the target company. For example, if Company A owns 60% of Company T and Company T amalgamates into Company A, only 40% of the CTC in Company T will be added to the pre-existing CTC in Company A.

CTC and Unbundling Transactions (Section 46)

An unbundling transaction essentially involves one company (i.e. the unbundling or "parent" company) distributing the shares that it holds in another company (i.e. the unbundled or "subsidiary" company).

Where an unbundling transaction takes place, the CTC in the parent (i.e. unbundling) company will need to be allocated between the parent company and the subsidiary (i.e. unbundled) company according to their relative market values. The historic CTC of the unbundled subsidiary will be lost. This rule is similar to the rules for the determination of the base cost of the shares that are unbundled to shareholders of the unbundling company.

> *Example. Facts.* Parent Company owns all the shares of Subsidiary. The CTC in Parent Company is R750, and the CTC in Subsidiary is R500. Holding Company has a value of R1000 by itself, and Subsidiary has a value of R500 by itself. Subsidiary is unbundled.
>
> *Result*. The CTC in Parent Company of R750 must be reduced to R500 (i.e. R1000/R1500), and the CTC in Subsidiary of R1000 must be reduced to R500 (i.e. (R500/R1000). Therefore, after the unbundling, Holding Company has a CTC of R500 and Subsidiary has a CTC of R250 (i.e. the division of the total CTC in both Parent and Subsidiary of R750. The CTC in Subsidiary that existed prior to the unbundling is lost.

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CTC and Liquidations

Liquidations have no impact on the CTC of the recipient. The CTC of the liquidating company is simply lost.

CTC Allocations Amongst and Per Class

As under current law, where a company makes a distribution out of CTC, the CTC distributed will be allocated pro rata to the shareholders of that class. If a company has several classes of shares, CTC must be maintained separately on a per class basis. Therefore, CTC created by virtue of an ordinary share issue cannot be reallocated to preference shares. Stated differently, if a company has two classes of shares, a CTC account should be maintained for each.

STC REFORMS – DIVIDEND TAX WITHHOLDING REGIME

Withholding by Company Payors

Under the proposed Dividend Tax regime, any resident company that pays a dividend will be required to withhold an amount of 10% of that dividend from the payment. Therefore, the payment of the dividend (and not its declaration) will trigger the liability to withhold. Dividends subject to the 10% charge will include all dividends less STC credit amounts (as discussed above).

Generally, exemption from the liability to withhold for the company payor depends on whether the share in respect of which the dividend is paid is an uncertificated or a certificated share. The rules relating to withholding in respect of payments of dividends will be less restrictive in the uncertificated environment, which is more regulated.

Certificated Shares: A company payor making payment in respect of certificated shares must not withhold dividend tax in respect of that payment in two sets of circumstances, i.e.:

(i) where payment is made to a shareholder that has properly submitted a declaration to the effect that the beneficial owner is exempt from the dividends tax; or
(ii) where payment is made to a controlled group company (as defined in section 41).

Uncertificated Shares: The company payor is exempt from the withholding obligation if it pays the dividend:

(i) to a person who is exempt from the dividend tax as indicated on the company payor's register/books. However, this exemption will not apply if the intermediary submits a declaration requiring the company payor to withhold (this would be the case where the intermediary does not wish to assume a liability for the Dividend Tax).

(ii) to a regulated intermediary; or

(iii) to an unregulated intermediary that receives the dividend on behalf of the beneficial owner of the dividend where that beneficial owner has filed an exempt declaration.

In order to determine whether the payee is exempt or not, a simplifying assumption will be utilised. In this regard, the company payor will be entitled to rely on its books as the sole mechanism for the determination. Therefore, if the company payor pays another company listed on the payor's share register, the company payor is exempt from the liability to withhold. The same registered shareholder concept applies to payments made by intermediaries.

Withholding by Intermediaries

As discussed above, a company payor will be relieved of any liability to withhold if that payor makes payment to a variety of exempt parties. Where the exempt party is an intermediary, the intermediary will instead be liable for the 10% charge (i.e. will have a secondary liability to withhold) to the extent that the company payor was entitled to exemption. If a series of exempt intermediaries are involved, each intermediary is potentially liable for the 10% charge.

An intermediary will assume the same obligations to withhold and will be subject to the same requirements regarding withholding as a company payor.

The above is merely a brief outline of the withholding regime.

PASSIVE HOLDING COMPANIES

Current Legislation

Current legislation provides for secondary tax on companies levied on the net amount of dividends declared by South African resident companies. The tax is on the company and not the shareholder.

Problem Statement

The STC will be discontinued and will be replaced by a dividend tax. The new dividend tax will be a tax on the shareholder receiving the dividend. Dividends will offer an arbitrage opportunity because company-to-company dividends will be exempt under the regime. As a practical matter, the deferral of dividends will is probably the largest revenue item of concern. The 28% company rate also offers an arbitrage advantage for individuals who face a top 40%

marginal rate. Of concern is passive income, such as interest, that can just as easily be earned in individual hands but for the tax.

Proposal

The passive holding company regime is intended to effectively eliminate the arbitrage benefit of certain passive holding companies. The net effect is to charge a 40% charge on passive ordinary revenue and a 10% charge on dividends. The regime will apply to pick-up all debt, equity, derivatives and annuities. However, royalties will fall outside this regime.

Unlike many internationally employed passive holding company regimes (which use a 5 or fewer/connected person ownership threshold), the proposal will apply regardless of the number of shareholders. PHC status will depend on subjective considerations (in lieu of an objective ownership test). Under this trigger, PHC status will exist if either:

(i) the company is formed or availed of for the sole or main purpose of "deferring, reducing or otherwise avoiding Income Tax or the new dividend tax" by accumulating ordinary revenue or dividends from financial instruments instead of having those amounts accumulated directly by natural persons; or

(ii) the tax benefit of accumulating ordinary revenue dividends from financial instruments instead of having those amounts accumulated directly by nature persons outweighs the other commercial benefits of utilising a company to accumulate those amounts.

The charge will operate as an offset against future dividends by the PHC entity. The tainted earnings will be deemed to come out first (like the CFC regime). Relief will be provided only at one level.

Example. Facts. Company is wholly owned by individual. Company has R80 of ordinary revenue from financial instruments and R20 from active business operations. The R80 is subject to an additional 12% due to the PHC rules. Company then distributes a R10 dividend to its individual shareholder.

Result. The R10 amount is not subject to any dividend tax (both the beneficial owner and the withholding agent). The tainted R80 is deemed to have come out first.

COMPANY REORGANISATIONS: DE-GROUPING CHARGE

Current Legislation

Under current law, a de-grouping will trigger a gain or loss based on the market value of the asset at the time of the de-grouping, with the asset obtaining a market value base cost once the de-grouping has taken place.

The depreciation is generally capped at the pre-de-grouping cost. Losses were intended to be clogged (i.e. deductible only against other section 45 gains of the transferee).

Problem Statement

Various flaws exist in the current de-grouping formula. The formula often results in double taxation, with gain not always reflected in base cost. The anti-loss rules may be prohibitive. Concerns also exist that the de-grouping charge does not work properly when multiple section 45 transfers (and other tax-free reorganisations) precede a de-grouping.

Proposal

General

The proposed amendments have the following effects:

- Only suspended gains will be triggered on de-grouping. Losses will be ignored (and effectively rolled over).
- The gain and cost concepts will be altered to move away from the "linear" formulation (i.e. the deemed sale/repurchase concept followed by various adjustments up to the de-grouping). The key will be that, on de-grouping, a gain will be triggered and added to current cost.
- Depreciable cost will be limited based on the concepts of section 23J.

Generally, the rules seek to ensure appropriate results when successive tax-free rollovers are involved.

Tax on Transfer – Capital Gains Plus Recoupments

1. Basic Gain (section 45(b)(i))

Under the proposal, a de-grouping will trigger a deemed disposal giving rise to built-in gain (i.e. the gain not recognised by virtue of the prior intra-group transfer). Built-in losses will be ignored. Gain will essentially be capped at the "lesser of" the gain at the time of the section 45 transfer and the gain on the date of de-grouping. The rules in this regard will be the same for capital assets as for trading stock.

> *Example 1. Facts.* Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Asset X to Sub 2 in 2007. Asset X has a value of R100 and a base cost of R20 at the time of the transfer. Section 45 intra-group rollover treatment applies to the transfer. In 2010, Parent sells all the shares of Sub 2, thereby triggering the de-grouping charge. Asset X has a value of R115 at the time of the de-grouping (and a base cost of R25).

Result. Sub 2 has R80 of built-in gain (R100 minus R20) at the time of the section 45 transfer and R90 of gain at the time of the de-grouping (R115 minus R25). The gain is therefore limited to R80.

Example 2. Facts. The facts are the same as for Example 1, except that Asset X has a value of only R95 at the time of the degrouping.

Result. Sub 2 has R80 of built-in gain (R100 minus R20) at the time of the section 45 transfer and R75 of gain at the time of the de-grouping (R100 minus R25). The gain is therefore limited to R75.

2. Recoupment (Section 45(4)(b)(iii))

Under the proposal, section 8(4) recoupment will apply with the section 8(4) recoupment being capped to the extent of the gain. In most cases, this task will follow the recoupment procedure of a standard sale. However, it is recognised that situations may arise where recoupment and total gain do not match. For instance, the initial transaction could have high overall gain with low recoupment, followed by lower overall gain and higher recoupment. In these situations, it is proposed that the section 8(4) recoupment will be the "higher of" the initial section 45 transfer recoupment or the de-grouping date recoupment. However, this recoupment should not exceed the total gain.

Example. Facts. Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Asset X to Sub 2 in 2007. Asset X has a value of R95 and a base cost of R55 at the time of the transfer. Asset X was initially purchased for R70 with the R55 base cost resulting from R15 of prior recoupment. Section 45 intra-group rollover treatment applies to the transfer. In 2010, Parent sells all the shares of Sub 2, thereby triggering the de-grouping charge. Asset X has a value of R70 at the time of the de-grouping (as well as a base cost of R40 with R30 of potential depreciation recoupment).

Result. The initial section 45 gain is R40 (R95 value minus R55 base cost), and the degrouping date gain is only R30 (R70 value minus a R40 base cost). However, the initial section 45 recoupment is R15 (R70 minus R55) while the degrouping date recoupment is R30 (R70 minus R40). Under these circumstances, only R30 of total gain is recognised, of which all R30 is treated as a recoupment.

Cost Adjustments

1. Capital gains Tax Base Cost

In the case of a de-grouping involving a capital asset, the taxpayer should have the same base cost as existed prior to the de-grouping plus any income/gain stemming from the de-grouping. Hence, if any ordinary revenue results from the de-grouping (e.g. due to a depreciation recoupment), the full amount is added to the capital gains tax base cost.

Example. Facts. Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Asset X to Sub 2 in 2007. Asset X has a value of R100 and a base cost of R90 in 2007. For the next few years, base cost is adjusted downward by R30 for depreciation, followed by a R10 increase for improvements. The net result is a base cost of R70. In 2010, a de-grouping occurs where the value of Asset X R125.

Result. The de-grouping charge is R10 (the lesser of the initial section 45 gain of R10 and the de-grouping date gain of R55). This R10 of gain is added onto the R70 de-grouping date base cost of R70 for a R80 total.

2. Trading Stock

Under the proposal, the trading stock section 22 "cost price" is uplifted just like capital gains tax base cost. Any net ordinary revenue (i.e. taxable income) triggered on the de-grouping will be added to section 22 "cost price."

3. Depreciation Cost

Under the proposal, the de-grouping charge will effectively trigger the same depreciation cost result as a "connected person" sale because the deemed sale is between the same de-grouping transferee company. In effect, the section 23J(2) paradigm will roughly apply for purposes of deprecation cost. Hence, depreciable cost will equal initial cost of the transferor plus ordinary revenue revenue triggered on the de-grouping, plus 50 per cent of the capital gains tax trigger on the de-grouping (section 45(4)(d)(iv)).

Successive Transfers

1. Application of the Six-Year Rule

If an asset is transferred via a series of section 45 transfers, each section 45 transfer is to be tested separately for purposes of the 6 year rule. As a practical matter, one will test the de-grouping by looking at the de-grouping date and going back six years.

Example. Facts. Parent owns all the shares of Sub 1, Sub 2, Sub 3, Sub 4 and Sub 5. In 2007, Sub 1 transfers Asset X to Sub 2 via section 45. In 2008, Sub 2 transfers Asset X to Sub 3 via section 45. In 2010, Sub 3 forms Sub 6 with Asset X transferred to Sub 6 via section 42. In 2012, Sub 6 transfers Asset X to Sub 5 via section 45. In 2014, Sub 5 de-groups from the whole Parent group.

Result. The 2014 de-grouping will trigger gains for section 45 transfers within the prior 6 years. The Sub 2 transfer in 2008 is triggered, and the Sub 6 transfer in 2012 is triggered. The Sub 1 transfer in 2007 is outside the scope of the de-grouping charge.

2. Successive Gain Considerations

Special adjustments are required if successive section 45 transfers are involved. The key is to pick-up the highest level of section 45 deferred gain and compare that gain with the gain at the date of de-grouping. In other words, the gain will essentially be capped at the "lesser of" (i) the gain potentially existing on the date of de-grouping and (ii) the highest level gain at the time of each section 45 transfer.

> *Example. Facts.* Parent owns all the shares of Sub 1, Sub 2 and Sub 3. Sub 1 transfers Asset X to Sub 2 in 2007. Sub 2 then sells Asset X to Sub 3 in 2008. Section 45 intra-group rollover treatment applies to both transfers. In 2010, Parent sells all the shares of Sub 3, thereby triggering the de-grouping charge for both transfers. In 2007, Asset X has a value of R100 and a base cost of R85. In 2008, Asset X has a value of R130 and a base cost of R85. In 2010, Asset X has a value of R200 and a base cost of R95.
>
> *Result.* The first step is to compare the gain for each deferred section 45 transfer and pick the highest gain. Hence, the 2008 deferred gain of R45 (R130 less R85 base cost) is the starting point because the deferred 2008 gain is higher than the deferred 2007 gain. This gain is then compared against the de-grouping gain of R105 (R200 less R95). The net result is a R45 gain de-grouping charge.

Related Exit Charges

Background

The company reorganisation rules have two related exit charges that should operate similarly to section 45. More specifically, section 42 applies an exit charge if the transferring shareholder falls below a qualifying interest (e.g. 20 per cent) within 18 months after the section 42 transfer. Section 44 amalgamations have a similar charge if the target (i.e. amalgamated company) shareholders similarly fall below a qualifying interest in the acquiring (i.e. resultant) company within 18 months after the amalgamation.

Section 42(6) "Asset-for-Share" Exit Charge

The current exit charge for section 42 has the same shortcomings as the current exit charge for section 45 (i.e. reliance on the deemed sale/repurchase at market value). The proposal is to follow the same formula for section 42(6) as the newly proposed de-grouping charge. However, the rules are slightly simpler because no recoupment issues arise. In essence, the deemed market value system will be replaced by the "lower of" gain system – i.e. gain at the time of the section 42 transfer versus the gain at the time the qualifying interest is lost. This gain is then added to the base cost of the shares.

Section 44(11) "Amalgamation Exit" Charge

The exit charge for amalgamations should follow the same format as the section 42(6) exit charge. Again, the "lower of" gain test will be used. This test will eliminate the trigger for built-in losses that exists under current law.

COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS

Current Legislation

Generally, rollover treatment for reorganisation transactions contemplated in Part III of the Act is elective. In the majority of cases, however, the parties to a reorganisation transaction prefer rollover treatment. Consequently, in practice, an election for the rollover treatment to apply is the rule rather than the exception.

Problem Statement

Given that the parties to a reorganization transaction invariably elect for rollover treatment to apply, concern has been expressed that the need to actively make an election creates uncertainty as well as an unnecessary administrative burden.

Proposals

General

In view of the administrative burden and uncertainties associated with the need to make an election in order for rollover treatment to apply, it is proposed that Part III of the Income Tax Act be amended so that:

- Rollover treatment applies as the automatic default for all reorganisations; and
- Where appropriate, parties are allowed to elect out of rollover treatment if desired.

Asset-for-Share and Intra-Group Transactions (Sections 42 and 45)

Current Legislation

For asset-for-share or intra-group transaction rollover relief to apply, an election must be made. In both types of transaction, the election is technically made on a "per asset" basis.

In the context of an asset-for-share transaction, section 42 requires that the election be made jointly (i.e. by both the transferee and the transferor). This is because rollover treatment could be disadvantageous to the transferee. This would be the case if, for example, the market value of the asset transferred exceeds its base cost. In these circumstances, the transferee will inherit the transferor's base cost (which will be lower than the market value of the asset on the date of transfer).

Similarly, in the case of an intra-group transaction, the rollover treatment afforded by section 45 could be disadvantageous to the transferor where, for example, the transferor has losses that it wishes to utilise against the transferred gain. Moreover, as is the case with an asset-for-share transaction, the transferee inherits the transferor's base cost.

Proposal

It is proposed that the definitions of "asset-for-share transaction" and "intra-group transaction" be amended so that it will no longer be necessary to elect in order for the rollover treatment to apply. Because rollover treatment could be disadvantageous in certain circumstances, it is proposed that it will generally be possible to make an election for the rollover treatment not to apply. Such election will need to be made jointly and on a "per asset" basis.

<u>Amalgamation and Unbundling Transactions (Sections 44 and 46)</u>

Current Legislation

Aside from the effects of amalgamation and unbundling transactions on the companies that are directly involved in these transactions, both an amalgamation and an unbundling transaction may have an impact on the shareholders of the amalgamated company and the unbundling company respectively.

In an amalgamation transaction, there may be a large number of impacted shareholders (many of which might not be easily contactable). Consequently, obtaining evidence of an election from such shareholders may present practical difficulties. Given these practical difficulties, rollover treatment is currently automatic with an election existing only as an "escape hatch" for group situations. Transferring parties with loss assets and/or accumulated losses may want to avoid the election.

In the case of unbundling transactions, the election is only available in group situations (again due to the practical difficulties involved in obtaining evidence of elections from a large base of shareholders in a listed company). The parties may want to elect out if the unbundling company has losses and/or the shareholders want to preserve the base cost in their unbundling company shares.

Proposal

Given that the rollover treatment is automatic and that provision is made for an election out of that treatment where this is appropriate, neither section 44 nor section 46 require amendment.

Transactions relating to Liquidation, Winding Up and Deregistration (Section 47)

Current Legislation

As is the case with "asset-for-share" transactions and "intra-group transactions," an election must be made in order for liquidation rollover treatment to apply. However, unlike "asset-for-share" transactions and "intra-group transactions," the election for liquidations applies to all aspects of the liquidation (as opposed to an election applicable on a "per asset" basis). An election is provided for liquidations because liquidating and parent companies may have losses that can offset triggered built-in gains (with the parent company obtaining a market value base cost in the liquidating company assets received).

Proposal

This proposal is essentially the same as that for sections 42 and 45. Rollover relief for liquidations will now be automatic. Both the holding (i.e. parent) company and the liquidating subsidiary must make a joint election to avoid rollover treatment, and the election may only be made in respect of the entire transaction (and not on an asset-by-asset basis).

SHARE ISSUE ANOMALIES

Current Legislation

In terms of section 24B(1), if shares are issued by a company in exchange for an asset, the company is deemed to have incurred expenditure equal to the market value of that asset at the time of its acquisition by the company. In addition, the person disposing of the asset is deemed to have disposed of the asset for the market value of the asset. This rule applies "for purposes of the Act".

Section 24B(2) is an anti-avoidance rule that prevents the artificial creation of base cost where a company acquires shares or debt instruments issued "directly or indirectly" in exchange for its shares or those of a connected person. In terms of the rule, the company is deemed not to have incurred any expenditure in respect of the acquisition. Consequently, a zero base cost will be triggered where Company A issues shares to Company B "in exchange for" shares issued by Company B.

Problem Statement

Section 24B(1) seems not to require that the value of the shares issued equal the market value of the asset exchanged for those shares. However, the disposal amount and the acquisition amount are deemed to equal the market value of the asset at the time of acquisition.

This deeming rule has the potential to create opportunities for avoidance, as is illustrated by the following example:

> *Example.*
>
> *Facts.* Taxpayer A owns an asset that has a market value of R100 000. Taxpayer A forms a trust, and contributes R100 to that trust. Company B is formed and issues 100 shares (comprising 100% of its issued share capital) to the trust at par in exchange for the R100 cash contributed to the trust by Taxpayer A (assume that the par value of each share is R1). Taxpayer A then transfers the asset to Company B (via the trust) in exchange for the issue of 100 shares (at par) in Company B.
>
> *Result.* The total value of the shares in Company B is R100 100. The base cost of the asset for Company B is deemed to be R100 000. However, the asset-for share exchange is mismatched (an asset of R100 000 is exchanged for shares with a market value of R100). As stated above, section 24B(1) deems the transfer of the asset from A to company B to have taken place at the market value of the asset <u>for purposes of the Act</u>. It therefore cannot be argued that A donated (or even partially donated) the asset to the company/trust. This deemed market value transaction also undermines the attribution rules of section 7(8) (because section 7(8) does not apply to dispositions at market value).

Another problem with section 24B(1) is that it only applies where shares are issued by a company "in exchange for" an asset. It does not apply where consideration is given by a person for shares in circumstances where there is no exchange between the company issuing the shares and the person giving the consideration. This problem may be illustrated by the following example:

> *Example.*
>
> *Facts.* Company X is indebted to Y in an amount of R1 000. Z wishes to acquire shares in Company X. Company X issues 1 000 shares to Z. As consideration for the issue of shares in Company X, Z, acting on behalf of Company X, settles the debt owed by Company X to Y by transferring cash of R1 000 to Y.
>
> *Result.* Since Company X did not acquire an asset from Z, section 24B may not technically apply to the issue of the shares by Company X to Z. Z did, however, give consideration for the shares, and consideration was received by Company X (in the form of the discharge from its liability to C).

A third problem with section 24B relates to the interpretation of section 24B(2). It has been incorrectly argued by taxpayers that where Company A issues shares for cash from Company B and Company B issues shares for cash from Company B (i.e. an issue for cash followed by another issue for cash), this will not necessarily trigger a zero base cost since there is no "indirect" issue of shares for shares – the two transactions are simply separate transactions.

Proposal

In order to address the above problems, a number of amendments to section 24B are proposed. Accordingly, it is proposed that:

- section 24B will no longer apply for purposes of donations tax;
- the wording of section 24B be amended in order to clarify the intention behind the section.

INTELLECTUAL PROPERTY ARBITRAGE

Background

The principle underlying section 23I is that where intellectual property ("IP") was previously owned by a "taxable person" (i.e. existed within the South African tax net), no tax arbitrage should result from the payment of royalties (or corresponding derivative / contractual expenditure) by a "taxable person" to a "non-taxable person" in respect of that IP.

Section 23I, as originally enacted in 2007, was overbroad in some respects (e.g. South African R&D conducted by foreign multinationals, s11(a) trading stock deductions) and overly narrow in other respects (e.g. royalty flows through CFCs, attribution of profits to a permanent establishment and tax sparing benefits). After further analysis, the proposed anti-avoidance legislation has been modified in order to achieve a better-targeted (and in some cases, more effective) result.

This section applies to expenditure incurred after 1January 2009, irrespective when the underlying transaction was concluded.

<u>Examples</u>

IP is developed by the end-user or a connected person in respect of the end user

Example 1

Facts. SA developer sells IP to a foreign person. SA developer then licenses the IP from the foreign person in consideration for royalty payments and uses the IP in the production of income (other than sub-licensing income) (“end-user”).

Result. The licensor is a non-taxable person and section 23I denies the licensee deductions in respect of royalty expenditure. The result is the same where a connected person in relation to the SA developer licenses the IP from the foreign person.

Example 2

Facts. Same as example 1, except that the foreign person licenses the SA developer via a SA intermediary licensee (who is a taxable person).

Result. The end-user will be allowed deductions for royalty payments made to the SA intermediary licensee, but section 23I will deny the SA intermediary licensee deductions in respect of royalty payments made to the foreign person.

Example 3

Facts. A SA licensor that licenses IP previously developed by a taxable person to a SA licensee concludes a credit default swap (CDS) with a non-taxable person (e.g. untaxed policyholder fund or foreign person) whereby variable payments linked to royalty receipts are paid by the SA licensor to the non-taxable person.

Result. The SA licensor will be denied deductions in respect of variable payments paid in terms of the CDS.

Note: securitisation transactions and linked loans may also fall within the scope of this section.

Licensing arrangements involving CFCs

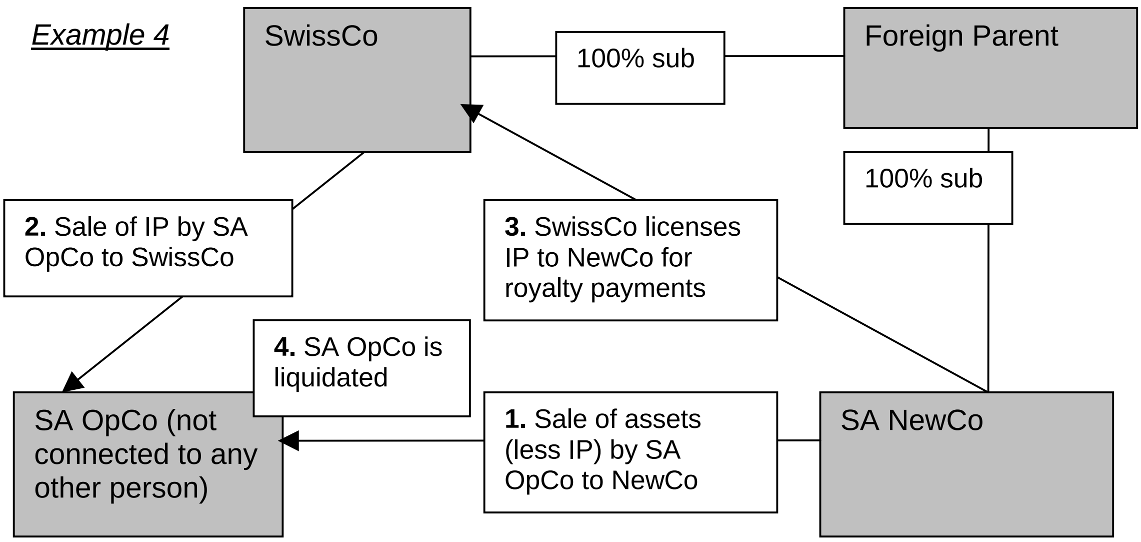
Although CFCs are not necessarily non-taxable persons in respect of royalty income, they are treated as non-taxable persons insofar as receipts do not constitute a proportional amount of net income which is included in the income of any resident in terms of the provisions of s9D.

To illustrate, assume that the foreign person in example 1 is a CFC that is 51% owned by residents. s23I will deny the licensee 49% deductions in respect of royalty expenditure. Furthermore, where residents benefit from “tax sparing” provisions in DTAs, such benefit will also act to reduce deductions in the hands of the licensee.

IP is used in SA within 2 years following transfer to a non-taxable person

Where: (i) a taxable person previously owned the IP; (ii) the IP was assigned to a non-taxable person; and (iii) the IP was “used” (i.e. the performance of an “infringing act” in respect of the IP) in SA by a taxable person during a period of 2 years following assignment, any tax arbitrage generated by associated royalty payments or payments in terms of associated contractual obligations/ derivatives will be denied in terms of section 23I.

Note: neither a formal licence nor any connection between the user and any of the other parties required.



Facts. SA operating company (which is not connected to any other party) sells IP to SwissCo and the rest of the business to SA NewCo. SwissCo licenses the IP to SA NewCo in consideration for royalty payments. SA NewCo uses the IP during a period of 2 years following assignment by SA OpCo.

Result. SA NewCo will be denied deductions in respect of royalties paid to SwissCo.

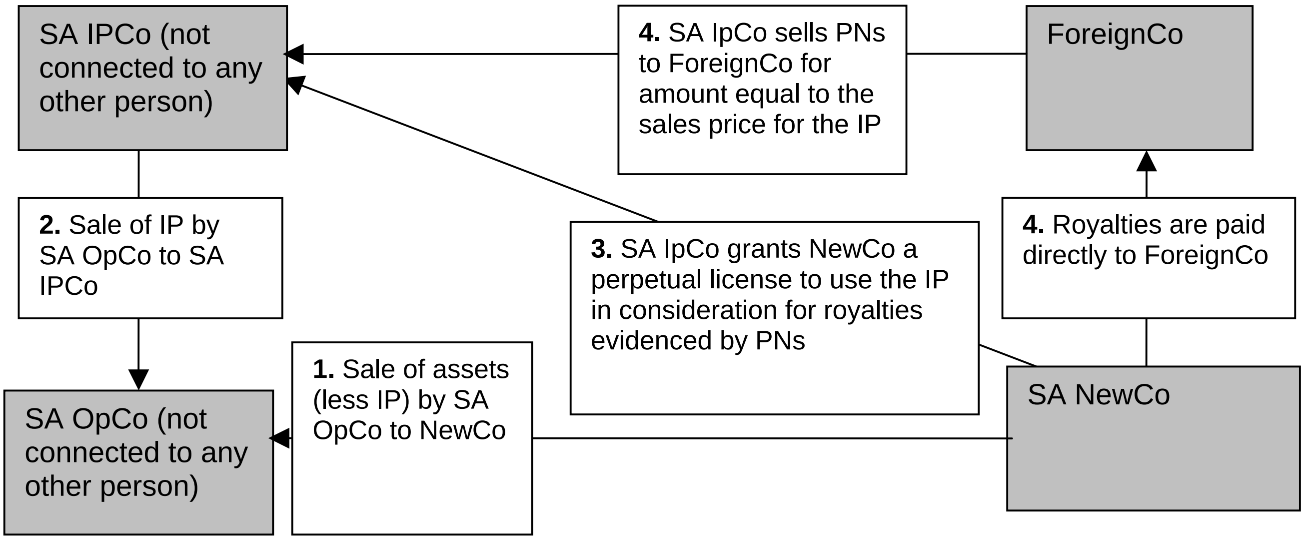
This section will impact various arrangements whereby foreign multinationals acquired South African businesses through the sale of assets.

Bare dominium transactions

Where: (i) a taxable person owns IP (i.e. is the registered proprietor / legal owner of the IP); (ii) the IP is used by a taxable end-user; and (iii) a non-taxable person receives associated royalty payments or payments in terms of associated contractual obligations / derivatives, any tax arbitrage generated by such payments will be denied deduction in terms of s23I. Any connection between the parties is not relevant.

DRAFT

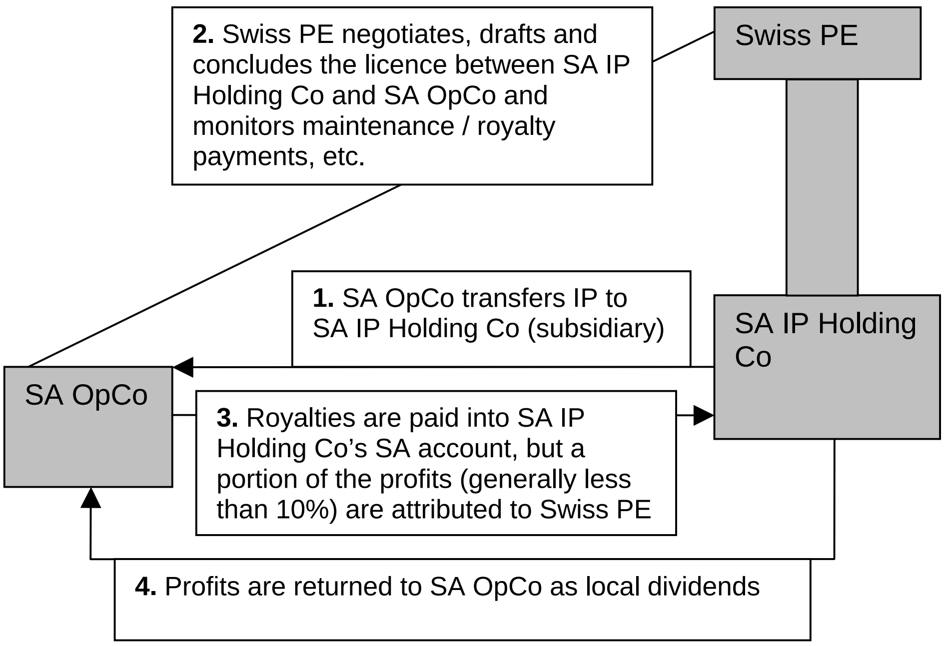
Example 5:



Result. SA NewCo will be denied deductions in respect of royalties paid to ForeignCo.

PE transactions

Example 6



Facts. SA IP Holding Co attributes a portion of its licensing profits in respect of licences concluded with SA OpCo to a Swiss PE and relies on the exemption method currently in the SA-Swiss DTA to reduce tax in SA.
Result. Where the royalties would be denied deductions if the licensor was a non-taxable person (as per the examples above), the licensee will be denied deductions proportional to the apportionment of royalty profits to the Swiss PE.

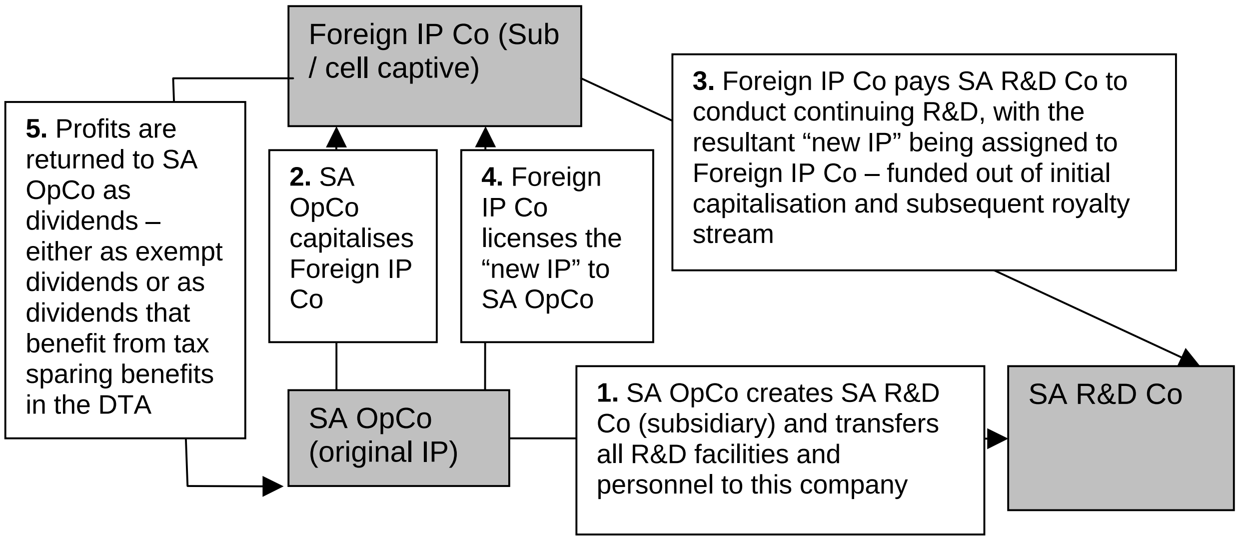
Note: only a small percentage of royalty profits may in any event be apportioned to the Swiss PE. Furthermore, material revisions to the Swiss DTA are in the process of being ratified.

IP is developed in SA in terms of an R&D arrangement

This category has been reduced in scope over concerns that an overly broad anti-avoidance provision in this area may dissuade foreign parent companies from utilising SA subsidiaries as IP developers.

IP developed by SA entities in terms of an R&D arrangement will only fall within the scope of section 23I where: (i) the IP is developed by the end user or a connected person in respect of the end user; (ii) the R&D activities are performed in SA, and (iii) the end-user, together with any taxable connected person in relation to the end-user either directly or indirectly holds at least 20 per cent of the participation rights or exercises at least 20% of the voting rights in the non taxable licensor.

Example 7:



Facts. A SA operating company forms a foreign IP company in which SA operating company holds 30% shares. Foreign IP company engages a South African R&D company (that is a connected person in relation to SA operating company) to conduct various R&D activities in SA. The R&D is fully funded by foreign IP company and the IP is assigned to the foreign IP company. The foreign IP company licenses the resultant IP to SA operating company. *Result.* The SA operating company will be denied deductions in respect of royalties paid to foreign IP company. However, should the SA operating company be a wholly owned subsidiary of a foreign multinational, the royalty expenditure will be deductible.

Note: the words "*wholly or mainly*", which appeared in the previous version of section 23I have been deleted as they were considered superfluous. The phrase "*material part*" captured the concept sufficiently.

Apportionment

Where a taxpayer concludes a license in respect of various items of IP, the royalty payable for the bundle of IP must be apportioned between the various portions of IP and each royalty component must be analysed to determine whether it is denied deduction in terms of section 23I. Similar principles as applicable in a transfer pricing determination should apply.

SMALL BUSINESS

SMALL BUSINESS PRESUMPTIVE TAX

Introduction

Small businesses have the potential to grow the economy, generate jobs and reduce poverty. Research, however, indicates that they face many obstacles, including relatively high tax compliance costs as a percentage of turnover. This is due to the generally high fixed costs associated with systems necessary to comply with the requirements of the tax system.

On average South African tax practitioners charge their small business clients R7 030 per annum (2007) to ensure that tax returns (for four key taxes – income tax, provisional tax, value-added tax and employees' tax) are prepared, completed and submitted as required by SARS.[1] As a percentage of turnover, tax compliance costs range between 2.2% for businesses with a turnover of up to R300 000 and 0.1% for businesses with a turnover around R14 million. Tax compliance costs therefore tend to be regressive, especially for businesses with a turnover under R1 million. In addition, it costs small businesses an average of R36 343 for a range of related services including accounting services.

[1] FIAS Study: Tax Compliance Burden for Small Businesses: A Survey of Tax Practitioners in South Africa (2007)

The reality is that many small businesses are outside the income tax net either because they generate small profits or because they are overwhelmed by the tax system. Many were also historically marginalised. Government, therefore, announced a small business amnesty in 2006 to encourage informal and other small businesses with a turnover of less than R10 million per annum to enter the tax system and regularise their tax affairs.

In addition to this outreach, SARS and National Treasury agreed to explore various options to reduce the tax compliance burden, especially for very small businesses, and to streamline the tax system for such businesses.

It was therefore proposed in the 2008 Budget Review that an elective presumptive turnover tax system be implemented for very small businesses with a turnover up to R1 million per annum. This instrument will effectively replace income tax, CGT, STC, and VAT. Payroll taxes such as PAYE and UIF contributions are excluded as they are taxes generally borne by employees and collected by employers on behalf of the State.

Structural Design

The presumptive turnover tax ("turnover tax") is a stand alone tax and does not form part of the normal calculations for determining income tax payable by a taxpayer on his or her taxable income. Receipts of a very small business forming part of the turnover tax system will therefore be exempted for purposes of calculating a taxpayer's income tax liability in terms of the Income Tax Act, 1962 ("the Act").

An important feature of the presumptive tax regime is that the tax liability imposed is aligned with the tax liability under the current income tax regime, but on a simplified base with reduced compliance requirements. However, the tax burden on very small businesses at the higher-end of the turnover range (R750,000 to R1 million) is increased beyond the liability in the current tax system thus effectively encouraging them to contemplate maintaining sufficient accounting records to migrate to the normal income tax regime. Special consideration was, therefore, given so as not to artificially or inadvertently encourage small businesses to remain trapped in the turnover tax system, but to grow and migrate into the standard tax system.

As a packaged approach, the compulsory VAT registration threshold will be increased to coincide with the turnover tax threshold of R1 million. Businesses that choose to voluntarily register for VAT, despite having a turnover of R1 million or less, will not be permitted to register for the turnover tax.

Overview of the Proposals

1. Who will qualify as a very small business?

The provisions of the new Schedule will apply to both incorporated (i.e. companies, close corporations and co-operatives) and unincorporated businesses (i.e. natural persons who trade as sole proprietors and partnerships). Where the qualifying turnover of such a very small business does not exceed the amount of R1 million in any year of assessment, it will be able to elect to be taxed in terms of this regime.

Qualifying turnover is defined to include the total amount received by a natural person or company for the year of assessment from carrying on business in South Africa.

For the sake of simplicity and delivering on the mandate to assist the truly small, start-up type of businesses, natural persons will not be able to access the simplified turnover tax where they—

- are a partner in more than one partnership;
- hold interests or shares in other close corporations, cooperatives and companies other than a select few e.g. a listed company and unit trust.

Where a person trades in different types of businesses, the total turnover of all business activities will be taken into account for purposes of determining the R1 million threshold.

Public benefit organisations and clubs are not permitted to access the turnover tax system as they are not businesses. However, the exempt threshold for public benefit organisations and clubs will be adjusted upwards to alleviate the administrative burden of accounting for income.

2. Amounts not taken into account in qualifying turnover

The following amounts will be excluded from the qualifying turnover of the very small business for purposes of determining the R1 million threshold:

- any receipt of a capital nature received by the very small business from conducting business, for example, an amount received from the sale of business equipment; and
- any other amounts exempt from income tax in terms of the Act, for example, a state grant.

The main reason for excluding these receipts is to prevent amounts, which would not normally form part of the trading income (i.e. turnover) of a very small business, from being taken into account for purposes of determining the R1 million threshold. A scenario to illustrate the need for these provisions is that of a very small business that generates a turnover of less than R1 million per annum but occasionally disposes off a rather large business asset during the year of assessment, which would disqualify it from the scope of the turnover tax system. A separate provision, which is discussed later, is proposed to ensure that large capital gains are not regularly routed through a very small business.

3. Specific anti-avoidance rule for qualifying turnover

An anti-avoidance rule to guard against income splitting by a very small business has been incorporated into the legislation. This will cater for circumstances where the very small business breaks up into smaller business components or sub-components to ensure that each business component remains within the R1 million threshold. The rule is designed to prevent the very small business from claiming that each component is a legitimate business of, for example, various family members when in reality these components are merely being managed by one or a few of the family members.

In such instances the turnover of the connected person's business activities will also be included in the turnover of the very small business for purposes of determining the R1 million threshold.

4. What disqualifications apply to a very small business?

4.1 Limit on interests in other companies

The provisions of the Sixth Schedule will not apply to a very small business that holds shares or has any interest in the equity of another private company or close corporation.

The specific relief to be afforded in terms of the turnover tax system is aimed at the very small start-up type of business. Multiple shareholdings indicate more complex legal structures belonging to more sophisticated taxpayers and hence have been excluded for purposes of this system. This exclusion is also an anti-avoidance measure to guard against income splitting where a business is conducted by more than one entity with the same shareholder in order to ensure that each business component remains within the R1 million threshold.

4.2 Limit on investment income

The provisions of the Sixth Schedule will not apply if more than 10% of the total receipts or accruals of the very small business consists of "investment income", as defined in section 12E of the Act.

"Investment income" includes income in the form of dividends, royalties, rental income, annuities, interest or proceeds derived from investment or trading in financial instruments, marketable securities or immovable property.

The intended relief in terms of the turnover tax system is mainly aimed at benefiting the very small business that **actively** engages in entrepreneurial business activities thereby stimulating the economy and creating employment. A typical very small business will usually not have substantial capital from which it can generate passive investment income.

Certain investments are, however, permitted because they are more of a public or social nature and present fewer opportunities for tax arbitrage. These are—

- interests in listed companies;
- interests in collective investment schemes;
- interests in body corporates and share block companies;
- less than 5% interest in social or consumer co-operatives;
- less than 5% interest in a co-operative burial society or primary savings co-operative bank; and
- interests in friendly societies.

4.3 Personal service providers excluded

The provisions of the Sixth Schedule will not apply where the very small business is a personal service provider. These entities have been targeted in specific anti-avoidance measures. As a result, it is not the intention for them to obtain any benefits from the turnover tax system.

4.4 Professional services excluded

As an anti-avoidance measure to protect the employment income tax base, it is proposed that the provisions of the Sixth Schedule will not apply where the very small business renders a “professional service”, as defined. Such services are generally rendered by more sophisticated, high income earning taxpayers, with profit margins that are significantly higher than those assumed in the design of the turnover tax. Professional services include, amongst others, any service in the field of accounting, broking, consulting, engineering, law, management, real estate, surveying or veterinary science.

4.5 Only interests and shares by natural person permitted

It is highly unlikely that a very small business will find itself within a complex legal structure or multi-level corporate structure that requires the expertise of professional legal, accounting and tax services. Such sophisticated legal structures often present opportunities for tax avoidance and hence need to be excluded for purposes of this simplified tax regime. Furthermore, these are not considered to be the simple truly small, start-up type of businesses that are targeted for assistance in the simplified tax dispensation. This exclusion is also an anti-avoidance measure to guard against income splitting where a business is conducted by more than one entity with the same shareholder in order to ensure that each business component remains within the R1 million threshold.

The provisions of the Sixth Schedule will, therefore, not apply where the very small business is a partnership, co-operative, close corporation or company and all the partners, members or shareholders of that company are **not** natural persons at all times during the relevant year of assessment.

4.6 The very small business must not be registered for VAT

The provisions of the Sixth Schedule will not apply where the very small business is registered for value-added tax in terms of the Value-Added Tax Act, 1991. Where the turnover of a very small business exceeds or is likely to exceed the VAT threshold, or it chooses to opt into the VAT regime despite having a turnover below the threshold, then that very small business must migrate to both the formal VAT and income tax regimes. These very small businesses should not be allowed to register for VAT and at the same time remain within the turnover tax regime instead of the current income tax system. The formal VAT system requires a high standard of record-keeping and thus a very small business should be in a position to comply with normal income tax requirements.

5. Special rules relating to partnerships

Partnerships will be taxed on a flow-through basis in that the turnover of the partnership will be taxed in the hands of each partner based on the profit sharing ratio or the partnership agreement.

However, it is important to look at the collective turnover of the partnership to ensure that only very small businesses access the turnover tax regime. Hence the total turnover of a partnership for the year of assessment must not exceed the amount of R1 million in order for each individual partner to qualify for the turnover tax.

6. What is the tax base?

6.1 Taxable turnover

The “taxable turnover” will basically be the amount, not of a capital nature, that is received by the business (i.e. cash basis) from conducting business activities in the Republic, with specific inclusions and exclusions.

6.1.1 Specific inclusions in taxable turnover

- 50% of the receipts of certain capital assets. See discussion on Capital Gains Tax below.
- In the case of a company, close corporation or cooperative, the investment income (interest, royalties, rental and annuities) received. Dividends will be included at a later date. The reason for excluding dividends until a later date is that dividends are currently exempt from income tax, but will be subject to a dividend withholding tax at a later stage. Since the withholding

tax will not apply to dividends paid to companies and the simplified tax regime will exempt shareholders in very small businesses from the withholding tax, it will be necessary to tax dividends as part of the turnover of a small incorporated business to mitigate revenue leakage.
- o Certain income tax allowances that were granted in the previous year of assessment and which would have been added back to taxable income in the following year of assessment in the current income tax system e.g. debtors' allowance.

6.1.2 Specific exclusions from taxable turnover

- Investment income (dividends, interest, royalties, rental and annuities) received by sole proprietorships (individuals) and partnerships. This income will be taxable under the current personal income tax provisions in the hands of the individual recipients. This is done to cater for the common law principle that businesses operated by natural persons are not distinct or separate legal entities from the natural person who own them. It will also allow for the exempt allowances that are currently granted to natural persons with regard to interest and dividend income.
- Any amount that is exempt from income tax e.g. government grants.
- Any amount that accrued to the business, and was subject to income tax in the hands of the business, in a year of assessment prior to it registering for the turnover tax.
- Salary income, excluding a notional salary payment made by a sole proprietor to himself or herself, will be taxed in terms of current personal income tax system.

7. Administration

7.1 Year of assessment

A year of assessment will run from 01 March to the last day of February of the following year.

7.2 Registration

As participation in the turnover tax regime is elective, a qualifying very small business may elect to register as a very small business with SARS for a year of assessment within two months from the beginning of the year of assessment, or where that very small business is a natural person that commences business activities during the course of the year of assessment, within two months from the date of commencement.

7.3 Deregistration

There are two circumstances when a registered very small business can deregister from the turnover tax regime namely—

- Voluntary deregistration, i.e. where that very small business elects to deregister. Unless it closes down, a very small business may only elect to deregister as a very small business after three years of being part of the turnover tax regime. This election must be made within two months from the end of a year of assessment.
- Compulsory deregistration i.e. where that very small business no longer qualifies as a very small business in terms of the provisions of the Sixth Schedule. For example, where the qualifying turnover of that very small business from carrying on business exceeds the R1 million threshold and the very small business cannot demonstrate that this will be a small and temporary event.

In the event of a compulsory deregistration of the very small business, that very small business will move back into the normal income tax regime with immediate effect i.e. from the first day of the month during which the business is disqualified from the turnover tax. It will therefore be assessed for two periods in the year of assessment – one in the turnover tax system and the other in the current income tax system. The business will also have to register for VAT where it exceeds, or is likely to exceed, the R1 million per annum threshold.

If the very small business is deregistered from the turnover tax, be it voluntary or compulsory, that very small business may not re-enter the turnover tax system for a period of three years from being so deregistered. This is shorter than the five-year period proposed in the 2008 Budget Review but matches the minimum period the very small business must remain in the turnover tax system.

7.4 Returns and payment of turnover tax

In this regard two options are being considered.

Option 1

This option requires the very small business to submit two returns.

The **first return** will contain an estimate of the taxable turnover of that very small business for the year of assessment and a calculation of the turnover tax payable in respect of the taxable turnover so estimated. The return and payment equal to one-half of the amount of turnover tax payable must be submitted to SARS within 21 days after the expiry of the period of 6 months from the beginning of the year of assessment i.e. 21 days after 31 August.

The **second return** must reflect the actual amount of taxable turnover for the year of assessment and a calculation of the turnover tax due in respect of that taxable turnover. The difference between this final amount and the provisional amount paid for the first six months must be paid to SARS. A return and payment equal to the amount of turnover tax payable (less the first payment) must be submitted to SARS within 21 days after the end of the year of assessment of that very small business i.e. 21 days after the last day of February.

Option 2

This option requires the very small business to submit 3 returns and three payments which is more in line with the current provisional tax system.

The **first** return will also contain an estimate of the taxable turnover of that very small business for the year of assessment and a calculation of the turnover tax payable in respect of the taxable turnover so estimated. The return and payment equal to one-half of the amount of turnover tax payable must be submitted to SARS shortly after the expiry of the period of 6 months from the beginning of the year of assessment.

The **second** return will also contain an estimate of the taxable turnover for the year of assessment and a calculation of the turnover tax due in respect of that taxable turnover so estimated. A return and payment equal to the amount of turnover tax payable (less the first payment) must be submitted to SARS at the end of the year of assessment of that very small business.

The **third return** will contain the actual amount of taxable turnover for the year of assessment and a calculation of the turnover tax due in respect of that taxable turnover so determined. A return and payment equal to the amount of turnover tax payable (less the first and second payments) must be submitted to SARS within a period of 6 months from the end of the year of assessment i.e. within 6 months after the last day of February.

Interest and penalties will apply on late returns and underestimates, or where there is a more than 10% difference between the final tax payable and the sum of the two provisional tax payments.

SARS is still investigating the two options from an operational and systems perspective.

7.5 General administrative provisions

The general administrative provisions relating to assessments, dispute resolution, interest, refunds and anti-avoidance provisions contained in the Act will also apply to the turnover tax system.

8. Rates Schedule for turnover tax

The rates that were announced in the 2008 National Budget were revised downwards following further analysis of very small business profitability. The revised rates are as follows:

Turnover	Tax Liability
On the first R100 000	0%
R100 001 to R300 000	1% of each R1 above R100 000
R300 001 to R500 000	R2 000 + 3% of the amount above R300 000
R500 001 to R750 000	R8 000 + 5% of the amount above R500 000
R750 001 and above	R20 500 + 7% of the amount above R750 000

9. Value-Added Tax

9.1 Increase in compulsory registration threshold

Surveys amongst small businesses clearly identify VAT as the most burdensome tax product to comply with. This is because it is transaction-based and requires diligent record-keeping.

The importance of a VAT threshold in designing a turnover tax system for very small businesses is the presumption that most small businesses above this level are obligated to comply with the normal VAT obligations, which are record-keeping intensive, and should be reasonably capable of complying with the standard income tax regime. In this regard, the proposed turnover tax system threshold includes the proposal to increase the compulsory VAT registration threshold to R1 million per annum as a packaged offer. This is one of the ways that will alleviate the compliance burden on very small businesses that choose to remain outside the VAT net.

9.2 VAT relief on exit

The normal rule is that when any vendor deregisters from the VAT system, it is required to pay VAT (exit VAT) on the value of the assets held before deregistering.

All vendors that deregister from the VAT system in light of the increase in the VAT registration threshold to R1 million will be allowed to pay the exit VAT over a period of six months.

Where a vendor deregisters from the VAT system in order to register for the turnover tax, further relief will be granted to that vendor by way of a deduction up to R100 000 of the value of the assets held by that vendor prior to such deregistration. This equates to an approximate reduction of up to R12 281 in the exit VAT that will be payable.

Accordingly, if a person deregistered as a VAT vendor and subsequently re-registers for VAT, the deduction that the vendor can claim on the value of assets upon re-entering the VAT system will be reduced by up to R100 000.

10. Capital Gains Tax

A small business that registers for the turnover tax will be exempted from capital gains tax provided that the receipts from the sale of assets used in the business do not exceed R1 million over a 3 year period.

As a substitute for capital gains tax, the qualifying small business will simply have to add, to the turnover that will be taxed, 50% of:

- receipts from the sale of assets used mainly in the business; and
- receipts from the sale of immovable property to the extent that it was used for business purposes

A typical very small business will not have substantial capital assets. As the proposed turnover tax regime has a favourable dispensation for capital gains, specific measures need to be put into place to avoid abuse.

Hence, the provisions of the Sixth Schedule will not apply where the receipts of that very small business from the disposal of capital assets exceed the amount of R1 million in a three year period that spans over the year of assessment during which the capital proceeds were received and the immediately two preceding years of assessment. It was decided to go for a big cap over a three year period to accommodate the occasional disposal of a large asset like immovable property.

11. Secondary Tax on Companies

If the qualifying small business is a cooperative, close corporation or company, it will also be exempt from secondary tax on companies (to be replaced with a dividend withholding tax), to the extent that the dividend distribution does not exceed R200,000 per annum.

Where the dividend distribution exceeds R200,000 per annum, the excess will be subject to tax.

VENTURE CAPITAL COMPANY REGIME

Current Legislation

Under current law, share investments in companies do not have any immediate tax implications (i.e. in a sense that the investor does not obtain a deduction of the amount invested in the company nor any immediate taxable revenue). The company is also not subject to tax on the receipt of the investment.

Under general rules, companies are generally subject to tax on their ordinary revenue, and companies are generally subject to Capital Gains Tax ("CGT") on any gains realised on the disposal of the investment. The rate of tax for companies is 28 per cent and from 10 per cent for small business companies. The effective CGT rate for companies is 14 per cent and 5 per cent for small business companies.

Problem Statement

As announced in the 2008 Budget Review, access to equity finance by small and medium-sized businesses is one of the main challenges to the growth of this sector of the economy. Equity finance is hard to obtain at this level because the potential growth opportunities often do not easily outweigh the risks. Small and medium-sized businesses also frequently lack the expertise and contacts to reach potential investors.

Proposal

General Aims

In order to assist small and medium-sized business in terms of equity finance, a tax incentive for investors in small and medium-sized enterprises through Venture Capital Companies ("VCCs") is proposed. The VCC is intended to be a marketing vehicle that will attract retail investors. It has the benefit of bringing together all small investors as well as concentrating investment expertise in favour of the small business sector. The controlled VCC environment also provides protection to investors by providing for liquidity and a balancing of risks in small business portfolios.

Tax Benefits of Regime

(i) Individual Investors

An individual who invests in the shares of a VCC is eligible for a 100% deduction of the amount invested (i.e. contributed to the VCC as consideration for the VCC shares), limited to an amount of R750 000 during any year of assessment in which the investment is made. Although secondary trading in VCC shares is allowed, the deduction is only available for contributions to the VCC in exchange for newly issued shares. The deduction is recouped if an individual disposes of the shares to the extent of the initial investment in the VCC. In all other respects, normal income tax and CGT rules apply in respect of VCC shares.

(ii) *Entity Investors*

Entities (companies and trusts) are not generally eligible for any special deductions when investing in VCC shares. This exclusion of entities prevents individual investors from overcoming the ceiling of R750 000 by making investments through closely-held entities.

However, an exception exists for listed companies and their controlled group subsidiaries when providing consideration to a VCC for newly issued equity share capital of the VCC. Listed companies (and their group subsidiaries) are eligible for the 100% deduction without regard to the R750 000 ceiling. However, these entities (and their controlled group subsidiaries) cannot hold more than 10% of the equity share capital of a VCC.

(iii) *VCC*

The VCC itself is a fully taxable entity. No special dividend or other tax rules apply.

(iv) *Investor Receipts*

The deduction is only available to investors who are in possession of a VCC investor certificate (i.e. certifying that SARS has granted VCC status approval).

VCC Requirements

(i) *VCC Entry Requirements*

The VCC must be a resident company and not have any group members. The VCC must be a taxpayer in good standing. As a general matter, the VCC must satisfy all requirements on the date of approval (or for new companies, a 36 month period is acceptable).

(ii) *VCC Portfolio Requirements*

Minimum Aggregate Assets

The VCC must have minimum gross assets of at least R50 million. However, if a VCC invests in one or more junior mining or exploration companies as part of its qualifying portfolio, the VCC must have minimum gross assets of R250 million.

Gross Income Requirements

The VCC's gross income must be solely derived from financial instruments. This financial instrument income automatically includes dividends/CGT/trading stock gains from equity share investments of small business percentage companies as described below. This rule also automatically excludes the VCC from generating rental income plus income from other trades.

(iii) *Investee Company Portfolio Limitations*

Entry Requirements:

(i) Qualifying Shares: VCC investments count toward the "small business percentages" only to the extent these investments consist of the equity share capital of the investee company. In addition, equity shares will be disqualified to the extent the VCC has a right (or option) to redeem/dispose of the investee company shares to any person at a value other than market value at the time of redemption/disposal.

(ii) Maximum VCC Portfolio Limits: VCC investments do not qualify towards the "small business percentages" if more than 15% of the VCC's gross assets are invested in financial instruments of any one investee company at any one time during the year.

(iii) No Control: A VCC investment does not count towards "small business percentages" if the VCC (together with, any connected person in relation to the VCC) holds more than 40% of the equity share capital of any investee company at any time during the year.

Small Business Percentages:

The VCC's investment portfolio must satisfy the following allocations:

(i) At least 10 per cent of the VCC's total gross assets must be invested in small companies (i.e. companies with a gross asset value of no more than R5 million immediately after the VCC investment).

(ii) At least 80 per cent of the VCC's total gross assets must be invested in medium-small companies (i.e. companies with a gross asset value of no more than R10 million immediately after the VCC investment). [Note the 80% includes the 10%/R5 million companies.]

Junior Mining Companies – Junior mining investee companies can have total gross assets of up to R100 million. This category of companies can count towards the 80% threshold.

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Investee Company Requirements

(i) Investee Entry Requirements

Permissible investment companies must be residents (and they must not have a non-resident group member). The investment company must be in good standing along with each section group member

The investee company may not be listed. However, a junior mining company may be listed on the ALTEX.

(ii) General Trade Requirements

The investee company (or a group member) must conduct a trade within 18 months of the investment. All investment proceeds must be invested in deductible expenses that are part of a group trade or in an asset used to produce income for the trade (not to liquidate investee company debts). All of these investments must occur within the same 18 months.

However, an investee company is disqualified from receiving any VCC investment if the investee company mainly engages in any of the following:

- Dealing in land, property development including refurbishment, rentals, redevelopment of property and deriving profits from the disposal of land when developed;
- Financial service activities such as banking, insurance, money-lending, hire-purchase financing and any other financial service activities;
- Provision of professional services such as legal, tax advisory, broking, management consulting, auditing, accounting and other related activities;
- Operating casino's or other gambling related activities including any other games of chance; and
- Manufacturing, buying or selling liquor, tobacco products or arms/munitions.

In addition, not more than 20% of the ordinary income of the investee company must be derived from investment income.

(iii) Junior Mining/Exploration

An investee company can qualify for the junior mining regime as long as that company (and all group companies) are not engaged in any other trade besides mining exploration or production. All these requirements must be satisfied at the time or the investment or within 18 months.

In addition, not more than 20% of the ordinary income of the investee company must be derived from investment income. This 20 per cent test applies to the investee company (and each member of the group).

SARS Approval

SARS has to approve that a company is a VCC upfront. This approval lasts until this approval is withdrawn. SARS also will have the power to provide approval to newly formed companies on the basis that they will become a VCC within 36 months.

Penalties

Failure to satisfy the VCC portfolio requirements can trigger the loss of VCC status on a going forward basis. In addition, the VCC has immediate ordinary revenue (i.e. a modified recoupment) equal to the lesser of the total VCC in existence (as measured by expenditure) or the total deductible investments receive by the VCC over its lifetime. The VCC can seek re-entry if the problem is rectified.

Failure on the part of the investee to satisfy its requirements (e.g. trading status and use) would trigger a narrower penalty. Under this approach, the VCC has ordinary income equal to the "now non-qualifying" investment at a 40/28 rate.

MISCELLANEOUS INCOME TAX ISSUES

DEPRECIATION ALLOWANCES FOR RESIDENTIAL UNITS

Current Legislation

Current legislation offers several unrelated regimes in respect of housing. Under section 13*ter* of the Income Tax Act, a depreciation allowance is available for certain residential dwellings. Section 13*ter* provides for an allowance of 12 per cent in the first year in which the residential dwelling is let or occupied, and a further 2 per cent in succeeding years. As a condition for the allowance, there must at least be five of those residential dwellings.

Problem Statement

Given the inherent risks involved in the property market, the construction and provision of low-income housing poses a unique challenge within the domestic environment. While Government has many outreach programmes in place to overcome these challenges, further support in a tax environment could prove beneficial.

As can be seen above, the rules for housing tend to be incoherent and confusing. Furthermore, little reason exists for favouring one sector of the economy over the others. A simple and comprehensive regime is therefore necessary for easier compliance and enforcement.

Proposal

Basic Regime (New section 13sex)

All depreciation for residential housing will be brought into one simplified and comprehensive regime modelled after section 13*quin*. Under the new regime all *new and unused* “residential units” or improvements thereon will be subject to an annual depreciation of 5 per cent over 20 years.

However, this annual allowance is subject to a condition that the “residential unit” or improvements thereon must be mainly or wholly used for producing income in the course of the taxpayer’s trade, or be occupied by employees of a taxpayer or employees of group of companies (as contemplated in section 41 of the Act). The term “residential unit” is defined as a residential building or self-contained apartments, with the exclusion of hotels, guest houses and other such similar accommodation

Low-income residential units are subject to an additional 5 per cent annual depreciation allowance, bringing the overall annual depreciation allowance for low-income residential units to 10 per cent. A “low-income residential unit” is defined as a residential unit the cost of which does not, in the case of a building, exceed R 200 000 and, in the case of an apartment, the cost of which does not exceed R 250 000. The amounts prescribed exclude the cost of land and bulk infrastructure. Another condition is that the owner of the low-income residential unit must not charge monthly rental rates in excess of one per cent of the amounts mentioned above.

URBAN DEVELOPMENT ZONES

Current Legislation

The Urban Development Zones (“the UDZ”) regime was introduced in 2003 as a tax incentive for the renewal of decaying inner cities. The regime provides for an accelerated depreciation regime that is targeted for areas in need for urban renewal with purpose of resurrecting declining areas. The regime provides for incentives for new buildings and new buildings acquired from developers.

New buildings are subject to a first year depreciation allowance amounting to 20 per cent of the cost of the building, followed by 5 per cent over the next 16 years. Improvements are subject to a depreciation allowance of 20 per cent over five years. New buildings acquired from a developer are subject to 55 per cent of the allowance, and new improvements acquired from a developer are subject to only 20 per cent of the allowance.

The UDZ incentive is only available until 31 March 2009.

Reasons for change

Various considerations necessitated an adjustment of the UDZ incentive. Some of them are the following:

- Some municipalities made submissions to National Treasury requesting the UDZ demarcations in the municipalities to be adjusted. Furthermore it was requested that the expiry date of 31 March 2009 be extended.
- The introduction of other depreciation regimes such as the depreciation regime for commercial buildings had an impact on the value of the UDZ incentive. The level of incentive vis-à-vis other depreciation allowance regimes and other issues occasioned the need for a reconsideration of the UDZ incentive.
- The current UDZ incentive is limited to the party erecting the building and the first purchaser (that is, the first party acquiring the property from the developer). A further restriction is that the first purchaser is entitled to only part of the incentive (55 per cent of the applicable depreciation for new buildings and 30 per cent for pre-existing buildings).

Proposal

A. Expiry Date of the UDZ regime

The expiry date of the UDZ regime will be extended to 31 March 2014.

B. Rate of Depreciation

The rate of depreciation for new buildings under the new regime will be adjusted to 20 per cent for the first year and 8 per cent for the next ten years while the rate of depreciation for improvements will remain to be subject to a 20 per cent allowance for five years.

C. Low-Income Residential Unit

The rate of new and unused low-income residential units (as defined in section 13*sex*) located in UDZ demarcations will be subject to an additional annual depreciation allowance of 5 per cent. The rate will be:

(i) 25 per cent in the first year;
(ii) 13 per cent in the succeeding 6 years; and

(iii) 10 per cent in the year following the last year contemplated in paragraph (ii) above.

Improvements will be subject to a depreciation allowance of 25 per cent over a period of four years.

D. Limit to Part Purchases

As already mentioned above, the current law restricted the UDZ incentive in respect to first purchasers to 55 per cent of the applicable incentive, in respect to new buildings; and 30 per cent in respect to pre existing buildings.

Under the proposed regime, the 55 per cent rule will only apply to a first purchase of part of a new building. The 30 per cent rule will apply to a purchase of part of a pre-existing building..

E. UDZ Demarcation Extensions

Every Municipality will be allowed to request an extension of the UDZ demarcated areas, provided that the other requirements under section 13*quat* are complied with.

F. Five Residential Units Minimum

The basic residential unit regime requires a minimum of 5 units in order to exclude potential housing arrangements that are partially personal in nature. As a matter of uniformity of treatment for residential units, this requirement should equally apply to the depreciation of buildings located within a UDZ demarcation.

EMPLOYER SALES OF LOW-COST RESIDENTIAL UNITS

Current Legislation

Currently, the Income Tax Act provides for a depreciation allowance for employers providing accomodation by way of renting out residential units to employees. The allowance is limited to instances where the employer retains ownership of the residential units that are let to employees. No relief is available for employers seeking to transfer ownership of the units to the employees.

Reasons for Change

As mentioned above, employers seeking to transfer ownership of residential units to their employees have no tax relief. This general principle makes no exception for the transfer of low-cost residential units.

Most employers have expressed an interest to sell (to their employees) low-cost residential units that are rented to their employees. Employers prefer to sell these residential units because rental housing often represents an inconvenient deviation from the employer's core business activities.

In light of the shortage of housing in South Africa and government's plans to provide an environment conducive to home ownership, it is necessary for employees to have the liberty of ownership of these houses. This situation is preferable to the employees who are permanently dependent upon their employers for provision of accommodation.

The sale of these low-cost residential units by employers provides neither a profit nor loss for the employer in accrual terms. It often requires a significant cash outlay, for an extended period, by an employer. The tax system does not take any of these significant cash outlays into account.

Proposal

A. Basic regime

Employers will be given tax relief for the transfer of ownership of employer-provided low-cost residential units to employees on loan. In essence, the amount of the loan provided by the employer to the employee for the acquisition of the low-cost residential units will be deductible over a 10-year period. There will be a recoupment of the aforesaid deduction when the employee repays the loan capital.

B. Threshold requirements

In order for an employer to qualify for the relief the following requirements must be met.

Firstly, it is required that the residential unit must be a "low-cost residential unit". A low-cost residential unit is a building, the cost of which does not exceed R 200 000 (inclusive of the land but not the bulk infrastructure), or an apartment, the cost of which does not exceed an amount of R 250 000 (also inclusive of land but not the bulk infrastructure).

Secondly, the low cost residential unit must be part of a residential establishment that consists of at least 5 residential units in the same geographic vicinity.

Thirdly, the taxpayer must sell the low-cost residential units to its employees or employees of companies in the same group of companies as the taxpayer.

Fourthly, the employer must sell the residential unit for a consideration that is not greater than the cost of that residential unit to the employer.

Lastly, the sale of the residential unit by the employer to the employee (or group company employees) must be subject to a resolutive condition for the repurchase of the residential unit at market value at the time of repurchase and/or a required repayment and/or a third party guaranteeing or securing the loan. The repurchase of the home and/or the guaranteeing or securing or repayment of the loan can only be triggered if the employee leaves the employ of the employer.

C. Loan account requirements

The relief is only available where the employer (or a group of companies in relation to that employer) provides loan financing to the employees (including employees of a group of companies in relation to the employer) for the purchase of the residential unit. The employer must be the sole financier and the loan must not be guaranteed or secured by any third party. The loan must also not bear interest.

D. Incentive

The employer will be allowed to deduct an allowance equal to 10 per cent of the loan provided to the employee over a period of ten years (or for as long as the loan arrangement exists). However, the allowance will be recouped every time the loan capital is repaid by the employee or when a third party guarantees or secures the loan.

The recoupment will be limited to 10 per cent in any year of assessment. Any recoupment in excess of 10 per cent will be deemed to arise in the succeeding year of assessment.

Example 1: Facts. An employer constructs a house for R 100 000 with the allocable land cost of R 20 000. In Year 1, the employer transfers ownership of the house to an employee for R 120 000 on a non-interest bearing loan account provided by the employer. The loan is repayable over 20 years. The employer transfers of ownership of the house of the employee subject to a condition that the employee remains in the employ of the employer for a minimum period of 5 years. The employee will be entitled to the market value of the house at the date of the potential return. In Year 2, the employee repays R 20 000 of the loan provided by the employer in Year 2.

Result: In each of the Years 1 and 2, the employer is entitled to a deductible allowance of R 12 000 on the loan provided to the employee.

However, the employer has a recoupment of R 20 000 in Year 2 due to the repayment of the loan capital by the employee.

Example 2: *Facts*. The facts are the same as in Example 1, except that the employee pays R 30 000 of the loan capital in Year 2.

Result: In each of the Years 1 and 2, the employer is entitled to a deductible allowance of R 12 000 on the loan provided to the employee. However, the employer has a recoupment of R 24 000 in Year 2 due to the repayment of the loan capital by the employee. The remaining amount of R 6 000 is carried forward to Year 3. In Year 3, the employer is entitled to a deductible allowance of R 12 000 with the R 6 000 recoupment carried over from Year 2.

ALLOWANCES IN RESPECT OF EXPENDITURE ON GOVERNMENT BUSINESS LICENSES

Current Legislation

Businesses often require government licenses (National, Provincial or Local) in order to conduct specified business activities (for example, telecommunications, casinos, hotels and mining). These businesses may be required to make upfront cash outlays for the licenses or permits. As an alternative, or in addition to these payments, they may be required to make annual cash payments to maintain these licenses or permits. These outlays may involve direct payments to the Government or outlays towards social expenditure to certain categories of the community.

Reasons for Change

Some license or permit fees may not be deductible (or depreciable) despite the business nature of the charge. Upfront fees cannot be depreciable because the Income Tax Act does not contain any special depreciation allowance for fees of this nature.

Annual fees in the nature of payments made directly to the Government should generally be deductible under section 11 (*a*) of the Act, but social expenditure may not be viewed as a cost incurred for the production of income.

Proposal

A. Upfront License Fees

The expenditure incurred by a taxpayer to obtain a license or permit required in order for the taxpayer to conduct a trade will be eligible for an allowance. This allowance will be allowed proportionately over the life of the license or permit.

If the license is acquired before the trade has commenced, the expenditure will still be subject to the allowance if it is so incurred in preparation for the carrying on of a trade. However, the pre-trade allowance will be suspended until the trade commences, subject to a ring-fending of the pre-trade losses.

The expenditure must be paid in cash or in kind and must be payable to any sphere of the Government or to a purpose approved by Government.

B. Annual License Fees

The expenditure incurred by a taxpayer to maintain a license or permit for the purposes of the taxpayer's trade will be deemed to be an expenditure incurred "in the production of income" and "not being of a capital nature" as envisaged in section 11(*a*) of the Act.

The expenditure must be paid in cash or in kind and must be payable to any sphere of the Government or to a purpose approved by Government.

ALLOWANCES IN RESPECT OF INDUSTRIAL POLICY PROJECTS

Introduction

South Africa has implemented a number of industrial policy initiatives since 1994. In the 2008 Budget, the Minister of Finance made available R5 billion over 3 years for incentives in aid of industrial policy objectives. It was further stated that such incentives would have to be carefully designed with clear identification of market failures and consideration for costs and benefits of the incentives.

Current law

In an attempt to encourage investment into manufacturing of industrial assets, computer and computer related activities and research and development activities, section 12G of the Act provides for an additional industrial allowance for investments in these assets. The Act does not provide any additional incentive for investment and training in respect of Industrial Policy Projects.

Proposal

The incentive programme is designed for Greenfield investment, upgrades and expansions in the manufacturing sector, with certain exclusions. It is divided into two components of allowances for investment and training. Thus, firms/projects benefit if they invest in improved production equipment and contribute towards labour market. The labour component can be achieved by either increase labour demand as a result of the investment or spending on the training of workers above a threshold.

In order to qualify for the programme a project must be in the manufacturing sector, with some exclusions applied. Projects are then evaluated to determine approval and the level of support. The criteria used for the investment component are the size of the investment, energy efficiency, cleaner production technologies, innovation and business linkages in the domestic economy. The energy efficiency criterion seeks to achieve energy savings in the manufacturing sector, based on either an industry benchmark or the firm's own electricity consumption of a given year. For the labour component firms/projects must generate a set minimum number of jobs per R1 million invested and their training costs must be at least 2% of the aggregate of all amounts paid annually to its employees by way of remuneration as defined in paragraph 1 of the Fourth Schedule.

The calculation of jobs per million rands is to be based on the legible investment cap, meaning that, to the benefits of applicants, the ratio may be higher than if based on the entire investment. A sub minimum score of 2 must be attained for the labour component of the incentive. Therefore, where applicants do not qualify on the jobs per R1 million criterion, they can make up on the training criterion.

The incentive is further designed such that it would not allow projects being split up into smaller projects so that each of the smaller projects qualifies on its own for incentives. A further innovation is to preserve the value of the incentive for 3 years so as to assist projects without a current tax base.

Qualifying criteria

The bulk of the qualifying criteria will be determined by regulations to be promulgated by the DTI. Companies will be divided into those with qualifying status and those with preferred status. These statuses will be determined by a point system in terms of which the ones that score less (but qualifying) points will receive the qualifying status and those that score higher will receive the preferred status.

The factors for determining whether a project qualifies will be as follows:

- Energy efficiency – This will be measured in energy consumed versus the value added. Consideration will be given to the decrease in the energy demand in percentages measured against the previous year;

- Cleaner production technology – Certification with the National Cleaner Production Centre;
- Innovation – this will entail the determination of whether and to what extent does the process demonstrate material improvement in production time, quality of product, longevity or reduced cost. It will also consider the procurement of direct inputs from small businesses or impact on upstream and downstream manufacturing clusters;
- Location in IDZ;
- Employment creation – a certain number of jobs need to be created per a determined amount of money invested; and
- Training – the training expenditure should exceed a certain percentage of the wage bill of the company.
- Small Business linkages - his factor will measure in percentages, the procurement of direct inputs from small businesses.

Training

An additional training allowance will be available for training initiatives provided by the employer to its employees. The additional allowance will be available for the cost of external (i.e. outside or contracted) training provided for the training of the employees of the qualifying manufacturing project employer. The allowance will also be available for the internal training provided by the employees of the qualifying manufacturing project employer to fellow employees. In this regard the employees providing the training should be employed specifically and exclusively to provide training.

The allowance amounts to 35% of the costs of the training for brownfield projects and 55% for greenfield projects.

Qualifying status

For entities with qualifying status, the actual training expenses as a tax allowance/deduction will be capped at R36 000 per employee over a period of 4 years. An entity will be allowed an overall maximum of R20 million an any 4 year period.

Preferred status

For entities with preferred status, the actual training expenses as a tax allowance/deduction will be capped at R36 000 per employee over a period of 4 years. An entity will be allowed an overall maximum of R30 million an any 4 year period.

Depreciation

A deduction will be allowed for investments in Industrial Policy Projects. The allowance will be available for new assets acquired, contracted for or brought into the Republic after the approval date which will be brought to use by the company within 4 years for purposes of carrying on a manufacturing project of that company.

For Brownfields or substantial upgrades the project should increase the value of the existing industrial assets by the higher of 25% of the cost of the assets or R30 million. In the case of greenfield the cost of the new and unused industrial assets should be at least R200 million.

Qualifying status

Entities with qualifying status will get a 35% investment allowance. The amount of the allowance will be capped at R550 million per project for Greenfield projects and R350 million per project for Brownfields and upgrades/expansions.

Preferred status

Entities with qualifying status will get a 55% investment allowance. The amount of the allowance will be capped at R900 million per project for greenfield projects and R550 million per project for brownfield and upgrades/expansions.

Inflationary increase for unused losses

It has been acknowledged that the investors in terms of this provision will generally not be able to use the deduction immediately. However, inflation would have a negative impact if the value of the incentive is not adjusted for inflationary increases.

The net present value of the approved incentive will be preserved from the date the investment is realised and the assets are brought into use. The preservation or inflationary adjustment will be made for a maximum period of three years. This adjustment will be made by using the standard SARS interest factor.

DONATIONS TO MULTILATERAL HUMANITARIAN ORGANISATIONS

Current law

As a general rule, donations made by a taxpayer represent expenditure of a private and philantrophic nature. This is not regarded as expenditure incurred in the production of income, and is therefore not tax deductible for income tax purposes. However, an exception exists where donations may qualify for a deduction from the taxable income of the taxpayer. This special tax dispensation is only available only to donations made by taxpayers to PBOs conducting certain categories of approved public benefit activities in terms of the Income Tax Act. This limitation stems from revenue and anti-avoidance concerns. Section 18A of the Income Tax Act requires a PBO to be registered in South Africa in order to be eligible for tax deductible donation status.

Reasons for change

Multilateral humanitarian organisations, such as United Nations specialised agencies, enjoy diplomatic immunity status in South Africa in terms of the Diplomatic Immunities and Privileges Act, 2001. Such organisations are therefore exempt from tax in South Africa. However, donations made to these agencies are not tax deductible in terms of section 18A. In order to qualify for section 18A tax deductible donation status, these agencies have to be registered in South Africa as local PBOs. If these agencies are registered as local PBOs, the programmes offered by them would qualify for tax deductible donations. The income tax act requirement that these agencies (even though they are exempt from tax in South Africa) should register as local PBOs in order to qualify for tax deductible donation status may have the unintended effect of discouraging offshore support from these agencies.

Proposal

In view of the fact that it might be impractical for these agencies to register in South Africa as local PBOs, it is proposed that United Nations Agencies (as defined in Schedule 4 of Diplomatic Immunities & Privileges Act, 2001) having diplomatic immunity status in South Africa should qualify for section 18A tax deductible donation status.

PROMOTION OF BIODIVERSITY

Current Legislation

In an effort to preserve nature and the environment, Government (through the Department of Environmental Affairs and Tourism (“DEAT”)) has created a regime for entering into bilateral agreements with private landowners to conserve and maintain a particular area of land on behalf of Government. These agreements are entered into in terms of the National Environmental Management: Protected Areas Act, 2003 (Act No.57 of 2003) and the National Environmental Management: Biodiversity Management Act, 2004 (Act No. 10 of 2004), both of which are laws for determining the areas of land to be protected or conserved. The National Environmental Management: Protected Areas Act, 2003 provides for at least three sets of possible conservation areas, namely, National Parks, Nature Reserves and Protected Environment. On the other hand, the National Environmental Management: Biodiversity Management Act, 2004 provides a list of critical species that need to be conserved and seeks to protect the habitats of these critical species. The manner in which the management of the declared area is to be performed and detail of expenses are stated in the management plan. The management plan is published in the Government Gazette and is subject to review every five years. Currently, as a general rule, only expenditure incurred in the production of income is allowable as a deduction in terms of the Income Tax Act. Therefore, the income tax system does not allow for a deduction for expenditure incurred by the landowner in the above-mentioned circumstances.

Reasons for Change

Maintenance: In entering into these agreements, the landowner agrees to maintain and conserve land on behalf of Government. In doing so, the landowner is incurring maintenance expenses and performing work that would have otherwise been done by Government.

Loss of Land Use Rights: In addition, the landowner is restricted from using the land, except as stipulated in the agreement. For example, the landowner cannot use the land to construct a building or to do a business. By entering into the agreement, the landowner loses the much of the valuable rights of use for his/her private land.

The fact that the income tax system does not compensate landowners for incurring nature conservation maintenance expenses on behalf of Government and for loss of right of use may have an unintended effect of discouraging measures to support conservation of South Africa's rich biodiversity.

Proposal

The proposed amendment creates a mechanism for the deductibility of environmental maintenance and rehabilitation expenses as well as the loss of the right of use of land associated with biodiversity conservation and management in terms of these agreements. The proposed amendment covers the following issues.

Issue 1: Maintenance

1.1 Deduction of conservation maintenance and rehabilitation expenses incurred by landowners conducting a trade

Section 37C(1) provides for a deduction in respect of maintenance and rehabilitation expenses (other than expenditure of a capital nature) incurred by a landowner that carries on trade, for the conservation or maintenance of land in terms of a biodiversity management agreement entered into by the landowner in terms of section 44 of the National Environmental Management: Biodiversity Management Act, 2004. Such deduction is allowable to the extent that the above-mentioned agreement is for a minimum period of 5 years and the conserved area is on the plot of the landowner's trade or within the geographical vicinity of the trade.

The deduction of expenses incurred by the landowner will be limited to income derived by him/her from carrying on of a trade during that particular year. Excess expenditure is carried forward to the following year. In addition, this section makes provision for recoupment of expenditure allowed as a deduction if the landowner has, within the period of five years, breached the terms of the agreement.

1.2 Deduction of conservation maintenance and rehabilitation expenses incurred by landowners conducting farming

Paragraph 12(1) of the First Schedule to the Income Tax Act provides for a deduction in respect of maintenance and rehabilitation expenses incurred by a landowner that carries on farming activity for the conservation or maintenance of land in terms of a biodiversity management agreement entered into by the landowner in terms of section 44 of the National Environmental Management: Biodiversity Management Act, 2004. Such deduction is allowable to the extent that the above-mentioned agreement is for a minimum period of 5 years and the conserved area is on the plot of the landowner’s trade or within the geographical vicinity of the trade.

The deduction of expenses incurred by the landowner will be limited to income derived by him/her from carrying on farming activity during that particular year. Excess expenditure is carried forward to the following year. In addition, this section makes provision for recoupment of expenditure allowed as a deduction if the landowner has, within the period of five years, breached the terms of the agreement.

Issue 2: Loss of right of use of land

2.1 Deduction for loss of right of use of land: 30 year period declaration

Section 37C(3) provides for a section 18A tax deduction in respect of maintenance and rehabilitation expenses incurred by a landowner (irrespective of whether the landowner is carrying on trade or not) for the conservation or maintenance of land according to a declaration in terms of section 28 of the National Environmental Management: Protected Areas Act, 2003. The amount of expenditure will qualify as a tax deductible donation to the extent that the above-mentioned declaration lasts for a period of 30 years. In addition, this section makes provision for a recoupment of the amount allowed as a tax deductible donation if the landowner has, within the period of five years, breached the terms of the agreement.

2.2 Deduction for loss of right of use of land: 99 year period declaration

Section 37C(5) provides for a section 18A tax deduction and exemption from capital gains tax in terms of paragraph 62 of the Eighth Schedule in respect of the amount of the cost to the landowner (irrespective of whether the landowner is carrying on trade or not) to acquire land (or a portion thereof) plus capital expenditure incurred by a landowner in respect of the land that has been declared a national park or nature reserve in terms of an agreement entered into by the landowner in terms of section 20(3) and 23(3) of the National Environmental Management: Protected Areas Act, 2003. Such amount will qualify as a tax deductible donation to the extent that the above-mentioned declaration lasts for a period of 99 years. In addition, this section makes provision for a special pro-rata rule to cater for circumstances where the land has been declared a natural park or a nature reserve and the landowner or connected persons use the land for personal use or trading purposes. According to this pro-rata rule, the amount regarded as a tax deductible donation is limited to the value of the land of which the landowner does not retain the right of use.

VALUE-ADDED TAX

INDUSTRIAL DEVELOPMENT ZONES

Current Legislation

If movable goods are temporarily removed from a customs controlled area and are not returned within 30 days of its removal or within a period approved by the Controller, there is a supply that is deemed to be made in terms of section 8(24).

The consideration for that supply is the open market value of those goods and the vendor is required to account for output tax on the supply.

Reasons for Change

The vendor does not qualify for any VAT relief in the instance that the goods are returned to the customs controlled area enterprise after the expiry of the periods envisaged in section 8(24). This inadvertently leads to a tax cascading effect.

Proposal

It is proposed that relief is given to the vendor where the movable goods are returned to the customs controlled area enterprise after the expiry of the envisaged periods. Where the goods returned to the customs controlled area differ in value, it is proposed that a valuation rule be created to ensure that the vendor is not entitled to a greater deduction than the output tax that was accounted for as per the deemed supply in section 8(24). The value rule, in most cases, aims to achieve the concept of neutrality by offsetting the output tax leviable on the deemed supply made versus the input tax relief given to the vendor when the goods are now returned. This in effect places the vendor in the position as if the goods have never left the customs controlled area enterprise.

Amended legislation

This was achieved by inserting paragraph (n) into section 16(3) to cater for the input tax relief; the eligible deduction is based on the tax fraction (14/114) of the lower of: OMV <u>or</u> original amount of consideration determined in terms of section 10(25).

Example A vendor (i.e. a Customs Controlled Area Enterprise) removes a facsimile machine, used in the course of making taxable supplies, from the CCAE to a supplier in the Republic to have it repaired. The facsimile machine is not returned to the CCA within 30 days of its removal. No alternate arrangement is made with the Controller to extend the 30 day period. Assume that the facsimile machine has an open market value of R1 000 on the last day of the period envisaged in section 8(24) and has a market value of R 1 400 on the day that it is returned to the CCAE. In terms of section 8(24), the consideration for the deemed supply is R1 000. The vendor has to account for output tax of R122.80. If the vendor is not allowed any relief when the goods are returned to the CCAE, the R122.80 becomes a cost to the vendor. Where the goods returned to the CCAE is trading stock this impact works its way into the pricing of those goods. The vendor now qualifies for relief of R122.80 [14/114 x R1 000 - the lower of the open market value or the consideration in terms of section 10(25) of the goods].

PUBLIC-PRIVATE PARTNERSHIPS

Current legislation

A Public Private Partnership (PPP) falls into the definition of a designated entity [section 1 “designated entity” (iii)]. Currently all payments made by any public authority or municipality to a designated entity are inclusive of VAT at 14% if the payments are in respect of a taxable supply made by that designated entity.

Reasons for change

A PPP is an agreement pursuant to which a special purpose vehicle (‘SPV’) may or may not be set up. The issue is that were a PPP agreement does not give rise to a SPV, it may potentially fall outside the definition of a designated entity as the PPP is arguably not an entity.

Proposal

It is proposed that the definition of designated entity be amended as follows:

- "Which is a PPP" is deleted;
- "which is a party to a PPP agreement" is added;
- The activities of the PPP are ring-fenced

The proposal aims to subject all payments made to a PPP by any public authority or municipality to VAT at 14% irrespective of whether or not the PPP agreement results in a SPV. The ring-fencing ensures that the private party's activities, only in respect of, the public partnership agreement fall into the ambit of a designated entity. Where for example, a private party has another activity that is not linked to the public partnership agreement, this would not be affected by the proposed change.

Amended legislation

Section 1 "designated entity" (iii).

SUPPLY OF THE RIGHT TO RECEIVE MONEY UNDER A RENTAL AGREEMENT

Current legislation

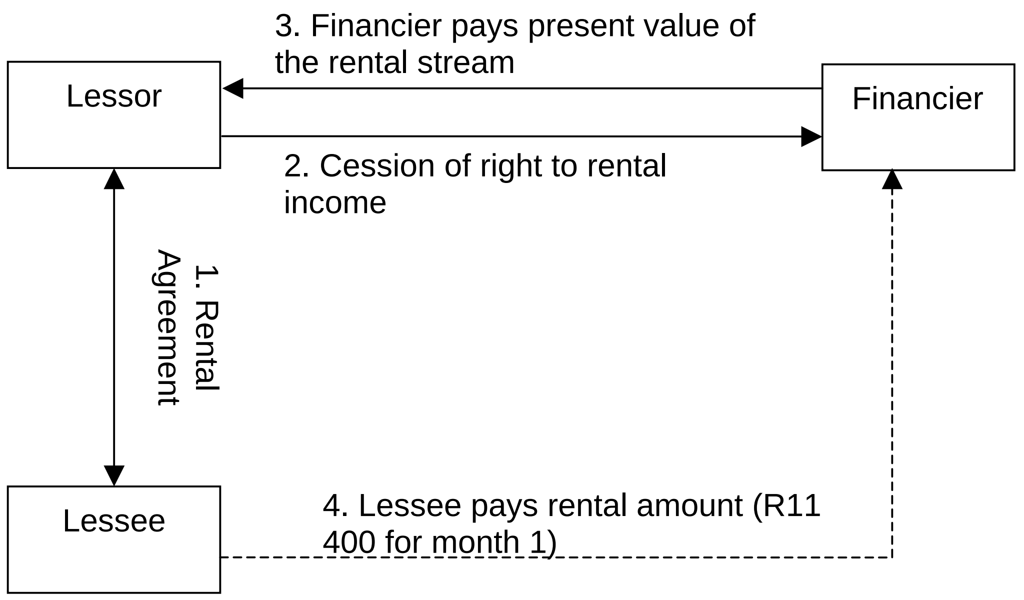
The supply of financial services is exempt from VAT. The transfer of ownership of a debt security, *inter alia*, is an example of financial services that enjoy the exemption. A debt security is defined to mean, *inter alia*, an interest in or right to be paid money that is, or is to be owing by any person. If a debt security is in relation to a rental agreement then the transfer of ownership of such debt security is no longer exempt but is subject to VAT at the rate of 14%. This is in light of the anti-avoidance section 2(4)(b) which excludes from the ambit of financial services the transfer of any interest in or right to be paid money that is, or is to be, owing by any person under a rental agreement.

Reasons for change

It has come to the attention of government that certain practices were contrived to abuse the provisions of section 2(4)(b). The Minister of Finance made the following observation regarding VAT and bare dominium structures in the 2007 Budget Speech:

It was mentioned in last year's Budget that certain taxpayers were entering into bare dominium structures designed to disguise actual financial services as rental payments, thereby misusing the statutory exception to the financial services definition. As a result input credits are claimed even though no *subsequent taxable supplies are made. The investigation has now been completed and the VAT implications will be clarified by legislative amendment."*

A typical supply of the right to receive money under a rental agreement [section 2(4)(b)] can be explained as follows:



Step 1: The lessor and lessee enter into a 20 year rental agreement with rent being payable on a monthly basis. (In this example the rental amount payable for the first month is R11 400, including VAT).

Step 2: The lessor cedes the right to its income under the rental agreement. Excluded from the cession are the obligations of the lessor in terms of the rental agreement and therefore the obligation to make the property available to the lessee remains with the lessor.

Step 3: The financier pays to the lessor the present value of the aggregate rental amounts (excluding VAT) payable in terms of the rental agreement.

Step 4: The lessee pays the financier the rental amounts in terms of the rental agreement. These rentals amounts are inclusive of VAT at 14%. Under a different structure, the lessee would pay the VAT exclusive rental amount to the financier and the VAT component to the lessor.

The VAT implications of the transactions are as follows:

Pre-cession: the lessor declares VAT on the monthly rentals (i.e. R1 400) and the lessee claims input tax on the rental paid (R1 400).

Post-cession: the lessor must charge VAT at 14% on the supply of the right to receive money under a rental agreement to the financier. The VAT implications for the lessor and the lessee are the same as above (it should be noted that the lessor and not the financier is legally responsible for making the property available to the lessee; only the right to receive the income was supplied to the financier and not the obligations attaching itself to the rental agreement).

The VAT levied on the supply made to the financier (of the right to receive the income under the rental agreement) is not input tax in the hands of the financier. The reason for this is that the financier did not incur the input tax to make taxable supplies – this is a pure financing/lending arrangement. It is understood that some financiers argued that the incurred input tax was deductible as the role of the lessor was subrogated with that of the financier.

If the financier is not in a position to claim the incurred input tax then there was a case of tax cascading prevalent.

Proposal

It is proposed that section 2(4)(b) be deleted to negate the tax cascading element and to eliminate any instances that the input tax in the hands of the financier may be claimed. The anti-avoidance that section 2(4(b) addressed is adequately dealt with by section 2(4)(a).

Amended legislation

Section 2(4)(b).

LAND REFORM TRANSACTIONS

Current legislation

The VAT Act does not contain any provisions aimed at providing relief to land reform transactions. As a result the normal VAT principles are applied to land reform transactions which presented a cash flow problem for Government, since the VAT paid by government was a cost to it.

Reasons for change

The land reform programme consists of 2 components: restitution and redistribution programmes. Land restitution envisaged the restitution of rights in land to persons or communities dispossessed of such rights as a result of past racially discriminatory laws or practices. Land redistribution envisaged the designation of certain land; to regulate the subdivision of such land and the settlement of persons thereon and provided for the rendering of financial assistance for the acquisition of land and to secure tenure rights of the same.

Transactions that occur within the land reform programme can be summarized as follows:

- Government buys the land from the seller (who may or may not be a vendor) and pays for the purchase wholly from designated funds for the same; and
- Government buys the land from the seller and partially pays for the purchase from designated funds and partly from contributions from beneficiaries (who would become the owners of such land).

In the second scenario, government transfers the land to the beneficiaries after a period of time, normally ranging from 1 to 3 years. Some of the beneficiaries may or may not be vendors that carry on an enterprise for VAT purposes.

As government is not a VAT vendor and where it purchased land from VAT registered vendors, the VAT paid by government was a cost to it. This contributed to the cost of government undertaking land reform transactions. Where the seller was not VAT registered there was no transfer duty leviable on such acquisitions by the government. It was necessary to align the VAT and transfer duty treatment to make the land reform transactions more seamless, from a transaction cost point of view. The quantum of funding (by way of a grant or advance) given by government in scenario 2 above also must be considered for zero rated VAT relief. It was also deemed necessary to eliminate transfer duty when government transferred the land to the ultimate beneficiary.

Proposal

It is proposed that all land supplied as part of the land reform regime be supplied at the zero rate for VAT purposes where the seller is a VAT vendor. It was also proposed to exempt from transfer duty, land that is transferred by the government to the beneficiaries and the beneficiaries will be prohibited from claiming a notional input tax on such land (if these beneficiaries are VAT vendors) by amending the definition of second-hand goods to exclude land envisaged as part of the land reform regime.

It was also proposed to zero rate the quantum of the grant or advance that was contributed by the government where the government and the beneficiary contributed to the purchase price of the land.

Amended legislation

Sections 11(1)(s); 11(1)(t). Section 1 “second-hand goods” (iv) and (v). Section 9(1)(n) and section 9(1)(o) of the Transfer Duty Act.

STORAGE WAREHOUSES

Current legislation

If imported goods are entered for storage in a licensed Customs and Excise storage warehouse and have not been entered for home consumption, any supply of those goods (before they are entered into home consumption) is zero rated.

Reasons for change

Most storage warehouses that are operated by foreigners are liable to register for VAT based on the ‘enterprise’ test in the VAT Act. The reason for allowing the zero rating of goods imported and entered into a storage warehouse was to unlock input tax that was borne by the vendor that operated a storage warehouse. Based on international trend, foreigners that operated storage warehouses were not compelled to register for VAT and could do so upon application to the Commissioner. This means that the operator of a storage warehouse could choose whether or not it wanted to be drawn into the VAT net.

It was necessary to align our practice to international practice.

Proposal

It is proposed that the supply of goods imported and entered for storage in a storage warehouse (provided that it has not been entered for home consumption) no longer be zero rated but instead be exempt from VAT. The activities of a storage warehouse will no longer be an ‘enterprise’ (only to the extent of the importation of goods stored in such warehouse) and this would negate the administrative burden of registering for VAT. The storage warehouse could apply for registration as a vendor in certain circumstances and where this transpires (i.e. the storage warehouse is a vendor), the supply of goods imported and stored in a storage warehouse are zero rated and no longer exempt.

Amended legislation

Section 11(1)(u) and section 12(k). Section 13(1) paragraph (ii) to the proviso is deleted.

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ESTATE DUTY

GENERAL ANTI-AVOIDANCE RULE

Current Legislation

In addition to specific anti-avoidance provisions, the Income Tax Act, the VAT Act, and the Transfer Duty Act all have a general anti-avoidance provision.

Problem Statement

Although the Estate Duty Act contains certain specific anti-avoidance provisions, there is currently no such general anti-avoidance provision in the Estate Duty Act.

Proposed Solution

It is proposed that a general anti-avoidance section be inserted into the Estate Duty Act to bring the Act in line with the other tax acts. It is therefore proposed that a new section 25B be inserted into the Act, which is similar to the general anti-avoidance provision contained in the Transfer Duty Act.

Amended Legislation

Estate Duty Act

- Insertion of section 25B

TIME LIMITS FOR ASSESSMENT

Current Legislation

The estate of a deceased person must be reported by any person having control or possession of any property or document that is or intends to be a will of the deceased, to a Master of the High Court within 14 days from date of death (section 7 of the Administration of Estates Act No. 66 of 1965). SARS can raise an initial assessment at any time after death (section 9 of the Estate duty Act). A time limit only applies to additional assessments to be raised after the initial assessment i.e. no additional assessment may be raised after five years from the date of the initial assessment notice (section 9A), unless the amount not assessed was due to fraud, misrepresentation or non-disclosure of material facts. In practice SARS does not raise an estate duty assessment on deceased estates below the tax threshold (R3.5 million).

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Problem Statement

The open-ended assessment period places a duty on the Commissioner to assess all deceased estates. This becomes problematic when SARS has to assess unreported estates (e.g. mostly unreported due to an inadvertent omission). In cases where the date of death was so many years ago it is very difficult and time consuming for SARS to look up the old law which is not readily available and in most cases the value of tax collected does not justify the administrative burden e.g. a husband and wife is married in community of property, each owning 50 per cent of a house. The house is registered in the husband's name only. Upon the death of the wife, the husband neglects to report the estate to the Master. Years later the husband wants to sell the house but the Deed's office will not transfer the property because 50 per cent of that house still forms part of the estate of the predeceased spouse. The husband then has to report her estate. If the predeceased spouse died 30 years ago, SARS has to raise an estate duty assessment on the law as it stood at the time of the predeceased's death. Another problem which occurs in such a case is to obtain a "fair market value" of that property at the time of death of the predeceased spouse.

Proposal

General Rule (Section 9(4)(a))

The Estate Duty will be converted to a self-assessment system with one of two triggers:

(i) L&D Account: A notice of assessment will be deemed to be issued in respect of every deceased person to the extent assets are disclosed in a liquidation and distribution account rendered to a Master via section 35 of the Administration of Estate Act No. 66 of 1965. The submission of the liquidation and distribution account will also trigger a deemed notice of assessment for all deemed property under section 3 of the Estate Duty; OR

(ii) No L&D Account Required: If no liquidation and distribution account is *required* under the Administration of Estate Act due to the small size of the estate, the deemed notice date is the death notice to the Master (Section 7 of the Administration of Estates Act).

The normal 5-year deemed additional assessment cut-off will then apply as per section 9A of the Estate Duty. The regime will come into effect on 1 January 2009 and be effective for deaths occurring before and after that date (thereby closing off old estates).

Supplementary Liquidation and Distribution Accounts (Section 9(4)(b) and (c)

Special timing rules are required for supplementary accounts (Section 35(1A) of the Administration of Estates Act. In these circumstances, one of two results will apply:

(i) Within 5 Years: If the supplementary account is submitted within 5 years of the initial account, the estate needs to be re-opened as if the assets were part of the initial estate for purposes of the Estate Duty. The deemed notice of assessment will also be delayed to account for the new submission (for example, if a supplementary account is opened three years after the initial account, the total estate is deemed to have received the notice of assessment in year 3 – not in the first year).

(ii) After 5 Years: If the supplementary account is submitted after 5 years of the initial account, the supplementary account is treated as a stand alone estate subject to Estate Duty with laws in effect as of the date of the supplementary submission (as if the person died on the date the additional assets were found).

LIFE INSURANCE AND PENSION BENEFITS

Current Legislation

Estate duty is levied on lump sum benefits payable in terms of a life policy and pension benefit, because these assets are deemed to be part of the deceased's estate. Annuities are exempt from Estate Duty. If a beneficiary paid the premiums on a life policy, the premiums and interest qualify as a deduction from the gross proceeds of the policy and the net amount is subject to estate duty.

Problem Statement

Most people rely on a life policy and pension benefit to address the potential financial problems of the surviving spouse and dependant children upon the death of the family's income provider. Young families may have a demand for a bigger benefit from life policies. The tax treatment will depend on the form of savings, for instance pension funds provide exempt annuities but the lump sum is taxable. As for life insurance, some planning can reduce the tax (i.e. the subtraction for premiums). It is not in line with government's social objectives to penalise the beneficiaries by reducing the value of the benefit, while the family's overall economic circumstances have declined.

Proposal

To alleviate some of the financial difficulties that a family may face upon the death of the family's income provider, it is proposed that all proceeds from life insurance policies and any lump sum benefit from a retirement fund (i.e. pension fund, pension preservation fund, provident fund, provident preservation fund and retirement annuity fund) be exempt from estate duty with respect to the estates of persons who died on or after 1 January 2009. It is not necessary to specifically exclude life insurance and pension benefits from the actual estate, because these benefits only accrue after death and therefore do not form part of the estate prior to death. Such a change to the current tax system will result in the favorable tax treatment of basic savings and will be in line with Government's savings and retirement reforms.

REPEAL OF STAMP DUTIES ACT

The ambit of the Stamp Duties Act 77 of 1968 has been steadily limited over the last number of years in accordance with modern trends. The Stamp Duties Act levied the duty on instruments such as leases of immovable property and unlisted marketable securities, whilst the Uncertificated Securities Tax Act, 1998 ("UST") catered for the change in beneficial ownership of listed securities. This difference in events which gave rise to the duty and tax payable in respect of both Acts resulted in anomalies and also complicated the administration of the tax and duties.

As a result the Securities Transfer Tax Act, 2007 was introduced to replace stamp duties and UST on securities with a single tax in respect of any transfer of listed and unlisted securities. It covers securities which are transferable with or without a written instrument and which may or may not be evidenced by a certificate. Consolidation of the "marketable securities" section of the Stamp Duties Act with the "securities" definition in the UST Act reduced administrative complexities and provided certainty on the tax payable on acquisition or cancellation of securities.

Another area in which Stamp Duties creates disparities is with regard to real estate lease transactions. Stamp Duties together with Transfer duties on the acquisition of fixed property have been on the statute books since the first half of the previous century. With the introduction of VAT in 1991, concerns arose that the imposition of VAT and transfer duty/stamp duty on the same transactions results in double taxation. Provisions were therefore created in both the VAT and Transfer Duty Acts to legally impose only one of these taxes on any given transaction. In addition, stamp duties are presently imposed on leases (residential and commercial).

The tendency with regard to commercial property is that landlords enter into long-term leases, particularly with government and quasi-government organisations. The development of the property attracts VAT which is claimed as an input tax by the property owner. If the property is sold, VAT is levied which VAT is also claimed as an input tax by the purchaser. However, if the property is leased in terms of a long-term lease, stamp duty is payable which is not deductible, and which forms an additional cost to business. The maximum amount of stamp duty payable is limited to 8% of the value of the property i.e. an amount equal to the transfer duty that would have been paid had the property been purchased from a non-vendor, but for VAT purposes the stamp duty is not deductible as an input tax, whereas a deduction of an amount equal to the transfer duty would have been allowed as a deduction as input tax had the property been purchased.

There is therefore a disparity between the cost of leasing of property in terms of a long-term lease, and the acquisition of property. Despite the gradual phase-out of the Stamp Duties Act, the existing disparities as mentioned above persist. As such, the only remaining item subject to Stamp Duty is real estate leases. It is now proposed that this final Stamp Duty charge be abolished and that the Stamp Duties Act be repealed.

Notwithstanding the repeal of the Stamp Duties Act, 1968, the provisions of the Stamp Duties Act will continue to apply in respect of any instrument described in Schedule 1 of that Act executed before the date of the repeal of that Act as if that Act had not been so repealed.

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CLAUSE BY CLAUSE EXPLANATION

CLAUSE 1

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

See notes on **LAND REFORM TRANSACTIONS**.

CLAUSE 2

Estate Duty: Amendment of section 3 of the Estate Duty Act, 1955

See notes on **ESTATE DUTY: LIFE INSURANCE AND PENSION BENEFITS**.

CLAUSE 3

Estate Duty: Amendment of section 9 of the Estate Duty Act, 1955

See notes on **ESTATE DUTY: TIME LIMITS FOR ASSESSMENT**.

CLAUSE 4

Estate Duty: Insertion of section 25B into the Estate Duty Act, 1955

See notes on **ESTATE DUTY: GENERAL ANTI-AVOIDANCE RULE**.

CLAUSE 5

Pension Funds Act: Amendment of section 37D of the Pension Funds Act, 1956

The proposed amendment effects a technical correction.

CLAUSE 6

Income Tax: Amendment of section 1 of the Income Tax Act, 1962

Subclause (a): The proposed amendment effects a technical correction.

Subclauses (b),(c) and (d): See notes on **STC REFORMS: REVISED DIVIDEND DEFINITION**.

Subclause (e): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

Subclause (f): The proposed amendment clarifies that pension funds may also pay certain "extraordinary" payments as recognised in paragraph 2C of the Second Schedule.

Subclause (g): The proposed amendment is to allow pension preservation funds to receive the tax-free transfers allowed in terms of paragraph 6 of the Second Schedule (as amended).

Subclause (h): The proposed amendment is to allow a pension preservation fund member to make one withdrawal from that fund for each amount transferred to that fund.

Subclause (i): The proposed amendment will allow the Commissioner to automatically recognise pension preservation funds previously registered under the "old" preservation fund dispensation until such time as these are officially registered under the "new" preservation fund dispensation. This will ensure a smooth transition from the "old" to the "new" dispensation with preservation funds not loosing its tax status.

Subclause (j): The proposed amendment clarifies that provident funds may also pay certain "extraordinary" payments as recognised in paragraph 2C of the Second Schedule.

Subclause (k): The proposed amendment is to allow provident preservation funds to receive the tax-free transfers allowed in terms of paragraph 6 of the Second Schedule (as amended).

Subclause (l): The proposed amendment is to allow a provident preservation fund member to make one withdrawal from that fund for each amount transferred to that fund.

Subclause (m): The proposed amendment will allow the Commissioner to automatically recognise provident preservation funds previously registered under the "old" preservation fund dispensation until such time as these are officially registered under the "new" preservation fund dispensation. This will ensure a smooth transition from the "old" to the "new" dispensation with preservation funds not loosing its tax status.

Subclause (n): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

Subclause (o): The proposed amendment updates a reference.

Subclause (q): See notes on **STC REFORMS: REVISED DIVIDEND DEFINITION**.

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CLAUSE 7

Income Tax: Amendment of section 5 of the Income Tax Act, 1962

Subclause (a): **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

Subclause (b): **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

CLAUSE 8

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

Subclause (a): **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

Subclause (b): **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

CLAUSE 9

Income Tax: Amendment of section 7 of the Income Tax Act, 1962

Subclause (a): The proposed amendment corrects a spelling error.

Subclause (b): **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS (RECURRING PAYMENTS)**.

CLAUSE 10

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

See notes on **BROAD BASED EMPLOYEE SHARE SCHEMES**.

CLAUSE 11

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

Subclause (a): In terms of section 8C, if an equity instrument is acquired by a taxpayer and that equity instrument is a restricted equity instrument (as defined in section 8C), the gain or loss resulting from the acquisition will only be brought into account in the taxpayer's hands when the equity instrument vests. If, as a result of corporate action by the company, capital contributions as contemplated in paragraph 74 of the Eighth Schedule accrue to or are received by a taxpayer in respect of a restricted equity instrument, it is proposed that they be brought into account in determining the gain or loss of the taxpayer when the restricted equity instrument vests. As the capital contributions will be brought into account in the taxpayer's taxable income before the inclusion of any capital gain they will, as a result of the operation of paragraph 35(3) of the Eighth Schedule, not be taken into account for capital gains purposes.

Subclauses (b) and (c): These are consequential amendments.

Subclauses (d), (e), (f) and (g): A number of schemes have been introduced to circumvent the operation of section 8C. These schemes purport to fall outside of the ambit of the section on the basis of the equity instruments involved not being convertible to a share, part of a share or a member's interest. Some of these schemes are in fact what is colloquially known as "Phantom Schemes", and although they fall outside the ambit of section 8C, the payments made in terms of the scheme fall within paragraph (*c*) of the definition of "gross income". It is proposed that a further financial instrument be included in the definition of equity instrument which does not require convertibility and which will draw these equity instruments into section 8C. Subclauses (*d*), (*e*), and (*f*) are consequential upon the amendment to subclause (*g*).

Subclause (h): The schemes mentioned above often also claim to circumvent paragraphs (*a*), (*b*) and (*c*) of the definition of "restricted equity instrument" on the basis that the employees do not forfeit the rights that they have. Other measures are imposed which penalise employees if they do not comply with the terms of the agreement for the acquisition of the equity instruments. It is proposed that the defined restriction be broadened.

CLAUSE 12

Income Tax: Amendment of section 9D of the Income Tax Act, 1962

The proposed amendment of subparagraph (ii) of section 9D(10)(*a*) effects a technical correction. There is a corresponding technical correction to subparagraph (iii) of section 9D(10)(*a*). Regarding the other amendment of subparagraph (iii) of section 9D(10)(*a*) (i.e. the insertion of the proviso to subparagraph (iii) of section 9D(10)(*a*)), see notes on **INTELLECTUAL PROPERTY ARBITRAGE**.

CLAUSE 13

Income Tax: Insertion of section 9E into the Income Tax Act, 1962

See notes on **PASSIVE HOLDING COMPANIES**.

DRAFT

CLAUSE 14

Income Tax: Amendment of section 9G of the Income Tax Act, 1962

The proposed amendment is for purposes of clarification.

CLAUSE 15

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

Subclauses (1)(a) and (b): **RETIREMENT ISSUES: ALLOCATIONS TO SPOUSE UPON DIVORCE**.

Subclause (c): This amendment exempts maintenance payments by a retirement fund on behalf of a member, in the hands of the member's spouse or former spouse

Subclause (e): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS (RECURRING PAYMENTS)**.

Subclause (1)(f): Section 10(1)(*z*) of the Income Tax Act provides for an exemption in respect of certain farming subsidies granted by the State. In the past, the Department of Agriculture granted subsidies for interest payable on loans utilised for purposes of farming operations. Since the Department of Agriculture no longer grants these subsidies, it is proposed that section 10(1)(*z*) be deleted as obsolete.

Subclause (1)(g): Section 10(1)(*z*D) of the Income Tax Act provides for an exemption in respect of reimbursements by the State for expenditure incurred in relocating to an economic development area. Paragraph (*l*B) of the definition of "gross income" (which included in gross income subsidies or reimbursements from the State aimed at encouraging the growth of economic development areas), was deleted in 2005. It is therefore proposed that section 10(1)(*z*D) be deleted as a consequence of the deletion of paragraph (*l*B) of the definition of "gross income".

CLAUSE 16

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

Subclause (a): The proposed amendment deletes an obsolete cross reference.

Subclause (b): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

Subclause (c): See notes on **BROAD BASED EMPLOYEE SHARE SCHEMES**.

Subclause (d): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

CLAUSE 17

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

Subclause (1)(a): The proposed amendment clarifies that in order for a section 11D deduction to be claimable in respect of the development of a computer program, there must be an element of originality involved in that development.

Subclause (1)(b) and (c): The proposed amendments clarify section 11D in order to more accurately reflect the intention behind the section.

CLAUSE 18

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

Subclauses (a) and (b): The proposed amendments effect technical corrections.

Subclauses (c) and (d): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

CLAUSE 19

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

See notes on **DEDUCTIONS IN RESPECT OF LEARNERSHIPS**.

CLAUSE 20

Income Tax: Insertion of section 12I into the Income Tax Act, 1962

See notes on **ALLOWANCES IN RESPECT OF INDUSTRIAL POLICY PROJECTS**.

CLAUSE 21

Income Tax: Insertion of section 12J into the Income Tax Act, 1962

See notes on **VENTURE CAPITAL COMPANY REGIME**.

CLAUSE 22

Income Tax: Amendment of section 13ter of the Income Tax Act, 1962

See notes on **DEPRECIATION ALLOWANCES FOR RESIDENTIAL UNITS**.

CLAUSE 23

Income Tax: Amendment of section 13quat of the Income Tax Act, 1962

See notes on **URBAN DEVELOPMENT ZONES**.

CLAUSE 24

Income Tax: Insertion of section 13sex into the Income Tax Act, 1962

See notes on **EMPLOYER SALES OF LOW COST HOUSING TO EMPLOYEES**.

CLAUSE 25

Income Tax: Insertion of section 13sept into the Income Tax Act, 1962

See notes on **EMPLOYER SALES OF LOW COST HOUSING TO EMPLOYEES**.

CLAUSE 26

Income Tax: Insertion of section 13oct into the Income Tax Act, 1962

See notes on **ALLOWANCES IN RESPECT OF EXPENDITURE ON GOVERNMENT BUSINESS LICENSES**.

CLAUSE 27

Income Tax: Amendment of section 18 of the Income Tax Act, 1962

Subclauses (a), (c), (e) and (f): See notes on **DEDUCTIONS IN RESPECT OF DISABILITY EXPENSES**.

Subclause (b): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

DRAFT

CLAUSE 28

Income Tax: Amendment of section 18A of the Income Tax Act, 1962

Subclauses (a) and (d): See notes on **DONATIONS TO MULTILATERAL HUMANITARIAN ORGANISATIONS**.

Subclause (b): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

Subclause (c): See notes on **DONATIONS TO MULTILATERAL HUMANITARIAN ORGANISATIONS** and on **PAYROLL GIVING**.

CLAUSE 29

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

See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS (RECURRING PAYMENTS)**.

CLAUSE 30

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

Subclauses (1)(a) and (b): The proposed amendment allows for an addition to the trading stock cost of an asset that was previously rented by the taxpayer.

Subclauses (1)(c) and (d): Under current law, there is no mechanism in section 22 to include in the cost price of shares in a CFC, that are held as trading stock, in the net income imputed to the resident holding those shares. There is also no mechanism by which the cost price of such shares may be reduced by the amount of any dividends received by that resident which are exempt from tax under the participation exemption in section 10(1)(*k*)(ii)(*cc*). The proposed amendment addresses this issue together with that of shares held as trading stock by CFCs in other CFCs in a multi-tier CFC structure. The proposed amendment mirrors the adjustments made to the base cost of such shares for CGT purposes under paragraph 20(1)(*h*)(iii) of the Eighth Schedule.

Subclause (1)(e): Regarding the deletion of the first proviso to section 22(4), it is proposed that this proviso be deleted as being superfluous. The issue of capitalisation shares by a company by itself has no effect on the respective interests of the shareholders in the company. There is therefore no need for this proviso. Regarding the deletion of the second proviso to section 22(4), see notes under clause xx below regarding the insertion of section 40C.

CLAUSE 31

Income Tax: Amendment of section 23 of the Income Tax Act, 1962

Subclause (a): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS (RECURRING PAYMENTS)**.

Subclause (b): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

Subclause (c): See notes on **REPAYABLE EMPLOYEE BENEFITS**.

CLAUSE 32

Income Tax: Substitution of section 23I of the Income Tax Act, 1962

See notes on **INTELLECTUAL PROPERTY ARBITRAGE**.

CLAUSE 33

Income Tax: Amendment of section 24B of the Income Tax Act, 1962

See notes on **SHARE ISSUE ANOMALIES**.

CLAUSE 34

Income Tax: Amendment of section 28 of the Income Tax Act, 1962

<u>Current Legislation</u>

In terms of section 28(2)(*c*A) of the Income Tax Act, a short term insurer is effectively entitled to a deduction of certain liabilities, subject to an adjustment by the Commissioner. Such liabilities include unearned premium provisions (as contemplated in section 32(1)(*b*) of the Short-Term Insurance Act, 1998) and unexpired risk provisions (as contemplated in section 32(1)(*d*) of the Short-Term Insurance Act).

<u>Problem Statement</u>

Infrequently, some insurers have, in their tax returns, combined and aggregated the liabilities contemplated in sections 32(1)(*b*) and 32(1)(*d*) of the Short-Term Insurance Act. In principle, the Commissioner will, in such circumstances, make an adjustment that has the effect that liabilities contemplated in section 32(1)(*d*) are excluded. Nevertheless, there appears to be some uncertainty in the minds of certain insurers to the effect that section 28(2)(*c*A), in its present form, allows an insurer to include both types of liability.

Proposal

The proposed amendment clarifies that liabilities in respect of unexpired risk provisions (i.e. as contemplated in section 32(1)(*d*) of the Short-Term Insurance Act) may not be included for purposes of section 28(2)(*c*A), subject, as always, to such adjustments as may be made by the Commissioner.

CLAUSE 35

Income Tax: Amendment of section 36 of the Income Tax Act, 1962

The proposed amendment amends section 36 of the Income Tax Act.

CLAUSE 36

Income Tax: Insertion of section 37C into the Income Tax Act, 1962

See notes on **PROMOTION OF BIODIVERSITY**.

CLAUSES 37 and 38

Income Tax: Repeal of sections 40A and 40B of the Income Tax Act, 1962

Simple conversions of close corporations to companies (or vice versa) and conversions of co-operatives to companies are merely changes of form and not substance. It is therefore proposed that sections 40A and 40B be deleted as superfluous.

CLAUSE 39

Income Tax: Insertion of section 40C into the Income Tax Act, 1962

The proposed amendment contains the rule that was previously contained in the second proviso to section 22(4). It is proposed that this rule be applicable for purposes of the entire Income Tax Act, and not only for trading stock purposes

CLAUSE 40

Income Tax: Amendment of section 41 of the Income Tax Act, 1962

See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

CLAUSE 41

Income Tax: Amendment of section 42 of the Income Tax Act, 1962

Subclauses (a) to (c): See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

Subclause (d): The proposed amendment inserts a reference to a collective investment scheme.

Subclause (e): The proposed amendment effects a technical correction.

Subclause (f): See notes on **COMPANY REORGANISATIONS: DE-GROUPING CHARGE**.

Subclause (g): See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

CLAUSE 42

Income Tax: Amendment of section 44 of the Income Tax Act, 1962

Subclause (a): See notes on **STC REFORMS: REVISED DIVIDEND DEFINITION**.

Subclause (b): See notes on **COMPANY REORGANISATIONS: DE-GROUPING CHARGE**.

CLAUSE 43

Income Tax: Amendment of section 45 of the Income Tax Act, 1962

Subclauses (1)(a) to (1)(c): See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

Subclause (1)(d): See notes on **COMPANY REORGANISATIONS: DE-GROUPING CHARGE**.

Subclause (1)(e): The proposed amendment deals with an effective date issue.

Subclauses (1)(f) and (1)(g): See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

DRAFT

CLAUSE 44

Income Tax: Amendment of section 46 of the Income Tax Act, 1962

Subclause (1)(a): The proposed amendment facilitates a restructuring in the context of an unbundling transaction where the unbundled company is a CFC.

Subclause (1)(b): See notes on **STC REFORMS: REVISED DIVIDEND DEFINITION**.

CLAUSE 45

Income Tax: Amendment of section 47 of the Income Tax Act, 1962

Subclause (1)(a): The proposed amendment extends rollover relief in the context of a liquidation transaction under section 47.

Subclause (1)(b): See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

Subclauses (1)(c) and (1)(d): The proposed amendment elaborates on the rules relating to liquidation transactions contemplated by section 47.

Subclause (1)(e): Following upon the introduction of part-disposal treatment for capital distributions on or after 1 October 2007, an unintended consequence has arisen in relation to section 47(5). Section 47(5) provides that a qualifying holding company must disregard any disposal of equity shares in a liquidating company "as a result of" the liquidation or deregistration of that company. Arguably, this does not address a liquidating distribution in anticipation of liquidation or deregistration which will trigger a part-disposal under paragraph 76A of the Eighth Schedule. It also does not address any capital gain arising after disposal of the shares as contemplated in paragraph 77(2) of the Eighth Schedule. Under the proposed amendment, section 47(5)(a) requires a holding company to disregard any disposal or part-disposal of its equity shares in the liquidating company as a result of the receipt or accrual of a liquidation distribution from that company. This will cover capital distributions of cash or assets in specie received or accrued in anticipation of or during the course of the liquidation, winding up or deregistration of the liquidating company. The proposed section 47(5)(*b*) requires the holding company to disregard any capital gain that arises if the liquidating company were to make a capital distribution after its shares have been disposed of. This could occur, for example, if further assets are discovered after deregistration, or after a liquidator has issued a certificate contemplated in paragraph 77(1)(*b*) of the Eighth Schedule.

Subclauses (1)(f) and (1)(g): See notes on **COMPANY REORGANISATIONS: ELECTIONS AND REORGANISATIONS**.

CLAUSE 46

Income Tax: Insertion of Part IV into Chapter II of the Income Tax Act, 1962

See notes on **SMALL BUSINESS PRESUMPTIVE TAX**.

CLAUSE 47

Income Tax: Amendment of section 64B of the Income Tax Act, 1962

See notes on **STC REFORMS: DIVIDEND TAX WITHHOLDING REGIME**.

CLAUSE 48

Income Tax: Insertion of Part VIII into Chapter II of the Income Tax Act, 1962

See notes on **STC REFORMS**.

CLAUSE 49

Income Tax: Amendment of section 73B of the Income Tax Act, 1962

In terms of section 73B(2), a person who is not required to render a return must retain all records relating to the disposal of assets in a year of assessment if all that person's capital gains or losses do not exceed R10 000. It is proposed that the reference to R10 000 be replaced with a reference to the annual exclusion in paragraph 5(1) of the Eighth Schedule, which is currently R16 000.

CLAUSE 50

Income Tax: Amendment of section 74 of the Income Tax Act, 1962

Section 74A provides the authorisation for obtaining information, "for the purposes of administration of this Act". "Administration of this Act" is in turn defined in section 74. This definition is fairly restrictive – and does not provide the authority for obtaining information on current transactions, that is, transactions that have taken place before the end of the financial year, and before the tax return has been filed. Current transactions could be section 76A arrangements, BEE deals or transactions under sections 42 to 47. The proposed amendment gives SARS the power to call for documentation on current deals.

CLAUSE 51

Income Tax: Amendment of section 76G of the Income Tax Act, 1962

Subclauses (1)(a) and (1)(c): The proposed amendment modifies the powers of SARS in relation to Advance Tax Rulings.

Subclause (b): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

CLAUSE 52

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

See notes on **BIODIVERSITY**.

CLAUSE 53

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

Subclause (a): This amendment is a transition measure from the "old" regime applicable to lump sum received upon retirement and the "new" regime applicable to retirement fund lump sum benefits, to allow for tax-free amounts received in the 2007/08 tax year under the "old" regime to be deducted from the tax-free amounts to be received in the same year but under the "new" regime.

Subclauses (b) and (c): See notes on **RETIREMENT ISSUES: TRANSFERS FROM PENSION TO PROVIDENT FUNDS**.

Subclause (d): See notes on **RETIREMENT ISSUES: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS (RECURRING PAYMENTS)**.

CLAUSE 54

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

Subclauses (a) and (b)(to the extent it inserts item (iA)): See notes on **RETIREMENT ISSUES: ALLOCATIONS TO SPOUSES ON DIVORCE**.

Subclause (b)(to the extent it inserts item (iB)): See notes on **RETIREMENT ISSUES: TRANSFERS FROM PENSION TO PROVIDENT FUNDS**.

Subclause (c): The proposed amendment effects a technical correction.

CLAUSE 55

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

See notes on **RETIREMENT SAVINGS: ALLOCATIONS TO SPOUSES ON DIVORCE**.

CLAUSE 56

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

This paragraph exempts certain amounts from income tax including "secret profits" made by retirement fund administrators that is now being repaid to former members of retirement funds. The proposed amendment is aimed at limiting the types of tax-free payments.

CLAUSE 57

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

Subclause (a): See notes on **RETIREMENT SAVINGS: DEFAULT WITHDRAWALS**

Subclause (b): See notes on **RETIREMENT SAVINGS: ALLOCATIONS TO SPOUSES ON DIVORCE.** This proposed amendment postpones the date of accrual of an amount of a retirement fund interest awarded to a non-member former spouse in terms of a divorce order granted prior to 13 September 2007, to the date the non-member elects to take the money in cash or have it transferred to his/her own retirement fund.

CLAUSE 59

Income Tax: Amendment of paragraph 6 of the Second Schedule to the Income Tax Act, 1962

See notes on **RETIREMENT SAVINGS: ALLOCATIONS TO SPOUSES ON DIVORCE**.

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CLAUSE 60

Income Tax: Repeal of paragraph 7 of the Second Schedule to the Income Tax Act, 1962

See notes on **RETIREMENT SAVINGS: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

CLAUSE 61

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

See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

CLAUSE 62

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

Subclause (a): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

Subclause (b): See notes on **REPAYABLE EMPLOYEE BENEFITS**.

Subclauses (c), (d) and (e): See notes on **PAYROLL GIVING**.

Subclause (f): See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

CLAUSE 63

Income Tax: Amendment of paragraph 9 of the Fourth Schedule to the Income Tax Act, 1962

See notes on **RETIREMENT SAVINGS: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS**.

CLAUSE 64

Income Tax: Amendment of paragraph 11 of the Fourth Schedule to the Income Tax Act, 1962

See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**.

CLAUSE 65

Income Tax: Amendment of paragraph 11B of the Fourth Schedule to the Income Tax Act, 1962

See notes on **RETIREMENT SAVINGS: TAXATION OF WITHDRAWALS FROM RETIREMENT FUNDS***.*

CLAUSE 66

Income Tax: Insertion of Sixth Schedule into the Income Tax Act, 1962

See notes on **SMALL BUSINESS PRESUMPTIVE TAX**.

CLAUSE 67

Income Tax: Amendment of paragraph 6 of the Seventh Schedule to the Income Tax Act, 1962

See notes on **PERSONAL USE OF BUSINESS CELL-PHONES AND COMPUTERS**.

CLAUSE 68

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

See notes on **PERSONAL USE OF BUSINESS CELL-PHONES AND COMPUTERS**.

CLAUSE 69

Income Tax: Amendment of paragraph 11 of the Eighth Schedule to the Income Tax Act, 1962

In view of the proposed introduction of paragraph 13(1)(*a*)(iiA), this provision is no longer required. The effect of the latter amendment is to backdate the distribution of the asset to the time of vesting. As a result, the distribution of the asset becomes a no gain or loss disposal and there is no need to treat it as a non-disposal.

CLAUSE 70

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

Where the business establishment exemption applies, a CFC that becomes a resident is deemed to have disposed of assets that were not in the tax net for an amount equal to their market value. For purposes of establishing a base cost for such assets, the proposed amendment treats the CFC as having reacquired those assets for an amount equal to their market value on the date that the CFC becomes a resident.

CLAUSE 71

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

Subclause (a): Under current law a disposal is triggered in the hands of a beneficiary of a trust when that beneficiary acquires an asset from the trust in respect of which that beneficiary had a pre-existing vested right. This follows from paragraph 13(1)(d) which stipulates that the time of disposal in respect of the vesting of an asset is the date of vesting. When the beneficiary receives the actual asset there is a further disposal in the form of an exchange of a vested right for a real right in the asset, and the time of that disposal is the date when the change of ownership occurs (paragraph 13(1)(*a*)(ix)). This treatment is inconsistent with the treatment of other assets when delivery is deferred. In such cases, paragraph 13(1)(*a*)(ii) ensures that the exchange of personal and real rights is backdated to the date of the agreement, thereby ensuring that the disposal is tax neutral. The tax neutrality flows from the fact that the base cost of the vested (personal) right is equal to the market value of the real right received (proceeds), resulting in no capital gain or loss when the rights are exchanged.

It is proposed that a similar approach be applied to the acquisition of an asset by a beneficiary to the extent that the beneficiary had a vested right in the asset. To achieve this it is proposed that a new paragraph 13(1)(*a*)(iiA) be introduced.

Subclause (b): The deletion of paragraph 13(1)(*d*) is consequential to the introduction of paragraph 13(1)(*a*)(iiA) (see subclause (*a*)).

Subclause (c): The proposed amendment relates to the effects of a CFC becoming a resident.

CLAUSE 72

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

Subclause (1)(a): The proposed amendment effects a technical correction.

Subclause (b): Paragraph 20(1)(*h*)(v) establishes a base cost for an asset acquired by inheritance from a non-resident. Two amendments are proposed to this provision. First, it is proposed that it be made subject to paragraph 12(5). This is consistent with the treatment of debts bequeathed to debtors by resident estates under paragraph 40(2). Secondly, it is proposed that it be clarified that the provision only applies in respect of assets acquired by inheritance on or after the valuation date. Assets acquired by inheritance before the valuation date are acquired at a nil cost on the date of inheritance. Again, this is consistent with the treatment of assets acquired from resident estates before valuation date, since paragraph 40 (read with paragraph 2) only applies to disposals on or after the valuation date.

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

Subclause (d): Under current law, there is some uncertainty as to whether paragraph 38 applies to assets acquired from a non-resident by donation, for a consideration not measurable in money or from a connected person at a non-arm's length price. This is because paragraph 38(1) refers to a person who has "disposed of an asset . . .". In terms of paragraph 2, the Eighth Schedule does not apply to disposals of assets by non-residents (except in the case of immovable property in South Africa and assets of a permanent establishment in South Africa). It may thus be suggested that the reference to "disposed of" only applies to deemed SA-source assets such as immovable property in SA, and hence paragraph 38 does not apply to other assets acquired from a non-resident. To clarify this point it is proposed that a new paragraph 20(1)(h)(vi) be inserted to establish a base cost for assets acquired from a non-resident that are acquired by donation, or for an expenditure not measurable in money or for a non-arm's length price when the non-resident is a connected person in relation to the resident acquirer.

CLAUSE 73

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

See notes on **ESTATE REDISTRIBUTIONS**.

CLAUSE 74

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

See notes on **SMALL BUSINESS PRESUMPTIVE TAX**.

CLAUSE 75

Income Tax: Amendment of paragraph 64B of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment extends the exclusion from the participation exemption in the context of section 64B(5).

CLAUSES 76 and 77

Income Tax: Amendment of paragraphs 67A and 67AB of the Eighth Schedule to the Income Tax Act, 1962

Paragraph 67A applies to a holder of a participatory interest in a collective investment scheme in property (CISP). With the introduction, on 1 October 2007, of part-disposal treatment for capital distributions in respect of shares, paragraph 67A(3) was amended by the Revenue Laws Amendment Act 35 of 2007 with the purpose of mirroring the treatment applied to capital distributions under paragraph 76. A new paragraph 67AB was introduced at the same time with the aim of triggering a part-disposal when a holder of a participatory interest in a CISP received a distribution of a capital nature from a CISP and was intended to be the equivalent of paragraph 76A. It has since emerged that there are a number of shortcomings and omissions from paragraphs 67A and 67AB, and it is accordingly proposed that these be corrected. For example, paragraph 67A appears to have the unintended effect of limiting proceeds to the amount of a pre-1 October 2007 distribution of capital from a CISP but is silent on the treatment of any actual proceeds on disposal of a participatory interest, and any distributions of a capital nature on or after 1 October 2007. Paragraph 67AB does not contain a negative base cost rule when the weighted average method is used.

To resolve these problems it is proposed that a distribution of capital from a CISP be treated in accordance with the same rules that apply to a capital distribution in respect of a share under paragraphs 76, 76A and 77. As a consequence it is proposed that paragraph 67AB be deleted.

DRAFT

CLAUSE 78

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

It is proposed that subparagraphs (2) and (3) of paragraph 78 be deleted as superfluous.

CLAUSE 79

Income Tax: Amendment of paragraph 80 of the Eighth Schedule to the Income Tax Act, 1962

Based on the current wording of paragraphs 63 and 63A of the Eighth Schedule, when a trust vests an asset or a capital gain it would appear that the exempt/partially exempt entity concerned (for example, a PBO) is not entitled to disregard any capital gain attributed to it under paragraph 80(1) or (2). This is because the capital gain concerned did not arise from the disposal of an asset by the entity itself.

It is proposed that paragraph 80(1) and (2) be amended to exclude attribution to a person, organisation, entity or recreational club contemplated in paragraph 62(*a*) to (*e*). The effect will be that the capital gain will remain in the trust, which will be entitled to disregard the capital gain or capital loss on the donation under paragraph 62. Furthermore, the wording of paragraph 80(2) is more closely aligned with the wording of paragraph 80(1).

CLAUSES 80 and 81

Income Tax: Amendment of paragraph 4 of Part I and paragraph 3 of Part II of the Ninth Schedule to the Income Tax Act, 1962

In terms of the proposed amendment, the provision of loans for study, research and teaching will be regarded as a public benefit activity.

CLAUSE 82

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

The proposed amendment reduces the tax rate on oil and gas income of an oil and gas company from 29% to 28%.

CLAUSE 83

Customs and Excise: Amendment of section 38 of the Customs and Excise Act, 1964

Section 38 regulates the entry of goods and also prescribes the periods within which such entry must be made.

Subsection (1)(a): In his 2008 Budget Review, the Minister announced that legislative amendments would be made to provide for the periodic clearance of goods imported into a licensed customs and excise warehouse.

The proposed amendment empowers the Commissioner to permit the removal of imported dutiable goods from a licensed customs and excise storage warehouse on the basis of an invoice or certificate or such other document as the Commissioner may prescribe, provided that both the licensee of the warehouse and the importer of the goods have been accredited by the Commissioner. This amendment comes into operation on the date of promulgation of this Act.

Subsection (1)(b): In his Budget Review, the Minister announced that the customs procedure to the storage and movement of bulk goods will be simplified with the aim of reducing industry compliance costs and of easing SARS' administration.

SARS wishes to relieve the administrative burden of investigating normal losses associated with the transport, handling and pumping of all liquid bulk dutiable goods or goods free of duty stored in and removed from customs and excise storage warehouses, licensed as contemplated in section 21(3).

CLAUSE 84

Customs and Excise: Amendment of section 43 of the Customs and Excise Act, 1964

Subsection (1)(a): Section 43 relates, *inter alia*, to the disposal of goods on failure to make due entry. The amendment is consequential to the amendment to section 38 insofar as it effects the time when imported goods must be removed to the State warehouse or dealt with otherwise as section 43 requires.

Subsections (1)(b) to (d): Under current legislation, the client could conceivably be liable for both State warehouse rent charged by the Commissioner and storage charges charged by the facility deemed to be a State warehouse. The proposed amendment rectifies this problem by removing the deemed State warehouse's entitlement to State warehouse rent, thereby providing a more equitable dispensation for the client. Further consequential amendments are made to the section and will also be made to the rules for section 17.

Presently, this section also provides that where goods are not removed to the State warehouse after expiry of the period within it should have been entered, but allowed to remain at the premises of a person having control of the goods that person is entitled, when the goods are sold, to payment of State warehouse rent as prescribed in the rules for section 17 to the extent that any amount become payable for the proceeds of sale according to the order stated in subsection (3). The effect of the amendment is that State warehouse rent will not be charged on such goods but the person concerned will be entitled to share in the proceeds of sale for storage charges in terms of the amendment to subsection (3).

Subsection (1)(e): This amendment relates to the disposal of counterfeit goods in terms of section 43, where the importer is not known or, in terms of the amendment, cannot despite reasonable efforts be located.

In certain instances, i.e. travellers, the person who imported counterfeit goods might be known, but cannot be located, because a false address had been given. It is therefore necessary to amplify the provision as proposed to provide for those notices.

CLAUSE 85

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

In the Income Tax Act, 1962, the Commissioner shall not authorise refunds or raise assessments if the initial amount was paid in accordance with the practice generally prevailing at the date of payment. The Value-Added Tax Act, 1991, also contains such a provision.

In order to align all Acts administered by SARS, a similar provision dealing with refunds is inserted in section 76B, as well as a corresponding provision in respect of the underpayment of duty in section 44.

CLAUSE 86

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

Section 47(2) provides for the Year 2000 compliant requirements, which have now become obsolete.

CLAUSE 87

Customs and Excise: Insertion of Section 54EA into the Customs and Excise Act, 1964

The insertion of section 54EA empowers the Commissioner to require by rule that a person or category of persons should register for the purpose of manufacturing environmental levy goods; and he may also exempt by rule a person or class of persons from licensing and the payment of environmental duty for any period in respect of any quantity of environmental levy goods manufactured by such person or class of persons.

CLAUSE 88

Customs and Excise: Amendment of section 65 of the Customs and Excise Act, 1964

Subsection (1)*(a)*: Section 65(4)*(a)* was amended in 2001 by section 128 of Act 60, with the wording indicating "and may be determined" and not "or may be determined". If regard is had to section 128(a) of that Act as it appears in Government Gazette 22923 of 12 December 2001, it is clear that the word 'and" was inserted accidentally in place of the word "or". The Afrikaans version of the amending Act still reads "of".

This was pointed out in the judgment of the Commissioner for the *South African Revenue Service v Trend Finance Pty Ltd and another [2007] JOL 1997 SCA* and this amendment rectifies the provision.

Subsection (1)*(b)*: The amendment aligns the definition of "buying commission" to the definition contained in the WTO Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade, to which the Republic is a signatory.

CLAUSE 89

Customs and Excise: Amendment of section 66 of the Customs and Excise Act, 1964

The WTO Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade, to which the Republic is a signatory, does not discriminate between containerised and break bulk cargo in respect of inland freight charges.

The effect of this amendment is that the place where the goods packed into a container in a foreign country, for export to the Republic, will no longer be regarded as the port or place of export and that the full cost of transporting the goods from an exporter's premises to the port or place where they are to be loaded on board a ship or any vehicle (inland freight charges) will be dutiable, thereby bringing it into line with break bulk cargo.

CLAUSE 90

Customs and Excise: Amendment of section 67 of the Customs and Excise Act, 1964

Subsection (1)*(a)* and *(c):* The WTO Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade, to which the Republic is a signatory, does not discriminate between containerised and break bulk cargo in respect of inland freight charges.
The effect of this amendment is that the place where the goods packed into a container in a foreign country, for export to the Republic, will no longer be regarded as the port or place of export and that the full cost of transporting the goods from an exporter's premises to the port or place where they are to be loaded on board a ship or any vehicle (inland freight charges) will be dutiable, thereby bringing it into line with break bulk cargo.

Subsection (1)*(a)* and *(c)* come into operation on a date to be fixed by the President by proclamation in the *Gazette*

Subsection (1)*(b):* The WTO Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade, to which the Republic is a signatory, does not provide for the deduction of buying commission from the price actually paid or payable as it is payable to the buying agent by the purchaser of the goods in the Republic. Section 67(2)*(b)* is thus amended by the deletion of subparagraph (v) where "buying commission" is listed and the following two subparagraphs are thus renumbered accordingly.

CLAUSE 91

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

Subsection (1)*(a)*: Limitation periods for refunds and drawbacks
Presently, the section, which concerns application for refunds, lacks clarity regarding the application of the limiting circumstances contained in section 76B. The proposed amendment aligns the provisions with those of section 76B regarding the time within which application for a refund must be submitted.

Subsection (1)*(b)*: Administration of International Agreements
This provision empowers the Minister to amend Schedule No. 4 or 5 to provide respectively for a rebate or refund of duty where it may be necessary to give effect to an agreement contemplated in section 49.

Subsection (1)*(c)*: Alignment with the Kyoto Convention

The proposed amendment provides that where goods are destroyed, any rebate of duty on such goods must be reduced on any waste or scrap that enters home consumption. Such waste or scrap is deemed to have been imported at the time it is entered for home consumption and is liable to duty in that state. The amendment accords with the Kyoto Convention.

CLAUSE 92

Customs and Excise: Amendment of section 76B of the Customs and Excise Act, 1964

In the Income Tax Act, 1962, the Commissioner shall not authorise refunds if the initial amount was paid in accordance with the practice generally prevailing at the date of payment. The Value-Added Tax Act, 1991, also contains a similar provision.

In order to align all Acts administered by SARS, similar provisions dealing with refunds and drawbacks are inserted, as well as a corresponding provision in respect of the underpayment of duty in section 44.

CLAUSE 93

Continuation of schedules 1 to 8 of Customs and Excise Act, 1964

The proposed amendment extends the date of applicability of certain schedules.

CLAUSE 94

Date of EFTA

The proposed amendment provides for the date of implementation of the Free Trade Agreement between EFTA States and SACU States.

CLAUSE 95

Stamp Duties: Repeal of the Stamp Duties Act, 1968

See notes on **REPEAL OF STAMP DUTIES ACT**.

CLAUSE 96

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

Subclause 1(a): See notes on **PUBLIC PRIVATE PARTNERSHIPS**.

Subclause 1(b): The amendment is consequential on the classification of the Road Accident Fund now falling into Schedule 3A of the Public Finance and Management Act, 1999.

Subclause 1(c): The amendment serves to clarify that electricity is and always was regarded as ‘goods’ for VAT purposes.

Subclause 1(d): The proposed amendment requires the definition of an inbound duty and tax free shop to be determined by Customs.

Subclause 1(e): This amendment is consequential on the insertion into section 1 of the VAT Act of the definition of “Securities Transfer Tax” (STT). With the repeal of stamp duties, vendors that incurred STT in respect of a non-taxable supply are entitled to claim a notional input tax relating to its enterprise.

Subclause 1(f): Refer to subclause 1(e) above.

Subclause 1(g): Refer to subclause 1(e) above.

Subclause 1(h): See notes on **LAND REFORM TRANSACTIONS**.

Subclause 1(i): Refer to subclause 1(e) above.

CLAUSE 97

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

See notes on the **SUPPLY OF THE RIGHT TO RECEIVE MONEY UNDER A RENTAL AGREEMENT**.

CLAUSE 98

Amendment of section 8 of the Value-Added Tax Act, 1991

Subclause 1(a): Vendors that opt to be registered for the turnover tax cannot be registered for VAT and consequentially must deregister for VAT. This amendment serves to provide relief to such vendors.

With the proposed increase in the monetary threshold for VAT to R1million, relief is provided to vendors that must now deregister for VAT.

Subclause 1(b): This amendment is to reinforce the policy that all payments made to a designated entity by a public authority or municipality concerned, is inclusive of VAT at 14%. A vendor can longer argue that the payment envisaged cannot be linked to a specific taxable supply and is therefore not taxable.

DRAFT

CLAUSE 99

Amendment of section 10 of the Value-Added Tax Act, 1991

See notes under subclause1(*a*) of Clause 98.

CLAUSE 100

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

See notes on **LAND REFORM TRANSACTIONS** for insertion of sections 11(1)(s) and (t).

See notes on **STORAGE WAREHOUSES** for insertion of section 11(1)(u).

The insertion of section 11(1)(v) into the VAT Act is to align the South African Customs practice with that of international practice, primarily for competitive reasons.

CLAUSE 101

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

Subclause 1(a): This amendment is to update an Act referenced in the envisaged section.

Subclause 1(b): See notes on **STORAGE WAREHOUSES**

CLAUSE 102

Amendment of section 13 of the Value-Added Tax Act, 1991

See notes on **STORAGE WAREHOUSES**

CLAUSE 103

Amendment of section 16 of the Value-Added Tax Act, 1991

Subclause 1(a): Refer to subclause 1(e) of the amendment to section 1 of the VAT Act.

Subclause 1(b): This is consequential on the insertion of section 16(3)(n).

Subclause 1(c): See notes on **INDUSTRIAL DEVELOPMENT ZONES**

CLAUSE 104

Amendment of section 18 of the Value-Added Tax Act, 1991

This amendment is consequential to the amendment to section 8(2) of the VAT Act – see Subclause 1(a) of Clause 98. It is intended to provide additional relief for vendors that opt out of the VAT system to be registered for the turnover tax.

CLAUSE 105

Amendment of section 23 of the Value-Added Tax Act, 1991

Subclause 1(a): This amendment is in light of the fact that the monetary threshold for VAT has not increased for the past few years and has not kept pace with inflation. Also with the proposed introduction of a turnover tax for small business it was necessary to align the turnover tax with that of the VAT.

Subclause 1(b): This amendment clarifies that the bank or institution referred to in the envisaged section is a South African Bank.

Subclause 1(c): This amendment is textural in nature.

CLAUSE 106

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

See Subclause 1(a) of Clause 98. Vendors that take longer than the required six months to pay the VAT liability on deregistration will be charged with interest for such outstanding liability.

CLAUSE 107

Amendment of section 41B of the Value-Added Tax Act, 1991

The proposed amendment provides for certain information to be supplied when applying for a VAT ruling or VAT class ruling. Furthermore, the proposed amendment grants a discretion to the Commissioner in determining whether VAT class rulings and VAT rulings should be published.

CLAUSE 108

Amendment of section 44 of the Value-Added Tax Act, 1991

The proposed amendment permits only: non-resident companies; subsidiary companies of a holding company to use the bank account of third parties (and in the case of subsidiaries the bank of its holding company) for purposes of obtaining a refund. This amendment will be effective from 1 April 2009 in order to allow vendor's affected by this proposed amendment to inform SARS of their banking particulars.

CLAUSE 109

Amendment of section 45 of the Value-Added Tax Act, 1991

The proposed amendment provides clarity that the Commissioner will only pay interest after 21 days of receiving the vendor's banking particulars. Where a vendor has specified in section 44(3)(d) of the VAT Act uses a bank account of a third party and has completed a VAT 119i, the 21 day interest free period commences from the date that the VAT 119i is received by the Commissioner.

CLAUSES 110 & 111

Amendment of section 42 of the Restitution of Land Rights Act, 1994

See notes on **LAND REFORM TRANSACTIONS**

CLAUSE 112

Income Tax: Amendment of Schedule 1 to the Revenue Laws Amendment Act, 2006

The proposed amendment deals with issues relating to the 2010 World Cup.

CLAUSE 113

Income Tax: Amendment of Appendix I of the Taxation Laws Amendment Act, 2007

The proposed amendment corrects an error.

DRAFT

CLAUSE 114

Income Tax: Amendment of section 5 of the Securities Transfer Tax Act, 2007

Certain listed shares are still in certificated form. Such shares are not held in custody by either a broker or a participant. The effect of the proposed amendment is that the Security Transfer Tax in the case of the transfer of listed shares in certificated form must be paid by the person to whom the shares are transferred via the company which issued those shares.

CLAUSE 115

Income Tax: Amendment of section 8 of the Securities Transfer Tax Act, 2007

The proposed amendment corrects an incorrect cross-reference.

CLAUSE 116

Income Tax: Amendment of section 52 of the Revenue Laws Amendment Act, 2007

The proposed amendment deals with an effective date issue.

CLAUSE 117

Income Tax: Amendment of Section 55 of the Revenue Laws Amendment Act, 2007

The proposed amendment deals with an effective date issue.

CLAUSE 118

Income Tax: Amendment of Section 56 of the Revenue Laws Amendment Act, 2007

Section 56 of the Revenue Laws Amendment Act, 2007 amended section 45 of the Income Tax Act to deny the rollover relief afforded by section 45 (which deals with intra-group transactions) in certain circumstances.

This amendment to section 45 was deemed to have come into operation on 30 October 2007 and to be applicable to any transaction entered into during any year of assessment ending on or after that date. This creates an unintended anomaly. For example, it is possible that a company with a year end of 30 November 2007 and which entered into a section 45 transaction in

December 2007 (i.e. long before the amendment to section 45 was announced) could retrospectively be denied the relief afforded by section 45.

It is therefore proposed that section 56 of the Revenue Laws Amendment Act be amended so that it is effective only in respect of transactions entered into on or after 30 October 2007 (with no regard being given to the year of assessment in which the transaction took place).

CLAUSE 119

Income Tax: Amendment of Section 59 of the Revenue Laws Amendment Act, 2007

The proposed amendment is of a technical nature.

Section 59 of the Revenue Laws Amendment Act, 2007 amended section 64B(5)(*c*) of the Income Tax Act. This amendment was to have been effective from 1 January 2009. A further amendment was made to section 64B(5)(*c*) by section 32 of the Taxation Laws Amendment Act, 2008. The amendment to section 64B(5)(*c*) by the Taxation Laws Amendment Act, 2008 has made the amendment to section 64B(5)(*c*) by the Revenue Laws Amendment Act, 2007 unnecessary.

CLAUSE 120

Income Tax: Amendment of section 38 of the Taxation Laws Amendment Act, 2008

The proposed amendment deals with an effective date issue.

CLAUSE 121

Income Tax: Amendment of Appendix I of the Taxation Laws Amendment Act, 2008

The proposed amendment corrects an error.

CLAUSE 122

Short Title and Commencement

This clause provides for the name of the Act and the commencement date thereof.