



# 2006/7

## Budget Tax Proposals

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South African Revenue Service

# 2006/7

## Budget Tax Proposals

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## INTRODUCTION

Buoyant corporate activity, a strong housing market, rising levels of imports, employment gains, real wage increases, robust consumption spending and continued improvements in tax collection capacity have contributed to across-the-board revenue increases over the past two years, over and above what was projected in 2004 and 2005. It is estimated that main budget revenue for the current fiscal year will rise to R411,1 billion.

The 2006 tax proposals reduce the tax burden on individuals and businesses, expand the tax base and simplify tax administration. A range of initiatives aims to stimulate investment, innovation, employment and skills development, thereby contributing to economic growth. Government continues its efforts to open the way for entrepreneurs and the development of small firms with a series of proposals that include tax relief and a tax amnesty for small businesses. To promote skills development and employment creation, particularly among youth, an extension of the learnership allowance is proposed. In keeping with efforts to accelerate economic growth and international competitiveness, incentives are proposed to foster research and development by South African companies.

Government is able to offer gross personal income tax relief of R13,5 billion. Raising the tax threshold to R40 000 effectively exempts many low-income earners from income tax. Similarly, the substantial transfer duty relief reduces the cost of property transactions at all levels, and eases the financial burden on first-time and low-income home buyers. To help South Africans accumulate adequate savings for retirement, a reduction in the retirement fund tax from 18 per cent to 9 per cent is proposed.

## OVERVIEW

Over the past decade South Africa has implemented major reforms to broaden the tax base, reduce marginal tax rates and improve the administration of tax collection. These reforms have been broadly in step with international tax reform trends and have bolstered government's revenue-raising capacity. The buoyant revenue collections and tax relief measures implemented over the past few years are evidence of the success of the tax reform agenda.

In the medium term, the tax policy framework supports the goals of accelerated and shared economic growth by promoting long-term retirement savings, reducing the costs of tax compliance and the tax burden on all businesses, fostering small business development, boosting investment in research and development (R&D), supporting skills development and encouraging home ownership. The monetary thresholds of the two top

personal income tax brackets are increased substantially - by 30 and 33 per cent respectively. The top marginal tax rate will now start at R400 000 a year, providing substantial relief for middle-income earners.

Proposed adjustments reinforce the long-term growth path by reducing the costs of tax compliance, broadening the tax base and lowering the tax burden on key economic activities. The 2006 Budget takes into account the elimination of RSC levies, which will be abolished on 30 June 2006. This decision effectively grants substantial tax relief for business, reduces their administrative burden and directly reduces the cost of employment. A consultative process has been initiated with a discussion paper exploring possible options for replacing the levies.

The South African Revenue Service (SARS) is also implementing a package of reduced compliance costs, enhanced service, and improved tax and customs administration. To encourage small businesses to become tax compliant, a tax amnesty is proposed. During 2006, legislation will be submitted to Parliament providing tax concessions for the international football association's operations during the 2010 Soccer World Cup.

## MAIN TAX PROPOSALS

The 2006 Budget tax proposals amount to net tax relief of R19,1 billion, in addition to reduced tax liabilities arising from abolition of the RSC levies. The proposals include:

### Tax relief

- Income tax rate reduction of R13,5 billion for individuals
- Tax relief of R7 billion for business resulting from abolition of the RSC levies
- Tax amnesty for small businesses
- Tax on retirement funds reduced from 18 per cent to 9 per cent
- Transfer duty thresholds raised to R500 000 and R1 million
- Monetary thresholds for qualifying small businesses increased
- Monetary thresholds for capital gains and estate duty increased
- Extension of the learnership allowance until 2011 and incentives to encourage the intake of learners with disabilities
- Incentives to boost expenditure on R&D
- Ad valorem excise duties abolished on certain products
- Increase in the biodiesel fuel tax concession to 40 per cent of the general fuel levy.

### Tax increases

- Increase in the Road Accident Fund levy by 5 cents a litre
- Increase in excise duty on tobacco products by between 4,7 and 10,2 per cent
- Increase in excise duty on alcohol products by between 9 and 20 per cent.

## RELIEF FOR INDIVIDUALS

### Personal income tax

Under the proposals made in the 2006 Budget, South Africans will benefit from significant personal income tax relief that takes into account the effects of inflation and provides for a real reduction in the individual tax burden. It is proposed to raise the income tax threshold by 14,3 per cent to R40 000, to widen the individual income tax brackets and to increase the upper tax bracket from R300 000 to R400 000, with 73 per cent of the income tax relief benefiting those earning R250 000 or less.

Personal income tax rate relief of R13,5 billion is proposed.

### Personal income tax rate and bracket adjustments:

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

#### The main adjustments are:

- The primary rebate is raised to R7 200 from R6 300, increasing the income tax threshold by 14,3 per cent to R40 000
- The tax threshold for taxpayers age 65 and over is raised to R65 000 from R60 000, an increase of 8,3 per cent.
- Brackets are adjusted to provide relief across the income spectrum.

**The distribution of the tax relief is as follows:**

Threshold to R60 000	13%
R60 000 to R150 000	36%
R150 000 to R250 000	24%
R250 000 and above	27%.

The proposed tax schedule eliminates the effects of inflation on income tax liabilities and results in a reduced tax liability for taxpayers at all income levels. More detailed examples are provided below.

**Income tax payable by individuals younger than 65**

Taxable income (R)	2005 rates (R)	Proposed rates (R)	Tax reduction (R)	% change
40,000	900	-	900	100.0
45,000	1,800	900	900	50.0
50,000	2,700	1,800	900	33.3
55,000	3,600	2,700	900	25.0
60,000	4,500	3,600	900	20.0
65,000	5,400	4,500	900	16.7
70,000	6,300	5,400	900	14.3
75,000	7,200	6,300	900	12.5
80,000	8,100	7,200	900	11.1
85,000	9,350	8,100	1,250	13.4
90,000	10,600	9,000	1,600	15.1
100,000	13,100	10,800	2,300	17.6
120,000	18,100	15,800	2,300	12.7
150,000	26,600	23,300	3,300	12.4
200,000	42,600	37,800	4,800	11.3
250,000	60,700	54,300	6,400	10.5
300,000	79,700	71,800	7,900	9.9
400,000	119,700	109,800	9,900	8.3
500,000	159,700	149,800	9,900	6.2
1,000,000	359,700	349,800	9,900	2.8



## Income tax payable by individuals 65 years of age and older

Taxable income (R)	2005 rates (R)	Proposed rates (R)	Tax reduction (R)	% change
65,000	900	–	900	100.0
70,000	1,800	900	900	50.0
75,000	2,700	1,800	900	33.3
80,000	3,600	2,700	900	25.0
85,000	4,850	3,600	1,250	25.8
90,000	6,100	4,500	1,600	26.2
95,000	7,350	5,400	1,950	26.5
100,000	8,600	6,300	2,300	26.7
120,000	13,600	11,300	2,300	16.9
150,000	22,100	18,800	3,300	14.9
200,000	38,100	33,300	4,800	12.6
250,000	56,200	49,800	6,400	11.4
300,000	75,200	67,300	7,900	10.5
500,000	155,200	145,300	9,900	6.4
1,000,000	355,200	345,300	9,900	2.8

## Interest and dividend income exemption

The domestic interest and dividend exemption is currently R15 000 for taxpayers under the age of 65, and R22 000 for taxpayers age 65 and over. This exemption encourages a culture of savings and helps retired South Africans to retain interest income. From 1 March 2006, the exemption threshold will increase to R16 500 (10 per cent) for taxpayers younger than 65 years and to R24 500 (11,4 per cent) for taxpayers age 65 and over. It is also proposed to increase the proportion of the exemption applicable to foreign interest income and dividends from R2 000 to R2 500 per year.

## Transfer duty

Property prices have increased substantially over the past few years, making it difficult for many people to purchase their first house. To ease the burden on first-time and lower-income home buyers, the exempt threshold for transfer duty will be increased significantly from R190 000 to R500 000, and the second threshold from R330 000 to R1 million.

### Proposed rates of transfer duty - 2006/07

Property value	Rates of tax
R0 – R500 000	0%
R500 001 – R1 000 000	5% on the value above R500 000
R1 000 001 and above	R25 000 plus 8% on the value above R1 000 000

It is also proposed to reduce the flat 10 per cent transfer duty rate for companies and trusts to 8 per cent. These amendments will bring significant relief of R4,5 billion to home buyers, and will come into effect on 1 March 2006.

## Current and proposed transfer duty

Property value	Current duty	% of value	Proposed duty	% of value	Tax reduction
R 500,000	R 20,600	4.1%	R 0	0.0%	R 20,600
R 550,000	R 24,600	4.5%	R 2,500	0.5%	R 22,100
R 600,000	R 28,600	4.8%	R 5,000	0.8%	R 23,600
R 650,000	R 32,600	5.0%	R 7,500	1.2%	R 25,100
R 700,000	R 36,600	5.2%	R 10,000	1.4%	R 26,600
R 800,000	R 44,600	5.6%	R 15,000	1.9%	R 29,600
R 1,000,000	R 60,600	6.1%	R 25,000	2.5%	R 35,600
R 1,500,000	R 100,600	6.7%	R 65,000	4.3%	R 35,600

## Stamp duties

It is proposed to increase the threshold exemption for stamp duties on leases from R200 to R500 per agreement from 1 March 2006, reducing the compliance burden for taxpayers entering into lower-value rental agreements, and the administrative burden on SARS.

## Individual monetary thresholds

The tax system contains a number of monetary thresholds that have not been changed for some time. Some of these thresholds are adjusted upwards to take into account the effects of inflation.

It is proposed that the annual donations tax exemption be increased from R30 000 to R50 000 and the estate duty exemption be increased from R1,5 million to R2,5 million, effective from 1 March 2006.

## Capital gains tax

The following proposals are made for tax years commencing on or after 1 March 2006:

- The annual capital gain/loss exclusion will increase from R10 000 to R12 500
- The primary residence exclusion will increase from R1 million to R1,5 million
- The exclusion on death will increase from R50 000 to R60 000.

## Motor vehicle allowances

As announced in the 2005 Budget, the deemed private kilometres (i.e. the number of kilometres assumed to have been driven for private use) for individuals who receive motor vehicle allowances will be increased to 18 000 per year, and the monthly taxable fringe benefit of a company car will be increased to 2,5 per cent of the determined value of the vehicle, effective from 1 March 2006. To ensure that the correct amount of income tax is collected through the PAYE system during the year, the percentage of the monthly motor vehicle allowances subject to tax will be increased from 50 per cent to 60 per cent from 1 March 2006. A new cost table will be published.

## MEDICAL SCHEME CONTRIBUTIONS AND MEDICAL EXPENSES

A revised tax regime for medical scheme contributions and other medical expenses was announced in the 2005 Budget. The purpose of this new regime is to shift the tax benefits in favour of middle and lower-income earners. This new regime introduces monthly monetary caps for tax-free medical scheme contributions (with the caps to be adjusted annually) and increases the threshold for individual tax-deductible medical expenses from 5 to 7,5 per cent of income. Taxpayers 65 years and older will continue to enjoy a full deduction for all medical expenses. These changes take effect on 1 March 2006.

## PROMOTING RETIREMENT SAVINGS

Proposals developed in the course of 2005 represent significant progress in the retirement fund regulatory reform process. To help South Africans accumulate adequate savings for retirement, and taking into account the stabilisation of interest rates at lower levels, the tax on retirement funds will be reduced from 18 per cent to 9 per cent from 1 March 2006 at an estimated cost of R2,4 billion.

This reduction will be accompanied by regulatory reforms in areas such as cost disclosure, commission structure and fund governance. The National Treasury will issue a discussion paper on proposed regulatory and tax reforms. These reforms will aim to ensure that the benefits of the lower tax rate are passed on to retirement fund members in the form of improved returns, and that retirement savings are not depleted by excessive charges and penalties. Further information is provided in a box on developments in the retirement savings industry in Chapter 2 of the 2006 Budget Review.

## RELIEF FOR BUSINESS

### RSC levy reform

By eliminating the RSC levies from 30 June 2006, the 2006 Budget provides significant direct tax relief to business, amounting to R7 billion for 2006/07 and totalling R24 billion over the MTEF period. The administrative burden will be significantly lowered for all businesses, as RSC levies required monthly submissions. Since one of the levies is imposed on payroll, its removal will effectively lower the costs of job creation.

### Small business

Small businesses play a valuable role in stimulating economic activity, job creation, poverty alleviation and broadening development. In addition to the benefits of removing the burden

of the RSC levies, government has made considerable efforts to improve the economic environment for small business. Following the tax stimulus measures introduced in the 2005 Budget, the monetary tax thresholds for small business will be adjusted as follows:

- For small business corporations, the following amendments will come into effect for tax years ending on or after 1 April 2006:
  - Firms with an annual turnover of up to R14 million (increased from a level of R6 million) will qualify for the special graduated corporate tax regime
  - The taxable income threshold for the reduced corporate tax rate of 10 per cent will be increased from R250 000 to R300 000
  - The small business income tax exemption threshold will be increased from R35 000 to R40 000.
- The one-time capital gains tax relief for small business will increase from R500 000 to R750 000 with effect from tax years commencing on or after 1 March 2006.
- Immediate 100 per cent depreciation exists for individual small items purchased for business purposes. This threshold will increase from R2 000 to R5 000 for assets purchased on or after 1 March 2006.
- The VAT threshold for both small farmers (Category D) and small business four-monthly filers (Category F) will increase from R1 million to R1,2 million for tax periods commencing on or after 1 July 2006.

It is estimated that these changes will cost R400 million.

In addition, the “small business corporation” and “deemed employee” definitions that affect some small businesses will be amended.

## TAX AMNESTY FOR SMALL BUSINESS

Although small businesses play a valuable economic and developmental role, many were historically marginalised. They were excluded from the economic mainstream, operated informally and remained outside the tax system. A growing understanding of the economic benefits of a more formal approach to doing business, of why it is necessary to pay tax, of the tax system's requirements, and of the risks of non-compliance have now led to greater willingness to enter the tax system.

An obstacle to becoming tax compliant faced by these small businesses is the fear of the consequences of past non-compliance, which include possible liability for additional tax, interest and prosecution. This fear makes the decision to enter the tax system a difficult one. Government is therefore proposing a tax amnesty to ensure that small businesses can overcome this obstacle.

The proposed amnesty will allow SARS to waive taxes due by small businesses for years of assessment ending on or before 31 March 2004, where the turnover for the 2005 year of assessment does not exceed R5 million. This waiver will require submission of an income tax return for 2005 as well as a non-disclosure penalty of 10 per cent based on taxable income for 2005. It will not be available to taxpayers who have already disclosed the amounts concerned, or who have been formally notified that they are under investigation before applying for amnesty. It is also proposed to waive penalties, additional taxes and interest on the underlying taxes due.

A two-phase approach is proposed, with the first phase of the amnesty focused on the taxi industry, since access to the taxi recapitalisation programme is dependent on tax compliance. The first phase of the amnesty will take effect on 1 August 2006 and will be open until 31 May 2007. The second phase of the amnesty for other small businesses will take effect later in the year. Small businesses that do not take advantage of this opportunity to enter the tax system voluntarily will be the subject of SARS enforcement activities and subject to additional tax, interest and prosecution.

## REVISED COOPERATIVE TAXATION

In view of the Cooperatives Act (2005), the tax dispensation will be adjusted. Amendments will also provide cooperatives that operate like small business corporations with the same level of benefits enjoyed by those companies.

## STIMULATING INVESTMENT AND ECONOMIC GROWTH

### Incentives for oil and gas

South Africa has a long history of special oil and gas contracts known as OP 26 leases with private companies. These leases include tax and other incentives to facilitate oil and gas exploration. With the OP 26 leases about to expire, certain tax incentives need to be renewed. These incentives will be renewed in legislation, which is a more transparent method of granting exemptions. Proposed amendments will include the removal of the 40 per cent discretionary surcharge on oil and gas profits, and accelerated depreciation for drilling.

### Review of revenue versus capital distinction

The disposal of assets (including shares) at a gain generally triggers a tax, either as ordinary revenue or capital gains, depending on whether the asset is purchased with the intent to resell. This question of intent is largely governed by judicial decision. However, an exception in the Income Tax Act (1962) allows taxpayers to elect capital treatment for the sale of listed shares held for at least five years. Evidence suggests that the current test

creates uneven results, especially for the ownership of shares. A review of the revenue versus capital distinction will begin in 2006.

## Incentives for intellectual capital and training

### Extension and increase of the learnership allowance

In 2002, government introduced the learnership tax allowance to encourage on-the-job training and to enhance skills development. This allowance, set to expire in October 2006, has boosted the number of learnerships. In support of the extension of the National Skills Development Strategy, it is proposed that this allowance be extended to October 2011. The maximum initial allowances will increase from R17 500 to R20 000 per year for existing employees and from R25 000 to R30 000 for new employees. Similarly, the maximum allowance upon the completion of the learnership will increase from R25 000 to R30 000 for agreements entered into from 1 March 2006, at an estimated cost of R80 million. Consideration will be given to increasing the allowance for business process outsourcing.

Given the additional expenses associated with employing disabled persons as learners, a more favourable allowance will be introduced effective 1 July 2006. An employer will be allowed to deduct an initial allowance of 150 per cent of the annual salary of an existing learner with a disability, up to a maximum of R40 000; and 175 per cent for an unemployed learner with a disability, up to a maximum of R50 000. The tax allowance for disabled persons completing a learnership will be 175 per cent of the employee's annual salary, up to a maximum of R50 000.

### Enhancement of scholarships and bursaries

Employee scholarships and bursaries are tax-exempt, unless viewed as being *in lieu* of salary compensation. The need to draw such a distinction creates unnecessary difficulties in application. To simplify matters, bursaries and scholarships for current and future employees will be tax-exempt as long as the employer's funds go directly to tuition and tuition-related expenses, and the employee agrees to repay the employer if the employee fails to fulfil their scholarship or bursary obligations. This proposal will take effect from 1 March 2007.

### Enhancement of research and development

To encourage businesses to increase investment in R&D, the deduction for current R&D expenditure will be increased from 100 per cent to 150 per cent. In addition, the depreciation allowance for capital expenditure will be increased from the current 40:20:20:20 to 50:30:20. Some modification of the R&D definition may be required as part of these amendments.

## INTERGOVERNMENTAL COORDINATION

### Strengthening the financial position of municipalities

#### Zero-rating of municipal property rates

It is proposed to zero-rate municipal property rates for VAT purposes for tax periods commencing on or after 1 July 2006. This will result in a loss of revenue to the fiscus and additional revenue of approximately R1 billion for category A and B municipalities for the municipal fiscal year 2006/07. This proposal will also help to simplify municipalities' accounting and tax records.

#### Income tax treatment of parastatals and municipalities

The tax system lacks a uniform framework for parastatals, municipalities and municipal entities. Taxable versus tax-exempt status is often dealt with on a case-by-case basis. In view of these shortcomings, the income tax status of these entities will be realigned in 2006 or 2007. An immediate issue to be considered is the income tax status of industrial development zone management companies and regional electricity distributors, both of which are central to key government initiatives.

#### VAT treatment of appropriations and grants

Government is completing its three-year effort to clarify the VAT treatment of appropriations and grants at the national level. The next step in this process is to provide greater clarity at the municipal level. Attention will focus on grants by national and provincial governments to municipalities, and on grants by municipalities to municipal entities. As a general rule, grants to municipalities should be zero-rated, with some exceptions (e.g. public bus transportation). Some of these changes may be retroactive to eliminate VAT assessments already raised.

### Diamond export levy

A proposed diamond export levy aims to reinforce regulatory measures to ensure an adequate supply of rough diamonds for the local market, thereby promoting domestic beneficiation. The levy will be designed to provide credits for local sales that would act as an offset in the determination of the export levy.

### Synthetic fuels

The synthetic fuel industry accounts for about 35 per cent of domestic liquid petroleum sales. This industry developed with extensive government support. From 1979 to 1995, the Equalisation Fund, created under the Central Energy Fund Act (1977), gave tariff protection to the industry (Sasol and Mossgas, which is now PetroSA). Funds were collected from motorists using the fuel levy to compensate the industry in times of low oil

prices. According to an agreement with the previous government, when the oil price rose above US\$28,50 a barrel, Sasol paid 25 per cent of revenues over that level into the Equalisation Fund. This was effective until 1995.

Given the price determination process (import parity pricing and partial regulation), the industry is in a position to reap substantial economic rents when crude oil prices are high. Such windfall gains should be shared with the public. A task force will accordingly be appointed to examine this issue for possible legislative resolution.

### Mining and other environmental rehabilitation funds

Rehabilitation funds address long-term environmental concerns and aim to ensure that adequate environmental protection is maintained when a business closes. Tax relief is granted to mining enterprises that make financial provision for rehabilitation in the form of trust funds. This relief entails a deduction for reserves as well as the tax-free build-up of those reserves. Government has received requests from the industry to consider the use of insurance products to facilitate rehabilitation of defunct mines. To provide the industry with greater flexibility, the current income tax exemption for mining rehabilitation trusts will be extended to insurance products and other instruments dedicated solely to rehabilitation funding.

Legal changes are expected that will extend environmental rehabilitation requirements to sectors other than mining. The current tax incentive for rehabilitation will be extended as required.

## CONSUMPTION TAXES

### Excise duties: alcoholic beverages

Excise duties on sparkling wine, unfortified wine, fortified wine, malt beer, alcoholic fruit beverages and spirits increase by 20 per cent, 12,5 per cent, 9,4 per cent, 9 per cent, 9 per cent and 9,5 per cent respectively with immediate effect. These adjustments are expected to raise about R725 million in additional revenue, and are in accordance with the policy decision to maintain a total tax burden (excise duties plus VAT) of 23, 33 and 43 per cent on wine products, malt beer and spirits respectively. No increase in the excise duty on traditional beer is proposed.

### Excise duties: tobacco products

The excise duties on cigarettes, cigarette tobacco, pipe tobacco and cigars will increase by 10,2 per cent, 4,7 per cent, 8,3 per cent and 4,8 per cent respectively with immediate effect and are expected to raise about R645 million in additional revenue. These increases



are in line with the policy decision to maintain a total tax burden (excise duties plus VAT) of 52 per cent on all categories of tobacco products.

Given that cigars are significantly more expensive than other categories of tobacco products, the total tax burden on cigars as a percentage of the retail-selling price will be reviewed. The method of calculating the total tax burden on cigarette tobacco will also be reviewed.

### Changes in specific excise duties - 2006/07

Product	Current excise duty rate	Proposed excise duty rate	Change in excise duty	
			Nominal	Real
Malt beer	R33,65 / litre of absolute alcohol (57,20c / average 340ml can)	R36,68 / litre of absolute alcohol (62,35c / average 340ml can)	9.0%	4.8%
Traditional African beer	7,82c / litre	7,82c / litre	0.0%	-4.2%
Traditional African beer powder	34,7c / kg	34,7c / kg	0.0%	-4.2%
Unfortified wine	140,52c / litre	158,09c / litre	12.5%	8.3%
Fortified wine	263,14c / litre	287,88c / litre	9.4%	5.2%
Sparkling wine	387,99c / litre	465,58c / litre	20.0%	15.8%
Ciders and alcoholic fruit beverages	168,24c / litre (57,20c / average 340 ml can)	183,38c / litre (62,35c / average 340 ml can)	9.0%	4.8%
Spirits	R50,42 / litre of absolute alcohol (R16,26c / average 750ml bottle)	R55,21 / litre of absolute alcohol (R17,80 / average 750ml bottle)	9.5%	5.3%
Cigarettes	504,44c / 20 cigarettes	556,08c / 20 cigarettes	10.2%	6.0%
Cigarette tobacco	747,30c / 50g	782,47c / 50g	4.7%	0.5%
Pipe tobacco	190,60c / 25g	260,55c / 25g	8.3%	4.1%
Cigars	R32,59 / 23g	R34,16 / 23g	4.8%	0.6%

## Specific excise duties

It is proposed that the customs and excise duties in Section A of Part 2 of Schedule No.1 of the Customs and Excise Act, No. 91 of 1964, be amended with effect from 15 February 2006 to the extent shown below:

Tariff item	Tariff heading	Description	Present rate of duty 2005/06		Proposed rate of duty 2006/07	
			Excise	Customs	Excise	Customs
104.00		Prepared foodstuffs; beverages, spirits and vinegar; tobacco				
104.01	19.01	Malt extract; food preparations of flour, groats, meal starch or malt extract, not containing cocoa or containing less than 40 per cent by mass of cocoa calculated on a totally defatted basis, not elsewhere specified or included; food preparations of goods of headings 04.01 to 04.04, not containing cocoa or containing less than 5 per cent by mass of cocoa calculated on a totally defatted basis not elsewhere specified or included not elsewhere specified or included:				
.10		Traditional African beer powder as defined in Additional Note 1 to Chapter 19	34.7 c/kg	34.7 c/kg	34.7 c/kg	34.7 c/kg
104.10	22.03	Beer made from malt				
.10		Traditional African beer as defined in Additional Note 1 to Chapter 22	7.82 c/l	7.82 c/l	7.82 c/l	7.82 c/l
.20		Other	3 364.98 c/l of absolute alcohol	3 364.98 c/l of absolute alcohol	3 667.82 c/l of absolute alcohol	3 667.82 c/l of absolute alcohol
104.15	22.04	Wine of fresh grapes, including fortified wines; grape must, other than that of heading no. 20.09				
	22.05	Vermouths and other wine of fresh grapes flavoured with plants or aromatic substances				
.02		Sparkling wine	387.99 c/l	387.99 c/l	465.58 c/l	465.58 c/l
.04		Unfortified wine	140.52 c/l	1140.52 c/l	158.09 c/l	158.09 c/l
.06		Fortified wine	263.14 c/l	263.14 c/l	287.88 c/l	287.88 c/l
104.17	22.06	Other fermented beverages, (for example, cider, perry and mead); mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages, not elsewhere specified or included:				
.05		Traditional African beer as defined in Additional Note 1 to Chapter 22	7.82 c/l	7.82 c/l	7.82 c/l	7.82 c/l
.15		Other fermented beverages, unfortified	168.24 c/l	168.24 c/l	183.38 c/l	183.38 c/l
.17		Other fermented beverages, fortified	333.65 c/l	333.65 c/l	365.35 c/l	365.35 c/l
.22		Mixtures of fermented beverages and mixtures of fermented beverages and non-alcoholic beverages	168.24 c/l	168.24 c/l	183.38 c/l	183.38 c/l
.90		Other	333.65 c/l	333.65 c/l	365.35 c/l	365.35 c/l
104.20	22.07	Undenatured ethyl alcohol of an alcoholic strength by volume of 80 per cent volume or higher; ethyl alcohol and other spirits, denatured, of any strength				
	22.08	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 per cent volume; spirits, liqueurs and other spirituous beverages:				
.10		Wine spirits, manufactured by the distillation of wine	5 042.01 c/l of absolute alcohol	4 945.88 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol

Tariff item	Tariff heading	Description	Present rate of duty 2005/06		Proposed rate of duty 2006/07	
			Excise	Customs	Excise	Customs
.15		Spirits, manufactured by the distillation of any sugar cane product	5 042.01 c/l of absolute alcohol	5 028.11 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.25		Spirits, manufactured by the distillation of any grain product	5 042.01 c/l of absolute alcohol	4 996.01 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.29		Other spirits	5 042.01 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
.40		Liqueurs and other spirituous beverages	5 042.01 c/l of absolute alcohol	5 042.01 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol	5 521.00 c/l of absolute alcohol
104.30	24.02	Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes				
.10		Cigars, cheroots, and cigarillos, of tobacco or of tobacco substitutes	141 676.55 c/kg net	141 676.55 c/kg net	148 515.70 c/kg net	148 515.70 c/kg net
.20		Cigarettes, of tobacco or of tobacco substitutes	252.22 c/10 cigarettes	252.22 c/10 cigarettes	278.04 c/10 cigarettes	278.04 c/10 cigarettes
104.35	24.03	Other manufactured tobacco and manufactured tobacco substitutes; "homogenised" or "reconstituted" tobacco; tobacco extracts and essences:				
.10		Cigarette tobacco and substitutes thereof	14 946.05 c/kg	14 946.05c/kg	15 649.41 c/kg	15 649.41 c/kg
.20		Pipe tobacco and substitutes thereof	7 624.01 c/kg net	7 624.01 c/kg net	8 261.93 c/kg net	8 261.93 c/kg net

## Ad valorem excise duties

A number of products on the list of items subject to ad valorem excise duties no longer exist or generate very little revenue. In the case of some items, such as fax machines, the tax is no longer appropriate. It is proposed to abolish duties by deleting the relevant sections in Section B of Part 2 of Schedule No.1 of the Customs and Excise Act, No. 91 of 1964 with effect from 1 April 2006 to the extent shown below.

## Ad valorem excise duties to be abolished

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

## Fuel taxes

### General fuel levy

Over the past several years government has limited increases in the general fuel levy to a level at or below the expected annual inflation rate. Considering the revenue overrun in 2005/06 and the impact of higher world oil prices on the local prices of petrol and diesel, no increase in the general fuel levy is proposed for 2006/07.

## Road Accident Fund levy

The value of claims lodged with the Road Accident Fund (RAF) increased significantly in recent years, mostly as a result of an increase in the number of car accidents. The RAF Amendment Act will limit claims for future loss of income and general damages to reduce the fund's exposure in the future, but the anticipated savings will not be realised until 2007/08.

The RAF fuel levy is to increase by 5 cents per litre effective 5 April 2006 to allow the fund to settle its expected road accident claims for 2006/07, while savings resulting from the legislative amendments will allow it to reduce its claims backlog over time.

## Total combined fuel levy on leaded petrol and diesel

	2004/05		2005/06		2006/07	
	93 Octane petrol	Diesel	93 Octane petrol	Diesel	93 Octane petrol	Diesel
General fuel levy	111.0	95.0	116.0	100.0	116.0	100.0
Road Accident Fund levy	26.5	26.5	31.5	31.5	36.5	36.5
Customs and Excise levy	4.0	4.0	4.0	4.0	4.0	4.0
Equalization Fund levy	–	–	–	–	–	–
Illuminating Paraffin marker	–	0.2	–	0.2	–	0.2
<b>Total</b>	<b>141.5</b>	<b>125.7</b>	<b>151.5</b>	<b>135.7</b>	<b>156.5</b>	<b>140.7</b>
Pump price: Gauteng (as in February) <sup>1</sup>	408.0	347.5	420.0	384.5	550.0	517.8
Taxes as % of pump price	34.7%	36.2%	36.1%	35.3%	28.5%	27.2%

1. Diesel (0,05% sulphur) wholesale price (retail price not regulated).

## Biodiesel fuel tax rebate

As announced in 2002, biodiesel will in future be classified as a fuel levy good, making it zero-rated for VAT and subject to fuel taxes. However, the original proposed rebate of 30 per cent on the general fuel levy was based on the limited information about production costs available in 2002. A review of international practice indicates that to support the industry the rebate should be set at 40 per cent of the general fuel levy. Given the emerging character of the industry, this is expected to have a limited effect on the fiscus.

## Extension of diesel refund scheme to peak power generation

In response to capacity constraints in electricity generation, four diesel-powered electricity generation plants are planned. Eskom will build two plants, and two independent power producers will build the others. Diesel power plants with a capacity of more than 200 MW will receive a full refund of the general fuel levy and the RAF levy.

## POLICY COHERENCE: REMOVAL OF ANOMALIES

### Public benefit organisations

Since 2001, government has continued to adjust tax rules for public benefit organisations (PBOs). Further proposed adjustments include:

- Refining the list of tax-exempt PBO activities
- Exempting foreign PBOs operating in South Africa
- Extending deductible donation status for PBOs committed to “Conservation, Environment & Animal Welfare”
- The alignment of the statutory tax rates for the taxable trading activities of all PBOs irrespective of their legal form
- Relaxing the rules for permissible investments
- Streamlining the dual registration process.

### South African organisations receiving developmental assistance

Some South African organisations receive development assistance pursuant to international agreements under which their management is accountable to government. International organisations offering such assistance often seek to ensure that aspects of these assistance packages remain tax-exempt. Although the National Treasury is part of the overall process, the Minister of Finance does not have the legislative authority to grant full or partial income tax exemption in these cases. This legislative weakness will be corrected.

### Recreational clubs

Recreational clubs operating for the benefit of their members are tax-exempt and subject to few restrictions. Some clubs appear to be claiming exemption irrespective of whether their amenities are used by the general public or by their members. Furthermore, some clubs are starting to conduct more trading activities to raise funds beyond membership contributions. As a result, the taxation of recreational clubs will be reviewed.

### VAT place of supply

The VAT treatment of internationally traded services presents challenges to tax authorities worldwide. Government seeks to provide greater clarity in this area, especially for telecommunications. Due consideration will be given to the current work of the OECD concerning VAT treatment of internationally traded services.

## MEASURES TO ENHANCE TAX ADMINISTRATION

### Corporate income tax

SARS plans to modernise the corporate income tax administrative system. A move to a full self-assessment system, which will provide faster turnaround times and greater certainty, is being explored. The system would be reliant on a number of building blocks, including greater reliance on taxpayer integrity, an advance rulings system to resolve cases of doubt, more clearly defined disclosure requirements, a shift from returns to be assessed to returns of tax owing, e-filing, more consistent interest charges, enhanced risk identification, and well-defined penalty systems for non-disclosure and under-declarations of income.

The advance tax ruling system will be brought into operation on a phased basis starting in 2006. A managed pilot programme of e-filing for large company income tax returns will also commence. Amendments will be proposed to align the provisional tax system for all taxpayers more closely with current incomes, rather than historical “basic amounts” for years of assessment commencing on or after 1 March 2007.

Provisions relating to interest paid and received will be reviewed to remove discretions and the inconsistent bases of calculation. The current STC dividend cycle system will be reviewed and additional guidance with regard to penalties to be imposed for non-disclosure and under-declaration of income will be issued.

### General anti-avoidance rule

Government received various comments in response to the discussion paper on the general anti-avoidance rule released by SARS in November 2005. These comments will be evaluated before legislation is finalised in the latter half of 2006.

### Personal income tax

The record 3,7 million individual income tax returns filed in 2005 is evidence of a growing culture of tax compliance. To help individuals file their returns and to speed up processing, some eFiling for individual income tax returns will be introduced by June 2006. SARS will select employers who provide employees' tax information electronically and will make eFiling available to those employers for employees who earn only a basic salary or wage.

The introduction of e-filing for individuals will be accompanied by the matching of information from third parties, such as employers, against information provided in returns.

## COMPLETION OF EXCHANGE CONTROL AND TAX AMNESTY ADJUDICATION PROCESS

The amnesty unit has completed the adjudication of all applications received since the announcement of the exchange control and tax amnesty by the Minister of Finance on 26 February 2003.

The amnesty gave South Africans an opportunity to voluntarily declare their offshore assets and to regularise their foreign asset holdings and tax affairs without fear of criminal or civil prosecution. Regularisation entailed the payment of a 10 per cent levy if the foreign assets were kept offshore, or 5 per cent if the assets were repatriated to South Africa. An additional 2 per cent levy was payable for violating certain domestic tax laws. The closing date for applications was extended to 29 February 2004. The Reserve Bank also issued regulations to deal with various challenges and concerns presented by certain complex offshore structures.

The amnesty unit has adjudicated all of the 42 672 applications (after allowing for 456 duplicates) it received since the announcement of the amnesty nearly three years ago. Of this number, 42 184 applications were approved; 924 applications of the total received applications (43 128 including duplicates) were withdrawn, deleted or voided; and 20 applications were declined. The amnesty process has raised R2,9 billion in levies.

When the amnesty process was announced in 2003, it had four objectives: (i) to broaden the tax base and increase future revenue collection through disclosure of assets (both legal and illegal); (ii) to enable South Africans to regularise their affairs without being prosecuted; (iii) to provide the South African Revenue Service (SARS) and the Reserve Bank with details of foreign assets; (iv) and to facilitate repatriation of foreign assets to South Africa, without fear of recrimination.

The amnesty process has successfully achieved all these objectives. A total of R68,6 billion worth of foreign assets have been disclosed under the amnesty process. Approximately 70% of these disclosed assets were illegal, while an approximate 30 per cent were legal or legalised through the Reserve Bank. It is estimated that the income tax base has been increased by an estimated R1,4 billion, which is likely to increase the collection of personal income taxes by an estimated R400 million per annum. SARS and the Reserve Bank will also be able to fully update their records on the basis of the information disclosed.

All the approved applications will be sanitised and submitted to SARS and the Reserve Bank with highly restricted access. Unsuccessful applications will be retained at the

National Treasury with the necessary security. These procedures will ensure that the objective of having enabled South Africans to regularise their affairs without fear of prosecution or recrimination is fully safeguarded.

Lastly, the R2,9 billion of revenue raised through the levies is a further indication of the success of the amnesty process, and will be used for social development and community infrastructure.

## MISCELLANEOUS AMENDMENTS

In addition to the aforementioned proposals, the 2006 legislation will contain miscellaneous amendments to the various tax acts. These amendments stem from problems identified in the current legislation as detected over the course of the year through internal review and public comments. Some of these amendments eliminate perceived loopholes while others ensure that tax legislation does not inadvertently hinder legitimate non-tax motivated transactions. These amendments are expected to have a limited impact on revenue for the fiscus.

### Income Tax Act (1962)

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

#### Proposed changes - Individuals

- *Foreign inherited assets*: No rules exist for determining the base cost of foreign-located assets received as an inheritance from a foreign estate. Foreign assets received in this manner should generally enter the South African tax jurisdiction at market value.
- *Fringe benefit taxation of employee-residential accommodation*: Employees receiving free or discounted residential accommodation are subject to fringe benefit taxation. This form of fringe benefit taxation is based on a formula, which is partly based on prior-year salary less R20 000. The R20 000 amount will be doubled to R40 000.
- *Travel benefits for employees engaged in the transport business*: Cross-border travel benefits up to R500 for transport business employees are not subject to fringe benefit taxation. This R500 monetary cap rule will be deleted as obsolete.
- *Bursaries for employee relatives*: Under current law, low-income employees can receive an annual tax-free bursary of up to R2 000 for their relatives. It is questionable whether this form of bursary operates as an effective means for subsidising lower-income education, thereby requiring reconsideration or adjustment.



- *Subsistence expenditure for foreign travel:* Employees who travel abroad on business may receive a subsistence allowance to cover meals and incidental expenses. In order to reduce record keeping in calculating the taxable portion of the allowance, provision is made for an amount which is deemed to have been spent for each day during which the employee is away from his or her usual place of residence. This amount is not a fair reflection of the actual expenses likely to be incurred in all countries, especially neighbouring countries. Consideration will be given to fixing amounts per country that are more closely aligned with the actual costs likely to be incurred for the 2006/07 tax year.

### Proposed changes - Business

- *Vesting of amounts by trust:* Depreciable assets are subject to potential capital gain treatment and recoupment of the prior depreciation benefit when sold. However, some have argued that the current rules create a possible mismatch between the granting of depreciation and recoupment on disposal by a trust. This potential anomaly will be rectified.
- *Collective investment scheme unit/share buy-backs:* The tax system treats certain gains as a dividend when a company enters into a buy-back of its own shares. While this tax principle is fundamentally sound for standard companies, dividend treatment could under certain circumstances be inappropriate with respect to collective investment schemes (i.e. deemed companies for tax purposes). It is proposed that dividend treatment be clarified by way of legislative amendment or interpretation.
- *Dividend-interest swaps involving collective investment schemes:* The act contains anti-avoidance rules to prevent the swap of tax-free dividends and other taxable income. It has come to the attention of SARS that certain collective investment schemes are designing yet another set of arrangements that allow for the conversion of taxable income in favour of tax-free dividends for investors. Legislation will be proposed to ensure that the current anti-avoidance rules effectively encompass these arrangements.
- *Grant funds used to purchase depreciable property:* In 2005, Government enacted a regulatory framework for exempting Government grants from income tax. At issue is the next step - the use of tax-free Government grants. Proposed legislation will address the entitlement to depreciation for depreciable assets acquired with tax-free grants.
- *Instalment sales involving mining property:* Taxpayers disposing of mining property must treat the disposal as occurring at an "effective value" determined by the Department of Minerals and Energy. It is uncertain how this rule applies when the consideration received on sale is payable in instalments that cannot be quantified with any real certainty (e.g. dependent on future profits), especially in light of the new rules that defer taxation of unquantifiable payments. This uncertainty will be clarified.
- *Leasehold improvements:* The deductibility of leasehold improvements on Government land was previously addressed in the context of public-private partnerships. This issue is now creating difficulties in terms of other Government-sponsored projects, thereby requiring remedial legislation.

- *Artificial repurchase transactions:* Repurchase schemes have been identified that attempt to deduct amounts that economically represent loan capital. These schemes are based on the spurious argument that the payments at issue are “manufactured interest” (as opposed to interest) and that a rule against double deduction or inclusion exists only for the latter (although both are taken into account in determining the accrual of interest). It is accordingly proposed that the tax rules for repurchase schemes be revisited to eliminate any of these arguments.
- *SETA grants:* Under present law, taxpayers are arguably eligible for a double tax benefit under the SETA regime. While taxpayers should be able to deduct the initial payment for SETA participation, payout of the SETA funds to a taxpayer should be a tax-neutral event (be included as income when the payout is received, and amounts incurred in respect of employee training should be deductible). This potential anomaly will be rectified.
- *Removal of allowance for general employee housing:* The act has historically allowed for special depreciation allowances for employee housing. While a case can be made for the continued use of employee housing allowances in terms of mining and farming employees, special depreciation allowances for other forms of employee housing should be deleted to the extent these allowances are no longer of practical use.
- *Company formations:* A taxpayer that disposes of shares shortly after receiving those shares in a tax-free company formation may be forced to treat the gain on those shares as ordinary revenue if the taxpayer transferred mainly ordinary revenue assets to the company pursuant to the tax-free company formation. While this treatment is designed to prevent taxpayers from artificially converting ordinary revenue assets into capital shares, the level of gain triggered on the disposal of the shares may be excessive given the overall construct of the corporate reorganisation regime. It is proposed that this gain be limited to the gain existing at the time of company formation.
- *Share-for-share acquisitions:* Share-for-share company acquisitions can be tax-free under certain conditions. One condition is that the acquiring company must obtain meaningful ownership over the target company’s shares. In the case of listed target companies, this acquisition of meaningful ownership can occur over 90 days, whereas unlisted companies must satisfy this level of ownership on the day of acquisition. It is proposed that the 90-day period should be made available for unlisted company acquisitions as well.
- *Reduction of base cost to prevent double benefits:* Taxpayers generally receive base cost for expenditure incurred with respect to an asset unless that expenditure was already accounted for (e.g. already deducted). This exception properly prevents any double counting for expenditure incurred. However, it appears that this rule against double counting applies even if the prior benefit was denied (e.g. as reduction of assessed loss upon creditor cancellation of debt). This anomaly will be rectified.
- *Denial of double deductions:* Taxpayers cannot claim double deductions for the same underlying expenditure or loss. It is argued by some that this rule against double deductions does not apply if the deductions claimed occur in different years. The law will accordingly be clarified to the extent necessary.

- *Recouplings for dividends and donations:* Disposals of depreciable assets trigger recoupment, including the disposal of these assets by way of a dividend or donation. However, in the case of a dividend or donation, the rules often do not trigger appropriate results. For instance, the recoupment equals the market value of the asset donated or distributed, not just the portion representing prior depreciation. Transfers for consideration below market value should also be treated as donations to the extent of the discount, even if not viewed as donations under case law.
- *Foreign companies and the "connected person" test:* The act contains a number of anti-avoidance rules to prevent schemes between connected persons. In some circumstances, the term "connected person" arguably is only determined with reference to domestic companies. This situation will be corrected.

### Changes dependent upon available facts - Individuals

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

### Changes dependent upon available facts - Business

- *Post-retirement medical coverage:* Many employers provide post-retirement medical coverage to former employees that must be fully reflected for financial reporting purposes as a future financial liability. Corporations are accordingly exploring options that will limit this impact. The viability of some options may require regulatory and ancillary tax changes.
- *Controlled foreign companies (CFCs):* In 1997, Government enacted the CFC regime for South African-controlled foreign companies as a necessary adjunct to the relaxation of exchange controls, and expanded it with the move to worldwide taxation for South

African residents. These rules require a careful balance between capital export neutrality (i.e. equal tax treatment for all South African-owned operations) and the opposing need for international competitiveness. While a number of adjustments have already taken place since the introduction of the CFC regime to account for practical realities, it appears that some anomalies remain. Any changes envisioned will not deviate from the core philosophy of the CFC rules developed over the past few years. The list of issues requiring possible further examination includes:

- Treatment of certain CFC mobile businesses as qualifying business establishments
  - Treatment of royalties that are central to core active CFC business operations
  - Offshore business operations that are subject to the CFC diversionary rules even though the CFC's activities represent no threat to the South African tax base
  - Taxation of a CFC business operating in multiple countries within a single economic market
  - Clarification of the "country of residence" concept.
- *CFC currency anomaly*: A longstanding policy position has been taken to tax liquid portfolio currency gains regardless of whether those gains exist in the hands of a South African resident or a CFC. It appears that a technical problem may exist that prevents this desired taxation of CFC liquid portfolio currency gains. This technical problem will be corrected as necessary.
  - *Financial instrument holding companies*: Preferential tax treatment is unavailable for the restructuring of companies owning mainly financial instruments. For purposes of this test, financial instruments with a tax cost equal to market value are ignored because these assets do not contain any built-in gain or loss that could benefit from the preferential tax treatment of the company restructuring rules. Concerns have been raised that other financial instruments posing little threat to the fiscus count against a tax preferred company restructuring.
  - *Cross-issues*: If a company issues shares in exchange for assets, the company is not subject to capital gains tax and normally obtains a base cost in the assets received equal to their market value. However, current law specifically provides for a zero base cost result if two companies issue their own shares in exchange for one another. A similar zero base cost result exists for debt. While sound reasons exist for the zero base cost approach, some have questioned whether this approach is too rigid, especially given the need for cross-issues as a means of satisfying other Government regulatory requirements.
  - *Minority shares*: Share-for-share transactions, amalgamations and other company acquisitions sometimes create situations in which minority shareholders are forced to exchange their shares. This forced exchange may trigger tax if the minority shareholders fail to satisfy certain technical requirements (i.e. the requirement to hold a 20 per cent share interest in the acquiring company). Consideration will be given to relaxing these requirements in limited circumstances, depending in part on whether this relaxation can be achieved without violating the integrity of the overall corporate restructuring regime.

- *Capital gains tax implementation date issues:* Problems may continue to arise around the 1 October implementation date for calculating capital gains and losses. As in prior years, these issues will be addressed based on the strength of the underlying facts presented.
- *Secondary tax on companies (STC) anti-avoidance:* Corporate distributions to shareholders are subject to a 12,5 per cent STC charge when those distributions represent underlying profits. Corporate distributions that fail to represent profits can be distributed free of STC. In 2005, Government identified schemes seeking to avoid the STC by artificially separating distributions from profits. This separation typically was achieved through the corporate restructuring rules, especially the rules allowing for the tax-free transfer of assets within a group of companies. These schemes were most acute in terms of distributions involving foreign shares that also benefited from the participation exemption from the capital gains tax. While Government sought to close the latter set of schemes, additional legislation may be required to overcome further attempts to circumvent the STC. Otherwise, more comprehensive changes to the STC will be held back until finalisation of corporate law reform undertaken by the Department of Trade and Industry.
- *Subsidiary distributions of parent company shares:* In 2005, Government introduced a rule to neutralise transactions that sought to avoid STC by having a subsidiary distribute the shares of its parent company as a dividend. It appears that this anti-avoidance rule did not cover all eventualities, thereby requiring further possible legislation.

## Value-Added Tax Act (1991)

- *Credits for excess consideration:* Taxpayers fail to account for VAT on amounts received that are in excess of invoice value. Consideration will be given to clarifying the imposition of VAT on the excess received as well as allowing input credits when the excess is refunded.
- *Irrecoverable debts:* Vendors who purchase goods or services must reverse any input credits claimed if the vendor ultimately fails to make payment within a 12-month period. In order to ensure that output tax is properly accounted for, provision must be made to shorten the period of reversal if vendors deregister within the 12-month period.
- *Bare dominium financing structures:* Vendors may not claim inputs for exempt supplies. However, certain taxpayers are entering into bare dominium structures designed to disguise actual financial services as rental payments, thereby misusing the statutory exception to the financial services definition. As a result, input credits are claimed even though no subsequent taxable supply is made. The VAT implications will accordingly be clarified either by legislative amendment or interpretation.
- *Industrial Development Zones (IDZs):* Government created IDZs to encourage the development of trade as well as to stimulate foreign and local investment in particular areas. Consistent with this philosophy, current VAT legislation generally provides that the supply of goods and services into a Customs Controlled Area (CCA) within an IDZ will be zero-rated. However, this zero-rating needs to be limited so that it does not apply

to goods or services artificially routed through the CCA or to goods or services that are not economically used, consumed or transformed in the CCA.

- *Entertainment for independent contractors:* Vendors cannot claim inputs for entertainment expenses, except in limited circumstances (such as personal subsistence in the case of overnight business travel for employees). Certain taxpayers are putting forth a case for expanding these exceptions to include comparable expenses for independent contractors. Consideration of expanding relief to this form of entertainment will depend on the facts presented.
- *Imported services:* Imported services are subject to VAT at the standard rate. The relevant imported services provisions will be reviewed so that this policy is fully maintained.
- *Documentary evidence for zero-rated exports:* Vendors receive zero-rated treatment for exports only upon documentary proof acceptable to the Commissioner. This requirement will be upgraded to permit the Commissioner to prescribe the documentary proof required.
- *Documentary proof for deemed inputs:* Vendors must be in possession of prescribed documents to claim input credits. However, as a practical matter, vendors cannot be in possession of these documents if the supply giving rise to the credits is a legislatively “deemed supply”. The provisions relating to these documentary requirements will be remedied.
- *Additional assessments:* The VAT Act provides SARS with the authority to issue one assessment. It is proposed that SARS be given the authority to issue additional assessments to the extent that further controversies subsequently arise. This authority to issue additional assessments will be akin to the authority SARS currently has in issuing additional assessments in terms of the Income Tax Act.

## Customs and Excise Act (1964)

- *General duties and powers of officers:* As part of its effort to promote information sharing, SARS is seeking to enhance its exchange of information with other customs administrations, especially in terms of mutual assistance agreements. This enhancement will require a refinement of the relevant sections.
- *Biodiesel:* Operational implementation of the biodiesel fuel rebate may need further adjustments to ensure smooth operation. Amendments will be made accordingly to the extent required.
- *Security seals:* SARS officials may under general provisions apply security seals. In order to facilitate compliance and service delivery, consideration will be given to introducing specific provisions for the application of seals by SARS and by other parties (e.g. external economic and logistic operators in the safeguarding of goods in transit).
- *Licensing:* Legislative changes will be made to provide for the licensing of all port, terminal and similar operations (whether private or public) to achieve more effective customs control.

- *International agreements:* South Africa has acceded to certain annexures of the Convention on Temporary Admission (Istanbul Convention) with possible further accessions to follow. This accession will require conforming amendments under domestic law. Other conforming amendments will be required under domestic law in light of the International Trade Administration Act (2002) as well as certain standards contained in the Marrakesh Agreement.
- *Rebates of excise duties:* Legal changes may be required as the review of Schedule No. 6 is now complete.
- *Record keeping:* The act is outmoded in terms of its private record keeping requirements. The act will accordingly be aligned with other tax acts, all of which provide for a five-year retention period for records.
- *Service of notices:* The act is outmoded in terms of its administrative processes for the service of notice requirements. Consideration will accordingly be given to alignment of the act with the Income Tax Act and the Admiralty Jurisdiction Regulation Act (1983).
- *Large-scale scanner:* The first mobile, state-of-the-art, large-scale scanner is likely to be commissioned in the third quarter of 2006 with further scanners to follow. Legislative amendments to support the effective use of such scanners will be required.
- *Electronic communication:* Large clearing and forwarding houses, importers, carriers and other supply chain participants will be required to communicate electronically with SARS to facilitate risk management, reduce error rates and speed up processing.

## Other taxes, duties and charges

- *Uncertificated securities tax imposed on listed collective investment schemes:* Listed collective investment schemes (e.g. index funds) potentially face double charges in terms of the uncertificated securities tax - one at the collective investment scheme level and another at the level of the holders of participatory interests (unit holders). This potential double charge is inconsistent with the treatment of unlisted collective investment schemes, which are subject to only one level of comparable charges at the collective investment scheme level.
- *Transfer duty upon divorce:* The transfer of real estate upon divorce is subject to transfer duty unless the marriage was in community of property. Transfer duty relief should in principle be extended to transfers arising from all types of unions.
- *Collecting estate duty on property falling outside the formal estate process:* According to a recent court decision, SARS may not collect estate duty from an executor in respect of property subject to estate duty but not directly under the control of the executor. This decision puts SARS at a severe disadvantage in terms of collecting estate duty for property of this kind. Legislation will be enacted to provide SARS with the right to appoint collecting agents for property of this kind.
- *Unemployment insurance contributions:* Government has been working to resolve certain anomalies between the Unemployment Insurance Contributions Act (2002) and the Unemployment Insurance Act (2001) for over two years. Of concern is the fact that certain parties are seemingly required to contribute even though they lack the potential

of fully receiving benefits. Given recent progress, this matter should be resolved within the coming fiscal year.

## SARS general administration

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

## TECHNICAL CORRECTIONS

In addition to the miscellaneous amendments above, the 2006 legislation will contain technical corrections. These technical corrections will address typing and grammatical issues, incorrect or misleading headings or definitions, misplaced cross-references, differences between the English and Afrikaans text, obsolete provisions (e.g., updating tax acts in light of other non-tax legislative changes), incorporation of regulations into law and problems relating to effective dates. These technical corrections may also occasionally include changes to legislation clearly at odds with legislative intent as well as obvious ambiguities and omissions, especially in terms of legislation promulgated since 2005. These changes are not intended to have any meaningful revenue impact or represent any change in policy. Technical corrections will be made during the upcoming year only as time permits.



## INTERNATIONAL TAX AGREEMENTS

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

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

The present position is as follows:

- Comprehensive agreements (57) are in force with Algeria, Australia, Austria, Belarus, Belgium, Botswana, Bulgaria, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Egypt, Ethiopia, Finland, France, Germany, Greece, Hungary, India, Indonesia, Iran, Ireland, Israel, Italy, Japan, Korea, Lesotho, Luxembourg, Malawi, Malta, Mauritius, Namibia, the Netherlands, New Zealand, Norway, Oman, Pakistan, the People's Republic of China, Poland, Romania, the Russian Federation, the Seychelles, Singapore, the Slovak Republic, Swaziland, Sweden, Switzerland, Taiwan, Thailand, Tunisia, Uganda, Ukraine, the United Kingdom, the United States of America, Zambia and Zimbabwe. An older agreement with the United Kingdom (1946) applies also to Grenada and Sierra Leone.
  - Comprehensive agreements (9) have been ratified with Brazil, the Democratic Republic of Congo, Gabon, Ghana, Kuwait, Malaysia, Nigeria, Rwanda and Turkey.
  - Comprehensive agreements (2) have been signed but not ratified with the Netherlands (renegotiated) and Tanzania.
  - New comprehensive agreements (16) are in the process of negotiation or are being finalised with Bangladesh, Chile, Cuba, Estonia, Latvia, Lithuania, Morocco, Mozambique, Portugal, Qatar, Saudi Arabia, Serbia and Montenegro, Spain, Sri Lanka, the United Arab Emirates and Vietnam.
  - Old comprehensive agreements (6) are in the process of renegotiation, signing or ratification with Germany, Malawi, Namibia, Switzerland, Zambia and Zimbabwe. Where agreements are being renegotiated, the existing agreements remain effective until the new agreements enter into force.
  - Limited sea and air transport agreements (3) are in force with Brazil, Portugal and Spain.
- Further information on the status of the agreements is available on the SARS website ([www.sars.gov.za](http://www.sars.gov.za)) under Legislation/International Treaties.

## AGREEMENTS FOR MUTUAL ADMINISTRATIVE ASSISTANCE BETWEEN CUSTOMS ADMINISTRATIONS

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

- Agreements (6) are in force with Algeria, France, Mozambique, the Netherlands, the United Kingdom and the United States of America.
- Agreements (2) have been ratified by South Africa with the Czech Republic and Zambia.

- Agreements (3) have been signed but not ratified with the Democratic Republic of Congo, Norway and Turkey.
- Agreements (9) are in the process of negotiation or are being finalised with Angola, Brazil, Iran, Israel, Malawi, Nigeria, Tanzania, Uganda and Zimbabwe.

## AGREEMENTS FOR MUTUAL AND TECHNICAL ASSISTANCE IN RESPECT OF VALUE-ADDED TAX

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

## SUMMARY OF THE EFFECTS OF THE 2006 BUDGET TAX PROPOSALS

The 2006 tax proposals are designed to stimulate business, investment, innovation, economic growth, home ownership and skills development, while concurrently improving the equity and efficiency of the tax system.

R million	Effect of tax proposals
<b>Taxes on individuals and companies</b>	<b>(14,925)</b>
<b>Personal income tax</b>	<b>(12,125)</b>
Adjust personal income tax rate structure	(13,500)
Increase in interest and dividend exemption under 65 years	(50)
Increase in interest and dividend exemption 65 years and over	(45)
Increase thresholds for learnership allowances	(80)
Increase PAYE withholding rate on motor allowances and fringe benefit on company cars	1,370
Capping of medical scheme contributions	180
<b>Corporate income tax</b>	<b>(2,400)</b>
Reduction in retirement fund tax	(2,400)
<b>Small business tax relief</b>	<b>(400)</b>
<b>Taxes on property</b>	<b>(4,540)</b>
Increase thresholds of donations tax and estate duty	(40)
Adjust table for transfer duties	(4,500)
<b>Stamp duties</b>	<b>(10)</b>
Increase threshold exemption for stamp duties on leases	(10)
<b>Taxes on goods and services</b>	<b>348</b>
Increase in duties on alcohol	725
Increase in duties on tobacco products (52% incidence)	645
Abolish ad valorem excise duties on certain products	(22)
Zero rating of municipal property rates	(1,000)
<b>Budget 2006/07 proposals</b>	<b>(19,127)</b>

# 2006/7

## Budget Tax Proposals



Legal and Policy: Legislation  
299 Bronkhorst Street, Nieuw Muckleneuk, Pretoria  
PO Box 402, Pretoria 0001