REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

REVENUE LAWS AMENDMENT BILL, 2003

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INTRODUCTION

The Revenue Laws Amendment Bill, 2003, introduces amendments to the Transfer Duty Act, 1949, the Estate Duty Act, 1955, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Value-Added Tax Act, 1991, the Skills Development Levies Act, 1998, the Uncertificated Securities Tax, 1998, the Taxation Laws Amendment Act, 2000, the Revenue Laws Amendment Act, 2001, the Second Revenue Laws Amendment Act, 2001, the Unemployment Insurance Contributions Act, 2002, and the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003 and repeals the Marketable Securities Tax Act, 1948,.

CORPORATE RESTRUCTURING RULES

A new comprehensive corporate reorganisation regime was introduced from 1 October 2001. This regime was modified and clarified in 2002 in response to taxpayer comments. The modified regime came into operation on 6 November 2002. A few issues, however, remained unresolved. In order to remedy any remaining minor issues, the National Treasury and SARS requested public comment with respect to the corporate reorganisation regime (and collateral related amendments) regarding issues that involve clarification of ambiguities, removal of inconsistencies, and changes to reflect the corporate reorganisation regime’s initial intent.

Most of the proposed amendments merely refine the present regime or clarify aspects thereof. The proposals regarding elective relief, the ring-fencing of trading stock and financial instruments, the treatment of financial instrument holding companies and unbundling transactions are, however, more substantive.

Elective versus mandatory relief

Provision was made during 2002 for elective rollover relief in the case of company formations and liquidation transactions, while rollover relief remained mandatory in the case of share-for-share transactions, amalgamations and unbundlings. It is proposed that an elective regime be implemented for the latter forms of corporate relief where the transactions involved are between companies forming part of the same group of companies. The provisions in respect of share-for-share transactions, amalgamations and unbundlings will in terms of this proposal apply unless excluded by the parties. This differs from the position in respect of company formations and intra-group and liquidation transactions where rollover relief applies only if the parties so elect.

The ring-fencing of trading stock and financial instruments

The corporate rules contain anti-avoidance provisions to prevent the shifting of built-in gain assets into a company transferee through the mechanism of a company formation transaction, share-for-share transaction, intra-group and amalgamation transaction and liquidation distribution. Without these anti-avoidance rules, taxpayers could use the rollover mechanism to shift built-in gain assets into a transferee company with excess losses. Transferee companies could then immediately sell those assets and set off any resulting gain against their own excess capital losses. Amendments effected in 2002 extended the rule regarding the ring-fencing of capital gains from capital assets disposed of within 18 months to trading stock or allowance assets acquired under the above-mentioned transactions that are disposed of within the 18 month period. This was an attempt to ensure the consistent treatment of capital assets, allowance assets and trading stock in this regard. It has become clear,

on further reflection, that the rule regarding the ring-fencing of trading stock is too broad in so far as it covers trading stock regularly and continuously disposed of in the course of a going concern. It is, therefore, proposed that trading stock acquired in terms of one of the abovementioned transactions be excluded from the 18 month ring-fencing rule if it is of the same kind or of the same or equivalent quality as trading stock regularly and continuously disposed of by the transferee. Paragraph *(b)* of the proposed definition of trading stock to be inserted in section 41 is aimed at achieving this result. It is proposed that this amendment be retrospective to 6 November 2002.

The 18 month ring-fencing rule applying in respect of company formations and share-for share, amalgamation, intra-group and liquidation transactions does not apply in respect of involuntary disposals as contemplated in paragraph 65 of the Eighth Schedule. Paragraph 65 does not, however, provide for involuntary disposals of financial instruments. The second substantive proposal regarding the 18 month rule is aimed at extending the list of exclusions from the ring-fencing rule to involuntary disposals of financial instruments.

Financial instrument holding companies

None of the domestic or foreign reorganisation/participation exemption rules apply to the sale of mere passive portfolio investments because the purpose of these rules is to promote the efficient restructuring of active businesses. Experience has shown that special tax treatment in respect of the transfer of passive financial instruments merely results in tax avoidance. The present financial instrument holding company rules provide a key backstop to the present dispensation by qualifying the corporate restructuring provisions so as to prevent, as a general rule, the transfer of financial instruments in a tax neutral manner. Definitions of “domestic financial instrument holding company” and “foreign financial instrument holding company” which significantly relaxed the limitation on the transfer of financial instruments were introduced during 2002. The definitions and the criteria built into these definitions are applied throughout Part III to limit company formation transactions, share-for-share transactions, amalgamation transactions, intra-group transactions, unbundling transactions and liquidation distribution transactions. Where more than half of the market value or actual cost of all the assets of a company together with any controlled company in relation to that company is attributable to financial instruments, the transfer of the shares of that company in terms of the rollover rules is unacceptable, as a general rule. However, an exception is made for debts in respect of goods sold or services rendered by that company or transferor where the amount of the transaction was included in the income of that entity or a controlled group company in relation to that entity and the debt is an integral part of a business conducted by the company involved as a going concern. Shares held in controlled group companies as well as loans, advances or debts between companies which form part of that group of companies are also disregarded when determining the portion of all assets of a group of companies in relation to a company consisting of financial instruments. An important further exception is made for financial instruments of, or financial instruments transferred to certain regulated financial institutions, e.g. banks, insurance companies and collective investment schemes. Equivalent exceptions apply in respect of foreign companies in terms of the definition of “foreign financial instrument holding company”.

(a) The prescribed financial instruments : all assets ratio

Some of the proposed amendments to the definitions of “domestic financial instrument holding company” and “foreign financial instrument holding company”

provide for the further relaxation of the present limitations on the transfer of financial instrument holding companies. The first proposal in this regard relates to the rule in terms of which a company's holding of financial instruments may not exceed half of its assets as measured in terms of historic cost as well as market value. Representations were made for the removal of the assets at historic cost test on the grounds of its perceived unfairness in view of the exclusion of self-generated goodwill. However, the assets at fair market value test would be insufficient on its own in view of the volatility of fair market value as well as its possible manipulation. It is proposed instead that the permissible limit for financial instruments as measured against the historic cost of the company's assets be relaxed by increasing it from one-half to two-thirds of such assets. A company that is a resident and a foreign company will, therefore, qualify as a financial instrument holding company once its financial instruments exceed two-thirds of all its assets when measured at their historic cost or half of all its assets when measured at their market value. It is proposed in terms of clauses 212 and 214 that this amendment be retrospective to 6 November 2002.

(b) Controlled group companies operating as financial institutions

The second proposal providing for the relaxation of the current limitations relates to the list of financial instruments to be disregarded when determining whether the financial instruments held by a company and by all its controlled group companies exceed the permissible ratio. The current definition of "domestic financial instrument holding company" exclude financial instruments held by a controlled group company in relation to a resident company where that controlled group company is a regulated financial institution such as a bank, insurance company or a collective investment scheme. The definition of "foreign financial instrument holding company" has a similar exclusion in respect of financial instruments held by a controlled group company in relation to a foreign company if that controlled group company is an institution that is similar to a local bank, insurer, dealer or broker meeting certain requirements. The current exclusions only apply, however, where the company and its controlled group companies are all resident or where none is resident. The exclusion does not apply, for example, to financial instruments held by a resident controlled group company in relation to a foreign company where that resident controlled group company is a regulated financial institution such as a bank regulated in terms of the Banks Act, 1990. It is proposed that this anomaly be removed by extending the list of excluded financial instruments to instruments held by controlled group companies that meet the requirements of either of the relevant exclusions applying in respect of regulated financial institutions and their foreign equivalents.

(c) The transfer of cash and cash equivalents

A further proposal is aimed at extending rollover relief to some transfers of cash and cash equivalents. The treatment of cash and cash equivalents as financial instruments for purposes of financial instrument company status makes little sense in the case of intra-group transfers or liquidations. Both situations should allow for the tax-free transfer of cash under the theory that companies within a group are economically the same as divisions of a single company. It is, therefore, proposed that any financial instrument the market value of which is equal to its base cost, be disregarded in the case of disposals in terms of intra-group transactions or liquidation distributions when calculating whether the financial instruments of the company effecting that disposal exceed the permissible limit. A holding of cash and cash equivalents will therefore not be taken into account when determining whether the company effecting the intra-group transaction or liquidation distribution qualifies as a domestic or foreign financial instrument holding company.

(d) Loans, advances or debts within a group

Finally, the proposed changes to the rules allowing financial instruments consisting of loans, advances or debts within a group to be disregarded, limit the excluded loans to those between a company and any controlled group company in relation to that company or between controlled group companies in relation to that company.

(e) Other proposals

Other proposed changes include the insertion of the definition of “foreign financial instrument holding company” in section 41 as well as some changes aimed at aligning the definitions of “domestic financial instrument holding company” and ‘foreign financial instrument holding company”.

Unbundling transactions

A new definition of “unbundling transaction” is proposed. In terms of the current provisions, the qualifying interest of the unbundling company in the unbundled company must consist of equity shares acquired at least 18 months prior to the transaction, shares acquired in terms of a substitution (as contemplated in paragraph 78(2) of the Eighth Schedule) of equity shares so acquired, or shares acquired in terms of a transaction contemplated in Part III or a transaction which would have qualified as such had the parties made the required election or had that asset been a gain asset at the time of disposal. The current formulation is confusing in some respects and does not clearly reflect the underlying intent. Shares can, moreover, as a general rule be disposed of by means of an unbundling transaction before the expiry of 18 months after their acquisition in terms of a transaction contemplated in Part III without triggering held-over gains or the ring-fencing rule. This cannot be reconciled with the current requirement of an 18 month holding period prior to an unbundling transaction. The proposed definition dispenses with the 18 month requirement. It provides, furthermore, for partial unbundlings, in the case of an unlisted unbundling company, to the extent to which the shares in the unbundled company are disposed of to a company that is a member of the same group of companies as that unbundling company. It also provides for a disposal of shares by means of an unbundling transaction effected to comply with an order made in terms of the Competition Act 89 of 1998 irrespective of whether or not the shares constitute the minimum shareholding normally required for an unbundling transaction. The proposed changes are retrospective to 6 November 2002.

PUBLIC PRIVATE PARTNERSHIPS

Current law

There is neither a definition of what a Public Private Partnership (“PPP”) is nor what the tax treatment of the various PPP projects is. Uncertainty exits around the tax treatment of Government grants received by the PPP to assist it with the acquisition of capital assets. In most cases depending on whether the project is a toll road, a hospital or a rail project the tax treatment differs between the different sections of the Income Tax Act. Current law proves problematic for certain PPP project where the ownership of the underlying land is not transferred by Government to the PPP. Thus the expenditure incurred by the PPP on project assets that attach to the land (therefore not owned by the PPP) cannot be deducted.

Reason for change

(A) Government Grants

To—
(i) align the South African tax treatment with international practice,
(ii) provide clarity to the PPP on the tax treatment of assets since the legal ownership of assets only affects the tax implications,
(iii) eliminate the circular flow of tax i.e. by subjecting grants for capital expenditure to tax creates a circular effect thereby necessitating an increase to the grant by Government to the PPP by the tax due, that Government in turn will receive from the South African Revenue Service when the tax revenues are paid over,
(iv) align the applicable sections in the Income Tax Act that require that the capital assets must be "owned " or "acquired" by the taxpayer for the taxpayer to qualify for the specific capital deduction, and
(v) clarify whether the grant received by the PPP to acquire capital assets is capital or revenue in nature.

(B) Capital Allowances

Generally the Government grant received for capital expenditure may only partially fund the design, construction and acquisition of capital assets. The concessionaire will be required to fund the remaining portion of the total expenditure incurred. On the termination of the concession period or the early termination of the concession contract all the capital assets will revert to Government. It would thus be equitable to provide the concessionaire with a tax deduction for the capital expenditure which will not be funded by the Government grant. Current law does not fully address this situation and would need to (i) clarify whether the capital contribution will reduce the amount that qualifies for a capital allowance and (ii) clarify what capital allowances and deductions are available to the PPP.

(C) PPP

Current tax law does not define a PPP, however, Treasury Regulation 16 contains a definition of a PPP that will qualify for this preferential tax treatment.

Proposed legislation

(A) Government Grants

Grants that are actually applied to fund capital expenditure will be exempt from tax in terms of section 10. This would be in line with the tax treatment of other Government incentives, which are exempt from tax in terms of section 10*(z*A*)* to section 10*(z*H*)*. This is in line with UK and Malaysian practice and will align South Africa's tax treatment to international practice.

(B) Capital Allowances

The income tax legislation is expanded to make provision for the unique and distinctive types of PPP assets. Government grants to fund capital expenditure will reduce the cost of capital assets for capital allowance purposes and the base cost for Capital Gains Tax purposes. Finally where an asset consists of depreciable and non-depreciable assets, the grant may be allocated at the instance of the PPP firstly and as far as possible to non-depreciable assets, and secondly to depreciable assets which have the longest write off period.

(C) Definition of a PPP

Treasury Regulation 16 defines a PPP as:
" … a commercial transaction between an institution and a private party in terms of which—

(a) the private party either performs an institutional function on behalf of the institution for a specified or indefinite period or acquires the use of state property for its own commercial purposes for a specified or indefinite period;

(b) the private party receives a benefit for performing the function or by utilising state property, either by way of:
   - (i) compensation from a revenue fund;
   - (ii) charges or fees collected by the private party from users or customers of a service provided to them; or
   - (iii) a combination of such compensation and such charges or fees."

This definition distinguishes between two basic types of PPP, one involving the performance by a private party of an "institutional function" and the other involving some form of "use of state property" by a private party for its own commercial purposes. For the first type of PPP, the concept "institutional function" is broadly defined as an ongoing service, task, assignment or other function that an institution performs in the "public interest" on behalf of Government where such performance and delivery are subject to specified outcomes. For the second type of PPP, the use of state property is defined as all movable and immovable property belonging to the State including intellectual property rights. Use may include a variety of use forms such as a lease or concession.

In the majority of PPP projects that involve the construction of infrastructure, Government will make land (often with existing improvements) available to the private party. During the project term the private party will manage the operation and maintenance of such land and infrastructure. A particular feature about PPP's is that the land (immovable property) belongs or will revert (movable or immovable property) back to Government at the end of the concession period. Usually a PPP agreement results in a special purpose vehicle ("SPV") incorporated in the Republic as a private limited liability company for the sole purpose of exercising its rights and performing of obligations under the PPP agreement.

The Government ownership requirement is satisfied as long as the infrastructure is returned to Government no later than the termination of the partnership. Eventual Government ownership of the infrastructure is an important requirement in terms of tax principles because ownership by Government means that the grant did not ultimately enrich the Public-Private-Partnership (a key element for income characterization).

REINVESTMENT RELIEF AND INVOLUNTARY DISPOSALS

General

It was proposed, with a view to stimulating business investment, that comprehensive tax relief be provided for ordinary income as well as capital gain when the sale proceeds of a depreciable asset, as defined, are reinvested in qualifying assets within a period of three years. The proposed treatment effectively defers any recoupment and/or capital gain upon the disposal of the old asset by spreading such recoupment and/or capital gain over the same period as wear and tear may be

claimed in respect of the replacement asset. This spreading nullifies the impact of one single inclusion in income by being offset against wear and tear claimed with respect to the newly acquired asset over the time-frame as mentioned above.

For income tax purposes, section 8(4)*(e)* of the Income Tax Act, 1962 (the Act), has always provided that where a qualifying allowance has been claimed in respect of an asset that was subsequently damaged or destroyed, the recoupment could be held over until the disposal of the replacement asset. Essentially this provision only catered for involuntary disposals in respect of recoupments.

For capital gains tax purposes, paragraphs 65 and 66 of the Eighth Schedule to the Act already provided for relief in respect of a capital gain. Paragraph 65 dealt with involuntary disposals and allowed any capital gain arising upon an involuntary disposal to be held over until the replacement asset was finally disposed of. Paragraph 66 dealt with a reinvestment in a replacement asset and spread any capital gain arising upon disposal of the old asset over five years from the date the replacement asset was brought into use. The former paragraph allowing for a total deferral until the replacement asset was disposed of, similar to the income tax provision for recoupments contained in section 8(4)*(e)*, the latter paragraph allowing for a part-deferral, spreading and taxing the capital gain over a five-year period. It was proposed that these provisions be amended expansively and also that both provide for a matching in respect of both capital gains and/or recoupments to be included in taxable income / income over the same period that the replacement asset may be written-down for tax purposes.

Furthermore, it was proposed, in the light of the current treatment in respect of "scrapping" being somewhat uncertain, that taxpayers be allowed to claim losses from ordinary revenue on the sale of devalued depreciable assets with short useful lives.

Specific Clauses

Clause 12(1)(b): *Income Tax: Insertion of the definition of "depreciable asset" in Section 1 of the Income Tax Act, 1962*

This insertion provides a definition of the type of asset referred to in the amended sections 8(4)*(e)*, 11*(o)* and the new paragraphs 65 and 66. A "depreciable asset" is more widely defined than a "capital asset" (defined in section 41 of the Act) but is narrower than an "allowance asset" (also defined in section 41 of the Act) in that the capital deductions or allowances are limited, in essence to wear and tear.

Clause 18: *Income Tax: Substitution of Section 8(4)(e) of the Income Tax Act, 1962*

This substitution allows for any amount recovered or recouped as a result of the disposal of any asset to be excluded from income where an election has been made in terms of either paragraph 65 or 66 of the Eighth Schedule, subject to four paragraphs, namely *(e*B*)*, *(e*C*)*, *(e*D*)* and *(e*E*)*.

Paragraph *(e)* provides that there shall be no recoupment or inclusion in income of an amount recovered upon the disposal of an asset where a person has made an election in terms of paragraphs 65 and 66 of the Eighth Schedule. Both paragraphs 65 and 66 of the Eighth Schedule require that proceeds either equal or exceed base cost.

It should be noted that paragraph *(e*A*)* now provides for the replacement of a single

asset with multiple assets. Where more than one replacement asset is acquired upon the disposal of a single asset, the amount recovered or recouped must be allocated to each newly acquired asset in the same ratio as the amount spent on each particular asset in relation to the total amount received or accrued upon disposal of the old asset. Hence, the amount recovered or recouped will be allocated in full to each replacement asset in proportion to each asset's cost. Neither paragraph 65 nor 66 of the Eighth Schedule provide for the situation where less than all the proceeds may be expended. It is possible, however, to acquire a replacement asset costing more that the proceeds realised upon disposal of the old asset.

Paragraph *(e*B*)* provides that where the replacement asset is a depreciable asset, the recoupment or the amount recovered may be spread and included in income over the same period as wear and tear may be claimed in respect of the replacement asset. Obviously, where the asset is a replacement asset in terms of paragraph 65, i.e. an involuntary disposal, and is not a depreciable asset, the recoupment or amount recovered must be held over until the replacement asset is disposed of and then included in income in full.

Paragraph *(e*C*)* provides that where the replacement asset is disposed of and any portion of the recoupment or amount recovered in respect of the original asset has not been recouped or recovered, it shall be so recouped or recovered in the year of assessment that the replacement asset is disposed of. Obviously, where the asset was not a depreciable asset, the full amount recovered or recouped and held over will be triggered for inclusion upon disposal of the replacement asset. It should be noted that it is possible to make an election in terms of paragraphs 65 and 66 of the Eighth Schedule where the asset being disposed of is already a replacement asset in terms of such an election. In other words, relief in respect of capital gains and/or recoupments may apply in respect of multiple replacements of an asset, i.e. an ongoing chain of relief in respect of replacement assets is permissible.

Paragraph *(e*D*)* provides for instances where the replacement asset is not disposed of but ceases to be used in the person's trade. In such cases, any portion of the amount apportioned to this replacement asset not yet recouped or recovered shall be deemed to be an amount recovered or recouped in the year of assessment where such cessation occurs.

Paragraph *(e*E*)* is similar to provisions contained in paragraphs 65 and 66 of the Eighth Schedule. Where a person fails to conclude a contract or fails to bring a replacement asset into use within the period prescribed in the aforementioned paragraphs, the amount contemplated for recovery or recoupment will firstly be deemed to be recovered or recouped on the date the prescribed period ends and, secondly, interest at the prescribed rate on the recovered or recouped amount shall be determined from the date of disposal to the end of the prescribed period and shall also be deemed to be an amount so recovered or recouped.

Clause 27(1)(f): *Income Tax: Substitution of Section 11(o) of the Income Tax Act, 1962*

This new section provides that the taxpayer may elect to be allowed to claim losses from ordinary revenue on the sale of devalued depreciable assets with short useful lives. The assets concerned must have qualified for capital allowances in terms of either section 11*(e)*, 12B, 12C, 12E, 14 or 14*bis* and the expected useful life of the depreciable asset concerned must not have exceeded ten years as determined from the date of original acquisition.

Clause 106: *Income Tax: Substitution of Paragraph 65 of the Eighth Schedule to the Income Tax Act, 1962*

It should be noted that where an involuntary disposal occurs, a person may, in terms of sub-paragraph (1), elect capital gains tax relief in terms of this paragraph which provides the mechanism to defer such capital gain. Where an election has been made, further relief may be obtained in respect of any amount recovered or recouped for income tax purposes in terms of Section 8(4)*(e)*.

Paragraph 65 applies to all assets other than financial instruments, where the asset is disposed of by way of operation of law, theft or destruction and proceeds accrue to that person by way of compensation. However, proceeds must equal or exceed the base cost of that asset. In other words, where a capital loss arises, this provision does not apply as most persons would want to claim the capital loss in the year of assessment in which it arises.

All the proceeds must be expended in acquiring one or more replacement assets. It is important to note that this paragraph cannot apply where less than all the proceeds are expended in acquiring a replacement asset. It is possible, however, to acquire a replacement asset costing more than the proceeds realised upon the disposal of the old asset.

The contract or contracts for the acquisition of the replacement asset or assets must be concluded within 12 months after the date of disposal of the asset being replaced and the replacement asset or assets must be brought into use within three years of the disposal of the asset being replaced. A replacement asset may be acquired (contract concluded) and brought into use prior to the disposal of the asset being replaced. The replacement asset however, should be considered in the context of "replacement" – it is doubtful whether an asset brought into use too far in advance of the disposal of the asset being replaced could be considered a "replacement". The Commissioner may extend either period by no more than 6 months if the taxpayer can demonstrate that reasonable steps have been taken.

Where an asset is deemed to have been disposed of and to have been reacquired, for example, in the case of a "degrouping" triggering of a capital gain where the Eighth Schedule provides for a disposal and an immediate reacquisition, this paragraph provides that the relevant person may not elect that relief provisions apply.

It should be noted that sub-paragraph (3) now provides for the replacement of a single asset with multiple assets. Where more than one replacement asset is acquired upon the disposal of a single asset, the capital gain must be allocated to each newly acquired asset in the same ratio as the amount spent on each particular asset in relation to the total amount received or accrued upon disposal of the old asset. Hence, the capital gain will be allocated in full to each replacement asset in proportion to each asset's cost. Neither paragraph 65 nor 66 of the Eighth Schedule provide for the situation where less than all the proceeds may be expended. It is possible, however, to acquire a replacement asset costing more that the proceeds realised upon disposal of the old asset.

Sub-paragraph (4) provides that where the asset disposed of is a depreciable asset, then the capital gain to be included in taxable income must be spread equally over the period that wear and tear may be claimed in respect of the replacement asset. Where there are a number of replacement assets, i.e. the total capital gain has been apportioned; the inclusion in taxable income may vary depending the period that wear and tear may be claimed for each replacement asset. Obviously, where the

asset disposed of is not a depreciable asset, then the capital gain is held over in full until such time as the replacement asset is disposed of.

Sub-paragraph (5) provides that where the replacement asset is disposed of and any portion of the disregarded capital gain in respect of the original asset has not been treated as a capital gain, it shall be included in taxable income in the year of assessment that the replacement asset is disposed of. Obviously, where the asset was not a depreciable asset, the full amount of the disregarded capital gain held over will be triggered for inclusion upon disposal of the replacement asset. It should be noted that it is possible to make an election in terms of paragraph 65 of the Eighth Schedule where the asset being disposed of is already a replacement asset in terms of such an election. In other words, relief in respect of capital gains and/or recoupments may apply in respect of multiple replacements of an asset, i.e. an ongoing chain of relief in respect of replacement assets is permissible.

Sub-paragraph (6) provides that where a person fails to conclude a contract or fails to bring any replacement asset into use within the period prescribed in this paragraph, the capital gain will firstly be treated as being triggered on the date the prescribed period ends and, secondly, interest at the prescribed rate on the capital gain shall be determined to that date and shall also be treated as a capital gain when determining that person's aggregate capital gain or aggregate capital loss.

Sub-paragraph (7) provides that where a replacement asset or assets constitute personal use assets, the provisions of paragraph 65 shall not apply. The intention of this provision is to prevent a switching from a trade asset to a non-trade asset and still benefit from the relief made available in this paragraph.

Clause 107: *Income Tax: Substitution of Paragraph 66 of the Eighth Schedule to the Income Tax Act, 1962*

A person may, in terms of sub-paragraph (1), elect capital gains tax relief in terms of this paragraph which also provides the mechanism to defer such capital gain. It should be noted however, that the asset disposed of must have qualified for a capital allowance in terms of section 11*(e)*, 12(B), 12(C), 12(E), 14 or 14*bis* and that the replacement asset must qualify for a capital allowance in terms of either section 11*(e)*, 12B, 12C or 12E. Where an election has been made, further relief may be obtained in respect of any amount recovered or recouped for income tax purposes in terms of Section 8(4)*(e)*.

Paragraph 66 essentially only applies to depreciable assets as specified above. However, proceeds must equal or exceed the base cost of the asset being disposed of. In other words, where a capital loss arises, this provision does not apply as most persons would want to claim the capital loss in the year of assessment in which it arises.

All the proceeds must be expended in acquiring one or more replacement assets. It is important to note that this paragraph cannot apply where less than all the proceeds are expended in acquiring a replacement asset. It is possible, however, to acquire a replacement asset costing more than the proceeds realised upon the disposal of the old asset.

The contract or contracts for the acquisition of the replacement asset or assets must be concluded within 12 months after the date of disposal of the asset being replaced and the replacement asset or assets must be brought into use within three years of the disposal of the asset being replaced. A replacement asset may be acquired

(contract concluded) and brought into use prior to the disposal of the asset being replaced. The replacement asset however, should be considered in the context of "replacement" – it is doubtful whether an asset brought into use too far in advance of the disposal of the asset being replaced could be considered a "replacement" asset. The Commissioner may extend either period by no more than 6 months if the taxpayer can demonstrate that reasonable steps have been taken.

Where an asset is deemed to have been disposed of and to have been reacquired, for example, in the case of a "degrouping" triggering of a capital gain where the Eighth Schedule provides for a disposal and an immediate reacquisition, this paragraph provides that the relevant persons may not elect that the relief provisions apply.

It should be noted that sub-paragraph (3) now provides for the replacement of a single asset with multiple assets. Where more than one replacement asset is acquired upon the disposal of a single asset, the capital gain must be allocated to each newly acquired asset in the same ratio as the amount spent on each particular asset in relation to the total amount received or accrued upon disposal of the old asset. Hence, the capital gain will be allocated in full to each replacement asset in proportion to each asset's cost. Neither paragraph 65 nor 66 of the Eighth Schedule provide for the situation where less than all the proceeds may be expended. It is possible, however, to acquire a replacement asset costing more that the proceeds realised upon disposal of the old asset.

Sub-paragraph (4) provides that the capital gain to be included in taxable income must be spread equally over the period that wear and tear may be claimed in respect of the replacement asset. Where there are a number of replacement assets, i.e. the total capital gain has been apportioned, the inclusion in taxable income may vary depending the period that wear and tear may be claimed for each replacement asset.

Sub-paragraph (5) provides that where the replacement asset is disposed of and any portion of the disregarded capital gain in respect of the original asset has not been treated as a capital gain, it shall be included in taxable income in the year of assessment that the replacement asset is disposed of. It should be noted that it is possible to make an election in terms of paragraph 66 of the Eighth Schedule where the asset being disposed of is already a replacement asset in terms of such an election. In other words, relief in respect of capital gains and/or recoupments may apply in respect of multiple replacements of an asset, i.e. an ongoing chain of relief in respect of replacement assets is permissible.

Sub-paragraph (6) provides that where during any year of assessment a person ceases to use a replacement asset for the purposes of that person's trade then any portion of the disregarded capital gain not yet treated as a capital gain must be treated as a capital gain during that year of assessment.

Sub-paragraph (7) provides that where a person fails to conclude a contract or fails to bring any replacement asset into use within the period prescribed in this paragraph, the capital gain will firstly be treated as being triggered on the date the prescribed period ends and, secondly, interest at the prescribed rate on the capital gain shall be determined to that date and shall also be treated as a capital gain when determining that person's aggregate capital gain or aggregate capital loss.

RESEARCH AND DEVELOPMENT

Current law

Research and development (R&D) expenditure, by virtue of its nature, will not, generally, fall within the provisions of the general deduction formula. Indeed there may not even be a trade as yet thereby preventing the deduction for R&D expenditure. Capital expenditure is allowed only once research commences, which may be after all other expenditure has taken place. Moreover research must be undertaken by the taxpayer or by a Council for Scientific and Industrial Research ("CSIR") approved research institution. Capital expenditure also requires CSIR approval.

CSIR approval relies on the declaration by the taxpayer's independent auditors that the expenditure being approved was undertaken for R&D purposes. In order for the independent auditors to provide such an assurance, reliance is placed on Generally Accepted Accounting Practice ("GAAP").

Reason for change

The South African rules have become obsolete and too restrictive and do not go far enough in recognising modern day developments, A more flexible system that is in line with modern reality that encourages innovation, and is comparable to international trends is appropriate. The current system discourages R&D through a complex system where, if research is successfully completed before 4 years and the expenditure has not been written off in full, the balance will not be deductible as no further certificates from the CSIR will be received.

The CSIR as a regulator (in terms of approving research and development) for taxpayers is generally seen as a complicating factor in promoting R&D. The tax abuse CSIR approval was meant to mitigate is no longer of great concern. Firstly, because the current R&D provisions have not kept up with the other tax provisions that offer a more generous tax dispensation. For the most part, these amendments bring the R&D provisions in line with those existing provisions. Secondly, the concern in respect of buying intangible property is adequately dealt with in other provisions.

Section 11B

This proposed section deals only with new (self generated) R&D undertaken by the taxpayer in the Republic that may lead to the creation of an intangible such as an invention, patent, design, copyright, other similar property or knowledge (trade mark is specifically excluded). Failed or abandoned research is not penalised, as the tax deduction granted under this provision is not recouped under these circumstances. The taxpayer may outsource R&D to a third party, if the payment is for R&D and all the risks and rewards of the R&D remain with the taxpayer. The contracted party must not have "off the shelf" R&D for sale to the taxpayer, in other words the contracting party's R&D must be fully innovative.

A new definition of "research and development" will replace the current definition of "scientific research". Generally this is in line with GAAP and will form the basis of the legislation. However this definition narrows the GAAP definition with specific exclusions, such as research in the fields of social sciences, arts, humanities or management, as well as market research, sales or marketing promotion.

Foremost must be the presence of an appreciable element of innovation. This is

usually seen as an activity departing from the routine and breaking new ground. The proposal encourages experimental or theoretical work undertaken primarily to acquire new scientific or technical knowledge for its own sake or directed towards a specific practical aim or application. Complimentary to this, is the use of this scientific or technical knowledge to produce new materials, devices, products or services or to install new processes or systems before the commencement of commercial production or applications.

Examples of excluded activities (i) expenditure on land and (ii) market research, design and drawing work associated with production standardisation, pre-production activities or sales and marketing promotion.

Expenditure incurred in creating an intangible can be grouped into 2 main categories:
(i) normal operating expenses; and
(ii) expenditure in acquiring a capital asset, such as a building, machinery, plant, implement, utensil or article.

Broadly speaking, under normal operating expenses, the creation of an intangible follows a research phase and a developmental phase. GAAP distinguishes between these phases and treats the associated expenditure differently. In the research phase all costs are expensed and in the developmental phase all costs are capitalised. To encourage research and development the tax deduction will not make this distinction and all costs associated with that intangible (including registration costs to obtain legal protection) are deductible immediately.
Assets of a capital nature can be depreciated on a 40:20:20:20 basis similar to other provisions in the Income Tax Act. All these assets (except for buildings) must be exclusively used for research and development in that year of assessment to qualify for the preferential allowance. The allowance for buildings that are not used exclusively for research and development must be apportioned.

The taxpayer may make an election (once only) at the time the capital asset is brought into use to claim a deduction under this section or any other section of the Income Tax Act (that may be more advantageous). The deduction can only be made either under this provision or another provision but no double deduction is permitted.

RING-FENCING OF ASSESSED LOSSES

Current Law

Section 11 of the Income Tax Act currently lays down the general requirements for deducting expenditures and losses to the extent a person derives income from carrying on any trade. Section 11 must be read in conjunction with section 23, the latter of which contains criteria for denying deductions for various items, such as domestic and private consumption.

Reasons for Change

Not every activity is a trade, even if intended or labelled by the taxpayer as such. Whether or not an activity is a trade is a question of law that depends on the "facts and circumstances" of each case. These "facts and circumstances" are deliberately left open to accommodate the wide range of trade activities existing in a modern economy.

While this "facts and circumstances" test is generally appropriate, special concerns exist when taxpayers disguise private consumption. More often than not, private

consumption can be masqueraded as a trade (i.e., a hobby) so that individuals can set-off these expenditures and losses against other income (usually salary or professional income). This attempt to deduct hobby-like expenses undermines the ability to pay principle of the Income Tax system because wealthier individuals have more means to disguise hobby expenses as a trade. Hence, a more stringent "facts and circumstances" test will be introduced as a means to uncover these artificially labelled trades.

In a recent court case the court had regard to the intention of the taxpayer which is a subjective test. Unfortunately, as was noted in an earlier judgement, this places SARS in a very difficult position. In the words of Smalberger J in ITC 1319 (42 SATC 263); "Insofar as the test propounded by Silke purports to be an entirely subjective one, I do not agree with it. It seems to me that before a person can be said to be carrying on farming operations there must be a genuine intention to farm, coupled with a reasonable prospect that an ultimate profit will be derived, thereby incorporating an objective element into the test. To hold otherwise would make it well-nigh impossible for the Commissioner to determine whether or not to allow farming losses as a deduction from other income, for he must needs adopt an objective approach when doing so."

Proposed Law (Section 20A)

1. General Rule

Section 20A aims to improve the integrity of the tax system by preventing expenditures and losses normally associated with suspect (i.e., disguised hobby) activities from being deducted as a means to reduce taxable income. Subsection (1) sets forth the general rule, which seeks to ring-fence assessed losses from suspect trades (as described in subsection (2)) to prevent these losses from being deducted against any other income that a taxpayer generates. This deduction limitation applies only to natural persons (not to other taxpayers such as companies or trusts).

Furthermore, the rules under this section do not prevent natural persons from using losses from a suspect trade against other income from that trade. However, these losses may be wholly disallowed if the losses stem from an activity that fails to qualify as a trade after application of the general "facts and circumstances" test.

2. Threshold for Ring-Fencing

Section 20A ring-fencing involves a two-part threshold, which determines the level of taxable income at which the taxpayer will become subject to scrutiny. The first part of the threshold focuses on the taxpayer's taxable income level, and the second part focuses on the loss-generating activity.

2.1 *Part 1 - Maximum Marginal Rates*

Section 20A ring-fencing applies only to natural persons whose taxable income equals or exceeds the amount at which the maximum marginal tax rate becomes applicable (currently 40 per cent imposed on taxable income exceeding R255 000). This part of the threshold is determined before set-offs of any assessed (i.e., net) losses incurred from any trade (not just from suspect trades described in paragraphs *(a)* and *(b)* of subsection (2)) that arise during the tax year at issue or any loss carryover from a prior year. This aspect of the threshold ensures that Section 20A ring-fencing is targeted solely at higher income individuals who have the means for

disguising hobbies as trades. This threshold can be illustrated by the following example:

> **Example**
>
> *Facts.* Individual is a medical practitioner and a dealer in collectible cars. In 2005, Individual generates R440 000 taxable income from the individual's medical practice. The collectible car dealing activities incur an assessed loss of R30 000 in the same year.
>
> *Result.* Individual's income from the medical practice is the sole amount taken into account for purposes of the maximum marginal rate threshold. Current and prior losses from the collectible car dealing are ignored. Section 20A potentially applies as the R440 000 from the medical practice exceeds the maximum marginal rate threshold for natural persons in 2005.

2.2 *Part 2 – Suspect Loss Trades*

Only losses from suspect trades are subject to potential ring-fencing. This aspect of the threshold represents an "either or" test. Under this "either or" test, the taxpayer has a suspect trade if the trade fails the "three out of five year" loss rule or has been explicitly listed as a suspect trade.

(a) "Three Out Of Five" Year Loss Trades

Under this aspect of the threshold, a loss activity is treated as a suspect trade if assessed losses arise during three out of the past five years, including the current tax year. Loss years are determined without regard to loss carry forwards. Sustained losses of this kind are frequently an indicator of a suspect trade because natural persons would rarely continue with a trade generating losses on a long-term scale as it does not make sense from an economic perspective unless tax motives are present.

> **Example 1**
>
> *Facts.* Individual operates a trade during the 2005 to 2009 tax years, respectively generating assessed losses of R12 000, R15 000, R20 000, R6 000, and R3 000 in each of those years.
>
> *Result.* The trade is a suspect trade from 2007 onwards. The trade has incurred assessed losses for three years.
>
> **Example 2**
>
> *Facts.* Individual operates a trade from 2005 until 2009. The trade results in a R12 000 assessed loss in 2005, R4 000 of taxable income in 2006, R2 000 of taxable income in 2007, R20 000 of assessed loss in 2008, and R3 000 of assessed loss in 2009.
>
> *Result.* The trade is a suspect trade in 2009. The taxable income arising in 2006 and 2007 count in individual's favour (thereby delaying suspect trade treatment), even if the R12 000 assessed loss remains partially unused as a loss carryover in 2006 and 2007.

Losses incurred in any year of assessment ending on or before 28 February 2004 will not count against a taxpayer.

(b) Listed Suspect Trades

Under this aspect of the threshold, a loss activity is treated as suspect if the loss activity falls within one of the eight categories on the list. These listed activities have been selected based on past experiences in terms of revenue enforcement and in terms of international comparative administrative approaches. More often than not, this information suggests that taxpayers use activities of this nature to generate little gross income as compared to their expenses because taxpayers are actually seeking to disguise private consumption.

This list of suspect activities generally contains qualifiers in order to ensure that this list is not overly punitive. For instance, many of the activities described below will be suspect only if practiced by the taxpayer or a relative. This focus is important because suspect activities practiced by the taxpayer (or relative) suggest a hobby element; whereas, a mere passive investment in which the taxpayer has no active operational involvement does not.

The following suspect categories have been identified:

(i) ***Sporting activities*** practiced by the taxpayer (or relative) include, for example, any form of sport, hunting, yachting or boat racing, water-skiing and scuba diving.

(ii) ***Dealing in collectibles*** by the taxpayer (or relative) includes, for example, cars, stamps, coins, antiques, militaria, art and wine.

(iii) ***The rental of residential accommodation*** is included unless at least 80% of residential accommodation is used by persons who are not relatives in relation to the taxpayer for at least half of the year of assessment. Residential accommodation within this category is intended to include the rental of holiday homes, bed and breakfast establishments, guesthouses and dwelling houses. For instance, the bed and breakfast leasing of a few rooms within the taxpayer's main home would fall under the suspect list. Holiday homes used by the taxpayer and not used by persons who are not relatives for at least half of the year of assessment would be similarly suspect.

(iv) ***The rental of vehicles, aircraft or boats*** constitutes a suspect activity unless at least 80% of the assets are used by persons who are not relatives in relation to the taxpayer for at least half of the year of assessment.

(v) ***The showing of animals in competitions*** by the taxpayer (or relative) is suspect and includes, for example, the showing of horses, dogs and cats.

(vi) ***Farming or animal breeding*** by the taxpayer other than on a full-time basis is suspect, such as weekend or casual farming. One notable activity within this suspect class would be game farming.

(vii) ***Performing or creative arts*** practiced by the taxpayer (or relative) scores as a suspect activity and includes, for example, acting, singing, film making, photography, writing, pottery and carpentry. As stated above, mere passive investment in these activities would not generally fall within the suspect class. For instance, investment in commercial film making would not be suspect if the taxpayer (or relative) has no real involvement with the making of the film, whereas the making of home movies may suggest a hobby-like element.

(viii) ***Gambling or betting*** by the taxpayer (or relative) includes trying one's luck at a casino on a regular basis, card playing, lottery purchases and sports betting.

Following deliberations before the Portfolio Committee on Finance, ownership of racehorses has not been specifically included in the list of suspect trades. From the evidence submitted to the Committee it appears that owners of racehorses represent a pillar of the racing industry as a whole and further consultation is required before a decision is made on the specific inclusion of this activity on the list. Owners of racehorses will, however, still be subject to the three out of five year rule just like any other trade.

3. "Facts and Circumstances" Escape Hatch

As stated above, the threshold qualification under subsection (2) generally results in ring-fenced treatment for the assessed losses (i.e., net losses) of a suspect trade. However, subsection (3) provides an escape route that allows the taxpayer to prevent ring-fenced deduction treatment by proving that the activity at issue is a legitimate trade despite suspect classification in subsection (2).

In order for an activity to escape the subsection (2) taint, the activity must constitute a "business" (as opposed to a hobby or a mere venture). More importantly, this business must have a **reasonable prospect** of generating taxable income within a **reasonable period** (which is determined pursuant to an objective standard rather than mere subjective taxpayer intent). This determination is based on the "facts and circumstances" in respect of which the taxpayer has the onus of proving (see section 82 of the Income Tax Act of 1962). This "facts and circumstances" test must have "special regard" to the "facts and circumstances" outlined in paragraphs *(a)* to *(f)* of subsection (3). Other "facts and circumstances" may also be considered should unique circumstances arise.

The "facts and circumstances" to which special regard will be had are as follows:

(a) *Proportionality of losses to income* - This factor focuses on the proportion of gross income the taxpayer derives from that activity in relation to the deductions arising in respect of that activity. If a taxpayer has relatively small amounts of gross income and claims large deductions, this disproportionality highlights a risk to the Fiscus. However, should the taxpayer be generating large amounts of gross income in relation to deductions, this proportionality will be a favourable factor.

(b) *Advertising and selling* - Typically, trading requires regular selling and marketing initiatives in terms of time and expense (including advertisements). More often than not, hobby activities tend to incur large amounts of expenses/losses while the level of selling activities is minimal. The taxpayer must demonstrate selling/advertising efforts in terms of activities performed or expenses incurred.

(c) *Commercial manner* - Consideration must be given to whether the activity is carried on in a business-like manner. A hallmark of a trade is the business-like system or method pursuant to which the activities are carried out. This factor takes into account:

(i) The number of full-time employees employed in the activity (as opposed to part-time help (distinguishable from employees limited to the high season) which could involve relatives). Employees providing services of

a domestic or private nature are excluded for this purpose (e.g., domestic servants and residential gardening workers regardless of whether they are also involved in the trade or not);

(ii) The commercial setting where the activity is situated (i.e., the business is located in a commercial district and the business-like nature of its appearance);

(iii) The amount and value of the equipment used exclusively for the business (hence, mixed use property, such as yachts, will be excluded from qualifying as a favourable factor); and

(iv) The amount of time a taxpayer spends at the premises conducting the activity.

(d) *Proportionality of period of losses to the duration of the activity* - Account will be taken of the number of years in which the activity incurs a loss in proportion to the total number of years that the taxpayer has been engaged in that activity. In determining the ratio, consideration will be given to:

(i) Any unexpected or unforeseen events that may give rise to losses (for instance, heavy rains or droughts would provide grounds for mitigating sustained losses for farmers); and

(ii) The nature of the activity (for instance, does the activity typically have a long start-up period such as olive farming).

(e) *Taxpayer's future business plans* - Favourable consideration will be given to the business plans and steps put in place by the taxpayer to prevent or limit further losses. Consideration will also be given as to whether the taxpayer intervened strategically to ensure the activity will ultimately be profitable.

(f) *Availability of property for recreational use or personal consumption* - This factor goes to the heart of the matter, but is often the most difficult to prove or disprove. A taxpayer will have to provide proof confirming that the asset was generally unavailable or not actually used by the taxpayer (or relative) for recreational use or personal enjoyment. For instance, where a taxpayer has a holiday home at the coast, the taxpayer will have to prove that the property was not readily available for personal use with details of periods when persons other than the taxpayer (or relatives) occupied the home during the tax year.

4. "Six Out of Ten Year Loss Trades"

The "facts and circumstances" escape route provided by subsection (3) does not apply if the taxpayer has incurred six years of losses during the last ten years of assessment (including the current year at issue). This test is applied in the same manner as the "three out of five" year threshold in subsection 2*(a)*.

This automatic ring-fencing of losses incurred from the year of assessment the taxpayer's trade generated losses for six out of ten years is premised on the notion that a person from an economic perspective could not afford a legitimate trade indefinitely if continuous losses are sustained (unless motives other than profit were present). Hobbies, on the other hand, frequently generate sustained losses for indefinite periods. Farming was excluded from the six out of ten year prohibition because many forms of legitimate farming entail long-term losses before the expectation of profit can be realised.

Losses incurred in any tax year ending on or before 28 February 2004 will not count against a taxpayer.

5. Permanent Ring-Fencing

Ring-fenced losses falling within section 20A are ring-fenced forever and may only be offset against income from that trade. Taxpayers will never be able to use these ring-fenced losses against income from other trades either during the current tax year during which the ring-fenced losses occur or in a subsequent year (in the form of a carry forward), for example:

> **Example**
>
> *Facts.* Taxpayer is an accountant and maintains a residential guesthouse that qualifies as a listed suspect trade under subsection (2)*(b)*. In 2005, Taxpayer generates R530 000 taxable income as an accountant and R12 000 of assessed loss from the guesthouse. The taxpayer is unable to demonstrate a reasonable prospect of generating taxable income.
>
> *Result.* The R12 000 of assessed loss from the guesthouse is ring-fenced in 2005. This ring-fenced treatment of the R12 000 assessed loss will continue for all subsequent years after 2005.

6. Set-Offs Against Recoupment

Generally, losses of a trade subject to ring-fencing under subsection (1) can be freely used against income from that trade. Subsection (6) clarifies that losses of a trade can similarly be used against income from recoupments under section 8(4)*(a)* associated with that trade, even if the recoupment income arguably does not otherwise qualify as income from conducting that trade.

This use of ring-fenced losses against recoupment income stems from the assumption that any recoupment most likely originates from depreciation or other losses that were ring-fenced. In contrast, ring-fenced losses cannot be offset against capital gains associated with the same trade because capital gains represent investment profits (as opposed to trading profits).

7. Multiple Farming Activities Deemed to Qualify as a Single Trade

Assessed losses from a single trade can only be set off against income from the same trade. Whether one or more related activities constitute the same trade or multiple trades is a question of fact. However, subsection (7) provides that multiple farming activities will be deemed to constitute a single trade for purposes of section 20A. This unified treatment of all farming activities is appropriate because farming typically entails multiple diverse activities.

8. Reporting Requirement

Subsection (8) creates a reporting obligation for taxpayers subject to section 20A. Under this rule, a taxpayer must report in the annual tax return each suspect trade as per the tax return form described under subsection (2)*(a)* (i.e., under the “three out of five year” test) or subsection (2)*(b)* (i.e., under the “suspected activity” list). This rule ensures that suspect trades are readily identifiable by SARS.

9. Effect of "three out of five" and "six out of ten" year roles

The application of the "three out of five year" and the "six out of ten year" rules will be applied only by taking into account assessed losses for tax years commencing on or after 1 March 2004.

10. Terminology

Subsection 10 provides that "assessed loss" means "assessed loss" as defined in section 20(2) and "relative" in relation to a person means a spouse, parent, child, stepchild, brother, sister, grandchild or grandparent of that person.

11. Effective Date

Section 20A will come into operation on 1 March 2004 and apply in respect of tax years commencing on or after that date.

VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES

Since 1994 a number of the functions previously performed by the national and provincial departments were delegated to entities outside of the national and provincial departments. The transfer of funds between national and provincial departments, local authorities and public entities has created many interpretation problems because of the different meanings attached to the defined term "transfer payments". The definition of "transfer payment" has been amended three times since the inception of VAT but there remain differences of opinions amongst role-players on the correct classification of payments such as appropriations, grants-in-aid and subsidies. This had lead to inconsistencies and anomalies in the application of the law.

As envisaged in the Budget, a review has been done by investigating nationally and internationally what the VAT dispensation of these bodies and transfers payments should be to ensure the most efficient structuring of the financing of these bodies.

The conclusions reached and reasoning behind the decisions made are as follows—

General Principle

The South African VAT system is based on the premise that the Government is the final consumer of the goods and services it uses to produce the goods and services it provides on a non-commercial basis. The major portion of the supplies made by national and provincial departments are outside the scope of VAT which means that no VAT is charged on the goods and services supplied by Government to the public, but Government cannot claim credit for the input tax paid on goods and services it acquires to provide these goods and services. If Government had supplied the goods or services which recipients supply as a result of the receipt of the transfer payments, the receipt of the transfer payment would not have been consideration and the Government would not have been able to claim an input deduction for the VAT it paid on its inputs. Accordingly the general principle for the taxation of transfer payments by Government is that they should be treated as outside the scope of VAT in the hands of the recipients unless they are used to make supplies which are the same or similar to taxable supplies made by other vendors.

National and Provincial Departments

It is proposed that the *status quo* with respect to the VAT treatment of appropriations to national and provincial government departments be retained, namely that they be treated as outside the scope of VAT unless the Minister is satisfied that the department is carrying on activities and making supplies which are the same or similar as taxable supplies made by other vendors.

Constitutional Institutions

National and provincial government institutions, public entities and business enterprises are listed in schedules to the Public Finance and Management Act, 1999 (PFM Act). It is proposed that all the Constitutional Institutions listed in Schedule 1 to the PFM Act, such as the Public Protector, the Human Rights Commission, the Commission for Gender Equality, etc be excluded from the definition of “enterprise” as their activities are not commercial or in competition with any other vendors.

Major Public Entities.

It is proposed that transfer payments to the major public entities listed in Schedule 2 to the PFM Act which carry on businesses, such as ESKOM, Transnet Ltd and Telkom S A Ltd, should fall within paragraph *(a)* of the definition of “enterprise” and be subject to VAT.

National and Provincial Public Entities

It is proposed that transfer payments to national public entities and provincial public entities listed in Parts A and C of Schedule 3 to the PFM Act respectively be treated on the same basis as government and provincial departments. The supplies of these entities such as the Competitions Board, Judicial Services Board, Legal Aid Board etc will generally not be the same or similar to taxable supplies made by other vendors therefore will not be subject to tax. However, if these entities supply goods or services which are the same or similar to taxable supplied by private sector vendors the Minister can identify them and those activities will be subject to VAT.

National and Provincial Business Enterprises

It is proposed that the transfer payments to the national government business enterprises and the provincial government business enterprises listed in Parts B and D of Schedule 3 to the PFM Act be subject to VAT. As their classification suggests they are business enterprises and will fall within paragraph *(a)* of the definition of “enterprise”.

Local Authorities

Supplies by local authorities of goods and services listed in paragraph *(c)* of the definition of “enterprise” such as electricity, water, gas, removal of sewage, drainage and certain businesses designated by the Minister are subject to VAT. A significant portion of the income generated by local authorities is from rates and no VAT is imposed on the rates. Local authorities can, therefore, not claim as input tax credit any VAT paid on goods and services acquired to provide goods and services financed from the rates account. It is proposed that transfer payments received by local authorities from national and provincial departments and other local authorities be treated as being outside the scope of VAT and that no input tax credit be allowed in respect of goods and services acquired as a result of the receipt of the transfer

payment.

Subsidies to Private Sector Vendors

It is proposed that transfer payments to private sector vendors (other than welfare organisations) by national and provincial departments and local authorities in the form of subsidies and grants be treated as outside the scope of Vat and that no input tax credit be allowed in respect of goods and services acquired as a result of the receipt of the transfer payment.

Welfare Organisations

It is proposed that payments to "welfare organisations" from national and provincial departments and local authorities continue to be zero-rated. These organisations will continue to have the advantage of being able to claim input credits on the tax paid on their purchases.

Public Private Partnerships

It is proposed that transfer payments to "public private partnerships", as defined in Regulation 16 of Treasury Regulations issued in terms of section 76 of the PFM Act be subject to VAT. This is naturally subject to the condition that if the activities of the partnership are exempt supplies as contemplated in section 12 of the VAT Act, and the transfer payment is paid to fund these activities, it will as a result of the general principles of the Act not be subject to tax. Input tax in these circumstances will therefore be denied.

Zero-rating of Transfer payments

Where services are deemed to be supplied to a national or provincial department or a local authority in terms of section 8(5) they are zero-rated to the extent that the payment is a transfer payment. This is the area most subject to abuse and confusion. It is proposed that this zero-rating be withdrawn except in the case of the housing subsidies paid by public authorities and local authorities in terms of the Housing Subsidy Scheme referred in section 3(5)of the Housing Act, 1997.

Deregistration of Vendors

The proposals above will result in a number of supplies by Government bodies and entities no longer being subject to VAT and they will have to deregister. These bodies will become subject to VAT on the market value of their assets on the date of deregistration in terms of section 8(2). As this will merely result in a circular flow of funds within the Government sphere, it is proposed that the operation of section 8(2) be suspended in these circumstances.

It may appear on the face of it that the proposed changes will have a significant effect on the financial position of the different entities involved and on the total tax collections of the Government. The purpose of the investigation was to ensure the most efficient and consistent financing of the activities of the different Government bodies. The changes proposed above are on Government's revenue side and corresponding changes will have to be made on the expenditure side to adjust the amount of the transfer payments to ensure that there is little, if any, change to the net position of the different government bodies and the total tax collections of the Government.

Amendments to give effect to the proposals are set out in the different clauses and where necessary a technical explanation is provided. It should be noted that it is proposed that the term "transfer payment" be replaced with the term "grant" and it is proposed that the amendments only come into operation on a date fixed by the President by proclamation in the *Gazette*. The reason for not bringing the amendments into operation earlier is that the introduction of the amendments must be coordinated with the Government budget cycle so that the necessary adjustments can be made on the expenditure side of the budget.

VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS

The Department of Trade and Industry ("DTI") has developed an Industrial Development Zone ("IDZ") Programme in order to attract foreign and local investment and thereby develop the economic potential in specific geographical areas. There are a number of role players involved in the establishment and development of the IDZ which is an area designated by the Minister of Trade and Industry. Once the Minister has designated the area the IDZ operator develops the infrastructure of the IDZ. Within the area of the IDZ there will be areas designated by the Commissioner in concurrence with DTI which will be called Customs Controlled Areas (CCA), and as the name indicates, these areas will be under the control of Customs. Businesses which will be called CCA enterprises will carry on activities such as the manufacturing of products and components and consolidation or de-consolidation of goods within these CCA's.

As far as SARS is concerned, the main legislation dealing with the IDZ is set out in the proposed section 21A of the Customs and Excise Act which also contains the definitions of the terms used in the paragraph above. The proposed section deems goods removed from a CCA to have been imported into the Republic, The VAT Act assigns the same meanings to the terms as the Customs and Excise Act. Other amendments to the VAT Act have been proposed to accommodate the introduction of IDZ's and CCA's.

VAT is levied on the importation of goods into the Republic where such goods have been cleared for home consumption. However, the VAT on the importation of goods directly into a CCA situated in an IDZ will be suspended as the goods will not have been entered for home consumption in terms of the Customs and Excise Act. Amendments have been proposed to sections 7(1)*(b)* and (13)(1) in terms of which goods from a CCA imported into the Republic will be subject to VAT when they are deemed to be imported in terms of section 21A of the Customs and Excise Act. It is proposed in section 13(2) that the value to be placed on the goods on importation into the Republic from a CCA will not be subject to the 10 per cent upliftment. Goods which are "exported" as defined in section 1 by a vendor from a CCA to an export country will be zero-rated.

The supply of goods by a registered vendor in terms of a sale or instalment credit agreement to a registered vendor in a CCA will be zero-rated if the supplier consigns or delivers the goods the goods to the vendor in that area. It is proposed that services physically rendered to a registered vendor in a CCA will also be zero-rated.

The effect of the proposed provisions is that a vendor in a CCA is afforded VAT treatment similar to that which is afforded to a vendor operating a bonded warehouse.

The amendments will come into operation on a date to be determined by the President by proclamation in the Gazette.

CLAUSE 1

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

In terms of amendments introduced in 2002 to the definition of “fair value”, the value of shares or member‘s interest in a company, which constitute “property” by virtue of it holding residential property, is the market value of the residential property it holds. The definition provides that in valuing the residential property, no account must be taken of the value of the leases or any liability in respect of any loan in relation to the property. It is proposed in the amendment that in determining the market value of the property no account should be taken of any right to or interest in the use of the immovable property conferred on the owner of a share in a share block company.

CLAUSE 2

Transfer Duty: Amendment of section 5 of the Transfer Duty Act, 1949

The purpose of the amendment is to prevent the use of tripartite agreements which are designed to avoid transfer duty. In terms of the section, if a property transaction is cancelled or dissolved by the operation of a resolutive condition before registration of the acquisition in a deeds registry, the amount paid and retained by the seller and any amount paid by either party to the transaction will be consideration on which transfer duty is payable. It is proposed that the consideration should consist of the amounts paid and retained by the seller and any amount paid by the buyer to the seller for the cancellation. A further condition proposed is that on the cancellation or dissolution of the transaction, the property must completely revert to the seller and the buyer must have relinquished all rights and may not receive any consideration arising from such cancellation or dissolution.

It is proposed that these provisions come into operation on the date of promulgation of this Act and apply in respect of the acquisition of property on or after that date.

CLAUSE 3

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

Subclause (a): A transfer duty exemption was inserted in 2002 to provide for the exemption of an acquisition of property in terms of an amalgamation or intra-group transaction or in terms of any liquidation distribution contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). The proposed amendment extends this exemption to any acquisition of property in terms of a transaction that would have constituted an amalgamation or intra-group transaction or liquidation distribution as contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of whether that property is acquired as a capital asset or trading stock. This proposal will align this exemption with that which exempts acquisitions of securities under such transactions from uncertificated securities tax. It is proposed that this amendment come into operation on 6 November 2002.

Subclause (b): The amendment proposes to introduce a subsection (18) to exempt the acquisition, renewal or conversion of mineral rights as a result of the disposal or acquisition in terms of the Mineral and Petroleum Resources Development Act. It is proposed that the amendment come into operation when the abovementioned Act comes into operation.

In terms of the amendments introduced in 2002 the acquisition of a share in a share block company are subject to transfer duty. On conversion of a share block share in terms of Item 8 of Schedule 1 to the Share Blocks Control Act a sectional title unit is acquired on which transfer duty is payable. A person who acquires a share in a share block and then converts it to a sectional title unit would be liable to transfer duty twice. The proposed provision provides an exemption from transfer duty where a natural person converts a share block share to a sectional title unit where transfer duty was paid by that person on the acquisition of the share. It is proposed that this amendment come into operation on 13 December 2002

CLAUSE 4

Transfer Duty: Amendment of section 11A of the Transfer Duty Act, 1949

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 5

Transfer Duty: Insertion of sections 13A, 13B and 13C in the Transfer Duty Act, 1949

The Commissioner has the power in terms of the Income Tax Act and the Value-Added Tax Act, 1991, to take steps to recover taxes and duties outstanding and it is proposed in the amendment that the same power to collect tax be introduced into the Transfer Duty Act. The provisions proposed will permit the Commissioner to:—

- Take judgment against any person for outstanding duty and penalty; and
- Appoint a person as an agent to collect tax from any moneys due by that agent to another person who in turn owes the Commissioner tax.

CLAUSE 6

Transfer Duty: Amendment of section 16 of the Transfer Duty Act, 1949

This proposed amendment is aimed at curbing artificial transactions whereby persons use nominees to avoid transfer duty and provides that section 16 of the Transfer Duty Act should be read with section 5(2)*(a)* of the Act. The proposal is that where a person has purchased a property acting as an agent for another person, he or she must furnish the seller on the day of the auction or on the day that the agreement is concluded, with the document appointing him or her as agent. If the person has the document of appointment as agent but fails to furnish the document and the name of the principal, he will be presumed to have acquired the property for himself or herself for the purposes of the duty, unless the contrary is proved.

CLAUSE 7

Transfer Duty: Insertion of section 17A in the Transfer Duty Act, 1949

The Commissioner is in terms of the Income Tax Act, 1962, and the Value-Added Tax Act, 1991, permitted to impose 200 per cent additional tax for tax evasion. The amendment proposes that the Commissioner have the same power to impose 200 per cent additional duty for evasion in terms of the Transfer Duty Act.

CLAUSE 8

Transfer Duty: Amendment of section 18 of the Transfer Duty Act, 1949

Subclause (a): The amendment is a consequential amendment.

Subclause (b): The proposed amendment provides that payment of the duty cannot be suspended by lodging an appeal, unless the Commissioner otherwise directs. This provision is the same as the provisions in the Income Tax, 1962, and Value-Added Tax Act, 1991. The amendment also provides that any interest paid by the Commissioner on successful appeals is a drawback from the National Revenue Fund.

CLAUSE 9

Transfer Duty: Insertion of section 20B in the Transfer Duty Act, 1949

The proposed amendment introduces a general anti-avoidance provision into the Transfer Duty Act which is similar to those contained in other tax Acts administered by the Commissioner.

CLAUSE 10

Estate Duty: Amendment of section 8A of the Estate Duty Act, 1955

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 11

Estate Duty: Amendment of section 24 of the Estate Duty Act, 1955

The amendment is of a consequential nature.

CLAUSE 12

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

Subclause (a): Provisions were inserted in the Income Tax Act, 1962, in 2001 to provide for electronic filing of tax returns and electronic signatures on these returns.

An e-filing system has also been implemented by SARS. The proposed amendment makes provision for electronic notices and assessments to be issued by the Commissioner.

Subclause (b): See notes on REINVESTMENT RELIEF AND INVOLUNTARY DISPOSALS.

Subclause (c): Despite the shift to worldwide taxation in 2001, large portions of foreign income remain outside the South African income tax net by virtue of “designated country exception”. Under this provision, income from listed foreign countries is exempt if it was derived from a country with a similar tax system to South Africa’s and subject to a statutory rate of at least 27 per cent. The underlying rationale was to eliminate high taxed foreign income, most of which would generate marginal additional revenue for the South Africa fiscus after offsetting foreign tax credits.

The current system creates an impression that South Africa’s tax system favours certain countries over others. The use of the list concept is also problematic because many countries have hidden incentives that do not simply eliminate statutory income or cannot be uncovered without a full understanding of the entire tax system involved.

It is proposed that the designated country exception be removed for all purposes, including for purposes of sections 9D(Controlled Foreign Companies), 9F(foreign source income), and section 64B(STC).

Subclause (d): The definition of dividend is amended by deleting the provisions relating to the granting of benefits by a company to shareholders in the form of a disguised dividend. The granting of these benefits and the transfer of assets are fully dealt with in the STC provisions.

Subclauses (e) and (f): The taxation of foreign dividends is dealt with under the definition of “gross income” and these amendments are consequential upon the repeal of section 9E.

Subclauses (g) and (l): With the introduction of the worldwide system of taxation, a special exemption from worldwide taxation and the foreign dividend tax was introduced in respect of International Headquarter Companies (IHC). In order to qualify for this IHC exemption, the entity had to be exclusively foreign owned, and it had to have more than 90 per cent of its value stem from equity or loan capital of more than 50 per cent owned foreign companies. This regime was designed so that foreign investors could use South African facilities as a regional headquarters.

Under the international best practice, the exemption could be viewed as a “Harmful Preferential Tax Regime”. The 90 per cent foreign ownership requirement makes the IHC a ring-fenced regime, whereby a country isolates its own economy from tax concessions by providing a special regime solely to foreign controlled taxpayers. International pressure requires that regimes of this kind be eliminated. The regime was also ineffective. Firstly, in terms of Exchange Control Regulations, the South African Reserve bank restricted the currency flow of 90 per cent foreign owned South African subsidiaries. Secondly, as the IHC was a non-resident for tax purposes, it could not qualify for the benefits of certain Double Taxation Agreements entered into by South Africa with other countries. It is, therefore, proposed that the IHC regime should be removed.

Subclause (h): This amendment is consequential upon the repeal of section 9E.

Subclauses (i) and (j): A person is a resident of the Republic if that person is ordinarily resident in the Republic, or if a person is physically present in the Republic for a certain number of days during the relevant year of assessment and the three preceding years of assessment. The "physical presence"-test is a year by year test. If a person qualifies as a resident in terms of this test, that person is deemed to be a resident from the first day of the year of assessment during which that person so qualifies. This proposed amendment clarifies this position.

Subclause (k): For purposes of determining whether a person is a resident of the Republic in terms of the "physical presence"-test, the days that a person is in transit through the Republic are not taken into account. This, however, only applies where a person does not enter the Republic through a port of entry. In terms of the Immigration Act, 2002 (Act No. 13 of 2002), a person may only enter the Republic through a port of entry. The term "port of entry" as defined in section 1 of the Immigration Act, 2002 refers only to foreigners who enter the Republic and does not include South African residents or citizens. Hence, the law pertaining to South African residents and citizens is unclear. The proposed amendment will clarify this issue so that the "port of entry" refers to all South African residents, citizens and foreigners who enter the Republic through a "port of entry". The Minister of Home Affairs may, however, authorise any person or category of persons to enter the Republic at a place other than a port of entry. It is proposed that "physical presence" test also take account of the possibility that a person may enter the Republic at such other place.

Subclause (m): This amendment is consequential upon the new provisions relating to the deduction of research and development expenses.

Subclause (n): A new definition of "securities lending arrangement" is proposed for purposes of the tax treatment of disposals, dividends received from shares which are transferred in terms of such an arrangement and where those shares are held as trading stock.

Subclause (o): The definition of "shareholder" is amended to provide that a person who is entitled to participate in the capital attaching to a share shall be deemed to be a shareholder.

CLAUSE 13

Income Tax: Amendment of section 3 of the Income Tax Act, 1962

Subclause (a) and (b): Since the South African Revenue Service no longer forms part of the public service, the wording in section 3 of the Income Tax Act, 1962, is amended to extend the wording as the reference to "officer" still contains an association with persons appointed under the Public Service Act.

Subclause (c): The proposed amendment deletes references to obsolete provisions.

CLAUSE 14

Income Tax: Amendment of section 4 of the Income Tax Act, 1962

The amendments proposed to section 4 of the Income Tax Act, 1962, makes it clear that persons who are engaged by the Commissioner on a contractual basis to provide professional services are also bound by the secrecy provisions and are also required to take and subscribe to the oath or solemn declaration of secrecy.

It is also proposed that the penalty, where a person carries out the provisions of the Income Tax Act without first taking the prescribed oath of secrecy or solemn declaration, be increased from R50 to R500.

CLAUSE 15

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

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

CLAUSE 16

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

Subclauses (a), (b) and (d): These amendments are consequential upon the repeal of section 9E.

Subclause (c): This amendment ensures that the granting of a foreign tax credit for a CFC is dependent on the submission of required information with regard to the CFC.

Subclause (e): This amendment ensures foreign tax credits are available to dividends received by collective investment scheme holders following transfer of flow through provisions to the proviso.

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

Subclauses (g) and (h): This amendment is collateral to new sections 9D(12) and 9D(13). Both sections allow certain South African shareholders of foreign companies to be taxed currently (upon election) on their pro rata share of foreign company income. This election effectively provides these South African shareholders with section 6*quat* rebates (i.e., foreign tax credits) for the foreign taxes paid by the foreign company with respect to their pro rata share of foreign income.

It is proposed that a resident may not generate excess foreign tax credits from foreign sourced income in the form of diversionary income, passive income, where the resident elects a foreign company to be treated as a CFC and where the resident elects that the exclusions provided for in section 9D(9) do not apply. The reason for this limitation is that the foreign tax credit provisions should only serve to avoid economic double taxation of these sources of income and not generate excess credits to shield South African tax on other sources of foreign income.

Subclause (i): These foreign tax credit provisions are no longer required in view of dividend exemption for substantial shareholdings.

Subclause (j): The amendment ensures that duplicated credit and deduction for foreign tax credits cannot take place following transfer of deduction option to section 11*(r)*.

Subclause (k): This amendment is consequential on the repeal of section 9E.

CLAUSE 17

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

This amendment is consequential upon the repeal of section 9E.

CLAUSE 18

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

See notes on REINVESTMENT RELIEF AND INVOLUNTARY DISPOSALS.

CLAUSE 19

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

Section 8E treats dividends on shares as South African sourced interest income if the share qualifies as an “affected instrument.” Among other circumstances, a share will be treated as an “affected instrument” if that share generates a yield akin to a bond (i.e., akin to disguised interest). Under current law, these situations arise when the dividend is calculated with reference to any specified rate of interest or is otherwise to be calculated having regard to the amount of capital subscribed for the share paying the dividend.

The proposed amendment provides an additional circumstance in which the dividend yield will be treated akin to disguised interest. This additional situation will arise if the dividend yield is calculated with regard to the amount of any loan or advance made directly or indirectly by any shareholder (or any connected person). Although this amendment applies to both domestic and foreign shares, this amendment is mainly designed to prevent foreign round-tripping schemes designed to generate South African source interest deductions along with tax-free foreign dividends.

Example 1

Facts: South African Company acquires shares in a foreign company at the cost of R1 million. South African Company pays for the shares by issuing a promissory note to repay the R1 million at a 10 per cent interest rate. The shares acquired act as security for failure to repay. The shares will provide a dividend yield equal to 1 per cent less than the yield on the promissory note (the 1 per cent differential being held back as a fee for the other parties to be involved in the transaction).

Result. The dividend yield on the foreign shares will be treated as taxable interest in the hands of South African Company because the dividend yield is calculated based on the promissory note (i.e., a loan made by the shareholder).

Example 2

Facts: The facts are the same as *Example 1*, except that South African Company immediately transfers all the foreign shares to a wholly owned South African Subsidiary in exchange for newly issued South African Subsidiary shares.

Result. The result is the same as *Example 1*. The dividends from the shares are still treated as taxable interest because the payments are based on amounts payable by a connected person.

CLAUSE 20

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

This amendment is of a textual nature.

CLAUSE 21

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

The amendment is consequential upon the insertion of the definition of "securities lending arrangement" in section 1.

CLAUSE 22

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

Subclause (a): This amendment is consequential upon the amendment of the definition of resident in the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003.

Subclause (b): The amendment to the definition of "foreign financial instrument holding company" is consistent with the definition applied for purposes of the corporate restructuring rules. However, shares, loans, advances and debts between companies which form part of the same group of companies must be disregarded in determining the required ratios.

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

Subclause (d): This amendment is consequential upon the repeal of section 9E.

Subclause (e): Under current law, a CFC cannot deduct items such as interest, royalties, rents, section 31 adjustments, currency exchange losses if these items relate to amounts arising with respect to other CFCs in the same controlled group of companies to the extent the other CFC treats the comparable amount as exempt under section 9D(9)(*f*A). This current rule ensures that parity exists between both

CFCs (i.e., if one CFC receives the benefit of exemption, the other CFC loses the corresponding deduction). The proposed amendment modifies this rule in light of newly proposed section 9D(12), which allows South African residents to treat section 9D(9)(*f*A) as includible CFC income. Under the proposed change, the CFC can deduct the above items associated with section 9D(9)(*f*A) to the extent a South African resident treats section 9D(9)(*f*A) amounts as includible income. This proposed change effectively maintains the current system of parity - intra-group CFC costs are deductible unless associated with corresponding exempt intra-group CFC net income.

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

Subclause (g): It is proposed that the designated country exemption be removed as the list is being wrongly perceived as an incentive system for investing in certain countries, the list consists of OECD and wealthy countries as opposed to developing countries and the designation does not take into account hidden incentives.

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

Subclauses *(k)* and *(l)*: The Scope of Diversionary Transactions Narrowed: South African CFCs generate current taxable income for their South African shareholders if that CFC generates passive or diversionary income. Diversionary income involves income that contains red-light indicators or transfer pricing avoidance. The scope of diversionary treatment may be unfair in certain situations. Under current law—

- CFC sales to connected persons who are residents will not trigger diversionary treatment if that CFC purchases those goods in the country of residence of the CFC because that CFC has a business reason for its location;
- CFC sales of South African assets will not trigger diversionary treatment if that CFC sells to local customers within the same country of CFC location because that CFC has a business reason for its location.

However, the law does not account for situations in which a CFC—

- purchases the same or similar goods mainly within the country of residence of the CFC;
- mostly sells to local customers but sells lesser amounts to customers from nearby countries. It is proposed that provision be made for these latter situations.

Subclause (m): Under present law, passive income generated by a CFC is generally subject to tax under section 9D even if that income is attributable to a business establishment. However, two types of passive income attributable to a business establishment will qualify for exemption - *de minimis* passive income (item *(aa)* income) and passive income stemming from the principal activities of a banking or financial services, insurance or rental business (item *(bb)* income).

The current *de minimis* passive exemption allows passive CFC income to be exempt if that income (gross income and gross capital gains) does not exceed 5 per cent of the total. None of this passive income is exempt once the 5 per cent threshold is exceeded. The proposed amendment shifts the policy of this exemption in favour of an objective working capital exemption. Most businesses have a small amount of working capital that is necessary for the proper functioning of that business. The current all-or-nothing cut off also makes little sense. Under the proposed amendment, the exemption is shifted to a 10 per cent of active income threshold with amounts below that threshold remaining exempt even if the total passive amounts exceed the 10 per cent threshold.

Example 1

Facts: South African Company owns all the shares of CFC. CFC generates R200 000 of gross income from the trading operations of its business establishment. CFC also maintains working capital that generates R23 000 of passive income.

Result. Under the amendment, R20 000 of the passive income is exempt under section 9D(9)*(b)*(iii)*(aa)*. The excess R3 000 falls within the CFC tax net.

Example 2

Facts: South African Company owns all the shares of CFC. CFC solely holds portfolio investments generating R200 000 of passive income. CFC does not have a business establishment.

Result. Section 9D(9)*(b)*(iii)*(aa)* does not apply under present or proposed law. No active income is attributable to a business establishment.

Proposed changes to section 9D(9)*(b)*(iii)*(aa)* also clarify the interaction of this exemption with other section 9D(9) exemptions. Under the proposed exemption, the 10 per cent calculation is determined without reference to the exemptions contained in section 9D(9)*(e)* through *(f*B*)* or to amounts not included as income (such as dividends that are exempt by virtue of the participation exemption under proposed section 10(1)*(k)*(ii).

Subclause (n): Section 9D(9)*(f)* exempts dividends received by a CFC to the extent these amounts represent CFC profits that were previously included as income by the same South African shareholder. The proposed amendment changes how this calculation is made in line with the proposed stacking rules of section 10(1)*(k)*(ii)*(cc)*.

Subclause (o): Section 9D(9)*(h)* currently contains a participation exemption for foreign dividends and the sale of shares by CFCs. Under this exemption, dividends from the foreign shares and the sale of foreign shares will be exempt if the CFC receiving the dividend or selling the shares has a more than 25 per cent interest in the equity shares of a foreign company. The proposed amendment moves the dividend exemption into section 10(1)*(k)*(ii)*(dd)* and the exemption for selling shares to paragraph 64B of the Eighth Schedule.

Subclause (p): The penalty provisions for failure to report details of CFCs have been deleted as a result of the inclusion of penalty provisions in section 72A.

Subclause (q): South African shareholders that hold from 10 to 25 per cent in a CFC can elect to treat all their pro rata share of CFC income as taxable under section 9D even if that income would otherwise be exempt under section 9D(9). This mechanism is an all-or-nothing election – South African shareholders cannot electively choose to bring only certain portions of otherwise exempt income into the net. Like section 9D(13), this election essentially mitigates the removal of the indirect tax credit system of section 9E by allowing South African shareholders to be taxed currently on foreign income in order to receive the benefit of section 6*quat* rebates (but note that no excess rebates can be generated from this election by virtue of section 6*quat*(1B)). This election may be made on a year-by-year basis. The 10 to

25 per cent threshold takes into account the interests of connected persons regardless of whether those connected persons choose to utilise the election provided under this subsection.

> **Example**
>
> *Facts:* South African Company owns 25 per cent of the ordinary shares of U.K. CFC. In 2005, U.K. Company generates 400 000 pounds of active income attributable to a U.K. business establishment as well as 20 000 pounds of passive income from related working capital. All this CFC income is subject to a 30 per cent U.K. tax. In 2006, U.K. Company distributes all remaining 294 000 pounds to South African shareholders as a dividend.
>
> *Result*. In 2005, South African Company can elect to treat an amount equal to its portion of CFC income as imputed amounts despite the exemptions of section 9D(9)*(b)* and the South African tax liability may be reduced by section 6*quat* rebates. South African Company can disregard the 2006 dividend because this dividend represents previously taxed income (see section 10(1)*(k)*(ii)*(cc)*).

This election can also be combined with the election of section 9D(13). Hence, if a South African resident owns a 20 per cent share in a foreign company that is not a CFC, that resident can elect to include all of that resident's 20 per cent pro rata share of foreign company income, even if that income would otherwise be exempt under section 9D(9).

South African shareholders that hold from 10 to 25 per cent in a foreign company can elect to treat their participation rights in that foreign company as controlled foreign company interest. The 10 to 25 per cent threshold takes into account the interests of connected persons regardless of whether those connected persons do not choose to utilise the election provided under this subsection. This election essentially mitigates the removal of the indirect tax credit system of section 9E by allowing South African shareholders to be taxed currently on foreign income in order to receive the benefit of section 6*quat* rebates and not to be taxed on the distribution of the profits of the foreign company. This enables the resident to avoid the economic double taxation of profits distributed and taxed as a foreign dividend where no underlying foreign tax credits may be claimed. However, this elective provision should not be used to bring foreign tax credits in excess of the South African tax liability into the tax system which would shield other sources of low taxed foreign income. Therefore, excess foreign tax credits will in these instances be forfeited. This election may be made on a year-by-year basis.

> **Example**
>
> *Facts:* South African Company owns 20 per cent of the ordinary shares of U.K. Company, the remainder of which is owned by an unconnected foreign individual. In 2005, U.K. Company generates 50 000 pounds of passive net income subject to a 30 per cent U.K. tax. In 2006, U.K. Company distributes all remaining 35 000 pounds to its shareholders as a dividend on a pro rata basis.

> *Result*. South African Company can elect to be subject to tax on its pro rata share of the 50 000 pounds earned by U.K. Company as if U.K. Company were a controlled foreign company. Hence, South African Company is deemed to receive 10 000 of pounds of income along with 3 000 pounds of 6*quat* rebates (resulting in zero of South African taxes). South African Company can disregard all 7 000 pounds of dividends received in the following year because all these dividends represent previously taxed income (see section 10(1)(k)(ii)*(cc)*).

CLAUSE 23

Income Tax: Repeal of section 9E of the Income Tax Act, 1962

Under present law, gross income includes any amount received or accrued as dividends including any "foreign dividend" as defined in section 9E. A foreign dividend is defined as any actual dividend declared from profits derived from a foreign company and any deemed dividend declared by any company (as contemplated in section 64C).

Section 9E contains a series of rules that provide direct and indirect tax credits, technically referred to as 6*quat* rebates. If a resident shareholder holds at least 10% of the equity share capital of the foreign company declaring the dividend, foreign corporate taxes paid will be allowed as an indirect tax credit and withholding tax paid will be allowed as a direct tax credit.

This regime has a series of exemptions. These exemptions include exemptions for dividends from dual listed foreign companies on the JSE Securities Exchange and those stemming from previously taxed South African profits. Other exemptions include exemptions applicable for unbundlings as well as a Ministerial exemption.

The current system of taxing foreign dividends under section 9E has the unintended effect of discouraging dividend inflows. This problem is most readily apparent in situations where South African taxpayers owning a meaningful interest in a foreign subsidiary delay or avoid the repatriation of dividends to avoid South African tax.

It is proposed that tax on foreign dividends should be removed if a resident shareholder has an interest of more than 25 percent in a foreign company paying the dividend. Dividends below this threshold will no longer be eligible for indirect tax credits under section 6*quat*. Indirect tax credits are problematic in terms of enforcement and compliance because of the difficulties of tracing historic profits to applicable foreign taxes. Moreover, little reason exists to maintain this complex system for the small class of South African shareholders otherwise remaining within the indirect tax credits system (i.e. those between the 10 – 25 percent range). Even in these limited instances, efforts have been taken to mitigate the loss of indirect tax credits. Hence, section 9D will now allow South African shareholders to receive tax credits for taxes paid by a foreign company if these shareholders elect to be taxed currently. The stacking rules for exempting previously taxed profits have also been amended in favour of taxpayers. While section 9E has been repealed, some of the section 9E exemptions have been moved to new section 10(1)(k). These exemptions include exemptions for dual listed companies and previously taxed South African income. The Ministerial exemption has been removed as superfluous in light of the new exemption for more than 25 percent foreign shareholding.

CLAUSE 24

Income Tax: Repeal of section 9F of the Income Tax Act, 1962

Section 9F, which exempts foreign source income from designated countries, is hereby repealed as part of the overall elimination of the designated country exception. All foreign source income, such as foreign branch income or foreign interest income, etc. will now be subject to tax regardless of the country where it arose.

CLAUSE 25

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

The amendments to section 9G are largely technical in nature. First, the definition of foreign currency has been revised in order to be consistent with other recently changed provisions to the Act. Second, the relationship between section 9G and section 25D has been clarified. Currency conversions under section 9G stand on their own without reference to section 25D. Lastly, the currency conversion rules for equity instruments acquired after 1 October 2001 are currently unclear. The proposed amendment clarifies that expenses incurred to acquire trading stock of this kind after 1 October 2001 are translated to the South African currency at the average exchange rate during the tax year in which that expenditure was incurred. Opening stock calculations for trading stock are similarly calculated with reference to the year of expenditure.

Subclause (a): This amendment brings the reference to the currency of the Republic in line with other references to the South African currency in the Income Tax Act.

Subclause (b): This amendment clarifies the average rate of exchange to be used where a foreign equity instrument is disposed off during a tax year following the tax year of acquisition thereof.

CLAUSE 26

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

Subclause (a): This amendment is for clarification purposes and brings the wording in line with the other exemption provisions. Technically, amounts received by or accrued to a person and not revenues, form the basis for determining a liability for income tax.

Subclause (b): Section 10(1)*(c*H*)* exempts the receipts and accruals of mining rehabilitation funds or entities. The current provisions contain various deficiencies and uncertainties and the proposed amendment—

- clarifies that the funds of the relevant exempt entity may only be used to discharge the rehabilitation obligation on the closure of a mine or part of a mine;
- specifies the types of instruments or investments in which unutilised funds may be invested;
- provides that the Commissioner approves the Constitution of the body or instrument establishing the trust;

- introduces certain provisions to prevent non-compliance; and
- introduces a mechanism whereby the Department of Minerals and Energy must certify that money withdrawn from the exempt entity has indeed been used for the sole purpose of the entity.

Subclause (c) and (d): These amendments are consequential upon the repeal of section 9E.

Subclause (e), (f), (g) and (h): Section 10(1)*(k)* is being revised to reflect the elimination of section 9E and the introduction of the exemptions for foreign dividends received by or accrued to a person. The core of this amendment is reflected in the enactment of the new section 10(1)*(k)*(ii).

South African Amounts

Section 9E(7)*(e)*(ii) and (iv) currently exempt foreign dividends to the extent that these amounts directly or indirectly stem from South African profits treated as South African taxable income or from South African company dividends (which were most likely subject to the Secondary Tax on Companies). These rules have been moved to proposed section 10(1)*(k)*(ii)*(aa)*.

Dual Listed Foreign Companies

Under the current section 9E(7)*(c)*, dividends from certain dual listed foreign companies on the JSE Securities Exchange are exempt from tax. In addition to moving the exemption to section 10(1)*(k)*(ii)*(bb)*, the proposed amendment revises the exemption in the light of the removal of the designated country exception and the extension of the participation exemption to dividends received by South African shareholders.

As revised, all dividends from a dual listed foreign company (i.e., a company listed on the JSE Securities Exchange and listed on a recognized foreign exchange) are exempt from tax. The shareholder receiving the dividend need not hold any threshold level of shares to receive the exemption. The only ownership requirement is that South African residents must own more than 10 per cent of the foreign company in the aggregate (i.e., the listing on the JSE Securities Exchange must be meaningful).

Dividends Out of Previously Taxed Foreign Profits

Foreign dividends from a CFC are not subject to tax to the extent those dividends represent previously taxed profits under section 9D. This rule prevents double taxation of the same profits. This exemption currently exists under section 9E and is now being moved to new section 10(1)*(k)*(ii)*(cc)*.

Under current law, dividends are deemed distributed out of profits pursuant to a year-by-year method on a last-in first-out basis. If a dividend represents a portion of a specific year's profits, the dividend is deemed to come out of a proportionate share of the year's profits if different types of profits arise during that year. Taxpayers may choose to shift the ordering of the year-by-year method through shareholder or director resolution but may not choose to change the proportionate allocation of profits within a single year. This total system of allocating profits was mainly important for indirect credits but also applied to determine previously taxed profits under section 9D.

The above tracing method is complicated because the shareholder receiving the dividends can only determine the tax consequence of a dividend by looking at how the profits were generated by the dividend-paying company. This tracing may require the review of profits over many years and may ultimately require another look-though to the profit of other companies if the profits at issue stem from lower-tier dividends.

The proposed amendment eliminates this complex tracing method with a simpler mechanism that is more taxpayer favourable. Under the new approach, all foreign dividends from a CFC are exempt until those foreign dividends exceed the amount of previously taxed section 9D income from that CFC (less any prior exempt dividends and foreign tax payable). No tracing of profits is required; all the calculations can be achieved solely at the shareholder level.

Example 1

Facts: Five South African residents each own 20 per cent of the shares of CFC. In 2004, CFC generates R150 000 of active business establishment income and R50 000 of passive income. Of the R50 000 passive amount, R35 000 gives rise to section 9D income for the shareholders (the other R15 000 amount is exempt by virtue of the *de minimis* exception). At the end of 2004, CFC distributes a R10 000 dividend to each of the five shareholders. Assume the income of CFC is totally exempt from foreign tax due to a foreign tax holiday.

Result. Each South African resident has R7 000 (R35 000 divided by 5) of section 9D income by virtue of their interest in the CFC. The R10 000 dividend received by each shareholder is exempt to the extent of R7 000 each by virtue of the previously taxed exemption of section 10(1)(k)(ii)*(cc)*. The exemption applies regardless of the profits utilised by CFC to distribute the dividend.

Example 2

Facts: Five South African residents each own 20 per cent of the shares of CFC. CFC generates R80 000 of passive income in 2004, and R60 000 of active business establishment income in 2005. CFC distributes a R10 000 dividend to each of the five shareholders at the end of 2004 and another R10 000 to each of the five shareholders at the end of 2005. Assume the income of CFC is totally exempt from foreign tax due to a foreign tax holiday.

Result. In 2004, each South African resident has R16 000 (R80 000 divided by 5) of section 9D CFC income, but all of the dividends are exempt by virtue of the previously taxed exemption of section 10(1)*(k)*(ii)*(cc)*. In 2005, the CFC income does not generate section 9D income for the shareholders. Of the R10 000 dividend amount received by each shareholder, the dividend gives rise to R4 000 of income (R10 000 dividend - (the R16 000 of previously taxed CFC income – the prior R10 000 exempt dividend)).

The proposed previously taxed exclusion also takes into account section 9D income stemming from lower tier CFCs. South African shareholders receiving dividends not only reduce the dividend amount for previously taxed earnings of the CFC but also section 9D amounts stemming from lower-tier CFCs held by virtue of the CFC paying the dividend.

Example

Facts: Five South African residents each own 20 per cent of the shares of CFC 1, and CFC 1 owns all the shares of CFC 2. In 2004, CFC 1 generates R100 000 of active business establishment income, and CFC 2 generates R60 000 of passive income. At the end of 2004, CFC 1 distributes a R10 000 dividend to each of the five shareholders. Assume the income of CFC 1 is totally exempt from foreign tax due to a foreign tax holiday.

Result. Each South African resident has R12 000 (R60 000 divided by 5) of section 9D income by virtue of their interest in the CFC 2 (which is held through CFC 1). The R10 000 dividend received by each shareholder is exempt by virtue of the previously taxed section 9D income of CFC 2. (Note: If CFC 2 distributes a dividend of R10 000 to CFC 1, this CFC-to-CFC dividend would be exempt from tax by virtue of the newly proposed section 9D(9)*(f)*).

Participation Exemption

Under current law, most dividends received by CFCs do not create taxable income under section 9D by virtue of the participation exemption of section 9D(9)*(h)*. This exemption effectively exempts dividends received by CFCs from shareholdings that represent an active stake in a foreign company (a rough comparable to the business establishment exemption). The participation exemption of section 9D(9)*(h)* in respect of foreign dividends has been moved to section 10(1)*(k)*(ii)*(dd)* with the effect that dividends from more than 25 per cent owned foreign companies will now be exempt if received by South African shareholders as well as by CFCs. This exemption ensures that South African taxpayers will not be penalized for bringing back dividends onshore.

Any person (i.e., any South African person or CFC) will receive exemption for dividends received from a foreign company if that person holds more than 25 per cent of that foreign company's total equity share capital. This more than 25 per cent share interest includes share interests held by other companies within the same controlled group of companies as the company receiving the dividend.

This exemption also contains two sets of rules to prevent this exemption from becoming a mechanism for employing tax avoidance round-tripping transactions (i.e., schemes designed to generate deductions by shifting payments offshore followed by the tax-free return of those funds in the form of exempt foreign dividends). The first set of rules prevent the application of this exemption with respect to shareholdings comparable to debt (i.e., shares qualifying as section 8E instruments without regard to the three year requirement contained in that section). Dividend paying shares involved in round-tripping schemes frequently contain criteria that are comparable to debt-like instruments. Shares falling within this suspect class cannot produce exempt dividends nor can they be relied upon by other parties for purposes of their own more than 25 per cent calculation. The second set of rules contains a more generalized anti-avoidance provision as a rearguard defence against schemes overcoming objective criteria of the first set of rules. Under this backup provision, the exemption is similarly denied for dividends that form part of any scheme to generate exempt dividends while that person (or any connected person) makes corresponding payments (excluding payments for goods or electricity) which are deductible for

South African tax purposes.

Example 1

Facts: Foreign Company 1, a shell company with no meaningful assets, has issued 100 ordinary shares, all of which are held by foreign persons. South African Company 1 owns all the shares of South African Company 2. South African Company 1 acquires participating preferred shares of Foreign Company 1 in exchange for a R10 million promissory note payable to Foreign Company 1 at a 15 per cent interest rate. South African Company 1 transfers all the participating preferred shares to South African Company 2. The participating preferred shares will provide a dividend equal to all the profits of Foreign Company 1 but no greater than R1,5 million per year.

Result. The dividends on the preferred shares do not qualify for the participation exemption. The dividends are effectively calculated on the basis of the note payable by South African Company 1 (i.e., person connected to the shareholder receiving the dividend). The dividends are also part of a scheme to generate exempt dividends with corresponding deductions against South African income.

Example 2

Facts: The facts are the same except that South African Company 2 owns 10 ordinary shares of Foreign Company.

Result. Any dividends received by South African Company 2 with respect to the ordinary shares also do not receive the benefit of the participation exemption. South African Company 2 cannot rely on the suspect preferred shares as a means for obtaining exemption with respect to the ordinary shares.

Subclause (i): This amendment is consequential upon the repeal of section 9F.

Subclause (j): In terms of section 10(1)*(o)* of the Income Tax Act, 1962, any remuneration received by or accrued to a person in respect of services rendered outside the Republic is exempt if that person was outside the Republic for a certain period. In determining the number of days that a person was so outside the Republic, the days that a person is in transit through the Republic are not taken into account. This, however, only applies where a person does not enter the Republic through a port of entry. In terms of the Immigration Act, 2002 (Act No. 13 of 2002), a person may enter the Republic through a port of entry. The Minister of Home Affairs may, however, authorise any person or category of persons to enter the Republic at a place other than a port of entry. It is proposed that in determining the period that a person is outside the Republic for purposes of section 10(1)*(o)* the possibility that a person may enter the Republic at such other place must also be taken into account.

Subclause (k): The exemption granted previously to certain domestic companies holding gold mining shares is now withdrawn as no discernable policy rationale exists for its continuance.

Subclause (l): The amendment provides for the exemption of the South African National Roads Agency Limited from the date of its incorporation.

Subclause (m): The proposed amendment deletes a reference to an obsolete provision.

Subclause (n): See notes on PUBLIC PRIVATE PARTNERSHIPS.

Subclause (o): This amendment clarifies the current interpretation that the exemptions from the payment of income tax in terms of section 10 do not cover capital gains determined in the Eighth Schedule. The Eighth Schedule contains the exemption provisions relating to capital gains.

CLAUSE 27

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

Subclause (a): These provisions were moved from section 9E(5A) in consequence of the repeal of section 9E.

Subclauses (b), (c), (d), (g) and (h): See notes on RESEARCH AND DEVELOPMENT.

Subclause (e): This amendment provides for the deduction of amounts paid in cash to section 10(1)*(c*H*)* persons. The deductible amount is limited in terms of a formula to be applied in respect of each mine of a taxpayer.

Subclause (f): See notes on REINVESTMENT RELIEF AND INVOLUNTARY DISPOSALS.

Subclause (i): This amendment provides for an election by a person to claim withholding tax proved to be payable in respect of foreign dividends received by or accrued to that person during a tax year as a deduction instead of qualifying as a foreign tax credit.

CLAUSE 28

Income Tax: Insertion of sections 11A of the Income Tax Act, 1962

Under current law, expenditures and losses incurred by a taxpayer before commencement of a trade may not qualify for deduction under section 11*(a*). The non-deductibility of these start-up costs stems from the fact that the taxpayer is not yet carrying on a “trade”.

Many countries allow start-up costs to be either deducted on the date of commencement of a trade or deducted over a certain period of time thereafter. Considering that new business formation is vital to our economy, sound economic principles dictate that ordinary tax principles should be disregarded in these circumstances.

The proposed section 11A provides taxpayers investing in new business ventures with a special deduction for start-up costs incurred before the commencement of trade. Costs that would have been allowed had trade commenced are now deductible in the year trading has commenced, irrespective of the year in which the costs have been incurred.

Start-up costs in this case refers to costs such as advertising and marketing promotion, insurance, accounting and legal fees, rent, telephone, licenses and permits, market research and feasibility studies.

Subsection 2 ring-fences start-up costs. Start-up costs incurred prior to the commencement of trade can only be set off against income from that trade. This ring-fencing prevents taxpayers from artificially disguising costs as business expenses (similar to the new ring-fencing provisions of section 20A).

CLAUSE 29

Income Tax: Insertion of sections 11B of the Income Tax Act, 1962

See notes on RESEARCH AND DEVELOPMENT.

CLAUSE 30

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

This amendment deletes the sunset clause on accelerated depreciation on assets used in the process of manufacture.

CLAUSE 31

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

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

Subclause (b): This amendment provides that a *de minimis* shareholding in other companies should not disqualify a company or close corporation from being a small business corporation.

Subclause (c): This paragraph measures the proportion of investment income of a company or close corporation to determine whether it is a small business corporation. This amendment ensures that capital gains are also taken into account.

Subclause (d): Provision is made for a special deduction for small business corporations. Section 12E small business corporations receive a double deduction for start-up costs. However, this double deduction cannot exceed R20 000. For example, if a section 12E company incurs R100 000 of start-up costs, this company receives a deduction of R120 000 in lieu of the standard R100 000 amount. This deduction is granted in the year of assessment during which the small business corporation commences trading. This double deduction provides a further incentive for the growth and development of the small business sector.

CLAUSE 32

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

Subclause (a): This amendment makes it possible to claim a double deduction to the extent envisaged in section 12H by overriding section 23B – prohibition of double

deduction.

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

CLAUSE 33

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

Under current law, the tax depreciation of buildings is generally low, either being nil, 2% or 5%. No provision exists for the accelerated tax depreciation of buildings. Like many countries, South Africa has a number of urban areas that are impoverished and suffering from extensive urban decay. In order to address these concerns and maintain existing infrastructure that was developed at great cost, governments internationally have utilised tax measures to support efforts aimed at regenerating these urban areas. These narrowly targeted capital allowances seek to attract private sector businesses to areas where interest would otherwise be lacking. The proposed legislation therefore introduces a tax incentive as a response, coming in the form of an accelerated depreciation allowance for investments in the inner cities. The core objectives of the incentive are to promote urban renewal and development by promoting investment by the private sector in the construction and improvement of buildings.

The Bill contains accelerated depreciation deductions for the construction and improvement of buildings within demarcated urban development zones. Significant time has been spent with municipalities in developing the criteria for determining the location and size of the zones.

Subsection (2)

General:

The proposed section 13*quat* provides taxpayers investing in under utilised designated urban areas with a special depreciation allowance. The allowance will cover the erection, extension, addition or improvement (the last three will be referred to as “refurbishment”) of any commercial or residential building in a demarcated area. The allowance is deductible in the year the erected building or the refurbished part of the building is brought into use by the taxpayer for purposes of trade. This tax expenditure will benefit owners, users or lessors of such buildings. The detailed set of criteria required to be met to qualify for this incentive are described below.

Demarcated Areas

The urban development allowance will apply to demarcated areas only. Accordingly, only buildings that are erected or refurbished within these areas will qualify for the incentive. Several criteria (set out in subsection 6) have been taken into account in demarcating qualifying zones (demarcated areas) within the selected metropolitan and urban areas. This approach is adopted in order to ensure that the impact of the incentive is maximised in these parts of the cities and towns that are most in need of development. International experience suggests that successful urban renewal occurs only if efforts are concentrated at specific locations.

Commencement of erection or refurbishment

As with any legislation, the proposed amendment contains an effective date. Under

this effective date, the contract in terms of which the erection or refurbishment is carried out must have be signed by all parties involved on or after the date the details of the relevant demarcated area are the published *Gazette*. This will encourage municipalities to demarcate their areas as quickly as possible. No relief is available for projects occurring before the effective date because these projects would have been performed in any event, thereby leading to a dead-weight loss.

Certificate of Occupancy

A Certificate of Occupancy must support the erection or refurbishment of any commercial or residential building. The purpose of the certificate is to differentiate between substantial changes and minor changes (i.e. repairs). Minor changes have been excluded from the incentive because these changes will have no meaningful impact on urban renewal.

Subsection (3)

Amount of allowance

The allowance covers all the costs of the erection or refurbishment of any commercial or residential building. These costs include the costs that a taxpayer has incurred in demolishing or destroying any existing building (or any part thereof) and costs that have been incurred with respect to permanent fixtures directly adjoining the site. These latter costs involve provision for amenities like water, power, sewage, access or parking for the building, drainage, security for the building (including fences, cameras and surveillance equipment), means of waste disposal, sidewalks and landscaping (including earthworks, greenery and irrigation). The amount of the allowance is dependant on whether the taxpayer erects a new building or refurbishes an existing commercial or residential building.

Depreciation on erection of new buildings

Taxpayers erecting a new commercial or residential building within a demarcated area will be allowed a 17-year write-off period. Specifically, they will be allowed a 20 percent write-off in the first year and an annual 5 percent write-off for the following 16 years.

Example

Facts: The taxpayer constructs a new commercial building for consumer retail purposes. The new construction costs R100 million.

Result: Under current law, the taxpayer receives a 0 percent deduction. Under proposed law, the taxpayer can deduct 20 percent of cost the in the first year (i.e., R20 million). Thereafter, the taxpayer can deduct 5 percent of the cost for the next 16 years (i.e., R5 million per annum for the next 16 years). The estimated tax savings for companies in this circumstance is R6 million in the first year (R20 million x 30 percent) and R1,5 million in each year thereafter (R5 million x 30 percent).

Depreciation on refurbishment of existing building

Taxpayers refurbishing existing buildings will receive a 20 percent straight-line

depreciation allowance over a 5-year period. The purpose of this enhanced incentive is to maintain structures considered worthy of retention and to maximise the use of all the sunken capital in existing buildings, which were developed at great cost. In order to qualify as a refurbishment, taxpayers must preserve a substantial part of the building's existing structural or exterior framework must be preserved. In addition, any extension or addition to an existing building must be of an incidental nature to the improvement.

Example

Facts: The taxpayer refurbishes an old commercial building for consumer retail purposes. The refurbishment costs R100 million.

Result: Under current law, the taxpayer receives a 0 percent deduction. Under proposed law, the taxpayer can deduct 20 percent of the cost over 5 years (i.e., R20 million over 5 years). The estimated tax savings over 5 years is R6 million per year for companies in this circumstance (R20 million x 30 percent).

Subsection (4)

Reporting Requirement

This subsection creates a reporting obligation in order for taxpayers to obtain deductions under section 13*quat*. Under this rule, a taxpayer must provide certain additional information when filing an income tax return. Failure to submit this prescribed information for the year means the deduction will not be available for that year. The reason for this subsection is to ensure that Government's revenue costs allocated to urban renewal are carefully monitored to review the affordability thereof. This subsection also provides a means of monitoring the success of the project through transparent tax expenditure reporting and budgeting.

A taxpayer must attach a certificate from the local authority confirming that the building is situated within a demarcated area of that local authority. In addition, a taxpayer must state the total amount of costs incurred by him for the erection or refurbishment of the building, and the extent to which those costs relate to any part of a building in respect of which a certificate of occupancy has been granted. Lastly, details as to whether the costs were incurred in the erection or the refurbishment of a building must be provided.

Subsection (5)

Limitation of allowance

As with all depreciation allowances, a taxpayer receives the deduction only while using the building for the purposes of trade or still owning it. If a taxpayer ceases to use the building solely for the purpose of trade or disposes of it, the deduction in respect of that building ceases.

Subsection (6)

Geographic Targeting - Designation of Inner City Districts

Subsection (6) stipulates that the Municipal Councils for each of the 16 municipal areas identified are responsible for the designation of one inner city district within their municipal boundaries. Each designation will specifically constitute an inner city district which traditionally formed the social and economic heart of a municipality and which has the potential with financial incentives to act as a catalyst for the rejuvenation of a wider area suffering from economic decline.

While tax incentives can be useful, urban renewal cannot be achieved by tax incentives alone. Tax incentives should merely act as a complementary intervention to best facilitate the achievement of development objectives. Hence, several criteria have been included in demarcating qualifying zones that seek to ensure that the proposed tax incentive complements other existing urban renewal efforts.

The criteria for selecting a single inner city district are as follows:

(a) *Formal resolution by municipal council*
The municipal council must demarcate the area by formal resolution by 30 June 2004 or such later date as the Minister may approve.

(b) *Municipality's Integrated Development Plan*
The demarcated area must be consistent with that municipality's integrated development plan. This plan often encompasses a short-term delivery strategy of approximately 3 to 5 years. The purpose of the integrated development plan is to bring about the rejuvenation of the area through a series of actions, which aim to:

- Support existing residential functions through refurbishment of existing properties, sensitively designed new developments, and the provision of adequate amenity or recreation space;
- Support the development of a broad based social mix in the area;
- Provide opportunities for employment to locate to the area;
- Impose linkages within the area and outside; and
- Bring vacant, derelict and unused buildings or sites back into productive use.

(c) *Declining contribution to total revenue*
This factor requires that the demarcated area currently contribute, or have previously contributed, the largest portion of the total revenue (i.e. rates and taxes) for the municipal area. Further, the level of contribution must evidence a declining trend. In other words, the demarcated area must currently be, or previously been, a focal point, but now demonstrates a high degree of urban decay relative to other parts of the city.

(d) *Additional Financial Measures*
Each municipality must provide additional financial measures to support and enhance regeneration within its area. These additional financial measures can take any number of forms, such as reduced property rates and local user charges.

(e) *Commitment to speedy processing of planning approval applications*
Each municipality must commit to the objective of processing all planning approval applications in the demarcated area within 90 days of submission and to providing National Treasury with regular reports of cases where this period is exceeded.

Subsection (7)

Demarcated areas

A hectare limitation is set for the surface area a municipality may demarcate based on its population. This limitation is designed to ensure that the incentive is properly targeted and to ensure that the incentive is within affordability constraints. The area is limited to 150 hectares for the first 500 000 or less persons in a municipality and an additional 20 hectares for each additional 100 000 persons. A municipality with a population of 2 million persons or more may divide its allowable area between two demarcated areas. The population of a municipality must be rounded to the nearest 100 000 in order to determine the allowable area. The legislation contains some flexibility so that municipalities can motivate for higher hectare limitations if required. The municipality must prove to the Minister that the extended area is part of a bigger integrated area and sound economic reasons exist for the extension. The Minister must also be satisfied that the extended area will be within Government affordability constraints.

Subsection (8)

Publication in Government Gazette

The demarcated area may be published by notice in the Government Gazette only after the Minister of Finance is satisfied that the selected area satisfies the requirements as set out in subsection 6 above.

Subsections (9)

Requirements for reporting by municipality

Subsection (9) lists the required information each municipality must provide in the annual report which it must furnish to the Commissioner and the Minister for each of its urban development zones. This requirement ensures proper monitoring of this initiative.

Subsection (10)

Failure to report

Subsection (10) provides that where the municipality does not provide the required reports and does not take corrective steps within the period specified by the Minister, the Minister may withdraw the notice in terms of subsection (8) for that municipality.

Subsection (11)

Commissioner's Report

SARS must annually provide information about the urban renewal project to the Minster of Finance so that the Minister can fully report to Parliament regarding:

(a) the number of taxpayers that claimed the allowance in that particular year;
(b) the total amount allowed as a deduction to taxpayers in that particular year; and

(c) the total amount of deductions allowable by taxpayers in that particular year.

This requirement ensures proper monitoring of this initiative and annual accountability to Parliament.

CLAUSE 34

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

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

Subclause (b): This amendment provides that donations to the State will also qualify as a tax deductible donation. Donations to any sphere of Government are limited to situations in which the relevant sphere of Government fully utilises the funds for an activity that is listed as qualifying for tax-deductible status in Part II of the Ninth Schedule to the Act.

Subclause (c): This amendment is consequential upon the incorporation of the Transfrontier Conservation Area regulations into the Act.

Subclause (d): This amendment enables conduit funds to engage in a number of public benefit activities, not all of which qualify for section 18A benefits to donors.

Subclause (e): Five per cent of taxable income at the tax threshold of R30 000 equals R1 500, therefore the granting of the deduction of R1 000 serves no purpose and is repealed.

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

Subclause (g): Incorporation of the provisions of the regulations issued in September 2002 relating to Transfrontier Conservation Areas into the Act.

Subclauses (h) to (j): These provisions provide for the issue of a receipt by the government, provincial administration or local authority in order to enable a donor to obtain a section 18A deduction for a donation to those spheres of government.

Subclause (k): Provision is made for organisations and bodies to carry on a mix of public benefit activities, not all of which for tax deductible status. This concession requires the introduction of additional control measures regarding the issue of receipts and the submission of an audit certificate confirming that the proper utilisation of funds.

Subclause (l): Provision is made that the deduction allowable to the donor in respect of assets (other than trading stock) donated, is limited to the lower of the cost to the donor or the fair market value of the asset, on the date of the donation.

Subclause (m): This amendment introduces a limitation on the type of asset donates which will qualify for a deduction in terms of section 18A. The donation of limited interests and intangible assets will not be allowed. The donation of cash, full interests and tangible assets is to be encouraged in contrast to the donation of intangible assets which are currently rarely donated in any event. The reasons for excluding limited interests and intangible assets are the risk of tax avoidance and problems with the valuation thereof.

CLAUSE 35

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

Subclause (a): See notes on RING-FENCING OF ASSESSED LOSSES.

Subclause (b): Paragraph *(b)* of the proviso to section 20(1) was inserted following the introduction of the worldwide basis of taxation. This provision ensures that losses incurred from carrying on any trade outside the Republic cannot be set-off against the income derived from any trade carried on in the Republic. At the time, the Act introducing this amendment was published, the words were not correctly aligned which incorrectly reflected that the words following paragraph *(b)*(ii) also applied to paragraph *(a)*. This amendment rectifies this printing error.

CLAUSE 36

Income Tax: Insertion of section 20A in the Income Tax Act, 1962

See notes on RING-FENCING OF ASSESSED LOSSES.

CLAUSE 37

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

Subclause (a): This amendment is consequential upon the introduction of a definition of “securities lending arrangement” in section 1 of the Act.

Subclause (b): This amendment is consequential upon the amendment in paragraph *(c)* below.

Subclause (c): This provision ensures that the donation of trading stock is tax neutral for the donor of the trading stock and that unrealised gains are not taxable as a result of the donation.

Subclause (d): This amendment results from the reference to the newly defined term "securities lending arrangement" in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962). The prior reference to section 23(1) of the Stamp Duties Act, 1968 (Act No. 77 of 1968) is now no longer required.

CLAUSE 38

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

Subclause (a): This amendment provides for apportionment of a single insurance premium in order that the portion relating to loss of income as a result of illness, injury, disability of unemployment may be allowed as a deduction against remuneration.

Subclause (b): See notes on PUBLIC PRIVATE PARTNERSHIPS.

CLAUSE 39

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

This amendment deletes a reference to an obsolete provision.

CLAUSE 40

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

These amendments delete references to obsolete provisions.

CLAUSE 41

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

This amendment deletes a reference to an obsolete provision.

CLAUSE 42

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

Subclause (a): The amendment is of a textual nature and is intended to clarify the wording and to promote uniformity throughout the Act.

Subclause (b): The amendment clarifies the meaning of the subsection and provides for the commencement value of exchange items of a foreign company at the date the foreign company becomes a CFC or when exchange items of a CFC became subject to the provisions of section 24I as a result of the change to the residence basis of taxation.

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

Subclause (d): Under current law, South African borrowers of foreign currency debt are taxed on an annual basis on currency gains economically arising with respect to that debt. Currency gains and losses associated with South African inventory imported to South Africa are ignored, even if the currency gains and losses arise with respect to those imports. This anomaly is corrected in respect of foreign currency debts associated with assets which are deemed to be a South African sourced asset (capital assets as well as trading stock). The amendment should be read with the amendment to paragraph 43(4) of the Eighth Schedule to the Income Tax Act. In essence, exchange gains and losses attributable to any asset will not be disallowed in terms of section 24I(11) where the provisions of section 9G or paragraph 43(4) of the Eighth Schedule would apply had the asset been disposed of regardless of whether or not that asset constitutes trading stock.

CLAUSE 43

Income Tax: Substitution of section 25C of the Income Tax Act, 1962

Currently, as a result of the wording of the section, there is confusion as to which

person should be regarded as one and the same person for the purposes of this section. The section has now been reworded to clarify the position.

CLAUSE 44

Income Tax: Substitution of section 25D of the Income Tax Act, 1962

Section 25D provides the general rule for purposes of determining taxable income when the initial starting point of the calculation begins in foreign currency. Taxpayers first "determine" the calculation in the applicable foreign currency and then "translate" the calculation to Rand at the average exchange rate for the year at issue.

Subsection 1

The proposed amendment to subsection 1 clarifies that amounts received, accrued or incurred in foreign currency are initially "determined" in:

(1) the financial reporting currency utilised by a foreign permanent establishment if amounts received, accrued or incurred are attributable to a permanent establishment of the person outside South Africa; or

(2) the actual currency of the amounts received, accrued or incurred in all other cases (i.e., the amounts are not attributable to a foreign permanent establishment).

However, foreign permanent establishments must rely on the actual currency in lieu of the financial reporting currency if the financial reporting currency involved falls within the common monetary area (i.e., Namibia, Swaziland, Lesotho or the Rand). This exception prevents foreign branches from choosing the Rand or a Rand equivalent currency solely as a means to artificially avoid currency gains and losses. This rule will have no effect on foreign permanent establishments within the common monetary area if the actual and financial reporting currencies are the same.

The proposed amendment also clarifies that the general rules provided above apply "unless expressly otherwise provided" in this Act. Hence, the provisions of section 9G and paragraph 43 of the Eighth Schedule generally take precedence over this provision.

Subsection 2

The proposed amendment to subsection 2 clarifies that once an amount has been determined under subsection 1(or any other provision of the Income Tax Act), the determined amount must be translated into Rand by applying the relevant average exchange rate for the tax year of the determination.

Example

Facts: South African Company imports and re-exports trading stock in Pounds solely from its South African location. The trading stock costs 100 pounds and the sale proceeds from the trading stock amounts to 120 Pounds. The cost and sale arise within the same year. The average exchange rate for the year is 10 Rand to the Pound.

Result. Under subsection 1, South African Company first determines taxable income in Pounds, which results in a net positive amount of 20 pounds. Under subsection 2, the 20 pound amount is translated into Rand at R10 (i.e., the average exchange rate for the year), resulting in taxable income of R200.

CLAUSE 45

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

Preferential tax treatment is granted to non-profit organisations because they complement government in terms of other domestic service deliveries. Approved public benefit organisations therefore enjoy the benefit of generating funds on a tax free basis. Under current law, public benefit organisations must devote at least 85 per cent of their activities for the benefit of people in South Africa to receive tax exemption, under the notion that charity must begin at home. The 85 per cent is measured in terms of time or costs, subject to a Ministerial exception.

The current 85 per cent rule has an unintended limiting effect on charitable activities are provided by public benefit organisations if their activities are funded by foreign donors. Hence, internationally supported organisations that have offices within the Republic may not qualify for exemption status. Nor is there any real detriment to South Africa if foreign donor funds are shifted offshore.

The proposed amendment to section 30 still considers the ‘costs’, ‘time’ and ‘Ministerial’ exception elements in determining public benefit activities, but exclude funds received from foreign donors in applying the cost test.

Example

Facts. An approved PBO carries on relief work both within South Africa and Mozambique. It has received donations of R100 000 from local donors and R40 000 from foreign donors. Expenditure of R90 000 is incurred for the benefit of people in South Africa and R50 000 is incurred in for the benefit of people in Mozambique.

Result. The R50 000 expenditure incurred for the benefit of people in Mozambique will be reduced by the R40 000 in foreign donations for purposes of the 85 per cent cost test. The PBO then passes the test as 90 per cent of its remaining costs are incurred for the benefit of people in South Africa.

CLAUSE 46

Income Tax: Amendment of section 31 of the Income Tax Act, 1962

This amendment deletes a superfluous reference as a result of the amendment to the definition of “resident” earlier this year.

CLAUSE 47

Income Tax: Insertion of section 31A in the Income Tax Act, 1962

A non-resident is subject to CGT only on the disposal of paragraph 2(1)*(b)* assets, namely any immovable property or any interest or right in immovable property situated in the Republic (including an interest held through a property company as contemplated in paragraph 2(2) of the Eighth Schedule), or any asset that is attributable to a permanent establishment of that non-resident in the Republic. The rules of the Income Tax Act governing the determination of taxable income (including any taxable capital gain) are not applied in respect of non-residents neither holding paragraph 2(1)*(b)* assets nor qualifying as controlled foreign companies as defined in section 9D. A disposal of an asset by a non-resident to a resident can, however, currently qualify for rollover relief in terms of the corporate reorganisation rules even where that asset is not a paragraph 2(1)*(b)* asset and that non-resident is not a controlled foreign company. The application of the rollover rules is problematic in these situations and may lead to anomalous results. It is therefore proposed that a new provision be inserted in respect of a disposal, to a resident, of an asset not constituting a paragraph 2(1)*(b)* asset that is effected by a non-resident that is not a controlled foreign company. Such disposal will, in terms of this proposal, be deemed for all purposes of the Income Tax Act excluding section 103 to have been effected for an amount equal to the consideration in respect of that disposal or, where that non-resident and resident are connected persons in relation to each other, the market value of the asset at the time of such disposal. This will prevent the artificial inflation of the value of assets between connected persons. These rules will generally encourage the inflow of assets into South Africa.

CLAUSE 48

Income Tax: Amendment of section 35 of the Income Tax Act, 1962

Withholding tax on royalties is now a stand alone tax and no longer a normal tax. Its base is, therefore, no longer part of taxable income, but an amount that accrues in terms of section 35. Therefore, clarification is required with regard to the imposition of additional tax and penalties in the case of non-payment of any withholding tax on royalties.

CLAUSE 49

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

Subclause (a): Definition of "allowance asset": The concept of a *"depreciable asset"* was replaced in 2002 with the concept of an *"allowance asset"*. The corporate rules extend rollover treatment to any asset of a person if that asset qualifies for a deduction or allowance under the Act that must be included in the income of that person in the year following that in which it was allowed or that is subject to recoupment in the hands of that person. The inclusion or potential recoupment associated with an asset transferred in terms of a company formation transaction shifts to the transferee company. All the remaining allowances or deductions associated with that asset also shift to the transferee company as if that company held those assets all along. The proposed amendment clarifies that the deductions or allowances concerned are limited to those taken into account when determining the portion of a person's taxable income not consisting of any taxable capital gain, for

example a deduction under section 11*(a)* or *(e)* or section 12C.

Subclauses (b) to (f): Definitions of *"domestic financial instrument holding company"* and *"foreign financial instrument holding company":* See the notes above on CORPORATE RESTRUCTURING RULES - *Financial instrument holding companies*.

Subclause (g): Definition of "shareholder": The proposed amendment is consequential on the proposed amendment of the definition of "shareholder" in section 1 – see clause 12(1)*(n)*.

Subclause (h): Definition of "trading stock": It is proposed that a definition of "trading stock" be inserted for purposes of Part III. Paragraph *(a)* of the proposed definition makes it clear that rollover relief in terms of a company formation, intra-group or amalgamation transaction or liquidation distribution also applies in respect of livestock or produce disposed of by means of one of those transactions. Paragraph *(b)* of the definition limits the operation of the 18 month ring-fencing rule in respect of trading stock - see the notes above on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*. It is proposed that these amendments be retrospective to 6 November 2002.

Subclause (i): Amendment of subsection (2) - This proposal excludes rollover relief in terms of the corporate restructuring rules where a non-resident disposes of an asset to a resident in terms of a disposal subject to the provisions of the proposed new section 31A – see clause 47.

Subclause (j): Amendment of subsection (4) - The prescribed steps for the liquidation or winding up of a company include the requirement that a company must have disposed of all of its assets, other than assets required to satisfy liquidation or winding up costs or to satisfy anticipated liabilities to the Commissioner. It is proposed that assets required to satisfy anticipated liabilities to any sphere of government of any country be included in this exclusion. It is also proposed that this amendment be retrospective to 6 November 2002 – see subclause (2)*(a)*.

CLAUSE 50

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

Subclause (a): Amendment of subsection (1) - Only potential gain assets qualify for the rollover in respect of a corporate formation transaction. It is proposed that this requirement be relaxed to allow the disposal of assets the market value of which is equal to or exceeds their base cost or the amount taken into account in respect of that asset in terms of section 11(a) or 22. This will allow for the disposal of debt claims that would otherwise be disqualified only in terms of this requirement. This proposal reflects the original intent underlying the corporate rules.

Subclauses (b) to (d): Amendment of subsection (2) - The proposed changes clarify the rules regarding the effect of a disposal in terms of a corporate formation transaction. They provide, in the case of trading stock, for a rollover to the transferee company of the amount at which the transferor reflected that stock for tax purposes, thereby correcting an oversight in the amendments effected in 2002. They also clarify that a valuation effected by the transferor in respect of an asset disposed of under a company formation transaction can be used by that transferor in respect of the shares acquired from the transferee company in return for that asset.

Subclauses (e) to (g): Amendment of subsection (4) - The disposal of an asset to a company under a company formation transaction for a consideration consisting partly of something other than equity shares issued by that company, will in terms of subsection (4) qualify only partly for relief. The proposed changes provide that the assumption of a debt by a transferee company as contemplated in subsection (8) will not be treated as other consideration for purposes of subsection (4), thereby clarifying the relationship between subsection (4) and (8). They also clarify the apportionment rules of subsection (4) according to which the amount qualifying for rollover relief must be determined.

Subclause (h): Amendment of subsection (6) - A failure by a transferor to maintain a qualifying interest in the transferee company for a period of at least 18 months after a company formation transaction triggers a deemed disposal, in the transferor's hands, of any remaining shares still retained in the company at a price equal to their market value at the time of their acquisition under that company formation, thereby triggering the roll-over gain at the time of the company formation transaction. The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see the notes above on CORPORATE RESTRUCTURING RULES - The ring-fencing of trading stock and financial instruments.

Subclause (i): Amendment of subsection (8) - Transfers of property securing any debt subject to subsection (8) receive full rollover treatment. However, tax-free treatment in this circumstance comes with a price upon the eventual disposal of the equity shares in the transferee company. The proposed changes clarify the rule governing such disposal by the transferor. The transferor must, in the case of shares held as capital assets, treat the face value of the debt as a capital distribution in respect of that share for purposes of paragraph 76 or, in the case of shares held as trading stock, as an amount to be included in the transferor's income.

Subclause (j): Amendment of subsection (9) - The proposed change is consequential upon the deletion of the definition of "financial instrument" from paragraph 1 of the Eighth Schedule and its insertion in section 1.

It is proposed that the amendments in respect of company formation transactions be retrospective to 6 November 2002 – see subclause (2).

CLAUSE 51

Income Tax: Amendment of section 43 of the Income Tax Act, 1962

Subclauses (a) and (b): Amendment of subsection (1) - Only potential gain assets qualify for the rollover in respect of a share-for-share transaction. It is proposed that this requirement be relaxed to allow the disposal of assets the market value of which is equal to or exceeds their base cost or the amount taken into account in respect of that asset in terms of section 11(a) or 22. It is also proposed that relief in terms of a share-for-share transaction be elective - see the notes above on CORPORATE RESTRUCTURING RULES - *Elective versus mandatory relief*.

Subclauses (c) and (d): Amendment of subsection (2) - The proposed amendments clarify the rollover rules regarding a valuation of a target share effected by the transferor by making it explicit that the transferor can use that valuation in respect of the shares acquired from the acquiring company in return for that target share.

Subclause (e): Amendment of subsection (3) - The proposals clarify the apportionment rules according to which the amount qualifying for rollover relief must be determined where a transaction qualifies only partly as a share-for-share transaction.

Subclause (f): Amendment of subsection (4) - A failure by a transferor to maintain a qualifying interest in the acquiring company for a period of at least 18 months after a share-for-share transaction triggers a deemed disposal, in the transferor's hands, of any remaining shares still retained in the company at a price equal to their market value at the time of their acquisition under that share-for-share transaction. This rule is similar to the rule contained in section 42(6). The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see the notes above on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

Subclause (g): Amendment of subsection (5) - A failure by an acquiring company to maintain a qualifying interest in the target company for a period of at least 18 months after a share-for-share transaction triggers the roll-over gain at the time of the share-for-share transaction. The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see the notes above on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments*.

The proposed changes in respect of share-for-share transactions, other than that providing for elective relief, are retrospective to 6 November 2002 – see subclause (2).

CLAUSE 52

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

Subclauses (a) and (b): Amendment of subsection (1) - Specific rules to provide relief for amalgamation transactions were introduced during 2002. The current rules provide for mandatory rollover relief where a company disposes of all of its assets by means of an amalgamation, conversion or merger. The first proposal in this regard provides for the retention, by an amalgamated company, of assets it elects to use to settle its trading debts. The second proposal provides for a form of elective relief in the case of amalgamations – see the notes above on CORPORATE RESTRUCTURING RULES - *Elective versus mandatory relief.*

Subclause (c): Amendment of subsection (4) - The relief provided for in respect of a disposal in terms of an amalgamation transaction currently applies only in so far as that disposal is effected in exchange for equity shares in the resultant company. However, debts owed by an amalgamated company are often taken over by the resultant company as part of an amalgamation. The proposed change extends the rollover relief to amalgamations also involving the assumption, by the resultant company, of such debts.

Subclause (d): Amendment of subsection (6) - A shareholder who disposes of shares in an amalgamated company in return for shares in the resultant company as part of an amalgamation transaction, qualifies for relief similar to that applying in respect of share-for-share transactions. The proposed changes clarify the rollover rules in this regard.

Subclause (e): Amendment of subsection (7) - The proposals regarding subsection (7) clarify the apportionment rules governing the determination of the amount qualifying for rollover relief where a transaction qualifies only partly as an amalgamation transaction.

Subclause (f): Amendment of subsection (9) - The rules regarding the treatment, for purposes of STC, of the disposal by an amalgamated company to its shareholders, as part of an amalgamation transaction, of shares in the resultant company acquired by that amalgamated company in terms of that transaction, are similar to those applying in respect of unbundling transactions. The disposal of those shares to its shareholders is not subject to STC in the hands of that amalgamated company. Any such shareholder who is a company cannot, however, set off the shares so acquired when determining the net amount of its dividends under section 64B(3) on which its STC liability is based. The shares so acquired are also deemed, for purposes of section 64B(5)*(c)*, to be profits which are not of a capital nature. This ensured that those shares would be subject to STC upon the liquidation of that company. Shares so acquired by such company will, however, in terms of an amendment effected to section 64B(5)*(c)* during 2002, in any event be subject to STC on the liquidation of that company. It is therefore proposed that this deeming provision be deleted.

Subclause (g): Amendment of subsection (10) - The amount of any consideration other than shares in the resultant company to which a person becomes entitled upon the disposal of shares in an amalgamated company is treated, for purposes of the STC payable by that amalgamated company, as a deemed dividend. The proposed changes limit the deemed dividend to the amalgamated company's profits and reserves available for distribution in order to make it consistent with section 64C(4)(c) and clarify the date of accrual of such deemed dividend.

Subclause (h): Amendment of subsection (11) - A rollover gain is triggered where a person who acquired shares in a resultant company in return for shares in an amalgamated company as part of an amalgamation transaction, fails to maintain a qualifying interest in that resultant company for a period of at least 18 months after that acquisition. The proposed changes clarify this rule. They also extend the list of exclusions from this rule to involuntary disposals of those shares – see the notes above on CORPORATE RESTRUCTURING RULES - *The ring-fencing of trading stock and financial instruments.*

Subclause (i): Amendment of subsection (12) - The proposed changes regarding the exclusion, as a general rule, of disposals of assets of an amalgamated company constituting a domestic or foreign financial instrument holding company from rollover relief, align this rule with the similar rule in respect of share-for-share transactions contained in section 43(7).

Subclause (j): Amendment of subsection (13) - Rollover relief under section 44 is available only if the steps required to terminate the amalgamated company's existence, as contemplated in section 41(4), have been taken within 6 months after the date of the amalgamation transaction. It is proposed that an amalgamation also be excluded from rollover relief where an amalgamated company at any stage withdraws or invalidates any step so taken. This will align the rule with the provisions of section 64B(5)*(c)*.

The proposed amendments in respect of amalgamation transactions, other than that providing for elective relief, are retrospective to 6 November 2002 – see subclause (2)

CLAUSE 53

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

Subclause (a): Amendment of subsection (1) - An intra-group transaction is a transaction between two companies where both companies form part of the same group of companies. The proposed change clarifies that those companies must qualify as members of the same group of companies as at the end of the day of such transaction.

Subclause (b): Amendment of subsection (4) - Rolled-over gains and losses are in effect triggered where a transferor company and a transferee company cease to be members of the same group of companies in relation to each other. This is done by means of a deemed disposal and reacquisition, by the transferee company, of an asset acquired from that transferor company in terms of an intra-group transaction. The proposed changes make it clear that such deemed disposal and reacquisition of an asset will not affect any capital allowances or deductions in respect of that asset to which that transferee company may be entitled in terms of section 11*(e)*, 12B, 12C or 12E. The deemed disposal and reacquisition of the affected asset is therefore ignored when determining whether that transferee company qualifies for such allowance or deduction as well as when determining the amount thereof.

Subclause (c): Amendment of subsection (5) - It is proposed that involuntary disposals of assets (including financial instruments) within 18 months after their acquisition in terms of an intra-group transaction, be excluded from the ring-fencing rule applying in respect of the held-over capital or revenue gains or losses triggered by such a disposal.

Subclauses (d) and (e): Amendment of subsection (6) - Specific categories of financial instruments are not subject to the general restrictions regarding the availability of rollover relief under the corporate restructuring provisions. Financial instruments not qualifying as one of the excluded categories will also qualify for rollover relief if they are transferred as part of a going concern provided they do not exceed 5 per cent of the value of the assets so transferred. The proposed amendment rectifies an oversight to ensure that financial instruments qualifying for the exclusion in subparagraph (iv) of paragraph *(a)* of subsection (6) be excluded when determining the ratio of instruments not otherwise qualifying for an exclusion that are transferred as part of a going concern. A further proposal extends the list of excluded financial instruments to any financial instrument the market value of which is equal to its base cost, thereby allowing the transfer of cash and cash equivalents – see the notes above on CORPORATE RESTRUCTURING RULES – *Financial instrument holding companies - (c) The transfer of cash and cash equivalents.*

The proposed amendments in respect of intra-group transactions are retrospective to 6 November 2002 – see subclause (2).

CLAUSE 54

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

Subclause (a): Amendment of subsection (1) - *See the notes above on* CORPORATE RESTRUCTURING RULES – Unbundling transactions.

Subclause (b): Amendment of subsection (2) - Where an unbundling company disposes of shares to its shareholders or its holding company in terms of an unbundling transaction, that unbundling company is currently treated as having disposed of those shares for proceeds equal to the base cost or amount otherwise taken into account in respect of those shares. The unbundling company will, therefore, not realise any capital or revenue gain or loss from that disposal. The proposed changes simplify this rule.

Subclauses (c) to (e): Amendment of subsection (3) - The proposed amendments relating to paragraphs *(a)*, *(b)* and *(d)* are mainly consequential upon the reformulation of the definition of "unbundling transaction". They also clarify the rule in paragraph *(b)* governing the apportionment of the cost of the shares previously held in the unbundling company between those previously held shares and the unbundled shares as well as the rollover rule in paragraph *(d)*.

Subclause (f): Amendment of subsection (4) - The proposed amendments are consequential upon the reformulation of the definition of "unbundling transaction" and correct a cross-reference.

Subclause (g): Amendment of subsection (5) - The proposed amendments are consequential upon the reformulation of the definition of "unbundling transaction". They also effect amendments relating to STC similar to those proposed in respect of section 44(9) – see the notes on section 44(9) above.

Subclauses (h) and (i): Amendment of subsections (6) and (7) - The proposed amendments are consequential upon the reformulation of the definition of "unbundling transaction".

Subclause (j): Amendment of subsection (8) - See the notes above on CORPORATE RESTRUCTURING RULES - *Elective versus mandatory relief.*

The proposed amendments in respect of unbundling transactions, other than that providing for elective relief, are retrospective to 6 November 2002 – see subclause (2).

CLAUSE 55

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

Subclause (a): Amendment of subsection (1) - A disposal of an asset by a liquidating company currently qualifies for rollover relief in respect of a liquidation distribution only if that company disposes of all of its assets to its holding company, thus excluding relief if any asset is retained or disposed of to a minority shareholder. The proposed amendments provide for the retention, by a liquidating company, of assets it elects to use to settle its trading debts. Provision is also made for partial relief to the extent to which its assets are disposed of to its holding company.

Subclause (b): Amendment of subsection (5) - Where a holding company disposes of any share in a liquidating company as a result of the liquidation, winding up or deregistration of that liquidating company, that holding company is currently treated as having disposed of those shares for proceeds equal to the base cost or amount otherwise taken into account in respect of those shares. The holding company will, therefore, not realise any capital or revenue gain or loss from that disposal. The proposed changes simplify this rule.

Subclauses (c) and (d): Amendment of subsection (6) - Rollover relief under section 47 is available only if the steps required to terminate the liquidating company's existence, as contemplated in section 41(4), have been taken within 6 months after the date of the liquidation distribution. It is proposed that a liquidation distribution also be excluded from rollover relief where a liquidating company at any stage withdraws or invalidates any step so taken. This will align the rule with the provisions of sections 44(13) and 64B(5)*(c)*. A further proposal relates to the list of financial instruments not taken into account when determining whether a liquidating company is a domestic or foreign financial instrument holding company. It is proposed that this list be extended to any financial instrument the market value of which is equal to its base cost, thereby allowing the transfer of cash and cash equivalents – see the notes above on CORPORATE RESTRUCTURING RULES – *Financial instrument holding companies - (c) The transfer of cash and cash equivalents.*

The proposals in respect of liquidation distributions are retrospective to 6 November 2002 – see subclause (2).

CLAUSE 56

Income Tax: Amendment of section 56 of the Income Tax Act, 1962

Substitution of subsection (1)(r): Transactions not occurring at fair value can raise a number of concerns, including donations tax, deemed STC dividends, and deemed capital gains taxes. These issues often arise with corporate groups where group members sell to one another at accounting cost rather than fair value. A disposal of property under a donation or a deemed donation is currently exempt from donations tax in terms of section 56(1)*(r)* to the extent that such disposal is deemed to be a dividend in terms of section 64C. The proposed substitution of this provision extends the exemption to donations between companies that are members of the same group of companies.

This proposal is retrospective to 1 October 2001 – see subclause (2).

CLAUSE 57

Income Tax: Amendment of section 61 of the Income Tax Act, 1962

The provisions relating to donations tax do not currently provide for additional tax and penalties where a person—

- makes default in rendering a return in respect of any year of assessment;
- omits from his return any amount which ought to have been included therein; or
- makes an incorrect statement in any return rendered by him which results or would if accepted result in the assessment of the normal tax at an amount which is less than the tax properly chargeable.

It is proposed that section 61 be amended to provide that any reference in section 76 to taxable income of a taxpayer is deemed to include a reference to the value of any property disposed of by that taxpayer under a donation.

CLAUSE 58

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

Subclause (a): The amendment is consequential on the insertion of subparagraphs (iii) and (iv) of the definition of "dividend cycle".

Subclause (b): The amendment clarifies the starting date of the first dividend cycle when a company comes into existence for the first time or becomes resident

Subclause (c): The amendment clarifies the closing date of the first dividend cycle when it is brought to a close by a deemed dividend.

Subclause (d): The amendment clarifies the closing date of the first dividend cycle for an long term insurance company when it is brought to a close by a deemed dividend.

Subclause (e): The amendment clarifies the closing date of any subsequent dividend cycle when it is brought to a close by a deemed dividend.

Subclause (f): Credits against Secondary Tax on Companies ("STC"): The proposed legislation eliminates the exemption for foreign income arising in designated countries. This exemption came to be wrongfully perceived as an incentive to invest abroad in certain (i.e., OCED and other developing) countries. Commentators have argued that dividends received by South African companies from these countries should still act as an offset against the STC on dividends paid by South African companies. This proposal is not supported since the decision to repatriate profits back to South Africa generally bears little relationship to a South African's company's decision to distribute dividends to its shareholders (which may be domestic or foreign). Offsets such as foreign tax credits arising from taxes on foreign income also do not work well with the STC because the STC has a different base (company law profits versus tax profits) and have a different trigger point (dividends declared versus income accrued).

The proposed legislation also does not allow borrowers to receive STC credits for dividends received by a borrower during the borrowing period as it would create an easy opportunity for tax avoidance. STC credits should theoretically be available only to owners because a borrower does not hold beneficial ownership of shares.

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

Subclause (h): The amendment is consequential on the repeal of section 10(1)*(s)*.

Subclause (i): As part of the *quid pro quo* for the extension of the deadline for the preparation of valuations for CGT purposes, the proposal makes it clear that the deadline will also apply to valuations for the purposes of the exemption of the distribution of capital profits from STC. The provision is extended to deal with companies becoming resident in South Africa.

Subclause (j): The provision is extended to exempt profit derived prior to becoming a resident from STC.

Subclause (k): The amendment ensures consistency between this provision and the dividend cycle provisions.

Subclause (l): The amendment ensures that the exemption is only available where

the company to which the dividend accrues controls (and controlled) the company declaring the dividend. It prevents the shifting of STC exemption within a group.

Subclause (m): The amendment is consequential on deletion of subparagraph (iv).

Subclause (n): The source principle in this subparagraph is no longer appropriate following the switch to residence. It has been repealed as three year window in subparagraph (iv) has now expired.

Subclause (o): This amendment allows a company declaring a dividend to benefit from the paragraph *(f)* relief where the company to whom the dividend accrues was formed by one or more companies in the same group of companies as the company declaring the dividend. The company which was so formed is deemed to have been in existence from the date its controlling group company was formed. This has the effect of meeting the requirement that the dividend is to be declared out of profits earned during the period the declaring company formed part of the same group of companies as the controlling group company shareholder.

Subclause (p): The deletion of subsection (6) is consequential upon the repeal of section 9F.

Subclause (q): This amendment repeals obsolete provisions.

Subclause (r): This amendment repeals obsolete provisions.

CLAUSE 59

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

Subclause (a): The amendment is consequential on the restructuring of section 64C.

Subclause (b): Subsections (2) and (3) are merged for greater clarity. The profit priority rule is repealed as it is superfluous. Subsection 4*(f)* incorporates the "notwithstanding" formulation, which is repealed.

Subclause (c): Subsections (2) and (3) are merged for greater clarity.

Subclause (d) and (f): These amendments are consequential following the merger of subsections (2) and (3).

Subclause (e),(g),(h),(i),(l),(n) and (o): These amendments are consequential on the deletion of the definition of "recipient".

Subclause (j): The deletion of subsection 4*(h)* is consequential upon the addition of subsection 4*(k)* and *(l)*.

Subclause (k): The amendment is of a textual nature.

Subclause (m): This amendment mirrors the exemption in terms of section 64B(5)*(f)* where an amount is deemed to be a dividend declared to a shareholder, which is a group company in relation to the company "declaring" the dividend.

Subclause (p): Clarifies the timing of a deemed dividend, which is important for purposes of determining the close of a dividend cycle and the payment of STC.

CLAUSE 60

Income Tax: Substitution of section 65 of the Income Tax Act, 1962

This amendment provides that the Commissioner may also prescribe where any return or other form must be submitted.

CLAUSE 61

Income Tax: Amendment of section 66 of the Income Tax Act, 1962

Subclause (a): This amendment is consequential upon the amendment of section 25C and clarifies for which periods persons who are sequestrated must submit returns

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

CLAUSE 62

Income Tax: Insertion of section 67 of the Income Tax Act, 1962

Taxpayers have a civil duty to register for tax purposes. No specific provision exists to oblige taxpayers to register for normal tax. It is, therefore, proposed to specifically place an obligation on taxpayers to register for tax when they become liable for normal tax.

CLAUSE 63

Income Tax: Amendment of section 70 of the Income Tax Act, 1962

The amendment is consequential upon the repeal of section 9E of the Income Tax Act, 1962.

CLAUSE 64

Income Tax: Amendment of section 70B of the Income Tax Act, 1962

The amendment is consequential upon the insertion last year of the definition of "financial instrument" in section 1 of the Income Tax Act, 1962. .

CLAUSE 65

Income Tax: Substitution of section 72A of the Income Tax Act, 1962

This amendment reflects a revision of the reporting requirements in respect of Controlled Foreign Companies (CFCs).

The reason for the reporting requirements is to determine whether a resident has an interest in a CFC which could result in an inclusion in the resident’s income and to

determine the type and scope of the activities conducted by the CFC. The requirement relating to the submission of the financial statements of a CFC requires financial statements prepared in accordance with generally accepted accounting practice. This would include the generally accepted accounting practice of the foreign jurisdiction in which business is conducted.

CLAUSE 66

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

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

Subclause (b): This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 67

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

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 68

Income Tax: Amendment of section 75 of the Income Tax Act, 1962

Taxpayers have a duty to register for tax purposes. It is proposed to introduce a penalty for failure to register as a taxpayer.

CLAUSE 69

Income Tax: Insertion of sections 76A in the Income Tax Act, 1962

It is proposed that special reporting rules for transactions that contain indicators of potential tax avoidance be introduced. The purpose of this reporting system is to uncover "innovative" corporate tax products that effectively cost the tax system hundreds of millions (and perhaps even billions) of Rand annually. Most of these innovative products stem from the Banks and other sophisticated financial institutions.

The scope of this reporting requirement is focused on only two types of arrangements, i.e.—

(i) those arrangements containing a tax rebate clause (in the typical situation, a rebate clause triggers the reversal of financial benefits provided by a bank if the alleged tax benefits of an arrangement do not materialise); and
(ii) those arrangements containing specific structures identified by Ministerial regulation (but only if reviewed by Parliament after 12 months).

The reporting obligation is limited to the parties receiving the tax benefit.

Failure to report will result in a penalty not exceeding the tax benefits where the failure was wilful or reckless. Other failures to report results in the stricter application of the General Anti-avoidance Provisions of section 103.

CLAUSE 70

Income Tax: Amendment of section 79B of the Income Tax Act, 1962

This amendment is in addition to the amendment to section 25C to clarify for which periods a person who is sequestrated is assessed. Where a sequestration order is set aside any assessments issued as a result of that sequestration must be withdrawn.

CLAUSE 71

Income Tax: Amendment of section 81 of the Income Tax Act, 1962

Subclause (a): Section 81(2) provides that the period within which an objection must be made, may be extended where the Commissioner is satisfied that "reasonable grounds" exist for the delay in lodging the objection. The limitation of the period of time within which the objection must be lodged is very important to ensure effective tax administration. In enacting time limits, it is the intention of the legislature that disputes should be brought to notice and resolved as speedily as possible so as to ensure the orderly administration of fiscal Acts and the collection of taxes. In practice it was evident that the onus of demonstrating "reasonable grounds" for the delay is fairly easily dischargeable. Therefore, the clear rationale of the legislature in limiting the period for objection was being negated. In certain jurisdictions no condonation of the prescribed periods for the filing of an objection is allowed, such is the seriousness with which such jurisdictions regard these prescribed periods. Furthermore, SARS is now bound to deal with objections and appeals within the time periods prescribed by the rules promulgated in terms of s107A of the Act. The limitation of the condonation of the filing of a late objection, after 60 days of the date of assessment (and before the expiry of 3 years after the date of the assessment), to "exceptional circumstances" is mitigated by the following factors:

- Adequate notice in the assessment notice and other public notice regarding the applicable time periods;
- The right, in terms of the new dispute resolution rules promulgated in terms of s 107A, to request reasons for the assessment where SARS has not provided, in the notice of assessment, such reasons. In the latter event, an objection need not be filed before receipt of such reasons.
- The remedies available in the event that SARS does not condone the late filing of the objection, for example the right to object against such decision of SARS, alternative dispute resolution ("ADR") or, where ADR is not appropriate or successful, to appeal to the Tax Court.

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

CLAUSE 72

Income Tax: Amendment of section 83 of the Income Tax Act, 1962

Subclause (a):

These amendments are necessary to remedy procedural shortcomings in the Tax Court procedure.

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

Subclause (c): This amendment is necessary to align the periods prescribed in rule 8, of the rules promulgated in terms of s107A, with section 83A(7).

CLAUSE 73

Income Tax: Amendment of section 83A of the Income Tax Act, 1962

This amendment is necessary to align the periods prescribed in rule 8 of the rules promulgated in terms of s107A, with section 83A(7).

CLAUSE 74

Income Tax: Insertion of Part IIIA in Chapter III [sections 88A to 88G] of the Income Tax Act, 1962

This Part incorporates into the legislation the provisions relating to the settlement of disputes which are currently contained in regulations

CLAUSE 75

Income Tax: Amendment of section 89sex of the Income Tax Act, 1962

A new subsection (2) has been added to provide that the Commissioner may prescribe the time by which any payment made on any business day must be received by the Commissioner and deems any payment received after that time to have been made on the first business day following that day.

CLAUSE 76

Income Tax: Amendment of section 106 of the Income Tax Act, 1962

As part of the detail of the e-filing legislation introduced in prior years, current law will be modified to allow for electronic notices and assessments.

Subclauses (a) and (c): These amendments are of a consequential nature.

Subclauses (b) and (d): As part of the detail of the e-filing legislation introduced in prior years, current law will be modified to allow for electronic notices and assessments.

CLAUSE 77

Income Tax: Repeal of section 107B of the Income Tax Act, 1962

This amendment is consequential upon the incorporation of section 107B under Part III [sections 88A to 88H] of the Income Tax Act, 1962.

CLAUSE 78

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

This amendment is of a textual nature.

CLAUSE 79

Income Tax: Amendment of paragraph 8 of the First Schedule to the Income Tax Act, 1962

This amendment deletes a reference to an obsolete provision.

CLAUSE 80

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

As explained in paragraph 20A of the Eighth Schedule (*CLAUSE 96)*, farmers are allowed in certain circumstances to write off all or portion of their capital development expenditure as part of the base cost on disposal of immovable property on which farming operations were carried on. If a farmer elects to write capital expenditure off as part of base cost then the expenditure carried forward in terms of paragraph 12(3) must be reduced by this amount.

CLAUSE 81

Income Tax: Amendment of paragraph 19 of the First Schedule to the Income Tax Act, 1962

This amendment deletes a reference to an obsolete provision.

CLAUSE 82

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

Up until 1998, the lump-sum payment to a member of the GEPF was exempt. When the exemption was removed, a provision was inserted to protect the interests of employees up to the date of the exemption termination. This rule, however, provided that no past service bought back after that date was permissible for tax purposes to

enjoy the benefit of the past service protection rule.

The proposed amendment provides for an equitable tax dispensation by allowing the same tax treatment to members of non-statutory forces where such members buy back past service, in the sense that they will enjoy the same tax benefits as under the past service protection rule.

CLAUSE 83

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

The current penalties for violating PAYE are insufficient. In order to promote consistency with other regimes, it is proposed that penalties of up to two hundred per cent be available in these circumstances.

CLAUSE 84

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

The Commissioner has always had the discretion to vary the payment of employees' tax in the cases of hardship or to correct errors. The amendment provides that in similar circumstances where companies have to pay over tax for directors, relief can be provided.

CLAUSE 85

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

Subclause (a): The amendment clarifies the position that in the formula for the deduction of tax from directors, the amount of remuneration must be determined on the remuneration received from that company.

Subclause (b): The amendment is of a consequential nature as a result of the extension of the relief provision in paragraph 11.

Subclause (c): The amendment extends the rights of employers to recover tax from a director where the company has paid employees tax on behalf of the director.

Subclause (d): Directors complained that although they received remuneration on the same basis as ordinary employees, a more complex method of determining the employees' tax was imposed on them.

The relief measure proposed in the Bill of excluding directors of private companies from applying the formula calculated remuneration will apply to directors earning at least 75 per cent of their remuneration in the form of fixed monthly payments. This means that a director of a private company can earn an annual bonus equal to a maximum of four months salary and not be subject to the formula based determination of PAYE to be deducted on a monthly basis.

CLAUSE 86

Income Tax: Amendment of paragraph 16 of the Fourth Schedule to the Income Tax Act, 1962

Subclause (a): The proposed amendment is of a textual nature. It is proposed that the provisions in the principal Act referred to be incorporated in paragraph 16(2A) of the Fourth Schedule.

Subclause (b): It is proposed that a personal liability be introduced in respect of employees' tax for representative employers, as well as directors or shareholders who control or are regularly involved in the management of the company's overall financial affairs. This liability of the representative employer, directors or shareholders only arises where that employer has withheld PAYE but has not paid it to SARS within the required period.

International experience has shown that the imposition of personal liability on officers and shareholders of a company is an effective procedure to prevent the misuse or misappropriation of funds collected on behalf of the State.

CLAUSE 87

Income Tax: Amendment of paragraph 19 of the Fourth Schedule to the Income Tax Act, 1962

Provisional tax must be paid based on the previous year's taxable income in certain circumstances when the assessment for the previous year has been issued more than 14 days before the provisional payment has to be made. It is proposed that this period be extended to 60 days.

CLAUSE 88

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

The Commissioner can impose additional tax if a person fails to submit a return. The amendment proposes that the additional tax may not be imposed on the taxpayer when the Commissioner increases the amount of the estimate on which the provisional tax is calculated.

CLAUSE 89

Income Tax: Amendment of paragraph 21 of the Fourth Schedule to the Income Tax Act, 1962

The amendment provides that any foreign tax a provisional taxpayer has paid in respect of income taxed in the Republic may be taken into account when calculating provisional tax.

CLAUSE 90

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

It was announced in the Budget that the reason for the distinction between exempt and taxed government and quasi-government bodies is not always clear and that consideration would be given to clarifying the matter. A number of the bodies on which clarity is required are presently exempt from tax in terms of section 10(1)(*c*A). In order to cater for the situation where the exemption of any of these bodies is withdrawn, it is proposed that provision be made for their transition to taxable status for CGT purposes. The amendment proposed is that where any person that is exempt from tax in terms of section 10(1)(*c*A) ceases to be exempt in terms of that section and paragraph 63 of the Eighth Schedule, that person's valuation date is the date the person ceased to be exempt. All the provisions that applied to taxable persons who owned assets on 1 October 2001 will apply in the same manner to these persons who were exempt except that their valuation date will be the date that became exempt.

CLAUSE 91

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

This proposed amendment is of a consequential nature and is as a result of the introduction of Part XIII of the Schedule.

CLAUSE 92

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

The definition of "lending arrangement" was previously contained in the Stamp Duties Act, 1977, but a new definition of "securities lending arrangement" has now been introduced into the Income Tax Act and this amendment is consequential on the introduction of the new definition.

CLAUSE 93

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

Subclause (a): Paragraph 12 deems certain events to be disposals, for example, cessation of residence or conversion of capital assets to trading stock. When these events occur the person is treated as having disposed of his/her assets for proceeds equal to their market value and to have reacquired those assets at that same market value.

The reference to proceeds in paragraph 12(1) has caused some uncertainty, because in some cases the market value of the asset would include amounts that are subject to tax as ordinary income. In terms of paragraph 35(3)*(a)* proceeds normally excludes such amounts. However, by stating that proceeds are equal to market value

the provisions of paragraph 35(3)*(a)* are bypassed and the result is double taxation. Our courts have held that there is a 'necessary implication' in the Act against double taxation, and this can be used to address the problem. It is proposed to eliminate any uncertainty by replacing the word 'proceeds' with the term 'amount received or accrued'. This makes it clear that the provisions of paragraph 35(3)*(a)* must still be applied to the amount of the deemed receipt or accrual.

Example

On 1.3.03 John buys a government bond for R100 when the prevailing interest rate is 10%. He earns R5 in interest every six months on 31 August and 28 February. On 27.02.04 John emigrates when prevailing interest rates are 5%. As a result of the decline in interest rates the market value of the bond has increased. The market value of his instrument including the accrued interest is R125 (R120 capital plus R5 accrued interest). As the law stands the "proceeds" are R125 and the capital gain is R125 – 100 = R25. In terms of the proposed amendment the proceeds will be R125 – R5 = R120 and the capital gain will be R120 – R100 = R20.

Subclause (b): The definition of "resident" has been amended to provide that a resident ceases to be a resident where the resident is treated as being non-resident as a result of a double taxation agreement. It is proposed that a consequential amendment be made to the subparagraph to prevent duplication of the provision.

Subclause (c): Where a creditor reduces or discharges a debt of a debtor, the debtor is treated as having a capital gain equal to the amount of the debt forgiven except where the amount is already a capital gain or has been taken into account in the hands of the debtor as a reduction of an assessed loss or a reduction in the base cost of an asset. There is a another situation which could result in double taxation and that is where the reduction or discharge of the debt results in a recoupment in the hands of the debtor in terms of section 8(4)*(m)*. It is proposed that the paragraph be amended to prevent this possible double taxation.

The operation of this paragraph has resulted in companies that owe money to other group companies not being deregistered or liquidated because of the potential tax consequence and this result in additional cost to groups of companies and unnecessarily increases the number of companies on register.

To alleviate the problem described above it is proposed that the provisions of paragraph 12(5) will not apply where the debtor and creditor are part of the same 'group of companies'. The term 'group of companies' is defined in s 1 and essentially refers to a group where the controlling company holds at least 75% of the equity share capital of a controlled group company.

The impact on the creditor

In terms of paragraph 56(1) the creditor company will not be able to claim a capital loss in respect of the cancellation or discharge of the debt owed to it (unless paragraph 56(2)*(b)* or *(c)* applies). Had paragraph 12(5) resulted in a capital gain in the hands of the debtor, the creditor would have been entitled to a capital loss in terms of paragraph 56(2)*(a).* However, since the capital gain will no longer arise, paragraph 56(2)*(a)* does not apply and paragraph 56(1) results in the loss being denied. This provides a symmetrical treatment of both debtor and creditor.

Exceptions to the exclusion of group companies rule

There is an exception to the general rule that paragraph 12(5) does not apply to groups of companies. This applies in two circumstances when the rule could be abused as part of a scheme to avoid any CGT that would otherwise have arisen under paragraph 12(5).

The two circumstances are as follows:

(a) Debt acquired from non-member of group

The provisions of paragraph 12(5) will apply where the debt (or any substituted debt) was acquired directly or indirectly from a person who is not a member of the group of companies.

Example 1

Holdco owns all the shares in Subco. In 2003 Subco owed R100 000 to Propco. Propco is not a member of the Holdco group of companies. Holdco purchased Subco's debt from Propco for R60 000 and thereafter waived its right to claim the debt from Subco. In this case Holdco will have a capital loss of R60 000 in terms of paragraph 56 while Subco will have a capital gain of R100 000 in terms of paragraph 12(5).

(b) The company becomes a member of the group of companies after the debt arose.

Example 2

Holdco owns all the shares in Subco. In 2003 Subco owed R100 000 to Propco. Propco is not a member of the Holdco group of companies. Holdco purchased the shares of Propco and then Propco writes off the debt of Subco. The relief from the operation of paragraph 12(5) will not apply and Propco will have a capital loss of R100 000 and Subco will have a capital gain of the same amount.

CLAUSE 94

Income Tax: Amendment of paragraph 19 of the Eighth Schedule to the Income Tax Act, 1962

Subclauses (a) and (b): These proposed amendments are of a consequential nature. In the paragraph use is made of the phrases "holding company" and "intermediate company" and they have the same meaning as these phrases in section 64B of the Income Tax Act. The phrase "holding company" in section 64B was deleted in 2002 and a new definition of "group of companies" was introduced in section 1of the Act. The proposed amendments bring the paragraph in line with the new definition.

Subclause (c): This amendment is of a consequential nature and brings the paragraph in line with the new definition of "group of companies".

CLAUSE 95

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

Subclause (a): This amendment is of a textual nature and brings the wording in line with the definition of "recognised exchange".

Subclause (b): This amendment is of a consequential nature as a result of the deletion of section 9E and the introduction of the exemption in section 10(1)(k)(ii)*(cc)*.

CLAUSE 96

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

Farmers are allowed as a deduction certain capital expenditure they incur in terms of paragraph 12 of the First Schedule to the Income Tax Act. This expenditure may only be allowed as a deduction against income derived from farming income. The way in which the deduction is allowed in terms of the First Schedule is that if the capital expenditure exceeds the income from farming, the full expenditure is allowed as a deduction and an amount equal to the excess expenditure is added to the income so that they cancel each other out. The excess expenditure is carried forward to the next year of assessment and deemed to be expenditure incurred in that next year.

The expenditure cannot form part of base cost in terms of paragraph 20 of the Eighth Schedule as paragraph 20(3)*(a)* requires that expenditure contemplated in this paragraph must be reduced by any expenditure that has been allowed as a deduction in determining taxable income of a person. Situations can arise on the death of a farmer or where farming operations cease and the farm is disposed of that there is still a balance of the capital expenditure that is available to be written off because the farmer has had insufficient ordinary farm income against which it could be written off.

An amendment is proposed that any balance of such expenditure or part thereof, on election of the farmer or on his or her death by the executor, be allowed as a deduction in the determination of any capital gain on the disposal of the property to match any increase in the proceeds as a result of the capital improvements made. Two restrictions are proposed. Firstly, if the farmer has adopted or determined market value as the valuation date of the immovable property only expenditure incurred after 1 October 2001 may be taken into account in determining the amount in respect of which an election can be made. Secondly, the amount of the capital expenditure in respect of which an election may be made may not exceed the proceeds from the sale of the immovable property reduced by other amounts allowable as base cost—

- in the case of a pre-valuation asset, the valuation date value of the asset plus any paragraph 20 expenditure incurred after 1 October 2001, and
- in any other case, the expenditure contemplated in paragraph 20.

Where a person has made an election as contemplated in this paragraph and any balance of expenditure is still carried forward in terms of the First Schedule adjustment will have to be made to that balance of expenditure. The consequential amendment is dealt with in the amendments to the First Schedule.

CLAUSE 97

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

The amendment proposed is a technical amendment to restrict the application of the provision to assets contemplated in subparagraph (1) which always was the intention.

CLAUSE 98

Income Tax: Amendment of paragraph 30 of Eighth Schedule to the Income Tax Act, 1962

The amendment is a correction of a printing error by the insertion of a bracket after "B_1" and it is proposed that it come into operation on 1 October 2001.

CLAUSE 99

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

When a part of an asset is disposed of, it is necessary to determine the portion of the base cost attributable to that part. Paragraph 33 contains rules that—

- determine the base cost attributable to the part disposed of, and
- prevent the allocation of a portion of the base cost in the case of certain part-disposals.

The following amendments are proposed:

*Substitution of reference to 'base cost' with 'expenditure' and 'market value' (*subparagraphs (1),(2) and (4))

The existing wording of paragraph 33 refers to the 'base cost' of the asset. This can be problematic when dealing with pre-valuation date assets, where the time apportionment base cost (TAB) or 20 per cent of proceeds methods have been adopted. Before these methods can be applied the proceeds must be known, and since it is only the part that has been disposed of, there are no proceeds in respect of the remainder of the asset.
This raises doubt as to whether these methods can be applied to part-disposals in terms of the existing law. In order to rectify this problem the provision has been reworded to refer to the expenditure allowable in terms of paragraph 20, or the market value adopted or determined in terms of paragraph 29(4). By establishing the expenditure and market value attributable to the part disposed of, this amendment also ensures that the kink tests in paragraphs 26 and 27 can be applied.

Situations where no allocation of base cost occurs (subparagraph (3))

Paragraph 33(3) prevents an allocation of part of the base cost of the asset in the case of certain part-disposals. This is done to prevent the triggering of premature capital losses. It is proposed that no base cost allocation occur in the following types of part-disposal.

- Improving or enhancing of a leased asset (subparagraph (3)*(c)*)

  Persons who lease assets, such as fixed property, and who have effected improvements to the property, have interpreted the Eighth Schedule as allowing them to claim as a capital loss the value of the *bare dominium* of the improvements in the year that they are affected. The argument advanced is that although they will have use of the asset they lose the ownership of the asset when it is affixed to the property The purpose of the proposed amendment is to clarify the position that the *bare dominium* of the cost of any asset used to improve a leased asset cannot be claimed as a capital loss as a part-disposal when the improvement is effected. The cost of improvements to the leased asset qualifies as part of the base cost in terms of paragraph 20 and will be brought into account for capital gains tax purposes on the termination of the lease.

Example

Grocer (Pty) Ltd enters into a 10 year lease for a shop and spend R100 000 on the shop front and fixtures on which no income tax allowances can be claimed. The *bare dominium* of the improvements calculated over a period of 10 years is R32 198 which the company wishes to claim as a capital loss in the year the improvements are effected. In terms of the proposed amendment the expenditure will form part of the base cost of the asset i.e. the lease, and if on termination of the lease no compensation for the improvements is received the capital loss will be allowed at the time of the expiry of the lease.

- Replacement of part of an asset comprising a repair

  The CGT rules triggering part-disposals are particularly wide. The current rules could be read as triggering a part disposal for the repair of assets. For instance, current law could be read as triggering a part sale if a taxpayer replaces a battery of a car. It is proposed that this anomaly be corrected.
  It is proposed that no portion of the base cost of an asset should be allocated to a part-disposal resulting from the replacement of a part of an asset where that replacement is a repair. The effect of this amendment is to prevent capital losses being triggered when the worn out or damaged part of an asset is replaced and disposed of. This amendment will not affect those persons who are entitled to claim repairs under section 11*(d),* since their base cost allocation would have been eliminated by paragraph 20(3)(a). Any proceeds derived from the disposal of the worn out part will be recognised as a capital gain at the time of its disposal with no base cost deduction.

Example
John purchased a country cottage for investment and letting purposes at a cost of R150 000. At the time of purchase the cottage was in a poor state of repair. During the first year of assessment during which he held the cottage John incurred R6 000 in replacing a rusty geyser, but was unable to claim this under section 11*(d)* because he had not yet secured a tenant and the cottage was not yet in a habitable state. He managed to sell the old geyser to a scrap metal merchant for R100. In terms of the proposed amendment, he does not have to determine the portion of the cost of the cottage attributable to the old geyser. The R100 proceeds will constitute a capital gain to be recognised in the year of assessment during which the geyser was disposed of.

Consistent adoption of the 20 per cent of proceeds method (subparagraph (5))

It is proposed that where a person has adopted the 20 per cent of proceeds method for a part-disposal, that person must thereafter continue to use that method for all subsequent disposals. A person who adopts this method does not need to allocate part of the expenditure or market value to the part disposed of and, therefore, falls outside subparagraph (1).

The 20 per cent of proceeds method determines the base cost of the part disposed of but does not determine the part of the expenditure allowable in terms of paragraph 20 or the part of the market value disposed of. It is therefore unclear how much of these components remain behind after a part-disposal effected using this method. For this reason it is desirable that consistency be prescribed.

Example
Louise purchased a piece of land at a cost of R5 000 in 1999. In 2015 she disposed of half of the land for proceeds of R100 000. The market value on valuation date of the property was R20 000. She decided to adopt the 20 per cent of proceeds method which gave her a base cost of R20 000 and a capital gain of R80 000. In 2017 she disposed of the remaining land for proceeds of R50 000. In terms of the proposed amendment she must adopt the 20 per cent of proceeds method and will have a base cost of R10 000 and a capital gain of R40 000. Had she been permitted to switch to TAB or market value for the second disposal it would have been unclear how much of the expenditure and market value remained after the first disposal.

CLAUSE 100

Income Tax: Amendment of paragraph 39 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 39 provides that a person must disregard capital losses determined in respect of the disposal of an asset to a connected person. It is proposed that this provision be extended to also cover capital losses determined in respect of the disposal of any asset to—

- a company which is a member of the same group of companies as that person, and
- a trust with a beneficiary which is a member of the same group of

companies as that person immediately after the transaction.

This could, for example, include a transaction, which is not a share for share transaction as contemplated in terms of section 42 because it will result in a capital loss, where a company A disposes of shares in a subsidiary company to company B in exchange for shares in company B and as a result of the transaction company A holds more than 75 per cent of the shares in company B. Companies A and B would be a group of companies after the transaction and the loss would be clogged.

CLAUSE 101

Income Tax: Amendment of paragraph 43 of Eighth Schedule to the Income Tax Act, 1962

Paragraph 43 provides rules for the translation of expenditure incurred in a foreign currency and/or proceeds received or accrued in a foreign currency for assets other than foreign currency which is dealt with in Part XIII of the Schedule.

Subclause (a): The amendment is of a consequential nature as a result of the amendment of section 25D.

Subclauses (b) and (c): These amendments are consequential upon the amendment of section 25D.

Subclause (d): Paragraph 43(4) deals specifically with the position of capital gains and losses arising from the disposal of—

- foreign equity instruments, which is a defined term and essentially means foreign liquid assets, and
- assets the capital gains or losses of which are derived or deemed to be derived from a source in the Republic as contemplated in section 9(2).

The purpose of the paragraph is to bring the capital gain or loss on the disposal of these assets as well as the capital gain or loss as a result of the currency fluctuation to account on disposal of the asset. The exclusion of assets contemplated in section 9(2)*(b)*(i) from the operation of paragraph 43(4) had the unintended consequence that a resident could acquire and dispose of South African source assets in foreign currency and thereby escape CGT consequences on the appreciation or depreciation of the Rand. It is proposed that that this unintended consequence be rectified.

Subclause (e): The subparagraph deals with two types of assets and as a result of a textual error only one type of asset is mentioned in paragraph 43(4)*(b)*(ii) and it is proposed that this error be corrected.

Subclause (f): On reconsideration it was found that it was not necessary to denominate a currency for the base cost in the circumstances described in paragraph 42 and 67 and an amendment is proposed.

Subclause (g): This amendment proposes that where paragraph 12(5) applies to a foreign debt, the base cost of the claim which is treated as having been acquired by the debtor must be treated as having been denominated in that foreign currency.

Subclause (h): There is concern that persons may use the currency of a country in the common monetary area to escape taxation on foreign currency fluctuations and it is proposed that this currency be excluded from the definition. See the explanation on section 25D.

CLAUSE 102

Income Tax: Amendment of paragraph 55 of the Eighth Schedule to the Income Tax Act, 1962

Paragraph 55 prescribes the circumstances in which the capital gains or losses on the disposal of long-term policies are disregarded. As a general rule the capital gains or losses determined in respect of second hand policies are subject to CGT but there are certain exceptions.

Subclause (a): Item *(b)* provides for the situation where an employer has taken out a policy on the life of an employee and paid the premiums on the policy which were deductible in terms of section 11*(w)*. The policy is ceded to the employee normally when the employee leaves the services of the employer and the value of the policy is taxable as ordinary income in the hands of the employee. This is technically a second hand policy but in terms of the item any capital gain or loss on this disposal is disregarded. Concern has been expressed that the wording may exclude persons who are not employees on the date of disposal of the policy and it is proposed that this matter be clarified.

Subclause (b): Item *(c)* of subparagraph (1) provides for the situation where a person takes out a policy to insure against the death of a partner or co-shareholder so that he or she can acquire the interest in the partnership or shares or similar interest in the company of if the partner or co-shareholder dies. If the partnership is disbanded or the person is no longer a shareholder the policy may be ceded to the person whose life was insured and this paragraph provides that any capital gain when the policy pays out is disregarded. As the item is worded it only operates on the death of the person insured and it was intended also to apply in the circumstances where the insured became disabled or severely ill. It is proposed that the wording be changed to give effect to what was intended.

CLAUSE 103

Income Tax: Substitution of paragraph 62 of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment provides for the disregarding of capital gains arising as a result of donations to the Government, Provincial local authorities and certain specific bodies which operate for the good of the general public.

CLAUSE 104

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

Paragraph 63 seeks to disregard all capital gains and losses in respect of the disposals by persons that are fully exempted from tax in terms of section 10, as opposed to those persons who are exempted in respect of specific types of receipts and accruals only. The proposed changes are to ensure that this is achieved.

CLAUSE 105

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

The participation exemption in respect of the disposal of a more than 25 per cent interest in a foreign company by a CFC has been moved to this paragraph of the Eighth Schedule.

The more than 25 per cent threshold now can be calculated with reference to holdings by other controlled group companies, and all foreign equity shares falling within the disguised debt rules of section 8E (without reference to the three year requirement) are no longer eligible for the exemption.

In the 2003 Budget Review, the Minister of Finance announced his intent to allow the tax free repatriation of foreign dividends back to South Africa, if the South African shareholder receiving the dividend has more than 25 per cent stake in the foreign company. This type of dividend exemption (which is known as the participation exemption) is frequently found in continental European systems, such as France, Netherlands, Belgium and Denmark. This exemption often exists alongside the tax free sale of foreign shares regarding the same percentage stake because profits from the sale of shares merely represent retained dividends. It is proposed that South African shareholders be allowed to make a tax free sale of foreign shares in a more than 25 per cent foreign company as long as that sale is made to foreign persons.

CLAUSE 106

Income Tax: Substitution of paragraph 65 of the Eighth Schedule to the Income Tax Act, 1962

See the notes on REINVESTMENT RELIEF AND INVOLUNTARY DISPOSALS.

CLAUSE 107

Income Tax: Substitution of paragraph 66 of the Eighth Schedule to the Income Tax Act, 1962

See the notes on REINVESTMENT RELIEF AND INVOLUNTARY DISPOSALS.

CLAUSE 108

Income Tax: Amendment of paragraph 67 of the Eighth Schedule to the Income Tax Act, 1962

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

Subclause (b): The proposed amendment provides that where a spouse transfers an asset to the other spouse the capital gain must be denominated in the same currency it was incurred by the transferor.

CLAUSE 109

Income Tax: Amendment of paragraph 67A of Eighth Schedule to the Income Tax Act, 1962

Part IX of the Eighth Schedule provides for roll-overs which effectively defer the taxation of specified capital gains.

Paragraph 67A rolls over any capital gains or losses in respect of participatory interest in collective investment schemes in property until the date of disposal of the interest by the holder. In terms of the Collective Investment Schemes Control Act, 2002, capital distributions may be made to investors while the portfolio remains in force which was not permitted in terms of the previous Act. In order to cater for these capital distributions it is proposed that all cash and the market value of any assets received by or accrued to a holder of a participatory interest which does not constitute gross income in that holder's hands constitutes proceeds when that interest is disposed of.

The proposed amendment provides that any asset acquired by the holder of the participatory interest in the circumstances mentioned above must be treated as having been acquired for expenditure equal to the market value on the date of acquisition and this expenditure must be treated as the amount of expenditure actually incurred and paid for the purposes of paragraph 20(1)*(a).*

The amendments will come into operation on the date of promulgation of this Act and apply to disposals of participatory interests from that date.

CLAUSE 110

Income Tax: Insertion of paragraph 67B of Eighth Schedule to the Income Tax Act, 1962

A company which operates a share block scheme in relation to immovable property which wishes to open a sectional titles register so that it can allow share block holders the right to take transfer of the property for which they hold the right of use, must follow the procedures prescribed in the First Schedule to the Share Blocks Control Act, 1980. In terms of this Schedule the share block holder who wishes to take transfer of the property must surrender his or her share certificate and right of use of the property and in return transfer of the property is given. Although seen from the point of view of the share block holder this is merely a change in the form of ownership of the immovable property, this is a disposal that can give rise to a capital gain or capital loss. In order not to create cash flow difficulties it is proposed that the recognition of the capital gain or loss be disregarded in the hands of the company and the person who acquires the sectional title unit. The capital gain or capital loss made by the person acquiring the unit is deferred until the person actually disposes of the immovable property. It is also proposed that the person acquiring the unit be treated as if—

- the expenditure incurred in respect of the acquisition and improvement of the share block interest was incurred to acquire and improve the sectional title unit; or
- the market value determination of the share block interest if made within the prescribed period be treated as if it were the market value of the sectional title interest;

- the date the share block interest was acquired, the use to which it was put and the date the expenditure was incurred is the same as the date of acquisition, use of the unit and date the expenditure was incurred. This will enable the person to use the time-apportioned base cost if the share block interest was a pre-valuation date asset and the full period of ordinary residence in the immovable property for the purposes of the R1million primary residence exclusion; and
- any market value determined on valuation date for the share block interest was determined for the unit.

CLAUSE 111

Income Tax: Insertion of paragraph 67C of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment deals with mineral, prospecting, mining, prospecting and production rights held before the introduction of the Mineral and Petroleum Resources Development Act and mining rights issued in terms of that Act. The amendment provides if the rights are wholly or partially continued, converted or renewed the old rights and the new rights will be treated as one and the same assets. This amendment will come into operation when the abovementioned Act comes into operation.

CLAUSE 112

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

This amendment is of a consequential nature as a result of the deletion of the definition of “foreign entity” in section 9D.

CLAUSE 113

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

Subclause (a) and (c): The proposed deletion of the definition of company in this paragraph means that the definition of “company” in section 1 applies which includes portfolios in collective investment schemes in equities. The proposed amendment to the definition of “share” brings a participatory interest within the ambit of the definition. These amendments ensure that capital distributions of Collective Investment Schemes in equities reduce the base cost of investors so that CGT is imposed when the participatory interest is disposed of.

Subclause (b): Paragraph 75 provides that distribution of an asset by a company to a shareholder must be treated as having been made for proceeds equal to the market value of the asset. The market value must be determined on the date the distribution is approved by the directors or by some other person with comparable authority conferred by the memorandum and articles of association of the company.

In the case of listed companies distributions by these companies must be approved by shareholders in terms of the rules of the JSE Securities Exchange SA. This Part

does not cater for this as the authority for the approval comes from the JSE rules and not the memorandum and articles of association. Even if the approval by the shareholders was sanctioned then the question still arises on what date the market value should be determined as in these transactions there are a number of possible dates. For example, should it be the date of the shareholder meeting, the date on which the shareholder must be registered to participate in the distribution or the date the asset is distributed? Similarly the authority of liquidators is not covered by this provision as the authority for the distribution comes from a law nor is a distribution which is not a formal dividend covered. The question also arises as to when an interim dividend accrue – when it is paid or when approved at the end of the year at the shareholder meeting. Similar questions arose in regard to the dates of declaration of dividends for the purposes of secondary tax on companies and section 64B(4) of the Income Tax Act was introduced to prescribe specific rules.

It is proposed that a definition of "date of distribution" which provides rules similar to those in section 64B(4) be introduced in paragraphs 74 to clarify the position.

CLAUSE 114

Income Tax: Amendment of paragraph 75 of Eighth Schedule to the Income Tax Act, 1962

As a result of the proposed introduction of the definition of "date of distribution" in paragraph 74 (see *CLAUSE 113*) it is proposed that subparagraph (2) be deleted and amendments be introduced to subparagraph (1). As explained in subclause *(a)* of *CLAUSE 93* which amends paragraph 12(1) the use of the defined term "proceeds" excludes the operation of paragraph 35(3) and it is proposed that the words "amounts received or accrued" be used rather than the defined term.

CLAUSE 115

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

The proposed amendment to the paragraph is consequential upon the introduction of the definition of the "date of distribution" in paragraph 74.

CLAUSE 116

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

Paragraph 78 deals with the shareholder level consequences of the issue of shares by a company.

Subclause (a): The proposed amendment is consequential upon the introduction of the definition of "date of distribution" in paragraph 74.

Subclause (b): Paragraph 78(2) provides a tax-free roll over for CGT purposes where new shares are substituted for previously held shares by reason of a subdivision, consolidation or similar arrangement. The 'base cost' of the previously held shares is allocated to the new shares with reference to the market value of the new shares.

It is proposed that the reference to the base cost of the previously held shares be replaced by references to—

- the expenditure incurred in terms of paragraph 20;
- the dates on which the expenditure was incurred; and
- any market value adopted or determined in terms of paragraph 29(4),

in respect of the previously held shares.

The intention always was that the expenditure, date of incurral thereof and market value on valuation date in respect of the previously held shares be carried over to the new shares. Under the previous wording it was unclear how the time-apportionment base cost (TAB) method was to be applied to the new shares. Under TAB the base cost is only determined when the new shares are disposed of and the proceeds are known. It was always the intention that paragraph 78(2) be applied in this manner, and this amendment now merely gives effect to this intention. Furthermore, the amendment provides clarity as to what constitutes expenditure before the valuation date in respect of the new shares for the purpose of applying the kink tests in paragraphs 26 and 27.

Subclause (c): Paragraph 78(3) deals with the situation where cash or assets *in specie* plus shares are given to a shareholder in substitution of previously held shares. A capital gain or loss is determined in respect of the non-share portion of the substitution.

For the same reasons explained in subclause *(a)* it is proposed that the reference in paragraph 78(3) to 'base cost' be replaced with a reference to the expenditure incurred and the market value adopted or determined in terms of paragraph 29(4).

It is also proposed that a consequential amendment be introduced as a result of the proposed introduction of definition of "date of distribution" in paragraph 74.

It is proposed that the amendment to subclauses *(b)* and *(c)* to the extent the term 'base cost" is replaced be deemed to come into operation on 1 October 2001.

CLAUSE 117

Income Tax: Amendment of paragraph 84 of the Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 118

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

Paragraph 86 prescribes how a person's foreign currency capital gain or capital loss in respect of foreign currency assets is to be determined. The proposed amendments provide that any amount of the foreign currency gain or loss which has otherwise been taken into account in calculating the person's taxable income, or in the case of an asset acquired from a spouse, that spouse's taxable income, must be excluded from the calculation. This could occur where the expenditure has been allowed as a

deduction against ordinary income or the proceeds have been included in income or have been taken into account in determining a capital gain or capital loss during the current or any previous year of assessment.

CLAUSE 119

Income Tax: Amendment of paragraph 88 of the Eighth Schedule to the Income Tax, 1962

Subclause (a): This amendment is of a textual nature and intended to clarify the wording.

Subclause (b): This amendment is of a consequential nature as the requirement deleted in this paragraph is included in the definition of "resident".

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

CLAUSE 120

Income Tax: Amendment of paragraph 92 of the Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature as the provision has been moved to paragraph 86.

CLAUSE 121

Income Tax: Amendment of paragraph 93 of the Eighth Schedule to the Income Tax Act, 1962

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

Subclause (b): The proposed amendment fixes the date on which the value of any foreign currency liability must be determined.

CLAUSE 122

Income Tax: Substitution of paragraph 94 of the Eighth Schedule to the Income Tax Act, 1962

It is proposed that the undefined terms 'foreign currency gain' and 'foreign currency loss' be replaced by the defined terms 'foreign currency capital gain' and 'foreign currency capital loss'. The latter terms are defined in paragraph 86.

CLAUSE 123

Income Tax: Amendment of paragraph 96 of Eighth Schedule to the Income Tax Act, 1962

This amendment is of a textual nature.

CLAUSE 124

Income Tax: Amendment of paragraph 1 of Part I of the Ninth Schedule to the Income Tax Act, 1962

This amendment adds the promotion of access to media and a free press to the list of activities which allows public benefit organisations to qualify for exemption.

CLAUSE 125

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

Subclause (a): It is proposed that the activity in paragraph 3(a) of Part I be performed for the benefit of low income persons instead of the poor and needy.

Subclause (b): Amends the activity relating to the residential care for retired persons by introducing the requirement that residential care for poor and needy persons is actively provided without full recovery of cost.

Subclause (c): A new activity is introduced which will enable an organisation carrying on the activity to qualify for tax exempt status.

CLAUSE 126

Income Tax: Amendment of paragraph 11 of Part I of the Ninth Schedule to the Income Tax Act, 1962

The activity is extended to include the company or organisation which handles the bid to host an international event approved by the Minister of Finance, e.g. the 2010 Soccer World Cup Bid.

CLAUSE 127

Income Tax: Amendment of paragraph 1 of Part II of the Ninth Schedule to the Income Tax Act, 1962

The activities listed are added to the list of welfare and humanitarian activities which would qualify approved public benefit organisations which carry on these activities for tax deductible contributions.

CLAUSE 128

Income Tax: Amendment of paragraph 2 of Part II of the Ninth Schedule to the Income Tax Act, 1962

The activities listed are added to the list of health care activities which would qualify approved public benefit organisations which carry on these activities for tax deductible contributions.

CLAUSE 129

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

The activities listed are added to the list of education and development activities which would qualify approved public benefit organisations which carry on these activities for tax deductible contributions.

CLAUSE 130

Income Tax: Addition of paragraph 5 of Part II of the Ninth Schedule to the Income Tax Act, 1962

A new class of activities relating to land and housing is added to the list of activities which would qualify approved public benefit organisations which carry on these activities for tax deductible contributions.

CLAUSE 131

Customs and Excise: Amendment of section 1 of the Customs and Excise Act, 1964

Definitions for "degrouping depot" and "degrouping operator" are inserted in view of the licensing of degrouping depots for air cargo as proposed in new section 64G.

A definition for "International Trade Administrative Commission" is inserted as a result of the implementation of certain provisions of the International Trade Administration Act (Act No. 71 of 2002). References in the Act to the Board on Tariffs and Trade accordingly require amendment. Where the Director-General: Trade and Industry was empowered in terms of the Schedules to the Customs and Excise Act to issue permits, the Director-General was substituted by the International Trade Administration Commission with effect from 1 June 2003.

CLAUSE 132

Customs and Excise: Amendment of section 3 of the Customs and Excise Act, 1964

Subsections (3) and (4), which presently provide for internal review of decisions, are deleted as new provisions in respect of internal administrative appeals and alternative dispute resolution are included in the proposed new Chapter XA.

CLAUSE 133

Customs and Excise: Amendment of section 4 of the Customs and Excise Act, 1964

The insertion of two new subsections, 3E and 8A, are proposed.

Subsection 3E follows the provisions of section 4(1)*(b)* of the Income Tax Act, 1962

(Act No. 58 of 1962) to provide for access of the Auditor-General to documents in the possession or custody of the Commissioner or a Controller.

A new subsection 8A empowers officers specifically with regard to section 107(2)*(a)* to stop or detain goods in order to ascertain whether the provisions of the Act or other law have been complied with. The release of goods may also be stopped at any time while goods are under customs control or any premises licensed under the Act.

The subsection also includes a definition if "goods under customs control" for the purpose of application of its provisions.

Where the officer or the Controller decides that it may be necessary to establish whether the goods are liable to forfeiture, a detention under section 88(1)*(a)* may be substituted for the detention under subsection (8A).

CLAUSE 134

Customs and Excise: Amendment of section 6 of the Customs and Excise Act, 1964

The proposed amendment to subsection (1)*(hC)* relates to the powers of the Commissioner to prescribe or appoint *inter alia* places where degrouping depots for air cargo may be established. Air cargo may be removed from a transit shed, to a degrouping depot before due entry thereof for the storage, detention, unpacking or examination of consolidated packing or its contents for the removal to another degrouping depot or for the delivery to importers of such contents after due entry. The existing paragraph *(hC)* also provides for the removal of air cargo before due entry to another transit shed, but in view thereof that transit sheds are not yet licensed, the reference to such removal is deleted.

CLAUSE 135

Customs and Excise: Amendment of section 35A of the Customs and Excise Act, 1964

The proposed amendment enables the Commissioner to make rules regarding distinguishing marks and numbers which must or must not appear on cigarettes containers in addition to the existing provision for a stamp impression. In terms of the provisions a licensee of a customs and excise warehouse may not remove cigarettes or allow cigarettes to be removed from such warehouse for home consumption or export unless they are packed, stamped or marked in the prescribed manner.

The amendment is intended to assist the Commissioner in curtailing the smuggling of cigarettes.

CLAUSE 136

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

Subsection (5) is amended and subsection (5C) is inserted to provide for the liability for duty of a degrouping depot operator and the circumstances in which such liability ceases.

CLAUSE 137

Customs and Excise: Amendment of section 46 of the Customs and Excise Act, 1964

In subsection (1)*(c)* and subsection (2), "International Trade Administration Commission" is substituted for "Board on Tariffs and Trade" in view of item 5(1) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002).

CLAUSE 138

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

Subsections (1) and (7) are amended in consequence of the provision in new Chapter VA for the imposition of an environmental levy.

Subsection (9) requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution. Presently the section contains reference to section 95A which relates to internal administrative appeals and had not yet come into operation. Section 135 of Act 60 of 2001 which inserted section 95A is accordingly repealed.

Certain amendments will come into operation when Chapter XA comes into operation.

CLAUSE 139

Customs and Excise: Insertion of Chapter VA [sections 47C to 47H] in the Customs and Excise Act, 1964

This chapter provides for the imposition of an environmental levy.

Provision for such a levy at the rate of R10 per kg is made in Part 3 of Schedule No. 1 on certain imported and locally manufactured carrier and flat bags which is included in Schedule 1 to this Bill.

The levy is payable in addition to any duty prescribed in Part 1 or Part 2 of Schedule No. 1 (section 47D(1)). Any imported goods or locally-manufactured excisable goods which are also liable to the environmental levy will thus be liable to both the duties.

Section 47D(2) provides that, subject to the provisions of the Chapter, the environmental levy is deemed to be a duty leviable under the Act, except for the

purposes of any customs union agreement contemplated in section 51 or any other law.

In terms of section 47E, the provisions of the Act relating to the importation of goods and imported goods and the manufacture of excisable goods, and entry for home consumption, removal from any customs and excise manufacturing warehouse and payment of duty contemplated in section 19A apply *mutatis mutandis* to environmental levy goods imported into or manufactured in the Republic. These provisions are subject to such exceptions and adaptations as may be prescribed in the Chapter, any Schedule or any rule.

The procedures prescribed in respect of "duty at source" in terms of section 19A may therefore, subject to the exceptions and adaptations provided, be applied to environmental levy goods manufactured in the Republic.

In terms of section 47F the Minister may provide under section 75(15) for rebates, refunds and drawbacks on environmental levy goods.

In terms of section 47G, no environmental levy goods may be manufactured in the Republic except in a customs and excise manufacturing warehouse licensed in terms of the Act.

Section 47H enables the Commissioner to make rules in respect of various matters for the administration of the section.

CLAUSE 140

Customs and Excise: Amendment of section 48 of the Customs and Excise Act, 1964

Subsection (2) is amended in consequence of the provision in new chapter VA for an environmental levy.

Subsection (2A) is amended by the substitution for "Director-General: Trade and Industry" of "International Trade Administration Commission" in terms of item 5(2) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002)

CLAUSE 141

Customs and Excise: Substitution of section 54 of the Customs and Excise Act, 1964

This proposed amendment which prescribes additional requirements in respect of imported cigarettes relates to the proposed amendment of section 35A which contains similar provisions in respect of cigarettes manufactured in the Republic.

CLAUSE 142

Customs and Excise: Substitution of section 57A of the Customs and Excise Act, 1964

This section provides for the imposition of provisional payments in respect of anti-dumping, countervailing or safeguard duty at the request of the Board on Tariffs and Trade. "International Trade Administration Commission" is substituted for "Board on Tariffs and Trade" in view of the provisions of item 2(2) and 5(1) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002).

CLAUSE 143

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

This section provides for the licensing of a degrouping depot. The provisions are primarily enabling in that requirements in respect of licensing and procedures may be prescribed by rule.

CLAUSE 144

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

As in the case of the amendment of section 47(9), this section requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution and in view of the reference therein to section 95A.

Certain amendments will come into operation when Chapter XA comes into operation.

CLAUSE 145

Customs and Excise: Substitution of section 69 of the Customs and Excise Act, 1964

Specific provision is made in subsection (1) for the value for duty purposes of DVD's, recorded compact discs, audio tapes and video tapes manufactured in the Republic that are dutiable in terms of item 124.65 of Section B of Part 2 of Schedule No. 1.

The section is further amended for the same reason as section 47(9) is amended. It requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution and in view of the reference therein to section 95 A.

Certain amendments will come into operation when Chapter XA comes into operation.

CLAUSE 146

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

Subsection (2)*(c)* is amended to substitute “International Trade Administration Commission” for “Board of Trade and Industries” in view of items 2(1) and 5(1) of Schedule 2 of the International Trade Administration Act, 2002 (Act No. 71 of 2002).

Paragraph *(c)* is added to section 11A to provide that the amount duly refundable in terms of any item of Schedule No. 6 may be an amount that may be set off by a licensee of a customs and excise warehouse in terms of section 77 where the goods have been entered or deemed to have been entered for home consumption and payment of duty in accordance with the provisions of the Act. This provision arises from the introduction of the “duty at source” system. The amendment is intended to clarify the application of set-off to any amount refundable under such item for the purposes of the subsection.

CLAUSE 147

Customs and Excise: Insertion of Chapter XA [sections 77A to 77P] in the Customs and Excise Act, 1964

This Chapter is inserted to provide firstly in Part A for internal administrative appeals. The legislation is mostly enabling in terms of which the Commissioner may prescribe various procedures by rule. Provision is also made for an appeal committee which may consist of officers or officers and other persons that will make recommendations to the Commissioner or decide on matters.

Part B provides for alternative dispute resolution (ADR). The Minister may, after consultation with the Minister of Justice, promulgate rules to provide for alternative dispute resolution. The rules may also include categories of decisions which are not suitable for alternative dispute resolution. Rules for alternative dispute resolution in respect of income tax disputes have already been promulgated by the Minister under section 107A of the Income Tax Act, 1962, (Act No. 58 of 1962).

Part C provides for the circumstances in which the Commissioner may settle a dispute. The contents follow the provisions previously published under section 93A. in GN R.468 of 1 April 2003.

CLAUSE 148

Customs and Excise: Amendment of section 80 of the Customs and Excise Act, 1964

Paragraph *(r)* is inserted to provide for an offence where a person without lawful cause fails to comply with a notice of appointment as agent in terms of section 114A within a period specified in such notice.

CLAUSE 149

Customs and Excise: Amendment of section 89 of the Customs and Excise Act, 1964

Section 89 is amended for the same reason section 47(9) is amended. The section requires amendment in consequence of the insertion of Chapter XA relating to internal administrative appeals and alternative dispute resolution and in view of the reference therein to section 95A.

CLAUSE 150

Customs and Excise: Substitution of section 93 of the Customs and Excise Act, 1964

The existing provision is restructured in subsection (1).

The proposed amendment further adds a subsection (2) which provides that any person who alleges ownership of any ship, vehicle, container or other transport equipment, plant, material or other goods, must prove ownership to the satisfaction of the Commissioner. If two or more persons claim ownership of the same goods, ownership must be decided by a competent court.

The amendment allows the courts, as opposed to the Commissioner, to settle disputes between two or more persons regarding ownership of goods in certain instances.

CLAUSE 151

Customs and Excise: Repeal of section 93A of the Customs and Excise Act, 1964

Section 93A is repealed in view of the provisions for dispute settlement in Part C of Chapter XA.

CLAUSE 152

Customs and Excise: Amendment of section 101 of the Customs and Excise Act, 1964

The reference to data created by means of a computer as defined in section 1 of the Computer Evidence Act, 1983 (Act No. 57 of 1983) is deleted as that Act was repealed by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 153

Customs and Excise: Amendment of section 101A of the Customs and Excise Act, 1964

Subsection (10) is amended to provide for the submission of reports electronically by

using the Internet as prescribed by rule.

CLAUSE 154

Customs and Excise: Insertion of section 114A and 114B in the Customs and Excise Act, 1964

Section 114A

This provision follows section 47 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991). In terms of the proposed section the Commissioner may if he thinks it necessary declare any person to be the agent of any other person. The person so declared must for the purposes of the Act be the agent of such other person in respect of payment of any amount of duty, interest, fine, penalty or forfeiture payable by such other person under the Act and may be required to make payment of such amount from any moneys which may be held by him or her for or be due by him or her to the person whose agent he or she has been declared to be.

In terms of a proviso the person who is so declared an agent who is unable to comply with the requirements of the notice of appointment as agent, must advise the Commissioner in writing of the reasons for not complying with that notice within the period specified in the notice.

Failure to comply with such notice of appointment as agent without lawful cause within the period specified in such notice is an offence in terms of section 80(1)*(r)*.

Section 114B

In terms of the proposed section the Commissioner has the same remedies against all property of any kind rested in or under the control or management of any person acting in a fiduciary capacity as he or she would have against other property of any person liable to pay any duty, interest fine, penalty or forfeiture payable under the Act and “in as full and ample a manner”. This provision follows section 49 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991).

CLAUSE 155

Customs and Excise: Substitution of Part 3 of Schedule No. 1 to the Customs and Excise Act, 1964

This amendment is consequential upon the insertion of Chapter VA in the Customs and Excise Act, 1964. Refer to *CLAUSE 139*.

CLAUSE 156

Stamp Duties: Amendment of section 7 of the Stamp Duties Act, 1968

Stamp duties have been gradually eliminated in line with international best practice. One item left unchanged involves negotiable certificate of deposit (NCD’s). NCD’s are classified as “marketable securities” under the Stamp Duties Act, but are subject to tax as fixed deposit accounts. NCD’s typically entail large sums of money that are utilised by commercial entities.

Subclause (a): Item 13 of Schedule 1 deals with the form of duty to be paid, it does not however indicate when the duty is payable. This amendment makes it clear that on the issue of NCDs duty is payable by the issuer.

Subclause (b): In the case of a transfer of a negotiable certificate of deposit, the duty is payable by the transferee.

CLAUSE 157

Stamp Duties: Amendment of section 23 of the Stamp Duties Act, 1968

The definition of lending arrangement has become superfluous as it is contained in the UST Act and is limited to listed securities. It is proposed that the definition be deleted.

Subclause (b): Consequential amendments following the deletion of the definition of "lending arrangement", as these subparagraphs have become obsolete.

Subclause (c): All of the other tax Acts require that records be kept by a person for at least five years. This amendment simply aligns the Stamp Duties Act record retention period with the other tax Acts.

CLAUSE 158

Stamp Duties: Insertion of section 30A and 30B and 30C in the Stamp Duties Act, 1968

The proposed amendments introduce a general anti-avoidance rule as section 30A which is similar to the rule in the VAT Act and in terms of the proposed sections 30B and 30C the Commissioner may appoint a person as an agent to collect outstanding stamp duty as is the case in the Income Tax and Value-Added Tax Act.

CLAUSE 159

Stamp Duties: Amendment of section 31 of the Stamp Duties Act, 1968

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 160

Stamp Duties: Amendment of section 32B of the Stamp Duties Act, 1968

The amendment is a consequential amendment and concerns the settlement of disputes.

CLAUSE 161

Stamp Duties: Amendment of Item 7 of Schedule 1 to the Stamp Duties Act, 1968

In order to facilitate the mortgage bond market, the 2002 legislation removed all stamp duties where creditors cede their interests in bonds. As a matter of parity duty relief is proposed for the cession or substitution of debtors in respect of bonds.

CLAUSE 162

Stamp Duties: Amendment of Item 13 of Schedule 1 to the Stamp Duties Act, 1968

Subclauses (a) and (b): Stamp duties have been gradually eliminated in line with international best practice. One item left unchanged involves negotiable certificates of deposit (NCDs). NCDs typically entail large sums of money that are utilised by commercial entities. Although duty on other types of fixed deposit receipts have been repealed due to Budgetary concerns, it is proposed that the definition of "fixed deposit" only refer to NCDs.

Subclause (c) and (d): These amendments delete obsolete provisions.

CLAUSE 163

Stamp Duties: Amendment of Item 15 of Schedule 1 to the Stamp Duties Act, 1968

Subclause (a), (b), (e) and (m): It is proposed that interest bearing debentures (which are not convertible into shares or similar equity interest or eligible to participate in dividends) be exempt from Stamp Duty as announced by the Minister in his 2003 Budget Speech. These amendments give effect to this proposal.

Subclause (c): The proposed amendment deletes obsolete provisions

Subclauses (d), (k) and (l): A registration of transfer of any marketable security acquired in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962) is exempt from stamp duty. This exemption was extended in 2002 to the registration of transfer of securities acquired in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of the market value of the asset exchanged for those securities. The proposed changes align the wording of the exemption in respect of unbundling transactions with that applying in respect of company formations, share-for-share and other corporate transactions. It is also proposed that the exemption be extended to securities acquired in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules regardless of whether those securities are acquired as capital assets or trading stock.

These proposals are retrospective to 6 November 2002 – see subclause (2)*(b)*.

Subclause (f): The proposed amendment deletes an obsolete provision.

Subclause (g): This proposed amendment is consequential upon the deletion of subparagraph *((g)* under subclause *(f).*

Subclause (h): This proposed amendment is a deletion of an obsolete provision.

*Subclause (i)and (j):*The proposed amendment proposes that were transfer duty is payable on the acquisition of marketable securities it should be exempt from stamp duty.

Subclause (n): The amendment is consequential upon the repeal of the Marketable Securities Tax Act, 1948.

Subclause (o): This proposed amendment deletes obsolete provisions.

CLAUSE 164

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

Subclause (a): There are a number of situations when input deductions or adjustments have to made in respect of goods used in the course or furtherance of an enterprise and these are set out in sections 16(3)*(h)*, 18(2), (4) and (5) of the VAT Act. The deductions and adjustments are calculated in terms of formulae prescribed in the different sections. One of the factors in the formulae is “the cost..... to the vendor of the acquisition, manufacture, assembly, construction or deduction of those goods or services”. As the cost is not defined, it includes all costs directly attributable to the acquisition, manufacture, etc of the goods. These costs can include the cost of many goods and services on which VAT has not been paid and would not have been paid even if VAT had been in operation in years prior to its commencement date, for example, financing charges and labour.

The purpose of the deductions and adjustments in terms of these sections is to bring into account or adjust the amount of input tax allowable. Using a cost which includes costs which were not subject to VAT distorts the deductions and adjustments.

A new definition of “adjusted cost” is proposed to limit input tax and output tax adjustments in sections 16(3)*(h)*, 18(2), (4) and (5) to amounts which bore VAT or would have borne VAT if the Act had been applicable prior to the commencement date or which are or would have been subject to a notional input deduction in respect of second-hand goods. .

Subclause (b): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that the definition of “consideration” be amended. The effect of the proposed amendment is that a “grant” which is a defined word will no longer constitute “consideration”. This will bring the law in line with the general principle that only if the payment made by a public authority or local authority is made for any goods and services supplied, to be supplied or deemed to be supplied to the public authority local authority will it constitute “consideration”. There is an exception to the proposed rule and that is a subsidy paid in terms of the Government Housing Subsidy Scheme which is dealt with in the notes and section 8(23).

Subclause (c): See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. It is proposed

that definitions of “customs controlled area” and “custom controlled area enterprise” be introduced. See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that a new definition of “designated entity” be inserted which in conjunction with the proposed section 8(5) deems these entities to have rendered services to public and local authorities to the extent of any payment made by these authorities in respect of the taxable supply of goods and services by these entities.

Subclause (d): In view of the introduction of the definitions in subclause *(c)* it is proposed that the definition of “customs secured area” be deleted.

Subclause (e): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that paragraph *(b)* of the definition of “enterprise” be amended by extending its ambit to include all national and provincial public entities as listed in Part A and C of the PFM Act. The effect of the proposed amendment is to bring national and provincial public entities into the definition on the same conditions as national and provincial departments. These entities are in the majority of cases not carrying on activities which are the same or similar to the taxable supplies of goods and services by private sector vendors. The supply of goods and services will only be treated as supplies of goods and services in the course or furtherance of an enterprise if the Minister is satisfied that they are supplied in competition with the private sector.

Subclause (f): A consequential amendment is proposed to item *(aa)* of subparagraph (iii) of the proviso to the definition of “enterprise” by the deletion of the reference to paragraphs (i) and (vii) of the definition of “remuneration” in paragraph 1 of the Fourth Schedule to the Income Tax Act which reference has been deleted in that Act.

Subclause (g): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that a new proviso (viii) be added to the definition of “enterprise”. The effect of the insertion of the proposed proviso is to exclude Constitutional Institutions listed in Schedule 1 to the PFM Act which do not carry on enterprises, from the definition of “enterprise” so that they will not be subject to VAT.

Subclause (h): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed a definition of the word “grant” be introduced to replace the term “transfer payment” which is deleted. The proposed definition includes a wider number of payments but it excludes payments made for any goods and services supplied, to be supplied or deemed to be supplied to public and local authorities. One of the effects of the proposed amendments is that payments for services deemed to be supplied to public and local authorities in terms of the proposed sections 8(5) and (23) cannot be grants as they are deemed to be supplied to these authorities.

Subclause (i): See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. An amended definition of “Industrial Development Zone” is proposed to bring it in line with the Customs and Excise Act.

Subclause (j): See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. A definition of “Industrial Development Zone operator” is proposed.

Subclause (k): A definition of the word “month” is proposed in section 1 as this word

is used a number of times in the Act and it is proposed that the definitions of "month" in the other sections of the Act be deleted.

Subclause (l) and (m): An amendment is introduced to exclude from the definition of "second-hand goods" any rights in property acquired as a result of the surrender or conversion of prospecting, mining, exploration or production rights as defined in Schedule 1 of the Mineral and Petroleum Resources Development Act, 2002. It is proposed that this amendment come into operation when the abovementioned Act comes into operation.

Subclause (n): See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. A definition of "service enterprise" is proposed.

Subclause (o): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that the definition of the phrase "transfer payment" be deleted as it has been replaced with the definition of the word "grant" to describe payments from public and local authorities.

CLAUSE 165

Value-Added Tax: Amendment of section 7 of the Value-Added Tax Act, 1991

See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS.

CLAUSE 166

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

Subclause (a): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. A number of Government entities which are currently registered as enterprises will have to deregister when the amendments come into operation. It will mean that they will have to pay output tax on the market value of their assets which will result in a circular flow of funds in the government sphere because the funds to pay the tax will have to be obtained from the Treasury. A proviso to section 8(2) is proposed to prevent the operation of the provisions of the section when Government bodies are deregistered in terms of this Act.

Subclause (b): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. The proposed amendment to section 8(5) places it beyond doubt that any payment made by a public authority or local authority to a "designated entity" in respect of the taxable supply of goods and services is a payment for the supply of services.

Subclause (c): Under current law where goods are transferred by a vendor to his or her branch or main business outside the Republic the vendor is deemed to supply goods in the course or furtherance of his or her enterprise. The current use of the word "transfers" leads to abuse where the ownership title in the goods was transferred to an entity outside the Republic (at the zero rate) without the physical transfer / export of the goods. It is proposed that section 8(9) of the Act be amended to provide that the goods must be consigned or delivered to a branch or main business of a vendor at an address which is outside South Africa. This amendment

is to ensure that the zero-rating will apply only if the goods or services are consigned or delivered to such branch or main business. See also *CLAUSE 169 (1)(c).*

Subclause (d): It is proposed that two new subsections be added to the section. The proposed subsection (22) deals with the situation where the Minister of Education has in terms of a direction in terms of section 23 or 24 of the Higher Education Act, 1997 merged two or more public education institutions or incorporated one or more subdivisions of such institutions into a single public higher education institution. The amendment proposes that the institutions or subdivisions prior to the merger or incorporation and the newly merged or incorporated single institutions be deemed to be one and the same institution for the purposes of the Act. The effect will be that any transfer of goods and services between the institutions will not be subject to VAT.

See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. The proposed subsection (23) provides a vendor is deemed to have supplied services to a public or local authority to the extent of any payment in terms of the Housing Subsidy Scheme referred to in section 3(5) of the Housing Act, 1997 made to or on behalf of that vendor in respect of the taxable supply of goods and services by the vendor. The subsection places it beyond doubt that the payment is for services and what the value of the services is. This provision must be read with *CLAUSE 169 (1)(k)* in terms which it is proposed that the services contemplated in this subsection be zero-rated.

CLAUSE 167

Value-Added Tax: Amendment of section 9 of the Value-Added Tax Act, 1991

This proposed amendment is consequential upon the amendment to section 8(9) and provides that the time of supply in regard to the supply of goods to a branch or main business outside South Africa is the time when the goods are consigned or delivered.

CLAUSE 168

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

Subclause (a): The section deals with the value of supplies of goods and services and this amendment is consequential upon the amendment in section 8(9).

Subclause (b): This amendment is consequential upon the amendment in section 1 of the definition of “adjusted cost”.

CLAUSE 169

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

Subclause (a): See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. It is proposed that section 11(1)*(m)* be amended to align it with the wording used in section 21A of the Customs and Excise Act.

Subclause (b): Paragraph *(n)* to section 11(1) proposes that consideration received

as a result of the continuation, conversion or renewal of a prospecting, mining, exploration or production right as defined in Schedule 1 and 2 of the Mineral and Petroleum Resources Development Act, 2002, be subject to VAT at the zero-rate. It is proposed that this amendment come into operation on the date the abovementioned Act comes into operation.

Subclause (c): It is proposed that the subsection be amended to prevent duplication in the wording.

Subclause (d): As a result of the proposed amendment of section 8(5) goods supplied using donor funds will not be zero-rated as in the past. It is, therefore, proposed that a new provision be inserted to ensure that the supply of the goods is zero-rated.

Subclause (e): See the notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. The proposed amendment will zero-rate services rendered to a registered vendor in a customs controlled area.

Subclause (f): This subsection provides for the zero-rating of grants to welfare organisations and is amended as a consequence of the amendment to section 8(5). The amendment does not change the operation of the section.

Subclause (g): It has been proposed that section 8(9) be amended to provide that goods must be consigned or delivered to a branch or main business at an address outside the Republic to prevent abuse. It is proposed that the zero-rating in section 11(2)*(o)* in the case of services supplied to or for the purposes of a branch or main business outside the Republic be limited to the same circumstances set out in section 11(2)*(l)* that would apply if a vendor supplied services to a person who was not resident in the Republic.

Subclause (h): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that section 11(2)*(p)* which provided for the zero-rating of transfer payments be deleted.

Subclause (i): The subsection 11(2)*(q)* allows for the zero-rating of foreign grants and the amendment is consequential upon the amendment to section 8(5). The amendment does not change the operation of the section.

Subclauses (j) and (k): See notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. It is proposed that the housing subsidies contemplated in section 8(23) be zero-rated

Subclause (l): The amendment proposed to section 11(3) provides for documentary evidence to be obtained and retained by a vendor where goods are exported while in a license Customs and Excise warehouse and is consequential upon the amendment to section 13. It is proposed that this amendment come into operation on 1 January 2002

CLAUSE 170

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

Subclause (a): In terms of the proposed section 21A of the Customs and Excise Act

goods removed from a customs controlled area are deemed to have been imported into the Republic for the purposes of that Act and the VAT Act. It is proposed that the date of importation be the date the goods are deemed to be imported in terms of the Customs and Excise Act

Subclause (b): Under present law VAT on importation of goods into the Republic is triggered on the date the goods are deemed to be imported in terms of the Customs and Excise Act. VAT is only levied when the goods are entered for home consumption. The VAT paid on the overhead costs of maintaining such a warehouse cannot be claimed as a VAT input because present law disregards the goods until importation. Goods held in a licensed Customs and Excise warehouse that are never intended for the domestic market (i.e. exclusively held for re-export) are currently disregarded for VAT purposes, and falls outside the scope of the VAT net. The proposed amendment to proviso (ii) to section 13 provides that the supply of goods in a licensed Customs and Excise warehouse to an export country will be a zero-rated supply. Enterprises engaged in the transit trade may now claim input tax in respect of expenses relating to the storage of such goods. The amendment is deemed to have come into operation 1 January 2002 and shall apply to supplies made on or after that date.

Subclause (c): See notes on VAT TREATMENT OF VENDORS IN INDUSTRIAL DEVELOPMENT ZONES AND CUSTOMS CONTROLLED AREAS. On importation of goods into the Republic the value of the goods is the customs value plus 10 per cent of that value. In the case of goods imported from Botswana, Lesotho, Swaziland or Namibia the 10 per cent upliftment is not added to the value. It is proposed that in the case of goods imported from a customs controlled area the 10 per cent uplift should also not be added to the value of the goods.

CLAUSE 171

Value-Added Tax: Amendment of section 14 of the Value-Added Tax Act, 1991

VAT is payable on the imported services by VAT vendors and non-VAT vendors. VAT on imported services is not payable if the supply of those services is subject to tax in terms of section 7(1)*(a)* under the normal provisions of the Act or, if the supply was made in the Republic, it would have been charged with tax at the zero per cent or the supply would have been exempt from VAT. Educational services supplied by institutions in the Republic that are registered in terms of a specific Act or are exempt from income tax, are exempt from VAT. Educational services supplied by foreign educational institutions do not meet these requirements and are not exempt from VAT. The proposed amendment provides for the addition of paragraph *(c)* to section 14(5) to exempt South African students from VAT on imported educational services where the services are supplied by an educational institution established in an export country and which is regulated by an educational authority in that country. This amendment shall be deemed to have come into operation on 1 December 1998.

CLAUSE 172

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

Subclause (a): The proposed amendment to section 16(2)*(a)* and *(e)* is consequential upon the amendment to section 20(4) as contained in Clauses 175 and 176.

Subclause (b): Where goods or services are used only partly for the purpose of making taxable supplies, and are subsequently sold, an input tax adjustment is allowed for the input tax previously denied. The amendment to section 16(3)*(h)* limits the adjustment to costs that bore VAT, would have borne VAT or would have been subject to a notional input tax deduction. This amendment must be read with the new definition of "adjusted cost" in section 1 of the VAT Act.

CLAUSE 173

Value-Added Tax: Amendment of section 17 of the Value-Added Tax Act, 1991

Subclause (a): Under current law, any form of entertainment includes meals supplied by an operator of any conveyance to the crew on board during the journey. Input tax is prohibited on meals and refreshments supplied by the employer to its crew on board the conveyance. The abuse that the provision intended to prevent was the claiming of an input credit where "entertainment" was provided in lieu of a salary. Clearly meals provided to cabin crew on board a conveyance is not the abuse that the provision intended to target. The amendment to subparagraph (iii) of paragraph *(a)* to section 17(2) allows suppliers of transport services to deduct an input tax deduction in respect of meals and refreshments supplied to crew on board the conveyance.

Subclause (b): Under current law, any form of entertainment includes meals and accommodation of employees when employees are hospitalised, at the employer's expense, due to injuries sustained during work-related activities. This prohibits the employer from claiming any input tax credits relating to those costs. VAT ruling 299 of 25 November 1991, states that expenses paid where an employee is injured at work are incurred in the normal course or furtherance of the vendor's enterprise and he or she may therefore claim an input tax deduction. The addition of subparagraph (vii) of paragraph *(a)* to section 17(2) allows an input tax deduction in respect of meals and refreshments supplied in hospital to employees, unless the costs thereof are charged for separately from the other costs.

Subclause (c): See the notes on VAT TREATMENT OF GRANTS PAID BY PUBLIC AUTHORITIES AND LOCAL AUTHORITIES. Section 17(2) provides that notwithstanding anything in the Act, vendors are not entitled to deduct input tax in the circumstances describe in the section. A new subsection is proposed that provides that input credit shall not be allowed in respect of goods and services that were acquired or imported for the purpose of consumption, use or supply in the course of making taxable supplies to the extent that those goods and services were acquired as a result of or in anticipation of the receipt of a "grant". The effect of the amendment will be that any input tax paid on goods and services acquired as a result of the receipt of the grant will not be allowed as a deduction.

CLAUSE 174

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

Subclause (a),(b) and (c): The amendments to sections 18(2), (4) and (5) limit the VAT adjustments in these sections to costs which bore VAT, would have borne VAT or would have been subject to a notional input tax deduction in line with the definition of "adjusted cost" in section 1 of the VAT Act.

CLAUSE 175

Value-Added Tax: Amendment of section 20 of the Value-Added Tax Act, 1991

Under current law a tax invoice of a supplier of the goods or services must, among the information required on a tax invoice, contain the name and address of the recipient. This has lead to some vendors abusing the system by claiming multiple deductions using numerous vendors with similar names. It is proposed that in addition to the name and address of the recipient, the full tax invoice for supplies in excess of R1 000 should also contain the VAT registration number of the recipient if he or she is a registered vendor. This amendment shall come into operation on 1 March 2005 and shall apply in respect of any supply made on or after that date.

CLAUSE 176

Value-Added Tax: Amendment of section 21 of the Value-Added Tax Act, 1991

Subclause (a) and (b): These amendments are consequential upon the amendment to section 20 that introduced the requirement for the VAT registration number of the recipient on the invoice when making purchases of more than R1 000. Similar amendments are proposed for the issue of credit and debit notes.

It is proposed that these amendments come into operation on 1 March 2005 and apply in respect of any supply made on or after that date.

CLAUSE 177

Value-Added Tax: Amendment of section 22 of the Value-Added Tax Act, 1991

The deletion of the definition of month from this section is proposed as it is now defined in section 1.

CLAUSE 178

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

The deletion of the definition of month from this section is proposed as it is now defined in section 1.

CLAUSE 179

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

Subclause (a): Section 28 prescribes on what dates VAT returns must be furnished and tax paid. It is proposed that, in addition, the Commissioner may prescribe the time by which any payment made on any business day must be received by him or her and if any payment is received after that time shall be deemed to have been made on the first business day following that day.

Subclause (b): The deletion of the definition of month from this section is proposed as it is now defined in section 1.

CLAUSE 180

Value-Added Tax: Amendment of section 31 of the Value-Added Tax Act, 1991

Under current law it is a criminal offence for parties to make unauthorised or fraudulent use of tax invoices with respect to the VAT Export Incentive Scheme. If a person is found guilty of an offence they are liable on conviction to a fine or to imprisonment for a period not exceeding 60 months. An abusive practice of late involves the falsification or alteration of tax invoices, to purport that a larger amount of VAT was paid for the goods and / or services by the recipient than was actually the case. In many instances the people involved in these schemes are non-vendors who reside in an export country. The falsified tax invoice is presented to the VAT Refund Administrator for a refund prior to the recipient leaving the Republic. This amendment is aimed at curbing this abusive practice. In addition to the present criminal charges, the proposed introduction of sub-section *(f)* enables the Commissioner to issue assessments on non-vendors who have obtained irregular refunds under the VAT Export Incentive Scheme.

CLAUSE 181

Value-Added Tax: Insertion of section 31A and 31B in the Value-Added Tax Act, 1991

The proposed introduction of section 31A is to enable the Commissioner to reduce assessments, notwithstanding that no objections have been lodged or appeals noted, to rectify processing errors made or where information in the returns was either incorrectly taken into account or overlooked when the assessments were issued. Assessments may not be reduced after the expiry of three years from the date of the assessment or if the taxpayer accepted the assessment and it was issued in accordance with practice generally prevailing at the date of the assessment.

The proposed introduction of section 31B is to enable the Commissioner to withdraw assessments, notwithstanding the fact that no objections have been lodged or appeals noted, which were issued to the incorrect person or was issued for the wrong period and the assessment shall be deemed not to have been issued.

CLAUSE 182

Value-Added Tax: Amendment of section 32 of the Value-Added Tax Act, 1991

Recently changes have been made to the Income Tax Act No. 58 of 1962, in relation to the rules of tax court and the settlement of disputes with reference to objections. The proposed amendment makes the rules in the Income Tax Act applicable to objections under the VAT Act.

CLAUSE 183

Value-Added Tax: Amendment of section 33 of the Value-Added Tax Act, 1991

Recently changes have been made to the Income Tax Act No. 58 of 1962, in relation to the rules of tax court and the settlement of disputes with reference to appeals.

The proposed amendment makes the rules in the Income Tax Act applicable to appeals under the VAT Act.

CLAUSE 184

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

Subclause (a): It is proposed that wording similar to the previous section 39(4) be introduced to clarify when and in what circumstances interest and penalties on the late payment of VAT on goods imported is to be levied.

Subclause (b): The amendment to section 39(7) is consequential on the introduction of section 39(4).

Subclause (c): The deletion of the definition of month from this section is proposed as it is now defined in section 1.

CLAUSE 185

Value-Added Tax: Amendment of section 46 of the Value-Added Tax Act, 1991

As can be seen from the wording of section 46 it was always the intention that natural persons be appointed as the representative taxpayers who are responsible for performing the duties in terms of the Act. The proposed amendment places it beyond doubt that a representative vendor must be a natural person who is a resident of the Republic.

CLAUSE 186

Value-Added Tax: Amendment of section 48 of the Value-Added Tax Act, 1991

Subclause (a): Section 48 deals with the liability to tax of the representative vendors. Subsection (2) provides that the representative vendor in respect of money controlled or transactions be liable to tax, penalty or interest as though such liability had been incurred by him personally, but such liability shall be deemed to have been incurred in his or her representative capacity. The proposed amendment provides that the right of recovery of the tax in subsection 48 (3) is restricted to the tax liability that arises in terms of subsection (2).

The proposed amendment to subsection 48(4) gives any person who is personally liable for the payment of any tax, penalty or interest in terms of subsection 48(6) and the proposed subsections 48(6A) and (9), the right of recovery of the amounts paid from the person on whose behalf it is paid or to recover it from the moneys held on behalf of that person.

Subclause (b): The proposed amendment is of a textual nature to make the subsection clearer.

Subclause(c): In terms of subsection (6) a personal liability arises on the representative taxpayer if while tax is unpaid he alienates or disposes of moneys which could have been used for the payment of the outstanding tax, penalty or interest. The proposed introduction of subsection (6A) gives the Commissioner the

right to recover the amount from the representative vendor.

Subclause (d): The amendment proposes that where the vendor is a company, every shareholder and director who controls or is regularly involved in the management of the company's overall financial affairs shall be personally liable for the tax, penalty or interest for which the company is liable.

CLAUSE 187

Value-Added Tax: Amendment of section 57 of the Value-Added Tax Act, 1991

The amendment proposed is to bring the VAT Act in line with the Electronic Communications and Transactions Act, No. 25 of 2002.

CLAUSE 188

Value-Added Tax: Amendment of section 74 of the Value-Added Tax Act, 1991

The proposed amendment is consequential upon the changes to the Customs and Excise Act. It allows the Minister to amend Schedule No. 1 and the notes thereto in order to align the VAT Act with the provisions of the Customs and Excise Act where necessary.

CLAUSE 189

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

The Board of Trade and Industry no longer issues permits for the temporary importation of construction plant and machinery and it is therefore proposed that this item of the Schedule be accordingly amended by the deletion of that requirement.

CLAUSE 190

Uncertificated Securities Tax: Amendment of section 1 of the Uncertificated Securities Tax Act, 1998

Subclause (a): Lending Arrangements: As announced in the 2003 Budget Review, the definition of lending arrangement will be modified to allow for securities on-lending as long as the loan is not outstanding for more than 12-months (i.e., the transaction is a real loan versus a sale). The borrowing of securities for redelivery to any lender will not qualify for tax-free treatment if the loan is designed to keep a loan position open for more than 12-months or for any other form of tax avoidance.

This amendment proposes the replacement of the definition of "lending arrangement". The new definition *inter alia* provides for the on-lending of listed securities and requires the borrower to deliver the securities within a 10 business day period after the date of agreement. The borrower is contractually required to compensate the lender for any distributions made in respect of the shares. The lending arrangement is deemed not to be a lending arrangement if the parties do not meet the requirements laid down.

Subclause (b): The amendment proposes the insertion of a definition of "person" for the purposes of the Act.

Subclause *(c)*: The amendment is consequential on the repeal of the Marketable Securities Tax Act, 1948, and the merger of its function into the Act. See the notes on CLAUSE 224.

CLAUSE 191

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

Uncertificated securities tax is not payable in respect of a change in beneficial ownership in securities if such beneficial ownership is acquired by a person in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962. This exemption was extended in 2002, in line with those applying in respect of marketable securities tax and stamp duty, to an acquisition of beneficial ownership in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules irrespective of whether or not an election was made for those rules to apply and regardless of the market value of the asset exchanged for those securities. The proposed changes align the wording of the exemption in respect of unbundling transactions with that applying in respect of company formations, share-for-share and other corporate transactions. It is also proposed that the exemption be extended to the acquisition of beneficial ownership in securities in terms of a transaction that would have constituted a transaction or distribution contemplated in those rules regardless of whether those securities are acquired as capital assets or trading stock. These proposals are in line with those proposed in respect of the equivalent stamp duty exemptions - see the notes on clause 163.

The proposed changes are retrospective to 6 November 2002 – see subclause (2).

CLAUSE 192

Uncertificated Securities Tax: Insertion of section 11A in the Uncertificated Securities Tax Act, 1998

The proposed amendments introduce a general anti-avoidance rule as section 11A which is similar to the rule in the VAT Act and in terms of the proposed sections 11B and 11C the Commissioner may appoint a person as an agent to collect outstanding tax as is the case in the Income Tax and Value-Added Tax Act.

CLAUSE 193

Uncertificated Securities Tax: Amendment of section 13 of the Uncertificated Securities Tax Act, 1998

This amendment is consequential upon the repeal of the Computer Evidence Act, 1983 (Act No. 57 of 1983) by the Electronic Communications and Transactions Act, 2002 (Act No. 25 of 2002).

CLAUSE 194

Uncertificated Securities Tax: Insertion of section 14A in the Uncertificated Securities Tax Act, 1998

Under current law it is unclear who is responsible for the retention of records and for how long these records need to be kept. The lack of such a provision has impeded the collection of taxes. This amendment aligns the UST Act to provisions that are present in the other Acts administered by the Commissioner. The issuer / member (stock broker) / participant will have to retain for a period of five years all records pertaining to issue of securities or trade in securities traded through that issuer / member (stock broker) / participant business.

CLAUSE 195

Uncertificated Securities Tax: Amendment of section 17A in the Uncertificated Securities Tax Act, 1998

The amendment is of a textual nature and concerns the settlement of disputes.

CLAUSE 196

Skills Development Levies: Amendment of section 4 of the Skills Development Levies Act, 1999

The amendment is of a textual nature.

CLAUSE 197

Skills Development Levies: Amendment of section 12 of the Skills Development Levies Act, 1999

The amendment proposes that if an employer fails to pay the skills development levy timeously and the Commissioner, the chief executive officer of the SETA or its approved body, as the case may be, is satisfied that the employer's failure was due to an intent to postpone or evade his or her obligations under the Act, a penalty of 200 per cent of the outstanding levy may be imposed on the employer. In any other case the penalty is as at present 10 per cent of the unpaid amount.

CLAUSE 198

Income Tax: Amendment of section 21 of the Taxation Laws Amendment Act, 2000

Under current law, public benefit organisations with tax exempt status and tax deductible donation (section 18A) status under old law must switch to the new 2000 dispensation by 31 December 2003. Failure to do so will mean loss of all tax beneficial status.

This amendment extends this deadline for applying for tax exempt status in terms of the 2000 dispensation to 31 December 2004 to permit additional time for PBOs to

come forward.

It also grants an extension to the same date to entities contemplated in section 10(1)*(d)*(iii) or (iv) (e.g. trade unions, chambers of commerce, sport clubs and professional bodies) to apply for exemption under that section. This will enable SARS and National Treasury to finalise the criteria to be applied to qualify for exemption and any regulations to be issued in terms of that section.

In view of the revenue risks associated with section 18A status a similar extension has not been granted for applying for tax deductible donation status in terms of the 2000 dispensation. Organisations that qualified for section 18A status under old law remain subject to the deadline of 31 December 2003. Failure to make application by the deadline will lead to the loss of section 18A status but tax exempt status will be retained pending an application by 31 December 2004. This provides an incentive for the switchover to the 2000 dispensation without overly penalising tardy PBOs.

CLAUSE 199

Customs and Excise: Amendment of section 113 of the Second Revenue Laws Amendment Act, 2001

A number of sections which would have come into operation on a date fixed by the President by proclamation in the *Gazette* are being repealed or amended. The sections provide for the licensing of wharfs, container terminals and transit sheds and degrouping depots.

The various provisions contemplated controlled movement of imported goods between those licensed premises until delivery after due entry. However, it has been found necessary to introduce licensing requirements for degrouping depots before any of the other activities concerned reached the implementation stage. As the introduction of the licensing requirements on a piecemeal basis could lead to numerous amendments of the existing legislation awaiting implementation, the provisions are repealed in the meantime. Enabling provisions will again be created when the necessary procedures have been fully developed. In consequence the relevant provisions are amended, deleted or repealed.

For these reasons section 113 (which was amended by section 73 of the Taxation Laws Amendment Act, 2002 (Act 30 of 2002) is amended as stated.

CLAUSE 200

Customs and Excise: Amendment of section 116 of the Second Revenue Laws Amendment Act, 2001

This section (which was amended by section 74 of the Taxation Laws Amendment Act, 2002 (Act 30 of 2002) is amended for the reasons stated in *CLAUSE 199.*

CLAUSE 201

Customs and Excise: Repeal of section 117 and 118 of the Second Revenue Laws Amendment Act, 2001

These sections are repealed for the reasons stated in respect of *CLAUSE 199*.

CLAUSE 202

Customs and Excise: Amendment of section 121 of the Second Revenue Laws Amendment Act, 2001

This section (which was amended by section 74 of the Taxation Laws Amendment Act, 2002 (Act 30 of 2002) is amended for the reasons stated in *CLAUSE 199.*

CLAUSE 203

Customs and Excise: Repeal of section 125 of the Second Revenue Laws Amendment Act, 2001

This section is repealed for the reasons stated in respect of *CLAUSE 199.*

CLAUSE 204

Customs and Excise: Repeal of section 135 of the Second Revenue Laws Amendment Act, 2001

This section is repealed. It inserted section 95A, which would have come into operation on a date fixed by the President by proclamation, but a new Chapter XA which provides for internal administrative appeals and alternative dispute resolution is now proposed.

CLAUSE 205

Customs and Excise: Repeal of section 137 of the Second Revenue Laws Amendment Act, 2001

This section (which was amended by section 76 of the Taxation Laws Amendment Act, 2002 (Act 30 of 2002)) is repealed for the reasons stated in respect of *CLAUSE 199*.

CLAUSE 206

Short Title: Amendment of section 190 of the Second Revenue Laws Amendment Act, 2001

Subsection (2) of this section is deleted in view of the repeal of section 125 of the Second Revenue Laws Amendment Act, 2001.

CLAUSE 207

Unemployment Insurance Contributions: Amendment of section 1 of the Unemployment Insurance Contributions Act, 2002

This amendment brings the Contribution Act in line with the amendments to the Unemployment Insurance Act which is currently before Parliament.

CLAUSE 208

Unemployment Insurance Contributions: Amendment of section 4 of the Unemployment Insurance Contributions Act, 2002

This amendment brings the Contribution Act in line with the amendments to the Unemployment Insurance Act which is currently before Parliament.

CLAUSE 209

Unemployment Insurance Contributions: Amendment of section 7 of the Unemployment Insurance Contributions Act, 2002

Employers are required to withhold and pay over UIF contributions. Unfortunately, certain employers withhold these funds only to expend them for their own business or private purposes, thereby misusing funds collected from employees on behalf of Government. This is especially troublesome since these funds are effectively held in a fiduciary capacity.

It is accordingly proposed that the representative employer, as well as every director and shareholder who controls or is regularly involved in the overall management of the company's management affairs, be held personally liable for unpaid UIF contributions. This personal liability only arises where that employer has withheld UIF contributions but has not paid it to SARS within the required period.

International experience has shown that the imposition of personal liability on officers and shareholders of a company is an effective procedure to prevent the misuse or misappropriation of funds collected on behalf of the State.

CLAUSE 210

Customs and Excise: Repeal of section 73 of the Taxation Laws Amendment Act, 2002

This section is repealed for the reasons stated in respect of *CLAUSE 199.*

CLAUSE 211

Customs and Excise: Amendment of section 76 of the Taxation Laws Amendment Act, 2002

This section is repealed for the reasons stated in respect of *CLAUSE 199.*

CLAUSE 212

Income Tax: Amendment of section 14 of the Revenue Laws Amendment Act, 2002

See the notes above on CORPORATE RESTRUCTURING RULES – *Financial instrument holding companies – (a) The prescribed financial instrument: all assets ratio*.

CLAUSE 213

Income Tax: Amendment of section 33 of the Revenue Laws Amendment Act, 2002

Section 38 of the Income Tax Act, 1962, was amended by the Revenue Laws Amendment Act, 2002 and it is proposed that that amendment come into operation when the Collective Investment Schemes Control Act.2002, comes into operation.

CLAUSE 214

Income Tax: Repeal of section 34 of the Revenue Laws Amendment Act, 2002

See the notes above on CORPORATE RESTRUCTURING RULES – *Financial instrument holding companies – (a) The prescribed financial instrument: all assets ratio*.

CLAUSE 215

Income Tax: Amendment of section 36 of the Revenue Laws Amendment Act, 2002

The substitution of the definition of "intermediate company" in section (1)*(b)* of the Revenue Laws Amendment Act,2002, was incorrect as the definition of a "group of companies had been introduced an it is proposed that that subsection be deleted with effect from 13 December 2002 when it came into operation.

CLAUSE 216

Stamp Duty: Amendment of section 113 of the Revenue Laws Amendment Act, 2002

Section 113 of the Revenue Laws Amendment Act, 2002 extended the stamp duty exemption in respect of the registration of transfer of any marketable security acquired in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). Similar amendments were effected to the equivalent marketable securities tax and uncertificated securities tax exemptions. The proposed amendment aligns the effective date of these amendments.

CLAUSE 217

Uncertificated Securities Tax: Amendment of section 122 of the Revenue Laws Amendment Act, 2002

Section 122 of the Revenue Laws Amendment Act, 2002 extended the uncertificated securities tax exemption in respect of the acquisition of beneficial ownership in any marketable security in terms of a transaction contemplated in the corporate reorganisation rules contained in Part III of Chapter II of the Income Tax Act, 1962 (Act No. 58 of 1962). Similar amendments were effected to the equivalent marketable securities tax and stamp duty exemptions. The proposed amendment aligns the effective date of these amendments.

CLAUSE 218

Customs and Excise: Repeal of section 128 of the Revenue Laws Amendment Act, 2002

This section is repealed for the reasons stated in respect of *CLAUSE 199*.

CLAUSE 219

Income Tax: Amendment of section 1 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003

Subclause (a): This amendment is of a textual nature and corrects an incorrect cross reference.

Subclause (b): This amendment excludes a contravention of an Act administered by the Commissioner, other than the Estate Duty Act, 1955, and the Income Tax Act, 1962, from the definition of unlawful activity - provided that the applicant or facilitator regularises his or her affairs within 60 days of making an application for amnesty. This amendment will cover GST, SDL, UIF, and VAT contraventions. These contraventions, therefore, no longer act as a bar to making an amnesty application.

No amendment is required in respect of PAYE and withholding tax on royalties contraventions as these taxes are levied in terms of the Income Tax Act, 1962, and are currently excluded from the definition of unlawful activity. An applicant or facilitator may already approach SARS to regularise his or her affairs with regard to these taxes.

CLAUSE 220

Income Tax: Amendment of section 4 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003

Subclause (a) to (c): These amendments provide that beneficiaries of discretionary foreign trusts may elect to be deemed to hold unauthorised foreign assets and thus make application for amnesty in respect of those assets.

Under current law, donors to discretionary foreign trusts holding illegal assets could apply for amnesty but non-donor beneficiaries could not. This exclusion of non-donor

beneficiaries was ill-advised by commentators and creates unnecessary complications. It is proposed that this exclusion be removed.

Subclause (d): Certain advisers are concerned that the deeming provision in section 4(3)(*a*)(ii) will lead to the levying of donations tax on the person making the election to be deemed to hold unauthorised foreign assets. Conversely, other advisers take the view that this deeming provision enables the avoidance of the domestic tax amnesty levy in respect of donations made in the last year of assessment ending on or before 28 February 2003. Although neither view is sustainable on a careful analysis of the amnesty legislation, an amendment is proposed to make it clear that the deeming provision in section 4(3)(*a*)(ii) does not apply with respect to either donations tax or secondary tax on companies.

CLAUSE 221

Income Tax: Amendment of section 5 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003

The Minister announced the extension of the deadline for amnesty applications from 30 November 2003 to 29 February 2004 in the 2003 Medium Term Budget Policy Statement. The extension is predicated on the following factors:

- The commitment by the public to the amnesty process that has been demonstrated by the substantial growth in amnesty applications over the past few weeks;
- The difficulties that some potential applicants have experienced in obtaining documentation and professional advice in respect of the complex structures they had set up; and
- The Amnesty Regulations and Exchange Control Circular No. D.405 were only issued towards the end of September 2003.

The amendment gives effect to the Minister's announcement.

CLAUSE 222

Income Tax: Amendment of section 10 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003

The amendment gives effect to the Minister's announcement of the extension of the deadline for amnesty applications to 29 February 2004.

CLAUSE 223

Income Tax: Amendment of section 17 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003

Certain advisers have attempted to argue that domestic tax amnesty is available for the last year of assessment ending on or before 28 February 2003. This argument disregards the structure of the amnesty legislation. It also disregards the clear statements at the time the legislation was developed that this year would be the first year of full disclosure in the normal tax system for amnesty applicants. The

amendment places the matter beyond doubt. It, however, leaves the door open for donations made on or before 28 February 2003 and the estates of persons dying on or before 28 February 2003 to qualify for amnesty, provided that all the other requirements of the amnesty legislation are met.

CLAUSE 224

Marketable Securities Tax Act, 1968: Repeal of Act and withdrawal of regulations

It is proposed that the Marketable Securities Tax Act, 1948, (the MST Act) be repealed in its entirety and that its function be merged into the Uncertificated Tax Act, 1998, (the UST Act). Both taxes apply to securities of listed companies, but UST applies where the transaction involved occurs by electronic transfer. MST applies when share certificates are used. The rates and basic structure of both regimes are the same.

The continuation of the MST Act is creating unintended administrative, compliance and legislative drafting problems. In order to eliminate this confusion, it is proposed that the MST Act be repealed and that the UST Act apply to all transactions involving listed equity instruments, regardless of paper or electronic form. All paper transactions are recorded on the JSE Securities Exchange electronic STRATE system to the same extent as wholly electronic transactions. The elimination of MST Act was to be expected once the full utilisation of electronic transfers for listed shares had been achieved.

Other than administrative savings, no financial implications are expected from the change given the substantial similarities between the two Acts noted above. Taxpayers should welcome the change because they have been arguing that the current dual MST/UST system creates confusion and administrative complexity.

CLAUSE 225

Transitional provisions relating to gold bullion and share companies

Transitional relief is proposed for the last company qualifying for partial exemption in terms of section 10(1)(*s*) of the Income Tax Act, 1962, so that it may restructure its affairs in a tax neutral manner following the repeal of that exemption.

CLAUSE 226

Short title and commencement

This clause provides for the short title of the Bill.