REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

REVENUE LAWS AMENDMENT BILL, 2006

[W.P.2 – ‘06]

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EXPLANATORY MEMORANDUM ON THE REVENUE LAWS AMENDMENT BILL, 2006

INTRODUCTION

The Revenue Laws Amendment Bill, 2006, 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 Finance and Financial Adjustments Act, 1977, the Value-Added Tax Act, 1991, the Uncertificated Securities Tax Act, 1998, the Unemployment Insurance Act, 2001, the Revenue Laws Amendment Act, 2003, the Taxation Laws Amendment Act, 2005 and the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006.

INCENTIVES FOR SCIENTIFIC AND TECHNOLOGICAL RESEARCH & DEVELOPMENT ("R&D")

Current law

Section 11B of the Income Tax Act allows a 100 per cent deduction for operating R&D expenditure undertaken directly by the taxpayer (or by way of payment to any other person undertaken on behalf of the taxpayer). Expenditure incurred for the purpose of registering, extending or renewing any invention, patent, design, copyright or other intangible property is also fully deductible (even if that expenditure is otherwise of a capital nature).

In terms of capital expenditure, a depreciation allowance exists for the cost of any building, machinery or plant, utensils and articles used for the purpose of R&D. This allowance contains a depreciation schedule of 40 per cent cost in the 1st year that the asset is brought to use, followed by 20 per cent depreciation for each of the following three years.

Reasons for change

Innovation, research and technological development are key factors for improved productivity (leading to new or improved products, processes or services). This enhanced productivity in turn leads to increased economic growth and international competitiveness. However, R&D is costly, involving high levels of technical risk. Given the high entry costs (and the indirect positive externalities for countries as whole), Governments sometimes provide extra support for local R&D via direct subsidies as well as through tax incentives (the latter of which operate as indirect subsidies). While South Africa offers a variety of direct subsidies for R&D, the South African tax regime for R&D does not provide

substantial incentives. South Africa accordingly needs an improved set of R&D tax incentives to ensure that local R&D is not at a global competitive disadvantage.

Proposal

A. Basic regime

The new regime for R&D contains two sets of incentives. Firstly, operating expenses will now be deductible at a 150 per cent level (section 11D(1)(a)). Secondly, the depreciation allowance for capital R&D will shift from the current 40:20:20:20 schedule to a new 50:30:20 schedule (section 11D(2)). Registration expenses incurred in registering, extending or renewing intellectual property (e.g. patents and designs) will remain fully deductible as before (section 11(*g*B).

In order for R&D expenditure to fall within this enhanced regime, R&D activities must be undertaken within South Africa (section 11D(1)(a)). In addition, this R&D must be performed for purposes of—

(i) The discovery of novel, practical and non-obvious information of a scientific or technological nature; or

(ii) The creation of any invention, patent, design or computer copyright or other similar property of a scientific or technological nature.

In other words, the R&D must be directed toward advancing scientific or technological knowledge (as opposed to routine learning associated with ongoing processes). Other forms of knowledge enhancement do not trigger incentives. For further clarity, specific forms of knowledge falling outside the incentive relate to: (a) the prospecting for minerals or exploration for oil and gas, (b) the management or enhancement of internal business processes, (c) trade mark creation, (d) social science and humanities, and (e) market research, sales or marketing promotion (section 11D(5)).

B. Part R&D Expenditure

In the case of expenditure partly for R&D purposes and partly for other purposes, the deduction of 150% of expenditure will be allowed to the extent that such expenditure is used for R&D purposes. Similar principles apply to buildings, machinery, plant, implements, utensils and articles partly used for R&D with only the R&D portion being eligible for the enhanced 50:30:20 depreciation. However, buildings (or parts thereof) will not be viewed as committed to R&D unless regularly used for R&D purposes and specifically equipped for R&D use (section 11D(4)).

Example 1:
Facts.
Cost of the building is R1 000

Result.

R&D Building Use	50%	30%	20%
100% R&D use	R500 deduction	R300 deduction	R200 deduction
25% R&D use	R125 deduction	R75 deduction	R50 deduction

C. Recoupments

If a taxpayer recovers R&D expenditure that was already allowed as a deduction, this recovery will trigger a recoupment of that income. This recoupment equals the previously allowed deduction (not the expenditure) (section 11D(9)*(a)*).

Example 2:

Facts.

Taxpayer buys R100 of laboratory equipment for R&D purposes. Taxpayer is eligible for R150 of deductions. Taxpayer subsequently sells half the equipment for R60.

Result.

Taxpayer will be required to include R75 in income. The R75 amount represents recovery of 50 per cent of the R&D expenditure.

D. Recoupments

If a taxpayer ceases using a building (or a part thereof) for R&D purposes, all deductions previously allowed will be recouped as income of the taxpayer. However, this recoupment is reduced by 10 per cent for each year the building is used for R&D (section 11D(9)*(b)*).

Example 3:

Facts.

Taxpayer buys a building for R1000. Taxpayer uses the building for R&D activities in that year and deducts a depreciation allowance of R500 in the first year. The following year, the taxpayer stops using the building for R&D purposes.

Result.

The taxpayer must include R400 of the depreciation allowance in income (i.e. R500 (50% depreciation allowance) less R100 (10% of the cost of the building for the one year of R&D use)).

No doubling of the 150 per cent deduction

Special rules are required to prevent the artificial doubling of the 150 per cent deduction in terms of the same activity. If a taxpayer hires another business to perform R&D on the taxpayer's behalf, only the party that initially commits the funds obtains the benefit of the 150 per cent deduction (section 11D(7)).

Example 4:

Facts.

Company hires Independent Contracting Business to conduct qualifying R&D activities on Company's behalf. Company pays R 1000 for the activity with Company receiving control over that R&D. Independent Contracting Business spends the R1 000 on employees and equipment to satisfy the R&D contract.

Result.

Only Company is eligible for the 150% deduction in respect of the R1 000 expenditure. Independent Contracting Business is not eligible for the 150% deduction because Independent Contracting Business received the funds from Company to conduct the R&D (through Independent Contracting Business would be eligible for the deductions on the R1 000 normally allowed for conducting its business.

D. Government grants

The 150 per cent deduction does not fully apply to R&D projects funded by Government grants (section 11D(8)). If a taxable Government grant is received by the taxpayer to fund the R&D expenditure incurred, the 150% is allowed only to the extent that the expenditure exceeds twice the amount of the Government grant. The net result is that the 150 per cent deduction does not apply in the case of 50/50 matching grants. If the Government grant is tax-free, no deduction is allowed equal to double the grant.

Example 5:

Facts.

Taxpayer receives a taxable government grant of R600. Taxpayer spends the R600 grant and an additional R1 400 for qualifying R&D activities.

Result.

Taxpayer is eligible for the 150% deduction only for R800 of the R&D expenditure. The other R1 200 falls outside the 150% regime (R600 x 2 = R1 200).

E. Reporting requirements

Taxpayers claiming the 150 per cent R&D deduction or the 50:30:30 R&D depreciation schedule must submit information about the R&D project to the Minister of Science and Technology (section 11D(11)). The Minister of Science and Technology will annually report to Parliament the number and type of R&D activities that qualified for the R&D incentives (section 11D(12)). The goal of this information reporting requirement is to measure the success of the R&D incentives proposed.

F. Effective Dates

The new R&D regime under section 11D will come into effect in respect of expenditure incurred on or after 2 November 2006. The old R&D regime under section 11B will terminate at the same time, except that R&D buildings acquired before the effective date will continue utilising the 40:20:20:20 depreciation schedule (Section 11B(7)).

INCENTIVES FOR EMPLOYEE SCHOLARSHIPS AND BURSARIES

Current Law

Bona fide scholarships and bursaries granted to an employee in order to study at a recognised educational or research institution are exempt from income tax in the employee's hands (section 10(1)*(q)*). Taxation arises only if the Commissioner views the grant as a payment in lieu of salary (i.e., salary sacrifice). If an employer grants a *bona fide* scholarship or bursary to an employee's relative, section 10(1)*(q)* provides limited relief (R 2 000 per year) to relatives of low income employees.

Current law also contains an anti-avoidance charge designed to dissuade employers from providing scholarships or bursaries as a form of salary sacrifice. Section 23*(j)* accordingly makes these salary sacrifice payments non-deductible for employers.

Reasons for change

Salary sacrifice as a component of the exemption creates unnecessary difficulties in application. While justifiable as a matter of legal theory, this distinction makes little economic sense in light of the skills shortage within South Africa.

Proposal

To simplify matters, the proposed amendment provides that all *bona fide* scholarships and bursaries for employees will be tax-exempt regardless of whether or not elements of a salary sacrifice are present (section 10(1)*(q)*). Similarly, the denial of employer deductions for scholarship and bursary payments acting as a salary sacrifice will be removed (i.e. section 23*(j)* will be deleted).

Instead, *bona fide* scholarships and bursaries to an employee will be tax-exempt as long as the employee agrees to repay the employer if the employee fails to fulfil his or her scholarship or bursary obligation (section 10(1)*(q)*(i)). This repayment clause provides an incentive for employees to take their scholarship or bursary commitments seriously. However, the employee need not repay the employer if the failure directly results from death, ill-health, or injury (see also section 12H(5)*(b)* allowing comparable relief in terms of incomplete learnerships). Finally, an inflationary adjustment was made to the R 2000 relief limit of bursaries or scholarships granted to relatives of employees. The new limit will be R 3 000 (section 10(1)*(q)*(ii)).

RELIEF FOR SMALL PERSONAL SERVICE ENTITIES

Current Law

The personal service company and personal service trust definitions were introduced into tax legislation with effect from 1 April 2000 (hereinafter referred to as personal service entities (or "PSEs"). These definitions and related amendments seek to discourage employees from disguising their employer/employee relationships by offering their services through a company or trust. Entities falling within these definitions trigger:

(i) an obligation on the payer to withhold employees tax at a rate of 34 per cent on all payments to the payee PSE; and

(ii) a denial of tax deductions for the PSE, except for salaries.

Reasons for change

Government was approached by various industry representatives about the cash-flow hardships of the PSE regime imposed on small businesses. The main concern is the overly broad anti-avoidance aspects of the PSE regime that fail to distinguish between avoidance mechanisms versus common legitimate business practices.

Proposal

A. Narrowing the scope of the PSE regime

Three amendments are proposed to limit the scope of the PSE definitions. The goal is to eliminate the automatic triggers for PSE treatment if the tax avoidance impact of those triggers can only be evaluated in light of the overall facts and circumstances.

Firstly, if a client controls or supervises how and when the work is performed, the entity providing the service automatically qualifies as a PSE under current law. In reality, however, many clients control or supervise work performed by the entity on a limited basis for quality control purposes or to avoid major disruptions of the client's business. This control or supervision does not necessarily constitute an employer/employee relationship. The proposed amendment accordingly limits the PSE regime to situations where the client controls or supervises how the work is performed but only if that work must be performed at the client's premises (paragraph 1(b) of the definitions of "Personal Service Company" and "Personal Service Trust" within the Fourth Schedule). The main area of avoidance involves employees reporting to work at the employer's premises (and under their full supervision) while artificially claiming independent status.

Secondly, if a client makes regular payments to an entity providing a service, current law requires that the entity automatically qualify as a PSE. In reality, regular payments are a frequent feature of legitimate ongoing business relationships, not necessarily an automatic feature of an employer/employee relationship. It is accordingly proposed that this requirement be deleted (paragraph 1(c) of the definitions of "Personal Service Company" and "Personal Service Trust" within the Fourth Schedule).

The third issue involves the PSE safe harbour (i.e. the escape hatch from the PSE definition despite the existence of other factors). Under current law, an entity escapes PSE status regardless of any other facts and circumstances if that

entity has four or more unconnected employees who are engaged in rendering services to clients. Following a review by National Treasury, a more appropriate number of employees is three or more. The proposed amendment accordingly reduces the minimum employee safe harbour from four employees to three (words following paragraph 1(d) of the definitions of "Personal Service Company" and "Personal Service Trust" within the Fourth Schedule).

It is also proposed that the definition of "investment income" be limited by excluding rental derived in respect of movable property. This will have the effect that the earning of vehicle leasing income will not disqualify a company from accessing small business corporation benefits.

B. Relaxation of client withholding

Under current law, clients bear the onus of proving that payments to an entity do not qualify as a payment to a PSE. Failure to treat an entity as a PSE (i.e. failure to withhold 34 per cent of the payment) when PSE treatment is actually required triggers a potential liability for clients (in addition to the entity). Many clients accordingly lean in favour of performing Fourth Schedule withholding when making payments to small entities to avoid tax risk.

In order to alleviate this tendency of over-withholding for risk adverse clients, the onus of proof on the client is relaxed. A client can now rely on an affidavit or solemn declaration issued by the small entity that it is not a PSE as long as the client makes this reliance in good faith (paragraph 2(1A) of the Fourth Schedule). The client will then be absolved from the failure to withhold (even if it later comes to light that the small entity was (in fact) a PSE).

C. Taxation of net profits

The current rules generally prohibit PSE deductions for business costs incurred, much like an actual employee which is similarly eligible for only a limited number of deductions (see section 23(m)). The only item of expense currently deductible is salaries for employees on a PSE payroll. This limitation unfairly prevents PSEs from deducting actual business costs incurred. The proposed changes accordingly allow deductions for operating expenses in respect of business premises, such as repairs and insurance in respect of assets, as well as related salary payments, such as pension fund contributions (section 23(k)).

With the admission of new allowable deductions (as outlined in the paragraph above), imposition of a flat 34 per cent level of withholding can now far exceed the actual net liability owed. This flat 34 per cent level of withholding may impose severe cash-flow constraints on small businesses (even if refundable at a later date). The new amendment provides relief for this over-withholding by allowing the Commissioner to issue a directive for a lower rate that more closely matches the final tax liability (paragraph 11 of the Fourth Schedule).

RELIEF FOR SMALL BUSINESS CO-OPERATIVES

Current Law

Co-operatives are taxed at the corporate tax rate of 29 per cent but are allowed special deductions on certain forms of income distributed to their members. However, co-operatives are not eligible for small business tax incentives provided in section 12E (as they do not technically qualify as "small business corporations" in terms of that definition).

Reasons for change

Small co-operatives bear a heavier tax burden than their company and close corporation counterparts due to the lack of availability of small business relief. This result is an undesirable situation for small entrepreneurs as to their preferred mode of business. It was also mentioned in the 2006 Budget Review that the tax dispensation relating to co-operatives will be adjusted in light of the new Co-operatives Act of 2005.

Proposal

The proposed changes are limited solely to the small business rules of section 12E. This lack of overall change is largely due to the fact that the Co-operatives Act of 2005 is not yet operative, and the fact that the National Treasury is still gathering information on the business operation of co-operatives. Moreover, even when the Co-operatives Act of 2005 comes into effect, it will only apply after a three-year transition period.

A. Small business relief

It is proposed that the definition of "small business corporation" be changed by the specific inclusion of co-operatives (section 12(4)(a)). With this inclusion, co-operatives will fully enjoy the small business tax benefits provided in section 12E.

B. Membership in consumer co-operatives and friendly societies

Section 12E disqualifies small corporations from incentives otherwise granted therein if a shareholder (or member) of such small business corporation is also a shareholder (or member) of another corporation. This disqualification (necessary to avoid business income splitting) is subject to certain exceptions. These

exceptions relate to holdings in non-business entities, such as a body corporate established to provide housing for its members in a townhouse complex.

Along these lines, two other forms of non-business shareholdings (or membership) will now be permitted without triggering disqualification of small business relief (despite the technical holding of shares of membership interests). Firstly, natural persons will be allowed to act as members of non-business co-operatives without nullifying small business relief for otherwise qualifying small business corporations (section 12E(4)*(a)*(ii)(*dd*)). These non-business co-operatives include consumer buy-aids, social cooperatives (such as child nursery facilities) and funeral societies. Secondly, natural persons will be allowed to act as members of friendly societies (section 12E(4)*(a)*(ii)(*ee*)).

INCENTIVES FOR OIL AND GAS EXPLORATION AND PRODUCTION

Current Law

South Africa's present investment regime for oil and gas exploration and production was established in terms of prospecting lease OP26 (granted in 1965). The OP26 agreement contains fiscal stabilisation clauses that freeze the Income Tax as of 1977. The net result is that oil and gas companies have a choice in terms of each provision of the tax acts – choose the 1977 regime or the current regime (whichever the oil and gas company views as more favourable). This fiscal stabilisation regime acts as an incentive to invest in "high risk" exploration activities that require substantial upfront capital investment.

Reasons for change

While South Africa is rich in many hard minerals, South Africa has not shared the same success in respect of oil and gas reserves. Exploration over the past thirty years has revealed only small deposits offshore in the South and in the West (all of which are small in comparison to both global and regional standards). However, a few companies remain interested in the region, especially given recent high oil prices.

At issue is the pending termination of the OP 26 regime, which is expected to expire as of 30 June 2007. Uncertainty around the renewal of the fiscal provisions contained in OP 26 led to certain companies postponing any further investment until this uncertainty is resolved. Given the high risks and historically low rewards, few active companies in the area would remain interested if the key features of the OP 26 regime are not renewed.

Proposals

Government intends to formalise key aspects of OP26 into explicit law, thereby creating transparency and certainty for oil and gas exploration/production. The new regime will be easier for SARS enforcement and taxpayer compliance because both sides will have improved access to the rules of the game. Core aspects of the regime will be renewed; lesser aspects will fall away.

A. New Tenth Schedule override

The proposed amendments create a new Tenth Schedule. This Tenth Schedule creates a special override for oil and gas companies. Oil and gas exploration and production will essentially be subject to the provisions of the Income Tax Act including the Secondary Tax on companies, subject to the provisions of the Tenth Schedule (all of which have overriding effect)(section 26B(1) and (2)). However, the General Anti-Avoidance Rule of Part IIA of Chapter III still can be asserted notwithstanding the Tenth Schedule (section 26B(3)).

B. List of Tenth Schedule provisions

1. Coverage (paragraph 1)

The Tenth Schedule incentives apply only to oil and gas companies. In order to qualify for oil and gas company treatment, the company at issue must satisfy a two prong test. First, the company must either hold an oil and gas right listed within the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) or engage in exploration or production with respect to those rights. The companies can either be domestic or foreign residents. Second, the oil and gas company cannot be engaged in any other form of trade (but can hold investments). For instance, foreign oil and gas operations would push a company outside the eligibility requirements of the regime because those foreign operations would constitute impermissible oil and gas company trade. Note that an oil and gas company includes a company that engages in refining of gas derived in respect of any oil and gas right held by that company.

The Tenth Schedule is mainly directed toward oil and gas income. Oil and gas income means the receipts, accruals or gains derived by an oil and gas company in respect of any oil and gas right. These receipts, accruals and gains can be derived from the sale of oil and gas commodities as well as the leasing or disposal of oil and gas rights.

Note: The definition of the “Republic” (within section 1) has been amended to take cognisance of South African Tax Treaty model, which makes reference to international law and is in line with same.

2. Income tax rates (paragraph 2)

This paragraph represents the prime fiscal stability feature. The rate of tax on South African oil and gas companies will not exceed the general 29 per cent company rate, notwithstanding changes to other parts of the Income Tax Act. The rate for South African branches of foreign companies may not exceed 32 percent (in lieu of the 34 per cent rate usually applied to foreign companies (as a proxy in lieu of the Secondary Tax on Companies ("STC")). Holders of OP26 rights currently are not subject to STC (see below) and as a result are not subject to the 3% (proxy) surcharge.

3. Dividend tax rates (paragraph 3)

As a general rule, distributions of oil and gas profits of an oil and gas company cannot be subject to tax at a rate in excess of 5 per cent (paragraph 3(1)). Hence, the current Secondary Tax on Companies is limited to 5 per cent. This general rule is subject to two deviations.

Firstly, any oil and gas company will receive the benefit of a zero per cent maximum rate if that oil and gas company's sole oil and gas rights directly or indirectly stems from previously existing OP 26 rights (paragraph 3(2)). Hence, any oil and gas company holder of a new order oil and gas right receives the benefit of the zero percent regime if that right relates to an OP 26 right previously held by that holder. Any holding of new order rights not stemming from these OP 26 rights prevents outright application of the zero per cent ceiling. This rule essentially rewards current participants who are arguably taking the highest risks (as opposed to later entrants who may emerge after more significant deposits are found).

Secondly, both the 0 and 5 per cent ceilings will be completely non-applicable if that company is engaged in refining (i.e. is vertically integrated)(paragraph 3(3)); normal dividend taxes will fully apply. The goal is to assist entrants attempting to uncover new oil and gas finds – a high risk endeavour (not to assist processes such as refining that will undoubtedly occur within South Africa in any event).

4. Foreign currency gains or losses (paragraph 4)

Generally, currency gains and losses are subject to tax and determined with reference to the Rand. However, companies under the OP 26 regime are not subject to taxation of currency gains and losses. If the general rule for currency were to be employed, most oil and gas companies would be subject to currency gain and loss taxation on the bulk of their earnings (oil sales and purchases of equipment).

In order to maintain this relief, oil and gas companies can determine their currency gains or losses solely with reference to the currency translation method

used by that company for financial reporting purposes (paragraph 4(1)). Hence, dollar based oil and gas companies can rely on the dollar as their base currency for tax purposes.

Notwithstanding the above, all taxes due must eventually be translated into Rands in order to make payment to SARS in Rands. This translation into Rands occurs by applying the average exchange rate for that year (paragraph 4(2); see section 1: "average exchange rate" definition).

The currency used by an oil and gas company for financial reporting may only be changed with the approval by the Commissioner (paragraph 4(3)*(a)*). The Commissioner allow this change only if satisfied that the change is not solely or mainly for the reduction of tax liability (paragraph 4(3)*(b)*).

Example:

Facts.

Oil and Gas Company, a company with a December 31 financial year-end, uses the U.S. dollar as its currency for financial reporting. Oil and Gas Company sells oil for 100 million U.S. dollars, makes purchases of 116 million U.S. dollars. In terms of working capital, Oil and Gas Company generates 20 million in U.S. dollars and 5 million in U.K. pounds.

Result.

The U.S. dollar acts as Oil and Gas Company's base currency for tax purposes. Currency gains or losses do not result from any U.S. dollar earnings. However in respect of the U.K. pounds, currency gains or losses are based on the difference between exchange rates between dollars and pounds. At year financial year end, all taxes due (initially determined in dollars) must be translated into Rands (at the average exchange rate).

5. Oil and gas deductions (paragraph 5)

Oil and gas has three sets of special rules for oil and gas exploration and production expenditures (as opposed to other forms of expenditures, such as expenditures for refining). The first set deals with operating expenses (OPEX). The second set deals with capital expenditures (CAPEX). The third set deals with ring-fencing.

5.1 OPEX (paragraph 5(1))

All oil and gas operating expenditures are fully deductible to the extent those expenditures are for oil and gas exploration or production. These fully deductible

expenditures implicitly include expenditures arising during pre-exploration or pre-production periods (as well as pre-exploration or pre-production finance charges).

5.2 CAPEX (paragraph 5(1) and (2))

Oil and gas capital expenditures are fully deductible like operating expenditure, but are also eligible for a percentage uplift. Oil and gas exploration capital expenditure generates an additional 100 per cent deduction (for a total of 200 per cent upon incurral). Oil and gas production capital expenditure generates an additional 50 per cent deduction (for a total of 150 per cent upon incurral). The uplift acts as an incentive to invest in high-risk, high cost capital expenditure that probably represents long-term sunken capital. Exploration is given a higher uplift due to the higher nature of the risk (and to compensate for the fact these losses will probably not be useable against income for a longer period than production expenses).

The above rules for capital expenditure are subject to one notable exception. Costs of acquiring oil and gas rights cannot be deducted at all (i.e. must merely be added to base cost for CGT purposes) unless that acquisition is covered by the participation treatment rules of paragraph 7(3)).

5.3 Ring-fencing (paragraph 5(3), 5(4) and 5(5))

As a general rule, all oil and gas exploration and production losses are ring-fenced against all oil and gas income and income derived from refining gas. No restrictions are imposed that would ring-fence the losses of a particular well against the income from the same well (i.e. there is no "per oil well" ring-fencing). In addition, the new regime allows 10% of the excess losses to be used as an offset against other forms of income (e.g. investment income). The purpose of this rule is to provide relief for ordinary working capital. Any assessed loss remaining after the set off is carried forward to the immediate year of assessment and deemed to arise in that year (i.e. like the rest of the Income Tax Act, losses can generally be carried forward indefinitely).

Example:

Facts.

Oil and Gas Company generates 192 million U.S. dollars in oil production receipts plus another 25 million in U.S. dollars from bond interest on working capital. Oil and Gas Company incurs 80 million U.S. dollars in oil operating expenditures as well as 60 million U.S. dollars for oil capital expenditures (i.e. for a new oil rig).

Result.

Oil and Gas Company has total oil losses of 200 million U.S. dollar (80 million plus 120 million (i.e. 60 million times 2)). This 200 million amount completely offsets the 192 million amount, leaving an 8 million excess. Of this 8 million excess, 800 000 can be used to offset the 25 million in U.S. dollar working capital income. At the end of the day, Oil and Gas Company is taxed on the 24.2 million of interest income (25 million – 800 000) and has 7.2 million of excess oil and gas loss (8 million – 800 000) as a carry forward into the following year.

6. Thin capitalisation (paragraph 6)

Generally, the income tax system has rules against thin capitalisation. Thin capitalisation prevents taxpayers from deducting interest in respect of excessive amounts of debt existing in relation to equity. The Tenth Schedule provides a safe harbour against the thin capitalisation rules found elsewhere in the Income Tax (i.e. section 31(3)). Note, however, that the Tenth Schedule rules do not act as a thin capitalisation charging provision. Hence, if the Income Tax Act were to be changed so as not provide any rules against thin capitalisation elsewhere; the Tenth Schedule cannot by itself be used to deny deductions

The thin capitalisation safe harbour involves two basic steps. First, the oil and gas company determines whether it owes interest-bearing loans, advances or debts to foreign connected persons in relation to that company (loans, advances or debts are interest bearing for a particular year only if they bear interest that year). Second, those loans, advances or debts are measured against the total fixed capital of that company. If those loans, advances or debts do not exceed three times the value of the total fixed capital (being share capital, share premiums and accumulated net realised and unrealised profits), the oil and gas company is free from any thin capitalisation rules found elsewhere. Fixed capital take net accumulated profits into account, net accumulated losses are implicitly ignored. The 3-to-1 measurement is calculated on the last day of the oil and gas company's assessment year.

Note: The Commissioner may disregard excessive levels of debt if that excess occurs only for temporary periods.

Example:

Facts.

Company X, a South African oil and gas company with a December 31 financial year-end, is wholly owned by Foreign Company. Company X owes 600 million to various independent banks as well as 300 million to Foreign Company. All loans are interest bearing. Company X has received 150 million to date for the issue of

its equity shares outstanding (but only has a history of accumulated losses). All calculations are performed in U.S. dollars at financial year-end.

Result.

Regardless of the existence of section 31(3) or any successor thin capitalisation rules, Company X will not be disallowed from deducting any interest (or finance charges) in relation to its loans owed to Foreign Company merely its loans are viewed as excessive in relation to fixed capital. The 600 million of Foreign Company debts do not exceed the 3-to-1 ratio in terms of total equity outstanding at the end of the year (i.e. which is equal to 150 million).

7. Disposal of oil and gas rights (paragraph 7)

7.1 Additional options (paragraph 7(1))

Special rules apply to disposals of oil and gas rights by oil and gas companies. In addition to the basic rules provided elsewhere in the Income Tax Act, the Tenth Schedule contains two elections. The oil and gas company disposing of any oil and gas right to another company may elect to have either rollover treatment or participation treatment. The election may be in the form and manner determined by the Commissioner (who may, among others, find it necessary for the disposing company to send official notice to the acquirer). These elections apply only to oil and gas rights that have a market value in excess of tax cost (i.e. base cost in the case of a capital gains asset or cost price in the case of trading stock). Loss assets (i.e. those with a tax cost in excess of market value) simply trigger losses upon disposal as allowed elsewhere in the Income Tax Act.

7.2 Rollover treatment (paragraph 7(3))

If rollover treatment is elected, the selling oil and gas company is deemed to have disposed of an oil and gas right for an amount equal to the tax cost of the right disposed regardless of whether that right is capital asset or trading stock. The net effect is to eliminate all capital or ordinary gain upon disposal for the seller. The acquiring company is similarly deemed to have acquired the oil and gas right for the same tax cost (i.e. the tax cost rolls over from the seller to the buyer). This regime essentially follows the same paradigm as Part III of Chapter II of the Income Tax Act (company restructuring rules). The rollover regime allows the seller to avoid gain with the purchaser bearing the price of acquiring the seller's reduced tax cost (in lieu of a market value tax cost).

7.3 Participation treatment (paragraph 7(3))

If participation treatment is elected, the selling oil and gas company treats all gains on the disposal of an oil and gas right as ordinary revenue regardless of whether that right is capital or trading stock. Meanwhile, the acquiring company, if an oil and gas company, obtains an immediate deduction equal to the deemed ordinary revenue gain included by the selling company. The participation regime essentially allows the transferor to transfer ordinary losses to an oil and gas company acquirer.

Example:

Facts.

Company X, an oil and gas company, holds multiple oil and gas rights off the South African coast, including a Block A offshore right. Company X acquired the off-shore right for 30 million U.S. dollars and that right is worth 100 million U.S. dollars as of 15 July 2008. Company X has 400 million U.S. dollars in excess oil and gas losses. Company X has agreed to sell the Block A offshore right for 100 million U.S. dollars in cash to Company Y, another oil and gas company. Assume Company X held the oil and gas right as a capital asset before the sale.

Result.

Both Company X and Company Y have three choices:

(i) If no election is made, basic capital gains tax principles apply. Under this scenario, Company X has 70 million U.S. dollars of capital gain (100 million – 30 million). Company Y meanwhile obtains a 100 million U.S. dollar base cost in the oil and gas right acquired.

(ii) If a rollover election is made, the sale does not trigger any capital gains tax for Company X. Company Y obtains a 30 million U.S. dollar base cost in the oil and gas right acquired.

(iii) If a participation election is made, Company X has ordinary revenue equal to 70 million U.S. dollars (which will be offset by the 400 million U.S. dollars of excess losses). Company Y obtains a 70 million U.S. dollar immediate deduction and obtains a 30 million U.S. dollar amount as the tax cost in the oil and gas right acquired.

8. Fiscal stability (paragraph 8)

A fiscal stability clause is viewed as important tool to facilitate future oil and gas investment (given the high costs of initial sunken capital, combined with high risk and delayed potential profit). The revised regime will accordingly provide fiscal stability on a company-by-company basis. In order to effectuate this regime, the Minister of Finance will be given the power, after consultation with the Department of Minerals and Energy, to enter in fiscal stability agreements when each oil and gas company receives a "new order" oil and gas right.

This fiscal stability agreement will remain in place over the full life of a "new order" right. In addition, fiscal stability will remain if exploration rights are renewed or are converted into a production right. However, oil and gas companies may unilaterally rescind these agreements if so desired (i.e. if subsequent tax law becomes even more taxpayer favourable than the regime currently proposed).

Example:

Facts.

Company X, an oil and gas company, enters the region in 2007 for the purpose of oil exploration and production. Company X obtains an oil and gas right in 2007. Company X renews the exploration right in 2012 and eventually converts that right to a production right in 2014. In 2044, Company Y renews the production right.

Result.

The Minister has the power to enter into a fiscal stability agreement with Company X. If the agreement arises in 2007, the 2007 version of the Tenth Schedule remains in effect from 2007 through 2044 (the full period of the initial exploration right, the period of exploration renewal and the period of the initial production right). The Minister may choose to enter into a new agreement on 2044 with the terms set by the tax law on that date.

Effective date

The new oil and gas regime will become operational on 2 November 2006 in respect of any year ending on or after that date.

MINING ENVIRONMENTAL REHABILITATION FUNDS

Current law

In terms of the Mineral and Petroleum Resources Development Act of 2002 (MPRDA), mining companies must make financial provision for the environmental rehabilitation of mining areas upon closure. Methods used for financial provision include reserve set asides within a rehabilitation company, society, association or trust (i.e. a rehabilitation fund). Contributions to these funds are deductible, and the growth in these funds is tax-free. The tax system provides these benefits as an incentive for environmental preservation.

Reasons for change

While Government is comfortable with the objectives of the rehabilitation fund mechanism, this mechanism has given rise to practical administrative problems, including:

(i) A lack co-ordination between the Department of Minerals and Energy (DME) and South African Revenue Services (SARS) in terms of approvals and regulatory provisions;

(ii) Unnecessary complexities in terms of the deduction contribution formula;

(iii) Concerns about compliance in terms of fund document amendments; and

(iv) Various uncertainties and complexities involving contraventions by rehabilitation funds.

Proposal

The amendments unify the deduction contribution rules of section 11*(hA)* and the exemption rules of section 10(1)*(cH)*. The proposed changes address the above-mentioned concerns and ensure that all contributions, distributions and withdrawals cater solely for mining rehabilitation upon closure.

A. Tax benefits

The new unified regime contains the same tax benefits as the previous mining rehabilitation regime. Contributions are deductible (section 37A) and fund growth is tax-exempt (section 10(1)*(cB)*). One benefit of the new regime is the removal of the formula limit. Section 37A allows for all contributions to the rehabilitation fund to be tax deductible.

B. Eligible contributing parties

The new regime allows for a wider group of persons to be eligible for deductible contributions (section 37A(1)*(d)*). Under the new regime, this group falls into three categories:

(i) Holders of new and old order mineral rights as classified under the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002);

(ii) Persons engaged in prospecting, exploration, mining or production in terms of new and old order mineral rights as classified under the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) (even if no mineral rights are held by those persons); and

(iii) Any other person, after approval by the Commissioner, unless that other person is making the contribution as part of a scheme to shift the contributing deduction from another person in favour of the person seeking approval.

Example 1:

Facts.

Company X owns 70 per cent of the shares of Company Y (with the other 30 per cent held by an independent trust formed on behalf of various individuals). Company Y is a special purpose vehicle that merely holds a new order mineral right. Company X engages in all mining activities with respect to that right.

Result.

Both Company X and Company Y may make deductible contributions to a mining rehabilitation fund. Company Y holds the right, and Company X is engaged in mining with respect to that right.

Example 2:

Facts.

Company Z has entered into a long-term agreement for the purchase of coal generated from a new order right held by Company X. Company Z converts all the coal to energy on a regular basis. As part of the long-term agreement, Company Z agrees to regularly contribute to the mining rehabilitation fund established for the new order mining right.

Result.

Company Z can make deductible contributions to the mining rehabilitation fund after approval from the Commissioner. No reason exists for the Commissioner to deny this approval solely based on these facts.

C. Eligible mining rehabilitation funds

Mining rehabilitation funds are eligible for incentives only upon certain conditions, as provided below. These conditions are essentially the same as prior law with a few technical adjustments and clarifications (note: funds have been limited to trusts or company legal forms, as only these forms currently exist in practice).

(i) The funds must have the sole object of mining environmental rehabilitation in terms of rights governed by the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) on premature or final closure, decommissioning, and to deal with post closure latent environmental impacts (section 37A(1)*(a)*).

(ii) The funds can only hold permitted assets (section 37A(1)*(a)*). These permitted assets are mainly limited to various forms of well regulated domestic financial instruments (including shares) subject to domestic regulation (section 37A(2)). The only significant deviation is for other investments held before 18 November 2003 (i.e. before the effective date of the initial requirement)(section 37A(2)*(d)*). The goal is to limit the investment portfolio assets that are relatively liquid and easy to value (for the benefit of regulatory oversight). Funds cannot invest in financial instruments issued by persons making contributions to the mining rehabilitation fund at issue.

(iii) The funds cannot make impermissible distributions (section 37A(1)*(c)*). In other words, funds cannot withdraw benefits for reasons other than for mine rehabilitation on closure. Moreover, excess reserves available on completion of rehabilitation will not revert to taxpayers. Excess reserves must be transferred to another fund established by the taxpayer for mining rehabilitation activities (or to a general trust account prescribed by the Minister of Minerals and Energy and subject to approval by the Commissioner) (section 37A(3)). Excess amounts held by funds (i.e. amounts exceeding the anticipated mining rehabilitation liability) can also be transferred to other funds before termination with approval from both the Minister of Minerals and Energy and the Commissioner (section 37A(4)).

D. Penalties

The new mining rehabilitation regime wholly revises the penalty system for contraventions in order to simplify administration. This new regime contains three penalties:

(i) If the company or trust holds impermissible investments (investments outside the list prescribed in the section), the entity is taxed on the market value of those impermissible assets as if that market value was fully received as income (section 37A(6)).

(ii) If the company or trust makes impermissible withdrawals (e.g. used for other profit making activities not related to rehabilitation or closure), these withdrawals will be taxed on their market value (section 37A(7)).

(iii) The Commissioner may, as he deems necessary, additionally impose income tax penalties equivalent to twice the market value of all property held if a trust or company is in violation of *any* provisions (including the holding of impermissible investments of the making of impermissible withdrawals) (section 37A(8)).

E. Effective dates

The new regime will have an effective date for years of assessment commencing on or after 2 November 2006. In terms of deductible contributions, the formula approach of section 11(*h*A) will be limited solely to years of assessment commencing before 2 November 2006 (section 37A(1)). All deductions previously deferred for being in excess of the amount allowed by the formula will continue to be deferred as long as the pre-effective date regime still applies. If any excess remains afterwards, it will become immediately deductible at the end of the first year of the new regime (because the excess will no longer be limited by the formula).

RETIREMENT FUND WITHDRAWALS

Current law

A. Amounts payable by Retirement Annuity Funds

In terms of current law, Retirement Annuity Funds may not pay any amount to a paid-up member prior to that member reaching the age of 55. The reason for this prohibition is to ensure that the money is preserved until retirement.

B. Taxation of withdrawal and retirement benefits

A member of a pension or provident fund will become entitled to a withdrawal benefit if that employee ceases to be employed. Upon employment cessation, a member can make an election to have the benefit transferred to another retirement fund or to withdraw the benefit. A transfer to another retirement fund will not be subject to tax, but a withdrawal will result in the benefit effectively being taxed at the member's highest average rate of tax for the year in which the benefit accrues (or the previous year).

A member of a pension, provident of retirement annuity fund who retires from the fund becomes entitled to a retirement benefit. This benefit is payable in the form of an annuity, a lump sum or a combination. Annuities are taxed when paid to the individual (e.g. monthly), and lump sums are taxed upon retirement. These annuities and lump sum payments are subject to withholding tax and retirement fund administrators have to apply for a tax directive before lump sums may be paid out.

C. Benefits payable in terms of the Statement of Intent

The Minister of Finance and the Long-term Insurance Industry signed a Statement of Intent in December 2005. In terms of this agreement, persons who became paid-up members (i.e. members of a retirement fund who prematurely discontinued contributing to the fund) after 1 January 2001 will be guaranteed a minimum benefit. These benefits will taxed on a similar basis as surplus apportionment benefits indicated above.

Reasons for change

A. Amounts payable by Retirement Annuity Funds

A problem arises once a member becomes a paid-up member (i.e. the member ceases to make contributions to the fund). If the member has a low fund value upon becoming a paid-up member, ongoing industry costs may exceed growth. The effect of the low fund value and high costs will result in negative growth in the individual paid-up member's fund interest (and may even result in no value being preserved by the time of retirement).

Example:

Mr A is a member of a retirement annuity fund. At the age of 45, he is retrenched and can no longer afford to make monthly contributions to his retirement annuity fund. He informs his broker that he will no longer contribute to this fund. At this date, his member's interest in the fund is R4,000. He cannot withdraw this amount from the fund due to the restrictions in the Income Tax Act. The gross annual growth on his member's interest is 8 per cent, but the costs amount to

R750 per annum. Ten years later he becomes entitled to a benefit from the fund, but his fund value is now 0.

B. Taxation of withdrawal and retirement benefits

Members withdrawing or retiring from a retirement fund after the effective date of the Pension Fund Amendment Act ("PFAA") (7 December 2001) are now guaranteed a minimum benefit. However, members who withdrew or retired before the effective date enjoyed no comparable protection. In order to provide former members with some additional benefit, the PFAA also provides that any fund surplus be apportioned in line with the PFAA. Former members may therefore join in this surplus apportionment.

Should benefits be paid to former members who previously withdrew from the fund, these benefits will be fully taxable as the former members cannot make an election to have the benefit transferred to another retirement fund. Benefits payable to former members who previously retired from the fund will be taxed as a withdrawal benefit and not as a retirement benefit.

Proposal

A. Amounts payable by Retirement Annuity Funds

The proposed amendment effectively allows the fund value of a paid up member to be paid out if the fund value is less than an amount to be determined by the Minister. This amount will be adjusted from time to time in consultation with the Financial Services Board in order to ensure that a paid-up member is not prohibited from accessing money that will eventually be consumed by industry costs. (Section 1 of the Income Tax Act: Definition of "retirement annuity fund" – paragraphs *(b)*(x) and *(b)*(xii)).

B. Taxation of withdrawal and retirement benefits

In terms of the proposed amendment, benefits accruing after withdrawal (or retirement) from the fund will subject to the same elections that were available to them upon the earlier withdrawal (or earlier retirement). This amendment effectively provides former members with the option of preserving additional benefits payable by retirement funds, thereby postponing the tax liability. (paragraphs 5 and 6 of the Second Schedule to the Income Tax Act).

Payment of benefits in terms of the surplus apportionment process and the Statement of Intent (indicated above) will result in numerous additional payments to be settled within the foreseeable future. Applying for a tax directive in these

circumstances will frustrate the timely settlement of these payments and may result in low income earners suffering a higher tax cost than is due. These payments will therefore not be subject to withholding tax, provided these payments are settled within a three year period (paragraph 9(3) of the Fourth Schedule to the Income Tax Act).

REFINEMENT OF PUBLIC BENEFIT ORGANISATION (PBO) TAXATION

Since the complete revision of the tax system for PBOs in 2001, Government has continued to adjust the tax system in order to further assist PBOs. While most of the big issues have been resolved, the 2006 proposed amendments address some anomalies.

1. Tax rates for PBO trading activities

Current law

PBO trading activities are presently subject to tax based on the legal form of the PBO. If a PBO is registered as a company, its trading activities will be subject to tax at a rate of 29 per cent whilst a PBO registered as a trust will be subject to tax at a rate of 40 per cent.

Reasons for change

The taxation of PBO trading activities at different rates causes an undue tax burden for PBOs operating as trusts (i.e. being subject to the 40 per cent rate). Many PBOs are established as trusts to save administration costs or as a matter of convenience. No reason exists to discriminate in terms of rates purely on the basis legal form, especially when all PBOs otherwise operate under the same general tax principles (unlike “for-profit” companies and trusts, which operate completely differently for tax purposes).

Proposed law

It is proposed that all PBO trading activities should be subject to a flat 29 per cent rate.

2. Refining the PBO activity list

Current law

A. Housing PBOs

In 2003, Government expanded the scope of exempt housing PBO activities. Firstly, the PBO limitation on housing assistance to poor and needy recipients was liberalised so that exempt housing PBO activities could additionally include assistance for the benefit of low-income earners (i.e. households with income up to R3 500 (as is consistent with the Housing Code)). Secondly, housing PBO activities became eligible to receive tax-deductible donations. Thirdly, current legislation not only covers direct procurement but other forms of housing assistance, such as subsidised housing loans (but this last group of PBOs only receives exemption; not eligibility for tax deductible donations).

B. Conservation, environment and animal welfare PBOs

Under present law, only a limited number of PBO activities are eligible to receive tax deductible donations. This limitation is due to the concern that deductible donations could lead to tax avoidance and/or undue erosion of the tax base. Conservation, environment and animal welfare generally fall outside tax deductible status. On the other hand, PBOs carrying on the establishment and management of transfrontier conservation areas can receive tax deductible donations up to 31 March 2010.

Reasons for change

A. Housing PBOs

Despite the liberalisation in 2003, the scope of PBO housing activities is still too limited. Many legitimate organisations remain outside PBO relief.

B. Conservation, environmental and animal welfare PBOs

Government has received ongoing requests to extend the list of PBOs eligible for tax deductible deductions so as to include conservation, environment and animal welfare. This extension was announced in the 2006 Budget and affected by

notice in the *Gazette* on 26 April 2006. It is now proposed that the extension be included in the Income Tax Act as provided for by section 18A of the Act.

Proposed law

A. Housing PBOs

Firstly, it is proposed that the current PBO housing ceiling be increased to cover beneficiaries earning beyond R3500 per month. The proposed level of increase will not be stated in the legislation but instead left to the Ministerial discretion, taking into account existing Housing Policy established by the Department of Housing (paragraph 3(a) of Part I of the Ninth Schedule; paragraph 5(a) of Part II of the Ninth Schedule). Secondly, PBOs that issue guarantees in respect of low income housing loans will now be eligible for tax exemption under similar conditions as PBOs engaged in low income housing loans (as determined in the regulations issued by the Minister) (paragraph 3*(f)* of Part I of the Ninth Schedule).

B. Conservation, environmental and animal welfare PBOs

It is proposed that the list of activities eligible for tax deductible donations in Part II of the Ninth Schedule be extended to cover all activities listed under the heading "Conservation, Environment and Animal Welfare" within Part I of the Ninth Schedule (paragraph 4 of Part II of the Ninth Schedule).

4. Foreign established charities

Current law

Most foreign charities abroad fail to enjoy South African PBO status. This failure does not stem from the core nature of the activity but by virtue of more technical aspects of South African tax legislation.

Reasons for change

Many foreign charities established in developed countries seek to provide assistance around the world. These foreign charities typically receive most of their funding in their home country with a portion of funds possibly allocated to

the Southern African region. As a policy matter, foreign charitable donor support should be encouraged, but technical tax issues may act as a barrier, especially if that foreign support attracts South African income tax.

South African tax law requires all exempt PBOs to transfer all of their assets to another South African PBO (or to a South African sphere of government or to an exempt South African parastatal) upon dissolution. This requirement makes little sense for foreign charities. Donors and fiduciaries of a foreign charity cannot be expected to transfer their global assets to South African PBOs upon dissolution merely to satisfy South African PBO requirements.

Proposed law

It is proposed that foreign established charities operating within South Africa should be exempt from South African tax on slightly different terms. Specific PBO exemption is now made for foreign charities operating as an agency or branch within South Africa (section 30(1)*(a)*(ii)). However, foreign PBOs of this nature must prove that they have PBO exempt status in their home country as a precondition for South African PBO exemption (section 30(1)*(a)*(ii)).

The key technical waiver relates to the dissolution requirement for exempt PBO status. Upon dissolution, foreign established charities are no longer required to transfer their global assets to another South African PBO (or to a South African sphere of government or to an exempt South African parastatal) (section 30(3)*(b)*(iv)). Under the proposal, only local donations (or income or assets derived therefrom) of the foreign charity need satisfy the dissolution requirement. Foreign donations (or income or assets derived therefrom) can be transferred anywhere upon dissolution, even if controlled by branch or agency within South Africa upon dissolution.

Foreign established PBOs will receive full income tax exemption. However, in no case will a foreign PBO be eligible to attract donations that are deductible in South African tax terms (section 18A(1)).

4. Liberalising permissible PBO investments

Current law

PBOs are presently limited to a strict set of passive investments. Some of these investments require approval by the Financial Services Board and the Director of

Non-Profit Organisations. If a PBO contravenes the investment rules stipulated in the Income Tax Act, tax exempt status can be withdrawn. The permissible investments rules were designed to ensure that PBOs do not engage in risky passive investments or conduct passive investment on a scale that constitutes trading activities.

Reasons for change

The current system of limiting investments for PBOs inhibits PBOs from receiving optimal returns on investments (which can then be applied for the public benefit). The tax system is not the appropriate place to assess financial risk, and the concerns against trading are already covered by other aspects of the PBO tax system.

Proposed law

It is proposed that the current PBO limitations in terms of passive investments be dropped with PBOs generally being allowed to invest as desired.

5. Capital gains on disposal of PBO assets

Current law

In terms of current CGT rules, PBOs are sbject to capital gains tax on assets not directly used for public benefit activities. This rule is consistent with the income tax act rules applicable to PBOs.

Reasons for change

The current application of these provisions creates problem with respect to assessment of CGT on assets that are used for dual purposes, e.g., for trading and public benefit activities or assets that undergo a change of use.

Proposed law

The proposed amendments clarify the rules for the disposal of capital assets by PBOs. Assets not used for any business/trading undertaking are fully exempt

from capital gains tax (i.e., pure investment income). In addition, assets the substantially whole of which are not directed at any taxable or tax-exempt business/trading activity are exempt (paragraph 63A of the Eighth Schedule).

6. Definition of PBO: Concept of public benefit

Current law

In terms of current law, a non-profit organisation will be regarded as a PBO if its sole object is carrying on one or more of the public benefit activities listed in the Ninth Schedule.

Reasons for change

The current "sole object test" for purposes of determining whether a non-profit organisation will fall under a PBO is too restrictive, especially given prior amendments explicitly recognising that PBOs may utilise trading activities as a source of funding.

Proposed law

It is proposed that the "sole object test" be relaxed. Therefore, a non-profit organisation will be regarded as a PBO if its sole or principal object is carrying one or more of the public benefit activities listed in the Ninth Schedule.

7. Administration

Current law

A. Dual registration

In terms of current law, PBOs must register with Director of Non-profit Organisations (NPO) as a precondition for exempt status. PBOs may be exempt from this dual registration requirement only if both the Director of the NPO and the Commissioner so approve.

B. Miscellaneous administration

(1) Some PBOs may become provisional taxpayers with the advent of partially taxable status since 2005 (for sizeable trading activities).

(2) PBOs found in violation of the tax requirements may have their tax privileges withdrawn. In addition, these violating PBOs may find themselves subject to tax for all accumulated net revenue to the extent that revenue is not distributed from the PBO.

Reasons for change

A. Dual registration

The current dual registration process causes an undue compliance burden for PBOs. The NPO Act's registration requirements are voluntary and not mandatory. Many PBOs are accordingly in a position that NPO registration offers no benefits besides tax.

B. Miscellaneous administration

(1) The impact of partial PBO taxation on provisional payments was not considered when partial taxation was imposed. Application of provisional payments in this context has accordingly given rise to unintended compliance and administrative difficulties.

(2) Taxation of (undistributed) accumulated net revenue for certain violating PBOs may be unrealistic as an administrative matter. Many PBOs simply do not have the records (possibly dating back many years) that track historically accumulated profits.

Proposed law

A. Dual registration

It is proposed that the dual registration requirement be removed. SARS will now grant exemption to PBOs without NPO registration as a precondition. However,

the Commissioner may (upon a request by the NPO) withdraw approval if a PBO is convicted of an offence under the NPO Act (section 30(3C)).

B. Miscellaneous administration

(1) PBOs will be specifically exempted from the provisional payment system given the compliance and administrative difficulties in the newly created context of partially taxable PBOs (paragraph (a) of the definition of "provisional taxpayer" of the Fourth Schedule). However, this exemption will last only for a three-year transitional period (or a later date set by the Commissioner). A similar 3-year transitional exemption period will exist for recreational clubs (which will become partially taxable for the first time pursuant to the amendments herein).

(2) The potential taxation of accumulated net revenues for contravening PBOs will be dropped. Taxation will instead apply based on the market value of assets held by the PBO less liabilities (i.e. the net value of PBO assets before the withdrawal) (section 30(7)).

PARTIAL TAXATION OF RECREATIONAL CLUBS

Current Law

Clubs currently receive complete exemption from Income Tax (section 10(1)(d)(iv)(aa)). This exemption is subject to few restrictions. Furthermore any gain or loss upon the disposal of any asset used to produce this exempt income is disregarded for Capital Gains Tax purposes (paragraph 64 of the Eighth Schedule).

Reasons for change

Clubs appear to be claiming exemption irrespective of whether their amenities are used by the general public or by their members. Furthermore, some clubs appear to be conducting a growing level of trading activities to raise funds in addition to membership contributions.

Concerns have been raised that the complete exemption enjoyed by recreational clubs is iniquitous. Recreational clubs are treated more leniently than Public Benefit Organisations (PBOs). Previously, the income tax system provided complete exemption for PBOs, even if those activities included a small level of trading. Since 1 April 2006, a system of partial taxation was implemented. As are result, sizeable trading activities no longer put at risk PBO exempt status.

However, the quid-pro-quo of this change left certain trading activities of PBOs subject to partial taxation. This partial taxation led to the review of the income tax status of clubs, which currently can claim complete exemption – even for sizeable trading activities.

Proposal

In view of the above, recreational clubs will become subject to a system of partial taxation. Clubs will be subject to exemption only to the extent their activities are based on the "mutuality principle." Under the mutuality principle, various taxpayers can join together for the sharing of expenses without that sharing triggering additional tax. In the case of recreational clubs, there is a sharing of "recreational" expenses (e.g. expenses for sports and other capital facilities).

It appears that recreational clubs follow a sharing of expenses approach as their core business model (where they generally break-even annually). The common objective of clubs excludes pecuniary gain. The proposed amendments narrow the exemption solely for these cost sharing situations. Income from non-members is generally subject to tax (i.e. leaving the members as a group largely in the same situation as if they had undertaken the activity without reliance on a separate legal entity).

The proposed amendments are consistent with PBO rules. Section 10(1)(*cO*) defines the limits of the new system for partial taxation (separating exempt income from taxable income). Section 30A covers the conditions for exemption.

A. Exemption versus taxation (section 10(1)(cO))

All club income is now subject to Income Tax unless that income falls within section 10(1)(*cO*). Section 10(1)(*cO*) provides exemption for the following forms of recreational club receipts and accruals (much of which follows the paradigm for public benefit orgaisations):

- (i) Membership fees or subscriptions paid by its members:
- (ii) Business undertakings/trading activities directly and integrally related to the provision of social or recreational facilities, amenities or services provided directly to the members (e.g. golf course fees and bar facility fees paid by members). This exemption presumes that these activities will be carried out for the recovery of costs and will not create unfair competition in relation to taxable entities;
- (iii) Fundraising activities of that club if those activities are of an occasional nature and substantially undertaken with unpaid voluntary assistance;
- (iv) Other sources (e.g. investment income and non-member income for club services and rentals) as long as these "other source" receipts and accruals do not in total exceed the greater of: (i) 5 per cent of the total membership and subscriptions in respect of that year or (ii)

R50 000. This exemption is designed as a *de minimis* rule to keep smaller clubs off the register.

Similarly, expenditure incurred in producing exempt income (viz. levies, membership fees or subscriptions) cannot be offset against club income falling outside the above categories. Capital gains on the disposal of recreational club property will be subject to rollover treatment (i.e. exemption from capital gains tax with rollover of base cost)(paragraph 65B of the Eighth Schedule). These rules essentially follow the same principles as the rollover provisions of paragraphs 65 and 66 of the Eight Schedule. The key condition is that all recreational club property must (i) be used mainly for providing social and recreational facilities, amenities and services and (ii) the property proceeds received on disposal must be reinvested in another recreational club directed-asset.

B. Conditions for exemption (section 30A)

A recreational club eligible for partial exemption must be established with the sole/principal object to provide social and recreational amenities or facilities for its members (section 30A(1)). Club exemption is not automatic. Clubs must apply for Commissioner approval by providing copies of the club constitution or other establishment document (as well as subsequent submission of amendments) (section 30A(2)(a) and (b)). The Commissioner must grant approval if—

(i) The club is committed to carrying on its activities solely in a non-profit manner;
(ii) In respect of surplus funds, the club is prohibited from direct or indirect distribution thereof to any person during club operations or upon club dissolution (except as provided in (iii);
(iii) On club dissolution, the club is required to transfer its assets and funds solely to any other club eligible for section 30A exemption (or to entities listed upon dissolution of a domestic PBO);
(iv) The club does not pay remuneration in excess of what is reasonable in the sector (nor bonus payments based on receipts and accruals), thereby preventing indirect profit distributions to employees;
(v) All members must be entitled to annual or seasonal membership;
(vi) Members cannot be allowed to sell their membership rights or any entitlements thereof (again to prevent indirect profit distributions); and
(vii) Clubs may not participate in schemes to facilitate tax avoidance.

C. Penalties

Clubs in violation of section 30A risk losing their exemption after reasonable notice. Failure to take steps could generate tax based on the market value of all property held by that club (less club liabilities). The penalties contained herein essentially follow the same format as the penalties for violating the exemption provisions for exempt PBOs.

D. Effective Dates

Clubs will be given a transitional period in order to apply for partial exemption (section 30A(4)), much like the transitional period provided to PBOs under section 30. A reasonable transition period is especially important for smaller clubs who may not have the wherewithal for speedy conversion. In terms of exact dates, clubs must apply for approval no later than 31 March 2008. Approval not only covers partial exemption on a going forward basis but also complete exemption under prior law (previous section 10) on a retroactive basis.

GOVERNMENT DEPARTMENTS, PUBLIC AND MUNICIPAL ENTITIES

Current law

The Income Tax Act contains various forms of exemption for different spheres of Government. National and provincial governments are fully exempt under section 10(1)(a). Certain institutions, boards and bodies subject to the Public Finance Management Act, 1999 (Act No. 1 of 1999)("PFMA") are exempt from income tax under section 10(1)(*cA*), along with their wholly owned subsidiaries. Municipalities receive exemption as a "local authority" under section 10(1)(b), but municipal entities that are subject to the Municipal Finance Management Act, 2000 (Act No. 32 of 2000)("MFMA") are fully taxable.

Reasons for change

The Income Tax system fails to provide a coherent regime for Government entities. These changes relate to the "local authority" definition contained in section 1 and other specialised non-privately controlled entities.

Proposal

A. Local councils, boards and committees

The various references to local councils, boards and committees are outdated. The definition of local authority will accordingly be scrapped in line with the new system for local government as prescribed by the Local Government: Municipal Structures Act, 1998 (Act No. 117 of 1998). Henceforth, only "municipalities" (Categories A, B and C) will be exempt as opposed to "local authorities." Collateral changes in this regard have already been made in the Value-added Tax Act along with corresponding changes to the Transfer Duty Act.

B. Water boards

Some water boards are exempt by virtue of paragraph (b) of the “local authority” definition, some are exempt by virtue of section 10(1)(*cA*) while a small group of others may be fully subject to tax. The new regime simply creates a new exemption for all water service providers (listed under either the PFMA or MFMA) regardless of their legal form.

C. Regional services councils and the joint services board

The current exemption for regional services councils and the joint services board will be deleted as obsolete. Similar deletions will be made to the Transfer Duty Act.

D. Regional Electricity Distributors (the “REDs”)

Government is in the process of restructuring electricity distribution. In the future, this function will be consolidated into entities (known as the REDs) for more efficient coordination. The transfer of electricity distribution operations from municipalities to REDs triggers various tax issues. For instance, all activities conducted by municipalities are fully exempt from income tax; whereas, the REDs should (in all-likelihood) be subject to income tax because electricity distribution is a commercial business activity (as opposed to a regulatory activity). The shift from exempt to fully taxable status could, however, undo some of the benefits of the desired consolidation, especially if full taxation takes immediate effect. In order to transitionally alleviate this problem, the newly created REDs will be fully exempt from income for all years of assessment commencing before 1 January 2014 (or a later date determined by the Minister if necessary) (section 10(1)*(t)*(viii). Correlative adjustments are also made for the Value-Added Tax Act.

Note: Eskom will not benefit from any of the proposed changes (i.e. the amendment will apply only to electricity distributors established after 1 January 2005. Eskom has long been fully taxable so continued taxation should not impact electricity restructuring process. However, asset transfers by Eskom to the REDs may require further legislative change at a later date.

E. Traditional councils

The tax status of traditional councils (as contemplated in the Communal Land Rights Act, 2004 (Act No. 11 of 2004) has never been entirely clear. Traditional councils may have been exempt by virtue of (i) the reference to councils in the “local authority” definition of section 1 of the Income Tax Act, (ii) as an institution, board or body under section 10(1)(*cA)*, or (iii) section 9 of the Finance and Financial Adjustments Act Consolidation Act, 1977 (Act No. 11 of 1977). All three sets of rules have accordingly been deleted or adjusted in this regard.

Because traditional councils should not be viewed as a Constitutional fourth arm of Government, income tax exemption for traditional councils will be eliminated in the long-term. This amendment bill retains the exemption but with a termination date to be set by the Minister. The termination date serves as notice to traditional councils that the income tax exemption will be eliminated while giving time for other legislative adjustments (if necessary).

F. Foreign governments

The amendments clarify the tax treatment of foreign governments. The amendments accordingly exempt the receipts and accruals of any sphere of any foreign government (i.e. national, provincial and local)(section 10(1)(*bA*)(i)). Other foreign government controlled bodies (e.g. foreign government-owned parastatals) are fully taxable, with the possible exception for developmental agencies (see section 10(1)(*bA*)(ii)).

DOMESTIC AND FOREIGN GOVERNMENT GRANTS AND ASSISTANCE

Current law

A. Domestic

Whilst considerable activity has been undertaken to clarify the VAT treatment of domestic government grants and assistance over the past few years, little comparable activity has occurred in respect of the Income Tax. Most income tax exemptions for grants have been ad hoc with each form of exempt grant listed by name. Only in 2005 was a generic provision added with the decision for exemption left to the Minister (taking into account a variety of factors). Other issues at play involve collateral aspects of exemption to the extent exemption is available. These collateral aspects mainly relate to the depreciation and base cost of assets acquired out of exempt grant funds.

B. Foreign

South Africa is a recipient of Official Development Assistance (ODA). ODAs involve support from international donors in the form of grants, discounted financial assistance and possibly discounted financial assistance. International donors offering this support often seek to ensure that their support packages remain free from South African tax (mainly Income Tax and VAT) as a precondition for funding.

Reasons for change

A. Domestic

The tax relationship between the receipt of Government grants and the use of grant funds is not always clear. As a general rule, taxpayers should not be able to use tax-free grants to obtain subsequent tax benefits (i.e. "double-dip"). This "double-dipping" may arise if exempt grant funds are used to acquire assets or operating expenditure, and the taxpayer then claims depreciation or deductible operating expense (as the case may be). That said, other instances may arise in which Government may actively calculate the grant with an otherwise impermissible "double-dip" in mind. Whilst some rules exist in this area, a comprehensive view seems lacking.

Another related issue involves Government payment for assets to destroy those assets. For instance, Government may acquire a sick animal solely to destroy that animal for health and safety reasons. As another example, Government is planning to acquire "unsafe" taxis in order to terminate their use on the road. In both cases, Government is paying for the removal of those items for the general public good (i.e. to remove negative public externalities). These payments are currently treated as taxable exchanges without possible tax relief.

B. Foreign

The tax relief provisions within ODA agreements and their relationship to domestic tax law are not entirely clear. ODA agreements bear the stamp of the executive authority by virtue of section 231(3) of the Constitution. Yet, they do not override Parliamentary enacted legislation (only an act of Parliament can alter another act of Parliament). Hence, SARS cannot comply with any exemption mandated by an ODA if that ODA is inconsistent with domestic tax law. The only remedy for a foreign party relying on an ODA agreement is to file a claim for a breach of that agreement (or to simply withdraw any further foreign donor support). Administrative problems also arise in terms of ODA agreements because of the uncertain role required of the Minister of Finance as well as communication of ODA relief to SARS. The net result is overall uncertainty that could deter future foreign donor support.

Proposal

A. Domestic

1. Anti-double-dipping rules

Government grants should not give rise double-dipping regardless of whether those grants are used to fund assets or expenditure. The proposed regime will disregard both subsequent expenditure and asset cost (for purposes of

depreciation and for purposes of capital gains) if Government grants those exempt funds for purposes of acquiring the asset or funding that subsequent expenditure (section 23*(n)*; paragraph 20(3)*(b)* of the Eighth Schedule).

The Minister, however, will have the power to override this anti-double dipping rule if desired (proviso to section 23*(n)*; proviso to paragraph 20(3)*(b)* of the Eighth Schedule). Instances may exist where Government will fund projects with the knowledge that double-dipping may be employed, but will accordingly take this double-dipping into account when setting funding amounts. In order to override this anti-double dipping rule, the Minister of Finance must state an intention to do so by way of notice in the *Gazette*.

2. Government scrapping payments

This proposal seeks to put Government scrapping payments on par with Government grants despite the fact that the grantee is disposing of an asset in exchange. As a general rule, these disposals will trigger gains and losses. However, the Minister of Finance may exempt the payment by way of notice in the *Gazette* (e.g. in lieu of providing full market replacement value) (section 10(1)*(y)*). If the Minister of Finance exempts the payment, the collateral consequences follow the same path as exempt Government grants (i.e. no double dipping unless the Minister of Finance specifically desires otherwise when determining funding) (paragraph 64A*(b)* of the Eighth Schedule). A comparable rule exists in the VAT Act that will zero rate similar payments for sick animals (section 11(1)*(r)* of the VAT).

B. Foreign

ODA agreements potentially give rise to different consequences depending upon the nature of the agreement. In most cases, an ODA involves an outright grant of funds for the benefit of South African beneficiaries. The grant entails payment to foreign or local contractors with those contractors providing services/assets to assist South African beneficiaries (e.g. providing food, medical aid or housing).

Other less common forms of assistance may involve discounted loans or discounted technical services. In these latter cases, the foreign provider (i.e. foreign agency or multinational organization) may receive partial compensation (i.e. compensation at less than market value).

1. Grants

In the case of outright grants, the income tax issue at play is whether the contractor receiving foreign funds is exempt from tax on that receipt, even though

that grant is for assisting South African beneficiaries (section 10(1)*(yA)*). Exemption under these circumstances requires several conditions:

i. The grant must be within an umbrella ODA agreement pursuant to section 231(3) of the Constitution;

ii. The grant must be pursuant to a project approved by the Minister of Finance after consultation with the Minister of Finance;

iii. The umbrella agreement must provide exemption as a precondition for funding; and

iv. The Minister of Finance must announce his intent to exempt the grant by way of notice in the Gazette.

The rules against double dipping fully apply in terms of these grants without any Ministerial waiver (section 20(3)*(n)*; paragraph 20(3)*(b)* of the Eighth Schedule).

In terms of VAT, project funding is zero-rated if approved by the Minister together with the Minister of Foreign Affairs. All taxable supplies made to the project will qualify for input tax deductions in the event that the Minister has approved the zero rating in terms of section 11(2)*(q)* of the VAT Act. If the Minister has not approved the zero-rating, the normal provisions of the VAT Act will apply.

2. Discounted loans and technical assistance

As discussed above, less common forms of assistance involve the foreign provision of discounted loans or technical services. These forms of assistance trigger potential tax consequences for the foreign party to the ODA (i.e. a foreign developmental agency or multinational organization). Foreign agencies will be exempt in these circumstances on the single condition that the agency has been appointed by a foreign government to administer the ODA (section 10(1)*(bA)*(ii)). Multinational organisations will only be exempt to the extent a project satisfies the same four conditions existing for independent contractors receiving grant funds to provide assistance (section 10(1)*(bA)*(iii))(see above).

It should also be noted that foreign subjects (who are not South African tax residents) will similarly receive exemption on their salary and emoluments. This exemption applies to agency employees if the agency is exempt and to

multinational organisation employees to the extent of an exempt ODA project (section 10(1)*(c)*(vi)).

2010 FIFA WORLD CUP

1. Introduction

As part of the bid to host the 2010 FIFA World Cup, the South African Government issued various guarantees to FIFA. Two of these guarantees, Government Guarantees No. 3 and 4 deal with Customs duties and other taxes respectively. Both guarantees are supported by a Tax Ruling issued by SARS. Following the award of the 2010 FIFA World Cup to South Africa, representatives of Government, FIFA and the Local Organising Committee met to clarify the intent and scope of these two guarantees and the Tax Ruling. The proposed legislation gives effect to the agreement reached.

2. Definitions

A number of definitions are in addition to, or supersede, those already contained in the FIFA List of Requirements and the Organising Association Agreement. These definitions apply only to Government Guarantees No. 3, No. 4 and the Tax Ruling.

3. Specific concepts

A. Tax-free bubble concept

Legislative provision is made for the concept of a "tax-free bubble" in terms of Income Tax and VAT (not other taxes). This "tax-free bubble" will be restricted to FIFA-designated Sites for the periods specified. To the extent the "tax-free bubble" applies, the profit on goods sold or services rendered will not be subject to any form of Income Tax, and the VAT will be applied at the zero rate. Conversely, from an income tax perspective, expenses incurred in production of exempt income will not be permitted as deductions. A reasonable allocation of expenses attributable to the exempt sales must be made. This factual allocation is to be a matter between SARS and the taxpayer where the taxpayer is otherwise subject to tax. VAT on supplies (goods and services) will be zero-rated; and hence, input credits will be claimable by the vendors concerned.

In terms of goods, the goods must be consumable and semi-durable goods (as opposed fixed capital investments). In terms of services, the services rendered must be: (i) intrinsic to the staging of the Championship, (ii) enjoyed or partially utilised at a Site, and (iii) paid for by individual members of the general public, FIFA or the Local Organising Committee. Tax relief within the "tax-free bubble" applies to both non-residents and residents.

The "tax-free bubble" will only be operative in respect of the following sub-components of a FIFA-designated Site (and for the periods) as set out below –

(i) The "tax-free bubble" is mainly intended to cover the Stadia, any Exclusion Zone, any official Championship-related parking areas, Championship press and television centres (including the International Broadcast Centre), VIP Areas and any other areas or facilities as may be agreed in good faith by FIFA and SARS utilised for Official Events. This concession will be allowed for the period commencing one week before the 2009 FIFA Confederation Cup and ending immediately after the closing ceremony. A similar period will be allowed for the 2010 FIFA World Cup South Africa.

(ii) Training sites will be part of the "tax-free bubble" for official FIFA sanctioned training days.

(iii) Official host city public viewing venues will be part of the "tax-free bubble" for Championship match days; and

(iv) The FIFA Flagship Store will be part of the "tax-free bubble" for six months before the 2009 Confederations Cup until one month after the Closing Ceremony of the 2010 FIFA World Cup.

B. FIFA retail outlets

FIFA stores, store-in-store outlets and kiosk outlets outside of Sites are <u>not</u> considered to be within "tax-free bubbles" (and accordingly not eligible for tax relief). Concession operated outlets (for food and beverages, as well as merchandise) within Sites will be within "tax-free bubbles". FIFA is permitted to nominate one FIFA Flagship Store. This store will be viewed as a Site (and hence a tax-free bubble) as long as no tobacco products or cosmetics are sold at this store and all alcoholic beverages are only sold for consumption within an in-store restaurant.

C. Associated persons

All references to natural persons or entities shall mean –

(i) in the case of natural persons, that natural person; and
(ii) (in the case of entities (other than FIFA or FIFA Subsidiaries), that entity and any affiliated entity, if that entity holds at least 20 per cent of the ordinary equity of the affiliated entity and the activities or services rendered by the affiliated entity are directly connected to the Championship.

Specifics of Guarantee No. 3 (Customs)

Clause 1 (persons qualifying for relief in respect of import taxes where such goods are re-exported) of Government Guarantee No. 3 shall include only the following qualifying persons –

(i) FIFA and FIFA subsidiaries;
(ii) FIFA National Associations;
(iii) FIFA Confederations;
(iv) Media Representatives;
(v) Commercial Affiliates;
(vi) Merchandising Partners;
(vii) Licencees;
(viii) The FIFA Flagship Store operator;
(ix) FIFA Designated Service Providers as well as the pitch importer, Concession Operators; Hospitality Service Providers; design servicers; event management and marketing operations, servicers and office suppliers;
(x) The Host Broadcaster, Broadcasters and Broadcast Rights Agencies; and
(xi) Any employee, not resident in the Host Country for income tax purposes, of any of the above entities who is temporarily seconded to the Host Country (in respect of household goods, motor vehicles or other goods normally associated with such relocation).

The following imports by a person contemplated in 1 above will be free from any import taxes –

(i) Trading stock, being consumable or semi-durable goods, provided it is imported by a qualifying person with the intention of resale at a Site or re-export within the Re-export timeframe;

(ii) Samples of trading stock, being consumable or semi-durable goods not for re-sale, provided they are imported by qualifying persons with the intention of distribution at a Site or re-export within the Re-export Timeframe;

(iii) Capital goods, consumable goods and promotional materials, not for resale and individually of little value, for use by a person listed in 1 above in connection with the Championship or re-export within the Re-export Timeframe; and

(iv) Household furniture and other household effects, one motor vehicle and equipment for the exercise of a trade by an employee of a qualifying person who is temporarily seconded to the RSA for the purposes of the 2010 FIFA World Cup.

Subject to 4 below, where goods imported free from any import taxes are not sold, distributed, used, or re-exported as contemplated in 2 above, customs duty and VAT (import taxes) will become payable on the lower of cost or market value for customs duty purposes on the earlier of the date of their disposal, use not in connection with the Championship or expiry of the Re-export Timeframe, and as if the goods were imported on that date.

Where goods imported free from any import taxes are not sold, distributed, used, or re-exported as contemplated in 2 above, but are donated to another person they must be treated as follows–

(i) Where goods are donated to a person carrying on an income tax approved public benefit activity contemplated in Part I of the Ninth Schedule to Income Tax Act, 1962, and the goods are disposed of by the that person within five years of the donation, import taxes will become payable on the lower of cost or market value for customs duty purposes at the date of the donation to the income tax exempt person, and as if the goods were imported by the donee (recipient) on that date; and

(ii) Where other goods are donated to any other person, import taxes will become payable on the lower of cost or market value for customs duty purposes at the date of donation, and as if the goods were imported by the donee (recipient) on that date.

Specifics of Guarantee No. 4 (Other Taxes, Duties and Levies)

In terms of this guarantee, the following entities are exempt from liability in respect of all South African taxes not covered by Government Guarantee No.3 unless specifically stated to the contrary –

(i) FIFA;
(ii) FIFA Subsidiaries; and
(iii) The Participating National Associations (excluding SAFA)

Furthermore, in respect of employees who are residents of the Republic of South Africa for tax purposes, FIFA and FIFA's subsidiaries will contribute and withhold Unemployment Insurance Contributions and will also contribute Skills Development Levies. Such returns and payments will be made as and when due. FIFA and FIFA's subsidiaries will, however not withhold employees' tax in respect of these same employees. FIFA and FIFA's subsidiaries will supply SARS with a list of these employees and the total remuneration paid annually to each employee.

In terms of this guarantee, regardless of residence of tax purposes, the following entities are exempt from income tax in respect of income derived from the sale of

goods (being consumable goods and semi-durable goods) or services rendered (provided the services rendered are (i) intrinsic to the staging of the Championship, (ii) enjoyed or partially utilised at a Site, and (iii) paid for by individual members of the general public, FIFA or the Local Organising Committee) at Sites, as defined, and, where VAT is applicable, must levy VAT at the zero rate on all supplies of such goods or services at these Sites –

- (i) Commercial Affiliates;
- (ii) Licensees;
- (iii) The Host Broadcaster, Broadcasters and Broadcast Rights Agencies;
- (iv) Merchandising Partners;
- (v) FIFA Designated Service Providers (see definition);
- (vi) Concession Operators;
- (vii) Hospitality Service Providers; or
- (viii) The FIFA Flagship Store operator.

FIFA Designated Service Providers ((v) above) are the only entities that may sell goods or render services for consumption, usage or enjoyment outside of Sites, provided that such goods or services are directly connected to the Championship and are within the parameters for which such entity has been accredited by FIFA. This is in respect of income tax only.

Where any entity as contemplated in 2 above is exempt from income tax on income derived from the sales of goods (being consumable goods and semi-durable goods) sold or services rendered (provided the services so rendered are (i) intrinsic to the staging of the Championship, (ii) enjoyed or partially utilised at a Site, and (iii) paid for by individual members of the general public, FIFA or the Local Organising Committee) at Sites, as defined, any expenditure (whether direct or indirect) incurred in producing that exempt income will not be permitted as a deduction for income tax purposes.

No withholding tax is to be levied on Championship-related payments between FIFA, FIFA's Subsidiaries, the Commercial Affiliates, Licensees, the Host Broadcaster, Broadcasters, Broadcast Rights Agencies, Merchandising Partners or the FIFA Designated Service providers.

Income arising from any good sold for foreign consumption or service rendered outside of South Africa by persons who are not residents for tax purposes in South Africa will not be attributed on a source basis to having been derived in South Africa as a result of that person's sponsoring of the Championship or broadcasting of the Championship.

Where a qualifying natural person (as listed below) is not resident for income tax purposes in the Republic, that person will not be subject to South African income

taxes with respect to income derived from activities connected to the Championship. Qualifying natural persons are as follows –

(i) All members of the FIFA Delegation;
(ii) Championship referees and assistant referees;
(iii) Participating National Association Officials;
(iv) FIFA Confederation Officials;
(v) Media Representatives;
(vi) All Commercial Affiliate staff;
(vii) All Merchandising Partner staff;
(viii) All FIFA Designated Service Providers staff; and
(ix) Host Broadcaster, Broadcast Rights Agency, and Broadcast staff

However, the following natural persons, not resident for income tax purposes in the Republic, are excluded from the exemption contemplated in 6 above –

(i) Team members, as defined;
(ii) Directors and personnel of SAFA; and
(iii) Directors and personnel of the Local Organising Committee.

Withholding taxes are to be levied in respect of non-resident Team members in accordance with international practice.

FIFA, FIFA Subsidiaries and the Participating National Associations, excluding SAFA, are to be treated on the same basis as diplomatic missions for VAT purposes in respect of the acquisition of goods and services directly relating to the Championship.

Notwithstanding any other provision relating to VAT, ticket sales will be subject to VAT at the standard rate of 14%. Should FIFA, a FIFA subsidiary or any Participating National Association choose to sell tickets as the principal ticket seller or as one of the principal ticket sellers then FIFA, its subsidiary or any Participating National Association must account for output VAT in respect of these sales, but may be registered for VAT and be entitled to claim input VAT. In other words, FIFA, its subsidiary or any Participating National Association will be liable to SARS for the payment of VAT collected on the sale of tickets in the aforementioned circumstances.

In respect of hospitality sales (excluding hospitality sales for hospitality within a Site), hotel and accommodation charges the standard VAT rate of 14% is to be applied. Should FIFA, a FIFA subsidiary or any Participating National Association choose to sell hospitality off-site or accommodation as the principal seller or as one of the principal sellers then FIFA, its subsidiary or any Participating National Association must account for output VAT in respect of these sales. In other words, FIFA, its subsidiary or any Participating National Association will be liable

to SARS for the payment of VAT collected on the sale of off-site hospitality or accommodation in the aforementioned circumstances.

Government Guarantee No. 4 does not include the following embedded taxes –

(i) Fuel taxes;
(ii) Excise duties;
(iii) The Plastic Bag Levy;
(iv) Air Passenger Departure tax;
(v) Provincial taxes (gambling taxes and motor vehicle license fees)
(vi) Local Government taxes (Property rates)

Administrative Aspects

All aspects pertaining to the calculation of import taxes as contemplated in Government Guarantee No.3 and other taxes, duties and levies as contemplated in Government Guarantee No.4, shall be a matter between the South African Revenue Service and the taxpayer concerned.

Where any person abuses one or more of the exemptions or concessions contemplated in this agreement by misrepresenting the purpose of an import, overstating sales within a tax-free bubble, understating purchases or expenses in respect of sales in a tax-free bubble or by any other method, SARS may, in addition to any other remedies that may be available to it, withdraw that person’s entitlement to any of the exemptions and concessions contemplated in this agreement, in whole or in part, with effect from the date that an exemption, waiver or concession was first claimed. Any such withdrawal will take place in consultation with FIFA.

Date of Implementation

The proposed legislation giving effect to the MOU agreed between FIFA and the South African Government will come into effect, retrospectively, as from 1 April 2006.

CONTROLLED FOREIGN COMPANIES (CFCs)

Since the introduction of the CFC regime in 1997, a number of adjustments have taken place to account for practical realities. However, it appears that some anomalies remain. The 2006 proposed amendments address these anomalies, without deviating from the core philosophy of the CFC rules developed over the past years.

1. Foreign business establishment test

Current law

A CFC engaged in active foreign business does not generate includible income for South African Income Tax purposes. The exception applies if the business is truly active, has some nexus to the country of residence and used for *bona fide* non-tax business purposes. The legislation sets out several tests that are used in order to determine these features. Different sets of rules exist for "general" places of business, places of extraction for natural resources; construction sites; farming; and international transport.

Reasons for change

The current definition of business establishment is too rigid, making it difficult for South African companies that are conducting genuine non-tax business activities. Also, the current definition fails to properly account for the country in which active business should be conducted. Lastly, confusion exists with regard to the locations for active business of international transport.

Proposal

In order to accommodate the above, it is proposed that the ("foreign") business establishment test (of section 9D(1)) should be amended as follows:

1. The general definition of foreign business establishment (paragraph *(a)*) is amended by clarifying that the place of business must have a nexus in a single country outside South Africa.

2. The definitions of foreign business establishment for natural resource extraction/exploration and for construction (paragraphs *(b)* and *(c)*) are amended by clarifying that these activities can take place at any location outside South Africa (including offshore locations).

3. The definition for foreign business establishment for an agricultural land (paragraph *(d)*) is amended by clarifying that the location must be within any single country outside South Africa.

4. The definition of foreign business establishment (paragraph *(e)*) is amended by relaxing the rules for international transport, fishing and

mineral resource exploration/extraction. These activities will now include activities connected to "vehicles" and "rolling stock" (rail). Also, the current limitation that these activities must take place within a single country will be relaxed. Hence, foreign business establishment transportation can now take place anywhere outside the Republic (in one or more foreign countries as well as international waters). It should be noted that temporary return of foreign transport to South Africa will not jeopardise foreign business establishment status as long as that return is not for purposes of generating transport income. Hence, the return of ships and aircraft solely for local repair will not be an issue. Similar concepts apply to fishing and natural resource exploration/extraction.

Other changes in terms of international transport, fishing and mineral resource extraction/exploration account for modern realities in terms of legal ownership of sizeable assets that need special "risk" insulation. The new definition accordingly allows this aspect of the foreign business establishment test to be determined with reference to group companies operating in the same country of residence.

2. Meaning of the term "country of residence"

Current law

The country of residence definition is very important for purposes of section 9D. Most of the anti-diversionary rules depend on whether a CFC operates within that CFC's country of residence.

Reasons for change

Some confusion exists as to the meaning of the "country of residence" definition. Potential problems arise in situations where more that one jurisdiction has a claim on the tax residence of the CFC. Often the tax systems of two or more countries (including that of South Africa) may apply the definition with different meanings – at issue is which country's perspective prevails.

Proposal

In order to clarify the issue, it is proposed that the definition of 'country of residence' be clarified to refer to the country where the CFC is "effectively managed" (as opposed to country of incorporation) because the "effective

management” test is most often utilized as the final tie-breaker for tax treaty purposes. With regard to the meaning of the term ”place of effective management”, South African tax law interpretation prevails.

3. Diversionary transactions

3.1 Meaning of the term ‘delivery”

Current law

In order to avoid taxation under the diversionary transaction rules, the CFC must have a bona fide business reason for operating in its particular country of residence outside South Africa. The “delivery“ test is one of the key tests used to determine if the CFC has this business rational by focusing on whether the CFC provides goods and services to local country end users (i.e. customers).

Reasons for change

Multiple interpretation issues exist with regard to the meaning of “delivery” (i.e. does this mean “legal” delivery, how does one deal with in-transit shipping, etc…).

Proposal

The proposed amendment clarifies that the term “delivery” has a physical focus, not a legal one. In particular, physical delivery will be required to the client’s premises situated in the CFC’s country of residence (section 9D(9)*(b)*(ii)(bb) and (cc)). However, physical delivery need not be undertaken directly by the CFC (e.g. it could be effected by the customer or other parties). The policy in this area is to ensure that CFC’s operations have an appropriate nexus to the physical business needs of genuine local customers.

3.2 Services performed by CFCs

Current law

Section 9D(9)(b)(ii)(cc) taxes income derived from services performed by the CFC to a South African company unless those services are performed outside South Africa and those services relate directly to goods utilised outside South Africa. No exemption exists for services wholly unrelated to the provision of goods.

Reasons for change

In a modern world, more and more services are provided without relation to underlying goods. While a need existed to be overly restrictive in this regard when the CFC regime was first established as an anti-avoidance measure, this regime can be relaxed in light of subsequent experience.

Proposal

CFC services will not longer be subject to taxation by virtue of the anti-diversionary rules in the following instances:

1. CFC services mainly for clients situated in the same country of residence as the CFC will be exempt from diversionary treatment (section 9D(9)*(b)*(ii)(cc)(C)). No reason exists to tax services if they are rendered for legitimate client use in that foreign country.

2. CFC services will no longer be subject to diversionary treatment if they do not give rise to South African deductions by a South African party holding a participation interest in that CFC (section 9D(9)*(b)*(ii)(cc)(D)). No potential for avoidance exists without a corresponding South African deduction that directly erodes the tax base. For example, assume South African company makes payment to fund R&D performed by its CFC outside the Republic, and this payment is not allowable as a deduction. In this instance, the South African company is ineligible for deductions so no need exists to trigger CFC income (i.e. the denial of deductions can be matched against by the non-inclusion of income).

4. CFC sale of foreign intangibles

Current law

In 2005, the disposal of CFC intangibles became eligible for tax free treatment if: (i) those intangibles were an integral part of CFC business activities, (ii) was not acquired by that CFC within 18 months before the disposal at issue, and (iii) the intangibles are disposed of as part of the disposal of the business to which the intangible was an integral part. In addition, this tax-free treatment applies only to intangibles created, devised and developed outside South Africa (South African intangibles is excluded. This exclusion of South African intangibles prevents double-dipping (South African deductions while the intangibles are created or enhanced in South Africa, followed by a tax-free sale of those intangibles by a CFC).

Reasons for change

The 18 month holding period makes little sense more, especially in light of the exclusion for South African intangibles. Also, with regard to certain types of intangible property, it is difficult to decide the official commencement date of the 18 month holding period.

Proposal

It is proposed that the 18 month holding period should be eliminated (section 9D(9)*(b)*(iii)(cc)(B) is hereby deleted).

5. Matching of intra-group deductions and interest

Current Law

Special rules exist for interest, royalties, rentals or income of a similar nature (including section 24I currency exchange differences) transacted between two CFCs that are part of the same group of companies held by a South African person having a direct or indirect participation interest in those CFCs. Normally, these items would give rise to a deduction and an inclusion of income on the other. Current CFC rules instead eliminate both the income and the offsetting deduction (acting as a form of offshore intra-group relief) (section 9D(2A) and (9)*(fA)*).

Reasons for change

The mutual exclusion of matching deductions and income for offshore group CFCs was designed to assist taxpayers. Without this measure, CFC income could be trapped on one side of a South African taxpayer's tax ledge without offset by the matching deduction (because separate CFCs can only give rise to net income, not net loss). This rule of mutual exclusion of deduction and income, however, does not work to the benefit of all CFC structures. Some CFC structures would instead benefit from a matching set of income and deductions once foreign taxes (and corresponding South African tax credits) are taken into account.

Proposal

The mutual exclusion of matching deductions and income for offshore groups CFCs will now be made elective (section 9D(9)*(fA)*). Taxpayers can either choose to include both the income and deduction or exclude both, based on the taxpayer's individual circumstances.

The mutual exclusion rule is also extended for CFC intra-group situations falling outside section 9D(9)*fA)*). Situations can arise in which payments are deductible on one side but not includible on the other by reasons other than section 9D(9)*(fA)*). For instance, interest paid by one group CFC to another group CFC may be excludible from income under the working capital exception (section 9D(9)*(b)*(iii)(aa), not section 9D(9)*(fA)*). The new regime (section 9D(2A)) would accordingly deny the interest deduction because matching income is missing.

6. CFC ruling escape hatch

Current law

Over the years, issues have emerged in the context of CFCs that are very fact intensive. Writing prescriptive legislation has proven to be unhelpful (either too conservative (thereby hindering legitimate transaction) or too permissive (allowing for excessive tax avoidance).

Reasons for change

Objective criteria often have problem of being too theoretically prescriptive without accounting for the full panoply of business realities (or for the variety of avoidance schemes). This problem escalates in the context of CFCs due to heightened level of complexity reflected in multinational cross-border transactions.

Proposed law

The proposed amendment allows for a ruling system in terms of which the Commissioner can grant various CFC waivers on a case-by-case basis (so business practices can be properly balanced against avoidance without going too far in either extreme). This process will allow for a series of informal rules to be developed that can later be legislatively codified. Rulings will only be given to the extent the Commissioner is satisfied that these rulings will not lead to an unacceptable erosion of the tax base. Any ruling issued by the Commissioner under these circumstances will generally be subject to the same procedures, terms and conditions as a SARS binding private ruling (with appropriate modifications).

A. Business establishment waiver for related CFC group employees, equipment and facilities

Under section 9D(10)*(a)*(i), the Commissioner may issue a ruling that allows a CFC to rely on related group CFCs when determining whether that CFC as a valid foreign business establishment under paragraph (a) of that definition. Reliance can be placed on related group CFC employees, equipment and facilities to the extent those CCs are tax residents of the CFC at issue. Another key criteria is that this reliance on employees, equipment and facilities will be permitted only if the CFC's place of business is integral or directly related to the group CFC on which reliance is placed.

B. Diversionary transaction waiver for centrally located operations

The diversionary rules generally subject certain sales of goods or services to immediate tax unless that CFC is providing goods and services to end-users within the same country of residence. However, occasions exist when a CFC locates itself in a country without tax being the dominant feature, even though no local end-users exist in that country. One circumstance in which this situation could arise is when a CFC is operating as a central location for goods and services to end-users in nearby countries.

In order to alleviate this circumstance, the Commissioner may waive the diversionary transaction rules if the CFC's foreign business establishment serves as a central location for end-users in at least two neighboring contiguous countries (section 9D(10)*(a)*(ii)). Contiguous means by land, but not by sea.

C. Passive income waiver for active royalties

Passive CFC income is generally subject to immediate taxation, even if attributable to a business establishment. Under current law, interest, dividends, capital gains, rents and royalties, etc... are largely viewed as passive. While some exceptions exist (such as the banking exception), no exception to passive treatment currently exists for royalties. Hence, royalties are always treated as passive, even if part and parcel of an active business. No prescriptive exemption was provided in terms of active royalties due to the inherently factual nature of the issue.

The Commissioner is now given the power to waive passive treatment for active royalties (section 9D(10)*(a)*(ii)). This waiver can be applied if that CFC directly and regularly creates, develops, substantially upgrades or adds value to (or provides substantial support services in respect of) intangibles giving rise to those royalties. They key is whether the activity is an ongoing value-enhancing process or merely a one-off event (followed by the mere collection of cash-flows).

D. Diversionary transaction and passive income waiver for high-taxed income

CFC taxation is mainly designed to prevent tax avoidance, but no tax avoidance can truly exist unless the shift outside South Africa reduces global taxation (aggregate taxes imposed by all countries). Under prior law, the designated country exception was designed to eliminate high-taxed countries from the ambit of CFC taxation, but this test eventually had to be scrapped as unsustainable. The most problematic aspect was the country list. The Commissioner is now given power to waive the diversionary transaction rules (subsection (9)(b)(ii)) and the passive income rules (subsection (9)(b)(iii)) for high-taxed CFC income on a case-by-case basis (without reliance on a country list). More specifically, this waiver will apply if the gross income of the CFC is subject to tax in a foreign country/countries that equals at least two thirds of the normal tax that would have been payable by the South African resident in respect of that CFC's income (section 9D(10)*(a)*(iv)). The two-thirds calculation takes into account applicable tax treaties, tax credits and rebates of other countries. However, the two-thirds calculation ignores current and assessed losses (i.e. rate of tax on the CFC income at issue is largely analysed on a gross basis).

E. Financial services comparably-taxed waiver

Under the newly revised regime for foreign financial services, active foreign services will not be viewed as a foreign financial instrument holding company if that CFC conducts more business activity in the CFC's country of residence than in any other single country (section 41 "foreign business establishment" definition). Under the new rulings provisions, the Commissioner is given the power to disregard high-taxed activities in other countries outside the CFC's country of residence (section 9D(10)*(a)*(v)). Income will be high-taxed under the same two-thirds test described in the previous segment, except that the comparison is made between the CFC's country of residence and the outside country (i.e. no comparison is made with South African taxes).

GENERAL ANTI-AVOIDANCE RULE

Current Law

Section 103 of the Income Tax Act contains the Act's General Anti-Avoidance Rule (GAAR). In order to invoke the GAAR the Commissioner must be satisfied that four elements exist. In the context of business, these requirements may be summarised as follows –

1. There must be a "transaction, operation or scheme";
2. It must result in the avoidance, reduction or postponement of a tax;
3. It must have been entered into or carried out in a manner not normally employed for *bona fide* business purposes, other than obtaining a tax benefit *or* have created rights and obligations that would not normally be created between persons dealing at arm's length for a transaction, operation or scheme of that nature; and
4. It must have been entered into solely or mainly for the purpose of avoiding, postponing or reducing any liability for payment of any tax, duty or levy imposed under any law administered by the Commissioner.

Once the second requirement is satisfied, a rebuttable presumption arises that the sole or main purpose of the transaction was to obtain a tax benefit.

The requirements remain the same outside the context of business, except that the first leg of the third requirement is satisfied if the transaction, operation or scheme is entered into or carried out in a manner that would not normally be employed for a transaction, operation or scheme of that nature.

When the requirements to invoke the GAAR have been satisfied the Commissioner is empowered to determine liability for tax as if the transaction had not been entered into or carried out, or, alternatively, "in such manner as in the circumstances of the case he deems appropriate for the prevention or diminution of such avoidance, postponement or reduction".

Reasons for Change

The GAAR has proven to be an inconsistent and, at times, ineffective deterrent to the increasingly sophisticated forms of impermissible tax avoidance that certain advisors and financial institutions are putting forward and some taxpayers are implementing. In addition it has become clear that the GAAR has not kept up with international developments. Finally, uncertainty has arisen with respect to the application of the GAAR in the alternative due to conflicting Court decisions in this regard.

Proposal

The proposed GAAR is inserted as Part IIA of Chapter III of the Income Tax Act. The GAAR opens by describing what an "impermissible avoidance arrangement" is in section 80A. The powers that the Commissioner has with respect to an impermissible avoidance arrangement are set out in section 80B. The remaining provisions expand on these first two provisions and deal with certain procedural issues that arise.

The requirements for an impermissible avoidance arrangement may be summarised very briefly as follows.

	Arrangement
+	Tax Effect
	Avoidance Arrangement
+	Sole or Main Purpose Tax Avoidance
+	Tainted Element
	Impermissible Tax Avoidance

Section 80L

This section defines 'arrangement', 'avoidance arrangement', 'impermissible avoidance arrangement', 'party', 'tax', and 'tax benefit' for use in the GAAR. With the exception of 'impermissible avoidance arrangement', which refers to section 80A, and 'party' these terms draw heavily on the provisions and interpretation of the current GAAR.

Section 80A

This section provides that an avoidance arrangement (or an arrangement which results in a tax benefit) is an impermissible avoidance arrangement if:

1. Its sole or main purpose was to obtain a tax benefit; and
2. A tainted element is present. There are three tainted elements although their formulation may vary depending on the context in which an arrangement was carried out or entered into.
   2.1 Abnormality (sections 80A(*a*)(i), 80A(*b*) and 80(*c*)(i));
   2.2 Lack of commercial substance (section 80A(*a*)(ii)); or
   2.3 Misuse or abuse of the provisions of the Act (section 80A(*c*)(ii)).

The abnormality element is largely based on the current GAAR,. The lack of commercial substance element is expanded on later in the proposed GAAR. The misuse or abuse element has its inspiration in Canadian and certain European jurisdictions approaches to impermissible tax avoidance. The two new elements are intended both to remedy the well-recognised weaknesses in the current abnormality requirement and to expand the scope of the GAAR to address as many forms of impermissible tax avoidance as possible.

Section 80B

This section provides the Commissioner with specific remedies to impermissible tax avoidance, as well an additional general remedy closely modelled on that provided for in the current GAAR.

It also introduces a requirement that the Commissioner make compensating adjustments that her or she is satisfied are necessary and appropriate to ensure the consistent treatment of all parties to an impermissible avoidance arrangement. Such compensating adjustments are subject to the normal three year prescription rules with respect to assessments that have already been issued, since they may result in both additional and reduced assessments.

Any determination in terms of section 80B is subject to objection and appeal.

Section 80C

This section provides a general rule for determining whether an avoidance arrangement lacks commercial substance for the purposes of section 80A, as well as a non-exclusive set of characteristics that serve as indicators of a lack of commercial substance.

The general rule is that an avoidance arrangement lacks commercial substance if it would result in a significant tax benefit for a party but does not have a significant effect upon *either* the business risks *or* the net cash flows of that party.

Indicators of a lack of commercial substance are:

1. A divergence between the legal substance of an avoidance arrangement as a whole and the legal form of its individual steps. These provisions draw upon precedent in both the United Kingdom and the United States and would adopt what the House of Lords has referred to as an "unblinkered" approach to complex multi-step "composite transactions. It would expand the scope of the narrow common law doctrine of substance over form.;
2. the inclusion or presence of—
   2.1 round trip financing as described in section 80D;
   2.2 an accommodating or tax indifferent party as described in section 80E; or
   2.3 elements that have the effect of offsetting or cancelling each other. This indicator draws upon precedent in the United Kingdom and other jurisdictions that gave rise to the so-called "fiscal nullity" doctrine. It is targeted primarily at complex schemes, typically involving complex financial derivatives, that seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another leg effectively neutralises the first leg for non-tax purposes.

Other factors that would tend to indicate a lack of commercial substance would include, for example, the absence of a reasonable expectation of pre-tax profit or an expectation of pre-tax profit that is insignificant in comparison to the amount of the expected tax benefit.

Section 80D

This section provides a non-exclusive description of round trip financing. This essentially relates to a transfer of funds between or among parties that results in directly or indirectly in a tax benefit *and* a significant reduction, offset or elimination of business risk. Tracing, timing, sequence, means, or manner of the transfers are not taken into account, given the fungibility of funds.

By way of comparison, the concept is analogous to the concept of "round robin financing" in Australia and "circular cash flows" in the United States.

Section 80E

This section provides a description of an accommodating or tax indifferent party. The provisions in subsections (1) are widely drawn to cover as wide a range of possible mechanisms for achieving this status, while subsection (2) focuses upon the ways in which these parties are typically used in impermissible avoidance arrangements in order to refine the scope of the section. In addition, two safe harbours are provided. The first comes into play where income tax actually paid in other jurisdictions amounts to more than two-thirds of the income tax that would have been paid in the Republic. The second relates to ongoing active business operations in connection with the avoidance arrangement that are

carried out through a substantial business establishment in the Republic or elsewhere.

Section 80F

Connected persons and accommodating or tax indifferent parties are often used to give the illusion of commercial substance in a specific entity and circumvent anti-avoidance rules. Accordingly the Commissioner is empowered to combine connected persons and disregard an accommodating or tax indifferent party or combine it with another party for the purposes of determining whether an avoidance arrangement lacks commercial substance or whether a tax benefit exists.

Section 80G

This section is analogous to the provisions of section 103(4) of the current GAAR that provide for a rebuttable presumption that an arrangement that provides a tax benefit was entered into or carried out for the sole or main purpose. It also makes it clear that a step in or part of an avoidance arrangement may have a different purpose from the arrangement as a whole. A step or part with the sole or main purpose of obtaining a tax benefit may thus no longer be “camouflaged” by a legitimate purpose of the arrangement as a whole.

Section 80H

This section confirms that the Commissioner may apply the GAAR to steps in or parts of an arrangement.

Section 80I

This section clarifies that the Commissioner may apply the GAAR as an alternative basis for raising an assessment.

Section 80J

This section provides that the Commissioner must give notice, with reasons, of an intention to invoke the GAAR. The taxpayer generally has 60 days to reply to the notice but may request an extension to reply. On receipt of the reply or expiry of the period for a reply the Commissioner has 180 days to raise further queries, withdraw the notice, or invoke the GAAR. If additional information comes to the knowledge of the Commissioner the reasons for invoking the GAAR may be modified or a new notice may be issued if a prior notice has been withdrawn.

Section 80K

This section carries over the provisions of section 103(6) of the current GAAR that provide that interest may not be waived in terms of section 89*quat*(3) or (3A) if the GAAR has been invoked.

CLAUSE 1

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

Subclause (a): The proposed amendment is pursuant to the Local Government Affairs Council Act (House of Assembly), 1989, being repealed by section 2 of the Local Government Affairs Council Act (House of Assembly), 1999 (Act No. 59 of 1999) and the Local Authorities Loans Fund Act, 1984, being repealed by section 2 of the Local Authorities Loans Fund Acts Repeal Act, 1997 (Act No. 98 of 1997) and the amendment or repeal of certain other legislation.

Subclause (b): The proposed amendment aligns the description of a water services provider with the Income Tax Act, 1962.

Subclauses (c) and *(d):* The proposed amendment is is due to the fact that public benefit organisations became partially taxable in terms of their years of assessment commencing after 1 April 2006.

CLAUSE 2

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

See notes in subclause (a) of Clause 1.

CLAUSE 3

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

Subclause (a): The proposed amendment provides for the inclusion of a co-operative in the definition of "company".

Subclause (b): The proposed amendment is consequential to the proposed amendment referred to in subclause (c) below.

Subclause (c): The proposed amendment inserts new criteria into the definition of "connected person" based on the "group of companies" definition.

Subclause (d): The proposed amendment inserts a definition of a co-operative.

Subclause (e): Share redemptions by a company trigger dividend treatment (in lieu of capital gains). Because collective investment schemes are also deemed to be (and may in fact actually be) a company, this redemption rule potentially applies to redemptions by collective investment schemes. This dividend treatment (caused by redemption) can create uneven results between open-ended schemes and close-ended schemes because one form of scheme allows members to opt out via sales to third parties (including sales to management companies) while the other requires redemptions via the company. In the case of foreign collective schemes, deemed dividends (caused by redemptions) are taxable at marginal rates whereas sales to third parties are generally taxable at capital gains rates (or exempt if sold by domestic collective investment schemes). In view of the above, deemed dividend treatment for all collective scheme redemptions has been eliminated.

Subclause (f): The rules are unclear when a company recovers its own shares via a dividend from a subsidiary. This situation often arises in a group context if a subsidiary acquires shares of a parent company, followed by that subsidiary's distribution of parent shares back to the parent. The proposed amendment effectively triggers deemed dividend treatment for the parent to the extent the parent's earnings and profits are reduced (in addition to the usual dividend treatment for the subsidiary making the distribution).

Subclause (g): The proposed amendment deletes an obsolete definition.

Subclause (h): The proposed amendment is consequential to the insertion of the Tenth Schedule to the Bill.

Subclause (i): The proposed amendment inserts the definition of "municipality" pursuant to the Local Government Affairs Council Act (House of Assembly), 1989, being repealed by section 2 of the Local Government Affairs Council Act (House of Assembly), 1999 (Act No. 59 of 1999) and the Local Authorities Loans Fund Act, 1984, being repealed by section 2 of the Local Authorities Loans Fund Acts Repeal Act, 1984 (Act No. 98 of 1997) and the amendment or repeal of certain other legislation.

Subclause (j): The proposed amendment is consequential upon the proposed amendment to insert a definition of "municipality" but it is proposed that the reference to "local authority" is preserved for purposes of certain pension funds established in relation to local authorities, which survive the abolition of the local authority.

Subclause (k): The proposed amendment is consequential upon the proposed amendment to insert a definition of "municipality" but it is proposed that the reference to "local authority" is preserved for purposes of certain pension funds

established in relation to local authorities, which survive the abolition of the local authority.

Subclause (l): The proposed amendment is consequential upon the proposed amendment to insert a definition of “municipality” but it is proposed that the reference to “local authority” is preserved for purposes of certain pension funds established in relation to municipal entities, which survive the abolition of the local authority.

Subclause (m): The proposed amendment provides for a definition in respect of the regional electricity distributors that are established or are to be established.

Subclause (n): The proposed amendment provides for a new definition of “Republic”.

Subclause (o): The proposed amendment provides for an extension of the requirements that a Retirement Annuity Fund may fulfil before approval thereof will be granted.

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

Subclause (q): The proposed amendment provides for an extension of the manner by which an interest in a Retirement Annuity may be surrendered for the purposes of SARS approval.

Subclause (r): The proposed amendment includes a member of a co-operative in the definition of a shareholder.

Subclause (s): The proposed amendment inserts a definition of a water services provider.

CLAUSE 4

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

Subclause (a): The proposed amendment is consequential to the proposed amendment in paragraph (b) below.

Subclause (b): The proposed amendment is consequential to the proposed insertion of the 10th Schedule to the Act to regulate the taxation of mining for oil and gas.

CLAUSE 5

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

Subclause (a): The proposed amendment provides that the Commissioner may determine the subsistence allowance rather than the Minister, and the allowance may now be determined by reference to a region or country.

Subclause (b): Section 8(4)(k) deems a recoupment to take place when an asset is donated, distributed as a dividend or disposed of to a connected person for a consideration which does not reflect an arms length consideration or where the consideration is not an adequate consideration or where the consideration is not measurable in money. In such event, it deems the amount recovered or recouped to be equal to the market value of the asset.

It is proposed that section 8(4)(k) be amended in the following respects:
Firstly, it is proposed that the words “in the case of a company” be inserted in subparagraph (ii). This is a textual amendment required because of the reference in subparagraph (ii) to “that company”.

Secondly, the amendment proposes that section 8(4)(*k*) deems that the asset is disposed of at market value and therefore this section no longer triggers the recoupment or the amount of the recoupment. This aspect will now be regulated by section 8(4)(*a*).

CLAUSE 6

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

The proposed amendment corrects incorrect cross references in the definition of “broad based employee share plan”. It is proposed that the amendments be introduced with retrospective effect from 8 November 2005 when the original amendments were introduced.

CLAUSE 7

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

The proposed amendment provides for the valuation of the shares of private companies where share option schemes are introduced for employees.

CLAUSE 8

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

Subclause (a): The proposed amendments are consequential to the proposed deletion of the definition of "local authority" and the proposed insertion of the definition of "municipality".

Subclause (b): The proposed amendment is consequential to the insertion of the Tenth Schedule.

Subclause (c): The proposed amendments are consequential to the proposed deletion of the definition of "local authority" and the proposed insertion of the definition of "municipality".

CLAUSE 9

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

See notes on **CONTROLLED FOREIGN COMPANIES (CFCs)**

CLAUSE 10

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

Subclause (a): The proposed amendment is consequential to the amendment in subclause (c) below.

Subclause (b): The proposed amendment is consequential to the proposed insertion of a definition of a municipality and the deletion of the definition of local authority.

Subclause (c): The proposed amendment provides for the exemption of the receipts and accruals of foreign governments, foreign government agencies and multinational organizations that provide foreign donor funding.

Subclause (d): The proposed amendment provides for the exemption of the salaries of foreign employees of foreign government agencies and certain multinational organizations.

Subclause (e): The proposed amendment provides that the receipts and accruals of the former "Black authorities", the regional electricity distributors and the water services providers are not exempt in terms of section 10(1)(*c*A).
Subclause (f): This proposed amendment provides that the receipts and accruals of a fund contemplated in section 37A are exempt.

Subclause (g): The proposed amendment is consequential to the proposed amendment in paragraph (e) above.

Subclause (h): The proposed amendments are consequential to the proposed deletion of the definition of "local authority" and the proposed insertion of the definition of "municipality".

Subclause (i): The proposed amendments are consequential to the proposed deletion of the definition of "local authority" and the proposed insertion of the definition of "municipality".

Subclause (j): The proposed amendments are consequential to the proposed deletion of the definition of "local authority" and the proposed insertion of the definition of "municipality".

Subclause (k): See notes on **PARTIAL TAXATION OF RECREATIONAL CLUBS**

Subclause (l): If a non-resident acquires an interest bearing loan at a discount, the discount is deemed to be interest in terms of the provisions of section 24J of the Act. The effect is that section 10(1)*(h)* applies to interest in the common law sense and not to interest as defined in section 24J of the Act. One could therefore have the situation that the non-resident is exempt on the "ordinary" interest in terms of section 10(1)*(h)*, but not on the discount (deemed to be interest in terms of section 24J of the Act) on the same loan. The proposal is that section 10(1)*(h)* be amended to refer to interest as defined in section 24J. A similar amendment is made for section 8E deemed interest.

Subclause (m): Where a non resident acquires an interest bearing loan at a discount, the discount is deemed to be interest in terms of the provisions of section 24J of the Act. The effect is that section 10(1)*(h)* applies to interest in the common law sense and not to interest as defined in section 24J of the Act. One could therefore have the situation that the non resident is exempt on the "ordinary" interest in terms of section 10(1)*(h)* but not on the discount (deemed to be interest in terms of section 24J of the Act) on the same loan. The proposal is that section 10(1)*(h)* be amended to refer to interest as defined in section 24J.

Subclause (n): The proposed amendment is textual in nature and is consequential to the amendment of the definition of "Republic".

Subclause (o): The proposed amendment is consequential to the proposed deletion of the definition of "local authority" and the proposed insertion of the definition of "municipality".

Subclause (p): See notes on **INCENTIVES FOR EMPLOYEE SCHOLARSHIPS AND BURSARIES**

Subclause (q): The proposed amendment provides for the exemption of the traditional councils, regional electricity distributors and water services providers.

Subclause (r) to (u): See notes on **DOMESTIC AND FOREIGN GOVERNMENT GRANTS AND ASSISTANCE**

CLAUSE 11

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

Subclause *(a)*: It is proposed that the amendment in respect of the costs of registration of intellectual property will be effective for years of assessment commencing on or after 2 November 2006.

Subclause *(b)*: See notes on **MINING ENVIRONMENTAL REHABILITATION FUNDS**

Subclause (c): The proposed amendment introduces parity into the income tax system by configuring a once-off lump sum payment in respect of mining royalties to be akin to the expenditure incurred for payment of mining royalties over successive years. However, this deduction is limited to transactions that empower only tribal communities and natural persons envisaged by the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002).

CLAUSE 12

Income Tax: Amendment of Section 11B of the Income Tax Act, 1962

Subclause (a): The proposed amendment is consequential to the proposed amendment to move the deduction of expenditure for the registration of intellectual property and the extension of the registration to section 11(*g*B).

Subclause (b): The proposed amendment is consequential to the proposed insertion of section 11D.

CLAUSE 13

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

See notes on **INCENTIVES FOR SCIENTIFIC AND TECHNOLOGICAL RESEARCH & DEVELOPMENT**

CLAUSE 14

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

See notes on **RELIEF FOR SMALL BUSINESS CO-OPERATIVES**

CLAUSE 15

Income Tax: Amendment of section 15 of the Income Tax Act, 1962

See notes on **INCENTIVES FOR OIL AND GAS EXPLORATION AND PRODUCTION**

CLAUSE 16

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

See notes on **REFINEMENT OF PUBLIC BENEFIT ORGANISATION (PBO) ANOMALIES**

CLAUSE 17

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

Subclause (a): See notes on **INCENTIVES FOR EMPLOYEE SCHOLARSHIPS AND BURSARIES**

Subclause (b): The proposed amendment provides for an extension of the expenditure that a personal services entity will be allowed to deduct.

Subclause (c): The proposed amendment further regulates deductions in respect of assets that were acquired or expenditure funded by means of government grants.

CLAUSE 18

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

Subclause (a): The proposed amendment clarifies that deductions may only be taken into account once when determining taxable income.

Subclause (b): The proposed amendment clarifies that deductions shall not be allowed under section 11 (a) where some other deduction was allowed in respect of the same expense, even if the other deduction would otherwise be granted in a different year of assessment.

CLAUSE 19

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

Section 24I provides a comprehensive mark-to-market regime for foreign currency gains and losses that are largely designed to follow financial accounting. However, anomalies arise where section 24I is not in line with accounting because section 24I predates recent changes. One area of concern involves currency hedges for the acquisition of shares. Currency gains and losses to hedge these acquisitions often trigger tax consequences even though these gains and losses often go unrecognized in terms of income statements required by International Financial Reporting Standards. The proposed amendment (section 24I(11A)) seeks to remedy significant situations of this kind.

More specifically, the new provision exempts currency gains and losses stemming from forward exchange contracts and foreign currency option contracts used to hedge foreign company acquisitions by residents. The acquisition must be of foreign shares amounting to at least 20 per cent of equity share capital of the foreign company to be acquired and the foreign company must qualify as a controlled foreign company in relation to the acquiring resident after the acquisition. However, given the elective nature of the financial statement rules in this area, the exemption from gain or loss will only apply to the extent the gain or loss is not reflected in the income statement of the resident for International Financial Statement Reporting purposes.

CLAUSE 20

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

Subclause (a): See subclause (c) below.

Subclause (b): See subclause (c) below.

Subclause (c): All amounts payable or receivable in terms of an instrument are taken into account in determining the yield to maturity rate to be applied to calculate the interest incurral or accrual in terms of section 24J. The net amount receivable or payable is equal to the interest accrued or incurred under an instrument. It is proposed that amounts taken into account to determine a yield to maturity rate or accrual amounts should not qualify for a deduction under section 11*(a)* or not be included in gross income. This proposed amendment gives effect to this proposal.

CLAUSE 21

Income Tax: Amendment of section 26B of the Income Tax Act, 1962

See notes on **INCENTIVES FOR OIL AND GAS EXPLORATION AND PRODUCTION**

CLAUSE 22

Income Tax: Repeal of Section 29 of the Income Tax Act, 1962

The section is deleted as obsolete.

CLAUSE 23

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

The proposed amendments delete obsolete provisions.

CLAUSE 24

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

See notes on **REFINEMENT OF PUBLIC BENEFIT ORGANISATION (PBO) TAXATION**

CLAUSE 25

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

See notes on **PARTIAL TAXATION OF RECREATIONAL CLUBS**

CLAUSE 26

Income Tax: Amendment of section 36 of the Income Tax Act, 1962
See notes on **INCENTIVES FOR OIL AND GAS EXPLORATION AND PRODUCTION**

CLAUSE 27

Income Tax: Amendment of section 37A of the Income Tax Act, 1962

See notes on **MINING ENVIRONMENTAL REHABILITATION FUNDS**

CLAUSE 28

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

6. Financial Instruments

The following amendments are proposed in the definition of “foreign financial instrument” in section 41.

Proposed law

6.1 Domestic Financial Instrument Holding Company: Section 41

- It is proposed that the definition of financial instrument be amended by including any financial instrument with a market value equal to the base cost and any instrument as defined in section 24J of the Income Tax Act with a term less than 12 months.

6.2 Foreign Financial Instrument Holding Company: Section 41

- It is proposed that the term “dealer” in the definition of FFIHC in section 41(1) (b) of the Income Tax Act be deleted as the activities conducted by a dealer are quite different from the activities conducted by the bank, financier, broker or insurer.

- It is proposed that the “mainly test” in section 41 (1) (b) be replaced by the plurality test” and the exemption will apply if the CFC conducts more business in the country of incorporation than any other single country. In determining whether the CFC conducts more business in the country of residence than in any other single country, the Commissioner may disregard business conducted in another country if attributable to a branch within that other country and subject to tax by that other country as income from tax branch, after taking into account applicable tax treaties.

- It is proposed that the provisions of section 41(1)(b)(i) be amended by inserting the following wording ” receives commissions”. This matches the type of income received by or accrues to the broker or insurer.

It is proposed that the definition of financial instrument be amended by including any financial instrument with a market value equal to the base cost and any

instrument as defined in section 24J of the Income Tax Act with a term less than 12 months.

Subclauses (a)-(i): The proposed amendments modify various aspects of the financial instrument holding company definitions (for both domestic and foreign companies). By way of background, financial instrument holdings companies cannot take part in the rollover regime for reorganisations nor the participation exemption for the sale of foreign shares. In addition, foreign financial instrument holdings companies operating as CFCs trigger deemed income under section 9D. The tax system seeks to enhance active business operations, not passive holdings.

Financial instruments are currently not taken into account for purposes of the financial instrument holding company definitions if the base cost of those instruments equal their market value (i.e. have no built-in gain or loss). Instruments lacking built-in gain or loss cannot give rise to tax avoidance in terms of the reorganisation rules (i.e. the reorganisation rollover rules cannot be used to artificially shift built-in gain or loss because none exist). The amendment further disregards financial instruments with terms of less than 12 months. These short-term instruments typically contain only small amounts of built-in gain or loss (and are often hard to monitor because ownership of these instruments are constantly changing). Note: Both the built-in gain/loss exemption as well as the less than 12 month exemption do not apply to the foreign financial instrument holding companies for purposes of section 9D (because section 9D is concerned with passive income that should be located onshore; the issue of built-in gain or loss is not a major concern).

Other changes are to the financial service aspects of the definition. Active financial services operations, such as banks, are generally excluded from the financial instrument holding company definition (i.e. they are not passive companies likely to be the subject of tax avoidance). Three changes are made in this regard. First, dealers are no longer exempt from the definition because treasury operations can easily be disguised as "dealing." Second, the amendment adds language to give effect to the exemption for brokerage houses. Third, the activity test has been liberalised. Under current law, the main activities of a financial service CFC must be conducted in the CFC's country of residence. Under the proposal, the CFC must merely conduct more activity in the country of residence than any other single country).

Subclause (j): The proposed amendment is consequential to the introduction of the new General Anti-Avoidance Rule.

CLAUSE 29

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

The proposed amendment regulates the sale of shares shortly after a company formation transaction where most of the assets disposed of in terms of the transaction are trading stock.

CLAUSE 30

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

The proposed amendment provides that share for share transactions for private companies and public companies are subject to the same time constraints.

CLAUSE 31

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

The proposed amendment deals with the situation where a holding company makes a loss on a disposal of shares, or where it makes a gain and that gain is wiped out by a capital loss or an assessed capital loss brought forward.

CLAUSE 32

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

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

Subclause (b): The proposed amendment provides for the deletion of the obsolete part of the provision.

Subclause (c): The proposed amendment deletes an obsolete provision.

Subclause (d): The proposed amendment deletes an obsolete provision.

CLAUSE 33

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

Subclause (a): The proposed amendment corrects an oversight.

Subclause (b): The proposed amendment extends the grounds upon which the Commissioner may not raise an additional assessment as provided for in section 79 to also include a case where any previous assessment made on the taxpayer in relation to a specific amount was amended or reduced pursuant to a decision

by the Tax Board, or the settlement, concession or resolution of a dispute in terms of the dispute resolution rules provided for in section 107(2) of the Income Tax Act.

CLAUSE 34

Income Tax: Insertion of Part IIA of Chapter III of the Income Tax Act, 1962

See note on **GENERAL ANTI-AVOIDANCE RULE**

CLAUSE 35

Income Tax: Amendment of section 102 of the Income Tax Act, 1962

Subclause (a): The proposed amendment provides that refunds will be subject to the *de minimus* rules of section 102A.

Subclause (b): The proposed amendment is textual in nature.

Subclause (c): The proposed amendment subjects refunds to the *de minimis* rules. The proposed amendment provides that a taxpayer will not be paid a refund unless all returns have been submitted.

Subclause (d): The proposed amendment provides that amounts not refunded due to the *de minimis* rule are carried forward to the succeeding year.

CLAUSE 36

Income Tax: Amendment of section 103 of the Income Tax Act, 1962

See note on **GENERAL ANTI-AVOIDANCE RULE**

CLAUSE 37

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

See notes on **RETIREMENT FUND WITHDRAWALS**

CLAUSE 38

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

See notes on **RETIREMENT FUND WITHDRAWALS**

CLAUSE 39

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

Subclause (a) through (f): See notes on **RELIEF FOR SMALL PERSONAL SERVICE ENTITIES**

Subclause (g): The proposed amendment excludes PBOs and Recreational Clubs from the definition of provisional taxpayer for a period of three years or such longer period as the Commissioner may allow.

Subclause (h): The proposed amendment clarifies that the tax threshold will be determined by including the rebates in section 6 of the Income Tax Act.

CLAUSE 40

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

See notes on **RELIEF FOR SMALL PERSONAL SERVICE ENTITIES**

CLAUSE 41

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

See notes on **RETIREMENT FUND WITHDRAWALS**

CLAUSE 42

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

See notes on **RELIEF FOR SMALL PERSONAL SERVICE ENTITIES**

CLAUSE 43

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

See notes on **RELIEF FOR SMALL PERSONAL SERVICE ENTITIES**

CLAUSE 44

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

The amendment clarifies that the issue or cancellation of a member's interest in a close corporation does not constitute the disposal of an asset.

CLAUSE 45

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

Subclause (a): In terms of paragraph 40 a deceased person is treated as having disposed of his or her assets to his or her deceased estate for proceeds equal to the market value of those assets at the date of death of the deceased and the deceased estate is treated as having acquired those assets at that value. When the assets are distributed by the deceased estate to heirs and legatees the assets are treated as having been distributed to them at the base cost of the deceased estate and to have been acquired by them at that value. The effect is that the deceased is taxed on any capital gains made on the deemed disposal of the assets at market value to the deceased estate and the heirs and legatees inherit the assets at a base cost equal to the market value at date of death of the deceased plus any expenditure qualifying as part of the base cost during the process of liquidation. Paragraph 40 deals with the assets of the deceased estates of residents and the assets of mentioned in paragraph 2(1)*(b)* in the case of non residents (i.e. immovable property and rights and interests in such property in the Republic and assets of a permanent establishment in the Republic).

Paragraph 40 does not deal with the situation where a resident inherits assets, other than the assets mentioned in paragraph 2(1)*(b)*, from a deceased estate of a non resident and in particular at what value the asset is acquired by the resident. It is proposed that the resident be treated as having acquired the asset for expenditure equal to the sum of the market value of the asset immediately before the death of the deceased and any qualifying expenditure contemplated in paragraph 20 incurred in respect of that asset during the liquidation of the deceased estate by the executor.

Subclause (b): Paragraph 20(1)*(h)* established inter alia the base cost of marketable securities and equity instruments acquired in the circumstances referred to in sections 8A and 8C. A proviso to paragraph 20(1)*(h)* was inserted by Act 31 of 2005. In the context of paragraph 20(1)*(h)*(i) the proviso prevented a person from claiming expenditure prior to the date on which the market value used in computing the section 8A or 8C gain or loss was determined. The proviso, however, did not deal with the situation referred to in paragraph

20(1)*(h)*(i) where the person disposes of the asset and the amount received or accrued is taken into account in section 8C to determine the gain or loss rather than the market value of the asset. It is proposed that the proviso be amended to address this oversight.

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

Subclause (d): The proposed amendment further regulates the base cost in respect of assets that were acquired with government grants.

Subclause (e): This amendment is consequential to the currency gain or loss exclusion described in proposed section 24I(11A). If any resident acquires shares in connection with a currency hedge and that currency hedge gain or loss is excluded by virtue of section 24I(11A), this exclusion must be reflected in the share (much like a rollover). Excluded currency gain will require a reduction in the base cost of the share, and excluded currency loss will trigger an increase in the base cost of the share.

CLAUSE 46

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

The proposed amendment is as a result of the splitting of the definition of "valuation date" to cater for public benefit organisations and recreational clubs that ceased to be exempt persons after 1 October 2001.

CLAUSE 47

Income Tax: Amendment of paragraph 29 of Eighth Schedule to the Income Tax Act, 1962

Subclause (a): The proposed amendment is to delete an obsolete provision.

Subclause (b): The proposed amendment is as a result of the splitting of the definition of "valuation date" to cater for public benefit organisations and recreational clubs that ceased to be exempt persons after 1 October 2001.

Subclause (c): The proposed amendment is to allow the Commissioner to permit the use a market valuation obtained by a person within the period prescribed by the paragraph but which was not attached to the relevant income tax return.

Subclause (d): The proposed amendment is as a result of the splitting of the definition of "valuation date" to cater for public benefit organisations and recreational clubs that ceased to be exempt persons after 1 October 2001.

CLAUSE 48

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

The proposed amendment is of a textual nature.

CLAUSE 49

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

The proposed amendment is as a result of the splitting of the definition of "valuation date" to cater for public benefit organisations and recreational clubs that ceased to be exempt persons after 1 October 2001.

CLAUSE 50

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

The proposed amendment corrects a cross-reference.

CLAUSE 51

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

When a person acquires and disposes of assets in the same foreign currency and the assets are attributable to a permanent establishment of the person which uses a different currency for financial reporting, it can be argued that the provisions of both paragraphs 43(1) and 43(2) are applicable to determine the capital gain or loss in disposal of the assets. In order to provide certainty it is proposed that paragraph 43(2) be amended to preclude its application where an asset qualifies for treatment under paragraph 43(1).

CLAUSE 52

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

The proposed amendments are to confirm that donations and bequests to approved public benefit organisations and approved recreational clubs which were previously disregarded in terms of subparagraphs *(b)* and *(c)* continue to be disregarded for CGT purposes.

CLAUSE 53

Income Tax: Insertion of paragraph 63A in the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment provides that the capital gain or loss from the disposal of an asset not used for trade purposes by a PBO will be disregarded and provides a capital gain or loss must be disregarded where the asset was primarily used in carrying on any public benefit activity.

CLAUSE 54

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

See notes on **PARTIAL TAXATION OF RECREATIONAL CLUBS**

CLAUSE 55

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

The proposed amendments provide that where a person disposes of an asset to the government for destruction any capital gain or loss must be disregarded, if the Minister of Finance has by notice identified the relevant scheme for that destruction for purposes of exemption.

CLAUSE 56

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

See notes on **PARTIAL TAXATION OF RECREATIONAL CLUBS**

CLAUSE 57

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

In terms of paragraph 40 a deceased person is treated as having disposed his or her assets to his or her deceased estate for proceeds equal to the market value of those assets at the date of death of the deceased and the deceased estate is treated as having acquired those assets at that value. When the assets are distributed by the deceased estate to heirs and legatees the assets are treated as having been distributed to them at the base cost of the deceased estate and to have been acquired by the heirs and legatees at that value. The effect of this is that the deceased is taxed on any capital gains made on the deemed disposal of the assets at market value to the deceased estate and the heirs and legatees inherit the assets at a base cost equal to the sum of the market value on the date of death of the deceased, plus any expenditure qualifying as part of the base cost incurred during the process of liquidation.. One exception to the general application of paragraph 40 is a disposal of an asset by a deceased person to his or her surviving spouse upon death. In these circumstances paragraph 67 provides that any capital gain or capital loss made on that disposal is disregarded. The surviving spouse is treated as having acquired the asset on the same date, for the same expenditure and used the asset in the same manner as the deceased person. The effect is that any capital gain or capital loss made on the disposal of the asset is deferred until the asset is disposed of by the surviving spouse. Where the heirs or legatees decide to enter into a redistribution agreement of the assets and one of the parties to the agreement is the surviving spouse, paragraph 67 it is not clear how the provisions of paragraph 40 and paragraph 67 interact. It is proposed that this be clarified.

Subclause (a): The purpose of the proposed amendments to the different sub-items of paragraph 67(1)(b) is as follows—

Sub-item (ii) – Paragraph 20 of the Principal Act deals with different kinds of expenditure in respect of an asset which includes, amongst other, expenditure for acquisition, valuation, disposal, establishing, maintaining and improving. Currently the sub-item only deals with acquisition expenditure and it is proposed that it be extended to all expenditure contemplated in paragraph 20. The sub-item also only provides for expenditure incurred by the deceased spouse to be brought into account by the surviving spouse and it is proposed that expenditure incurred by the executor of the estate of the deceased spouse also be brought to account by the surviving spouse.

Sub-item (iii) - This sub-item also only applies to expenditure incurred by the deceased spouse and it is proposed that the sub-item also apply to expenditure incurred by the executor of the estate of the deceased spouse.

Sub-item (iv) - The sub-item only deals with the use of the asset by the deceased spouse and it is proposed that the use of the asset by the executor of the deceased estate also be brought to account.

Subclause (b): As mentioned in the introduction, paragraph 67 did not expressly provide for the circumstances where the surviving spouse, heirs and legatees enter into a redistribution agreement. A further problem is that subparagraph (2) provides that the paragraph applies if the asset accrues to the surviving spouse upon the death of the deceased spouse. The asset does not, however, accrue on death of the deceased spouse but only after confirmation of the liquidation and distribution account.

It is proposed that that the disposal be treated by the deceased spouse as having occurred if ownership of the asset is acquired by the surviving spouse. The effect of this is that in the paragraph will only operate when it is clear what assets the surviving spouse has received, which will occur almost exclusively when there is confirmation of the liquidation and distribution account. In the case where there is a redistribution agreement the liquidation and distribution account will reflect the effect of the agreement.

CLAUSE 58

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

Paragraph 80 (2) of the Eighth Schedule applies where –

- a capital gain arises in a trust (for example, as a result of the sale of an asset to a third party) during a year of assessment, and
- the trustee vests that capital gain in a resident beneficiary during the same year of assessment.

In these circumstances the capital gain is disregarded in the trust and is taxed in the hands of the beneficiary.

Some commentators have expressed concern that the present wording does not permit

- the attribution of a portion of a capital gain in a single beneficiary, or
- the attribution of a capital gain in multiple beneficiaries.

It is proposed that paragraph 80 (2) be amended to put it beyond doubt that the portion of a capital gain can be attributed to a beneficiary or beneficiaries.

CLAUSE 59

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

The proposed amendment clarifies that the proceeds from the disposal of a foreign currency asset must be increased by any capital loss which had otherwise been determined in terms of the Eight Schedule if that loss has been taken into account in determining the proceeds.

CLAUSE 60

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

See notes on ***REFINEMENT OF PUBLIC BENEFIT ORGANISATIONS (PBO) TAXATION***

CLAUSE 61 AND 62

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

See notes on ***REFINEMENT OF PUBLIC BENEFIT ORGANISATIONS (PBO) TAXATION***

CLAUSE 63

Income Tax: Insertion of the Tenth Schedule to the Income Tax Act, 1962

See notes on **INCENTIVES FOR OIL AND GAS EXPLORATION AND PRODUCTION**

CLAUSE 64

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

Section 44 provides for the liability of duty and imposes liability on and terminates liability of supply chain participants as cargo moves through the supply chain.

The proposed amendment now extends such liability to container terminal operators, combination terminal operators, bulk goods terminal operator and road vehicle terminal operators as they will in future be required to be licensed in terms of the Customs and Excise Act.

This will come into operation on a date fixed by the President by Proclamation in the Gazette.

CLAUSES 65 & 66

Customs and Excise: Amendment of section 55 of the Customs and Excise Act, 1964

The heading of Chapter VI, which contains sections 55 – 57A is amended to also make provision for safeguard measures and not only safeguard duties as provided for in the International Trade Administration Act, 2002.

Subsections (2)*(a)*, (3)*(a)* and (4) are amended for the same reason.

CLAUSE 67

Customs and Excise: Amendment of section 56 of the Customs and Excise Act, 1964

Subsection 56 is amended to provide for the amendment and not only the imposition of an anti-dumping duty as provided for in the International Trade Administration Act, 2002.

CLAUSE 68

Customs and Excise: Amendment of section 56A of the Customs and Excise Act, 1964

Subsection (2) is amended to provide for the amendment and not only the imposition of countervailing duties as provided for in the International Trade Administration Act (2002).

CLAUSE 69

Customs and Excise: Amendment of section 57 of the Customs and Excise Act, 1964

The heading as well as subsections (1) and (2) are amended to provide for safeguard measures as provided for in the International Trade Administration Act, 2002.

CLAUSE 70

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

In paragraph *(a)* the reference to item 540.02 of Schedule No. 5 is deleted, as this specific item was deleted on 23 September 1999 in Government Gazette No. 20498, Notice No. R1150.

The amendments numbered *(a)* to *(h)* in section 75 are being made as a consequence to the review of Schedule No. 6 to the Act that was published on 31 March 2006. The structure of Schedule No. 6 has changed and therefore different item numbers now exist.

The amendment in paragraph (i) is a deletion of the 0,5 percent losses for wine and other fermented beverages. The original reason for the introduction of these losses was that manufacturers of wine and other fermented beverages received a full rebate on their losses up to the bottling stage of the product. Any losses occurring after the bottling were dutiable at the relevant rate of duty. In order to compensate for these bottling losses, the 0,5 percent allowance was introduced. The manufacturers of wine and other fermented beverages already receive manufacturing losses in terms of section 20(5) up to the point where the end product leaves the warehouse. The deletion is thus to take away the double allowance of losses.

The amendment in paragraph *(j)* is to include unmarked illuminating kerosene and unmarked specified aliphatic hydrocarbon solvents to qualify for the same losses as distillate fuel.

CLAUSE 71

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

A technical error is being corrected – the reference to section 77(1)*(a)* within subsection (2) is being amended to refer to section 77*(a)* only, as there is no section 77(1)*(a).*

CLAUSE 72

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

The amendments in section 105 made in Revenue Laws Amendment Act, 2005 (Act 31 of 2005) were as a result of the need to achieve uniformity with regards to the order in which payments received must be applied in order to discharge any

duty owed, as well as other amounts. "Fine" was included in section 105 in view of its presence in section 114.

In the past such fines were paid over to the Controller by the Department of Justice, but this practice is no longer followed and the reference to "fine" is therefore deleted. All fines imposed and collected by the courts are paid directly into the National Revenue Fund.

CLAUSE 73

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

The amendments in section 114 made in Revenue Laws Amendment Act, 2005 (Act 31 of 2005) were as a result of the need to achieve uniformity with regards to the order in which payments received must be applied in order to discharge any duty owed, as well as other amounts. "Fine" was included in section 114 in view of its presence in section 105.

In the past such fines were paid over to the Controller by the Department of Justice, but this practice is no longer followed and the reference to "fine" is therefore deleted. All fines imposed and collected by the courts are paid directly into the National Revenue Fund.

CLAUSE 74

Stamp Duties: Amendment of section 4 of the Stamp Duties Act, 1968

Subclause (a): The proposed amendment is pursuant to certain councils and boards no longer existing and the exemption now applies to any municipality as defined in the Income Tax Act, 1962.

Subclause (b): The proposed amendment aligns the exemption for entities qualifying as water services providers as contemplated in the Income Tax Act, 1962.

Subclauses (c) and (d): The proposed amendments are of a textual nature by deleting the word "or" at the end of subparagraphs (vi) and (vii).

Subclause (e): The proposed amendment is pursuant to the Local Authorities Loans Fund Act, 1984, being repealed by section 2 of the Local Authorities Loans Fund Acts Repeal Act, 1997 (Act No. 98 of 1997) and the regional services councils and joint services board becoming redundant.

Subclause (f): The proposed amendment provides that stamp duty shall not be payable in respect of any instrument if the duty thereon would be legally payable

and borne by any “traditional council” as contemplated Communal Land Rights Act, 2004, or any “regional electricity distributor” as defined in the Income Tax Act, 1962.

Subclause (g): The proposed amendment is due to the fact that public benefit organisations became partially taxable in terms of their years of assessment commencing after 1 April 2006.

CLAUSE 75

Stamp Duties: Amendment of Item 15 of Schedule 1 to the Stamp Duties Act, 1968

Subclause (a): The proposed amendment is pursuant to the term “local authority” becoming redundant as various Acts applicable to the local sphere of Government now refer to “municipality”. The proposed amendment aligns the definition of a “municipality” with that of the Income Tax Act, 1962.

Subclause (b): The proposed amendment aligns the exemption for entities qualifying as water services providers where the entities contemplated in the Income Tax Act, 1962.

Subclause (c): The proposed amendment is pursuant to the Local Authorities Loans Fund Act, 1984, being repealed by section 2 of the Local Authorities Loans Fund Acts Repeal Act, 1997 (Act No. 98 of 1997). The proposed deletion of paragraphs (viii) and (ix) is consequential upon the proposed amendment to paragraph (ii) – see subclause (*b*).

Subclause (d): The proposed amendment is of a textual nature by including the word “and” at the end of subparagraph (xvi).

Subclause (e): The proposed amendments are of a textual nature.

Subclause (f): The proposed amendment provides that stamp duty shall not be payable in respect of any instrument if the duty thereon would be legally payable and borne by any “traditional council” as contemplated Communal Land Rights Act, 2004, or any “regional electricity distributor” as defined in the Income Tax Act, 1962.

CLAUSE 76

Finance and Financial Adjustments Act: Amendment of section 9 of the Finance and Financial Adjustments Act, 1977

See notes on **DIFFERENT SPHERES OF DOMESTIC AND FOREIGN GOVERNMENT**

CLAUSE 77

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

Subclause (a): The proposed amendment is of a textual nature by deleting the word "or" at the end of paragraph (iv) and by including the word "or" at the end of paragraph (v).

Subclause (b): The proposed amendment is to also include any water board or any other institution which has powers similar to those of any such board as a designated entity. The result will be that any grants received by any such entity will be subject to VAT at the standard rate in terms of section 7(1)*(a)* of the VAT Act.

Subclause (c): A "foreign donor funded project" as defined in section 1 of the VAT Act, means a project which came about as a result of an international donor funding agreement entered into by the Government of the Republic. The proposed amendment is to clarify that a foreign donor funded project refers to an international agreement entered into by the Government as envisaged in section 231(3) of the Constitution of the Republic of South Africa, 1996. In addition, the international agreement must specifically provide that the funds should not be subject to any form of taxation in the Republic.

Subclause (d): The proposed amendment aligns the definition of a "municipality with that of the Income Tax Act, 1962.

Subclause (e): The proposed amendment amends the reference to the Income Tax Act.

CLAUSE 78

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

The proposed amendment is of a textual nature to include the full reference to the Collective Investment Schemes Control Act.

CLAUSE 79

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

Subclause (a): The purpose of section 8(24) of the VAT Act is to deem a CCAE to supply goods where movable goods are temporarily removed from the CCA to a place in the Republic and such goods are not returned to the CCA within a period of 30 days from its removal, or such other period as approved by the controller. Output tax must be declared by the CCAE in this instance. As it was always the intention that the IDZ operator be treated on a similar basis to a

CCAE, the proposed amendment clarifies the original intention by also deeming the IDZ operator to supply goods where movable goods are not returned to the CCA within a period of 30 days from its removal, or such other period as approved by the controller.
Subclause (b): The proposed amendment is to ensure that in circumstances where a vendor receives any amount that is in excess of the consideration charged for that supply and such excess amount is not refunded, output tax will be payable on the excess portion of the amount received. The vendor will have to account for output tax on the excess amount of money received on the last day of the tax period which ends 4 months after the excess amount was received. In the event that the excess amount is refunded by the vendor, he or she will be entitled to claim input tax.

Example 1:

Vendor A, registered on category B, issues a tax invoice to John for R114 (invoice no. 10 dated 01/3/2006) and sends a statement to him a week later.
John pays Vendor A R114. His wife on receiving the statement also pays Vendor A R114 on 30/04/2006 in respect of the same invoice. Vendor A retains both payments and does not refund the overpayment received from John's wife.

VAT Treatment:

1. The excess payment of R114 received by Vendor A will be treated as a deemed supply and output tax will be payable.
2. Vendor A will be liable to account for output tax amounting to R14 (i.e R114 x 14/114) during the 08/2006 tax period, which is the last day of the tax period during which the 4 month period ends, i.e. the 4 month period is calculated from 30/4/2006 and therefore ends on 31/8/2006. (also see proposed amendment to section 10(26)).

Example 2:

Same facts as the above example, however Vendor A refunds (see proposed amendment to section 16(3)(l)) the overpayment received from John's wife on 25/9/2006.

VAT Treatment:

Vendor A on refunding the overpayment of R114 to John on 25/09/2006 will be entitled to input tax of R14 in the 10/06 tax period.

CLAUSE 80

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

The proposed amendment is consequential upon the insertion of the deeming provision in section 8(27) and determines the value for that deemed supply to be the consideration in money for that supply.

CLAUSE 81

Value-Added Tax: Amendment to section 11 of the Value-Added Tax, 1991

Subclause (a): A vendor may in terms of section 11(1)(c), supply movable goods under a rental agreement, charter party or agreement for chartering at the zero rate, if such goods are used in a CCA. However, the current wording allows a vendor to zero rate such supply where the supply is to a vendor in a customs controlled area provided that the movable goods are use exclusively in a CCA. The proposed amendment is to clarify that the zero-rating will only apply to movable goods used in a customs controlled area by a customs controlled area enterprise or an IDZ operator.

Subclause (b): A vendor may in terms of section 11(1)(m) supply movable goods (excluding a "motor car") in terms of a sale or instalment credit agreement to a registered vendor in a customs controlled area, if such goods are physically delivered by the supplier or by the supplier's cartage contractor. The proposed amendment replaces the reference to a registered vendor with that of a CCAE or an IDZ operator. The zero rating therefore only applies when the movable goods are supplied to a CCAE or IDZ operator. The remaining amendments are of a textual nature to clarify that the zero-rating only applies where the supplier is contractually liable for the delivery of the goods into the CCA.

Subclause (c): The VAT Act currently does not make provision for the supply of fixed property situated in a CCA, to be zero-rated. The proposed amendment is to allow a vendor to supply fixed property or the right to use or the granting of permission to use such fixed property under any rental agreement or any other agreement, at the zero rate where the fixed property is situated in a customs controlled area. The supply must however be made to a CCAE or an IDZ operator to qualify for the zero rate.

Subclause (d): The proposed amendment is of a textual nature by including the word "or" at the end of paragraph (q).

Subclause (e): The VAT Act does not provide for a specific zero-rating where a vendor supplies goods and/or services to a public authority. Accordingly, such supply will be standard rated. The proposed amendment will provide for the payment (i.e. compensation) received by the vendor in terms of section 19 of the

Animal Diseases Act, 1984 (Act No. 35 of 1984) to be zero-rated in respect of the supply by the vendor to the public authority of controlled animals or things.

Subclause (f): Section 11(2)(k) currently entitles a vendor to supply services, which are physically rendered to any registered vendor in a customs controlled area at the zero rate. The registered vendor does not have to be a customs controlled area enterprise or an IDZ operator. The proposed amendment replaces the reference to a registered vendor with that of a CCAE and as it was always the intention that an IDZ operator would receive the same benefit as that of a CCAE where services are supplied physically in a CCA to a CCAE or an IDZ operator at the zero rate, the proposed amendment therefore also clarifies this intention by inserting an IDZ operator.

Subclause (g): The receipt of international donor funding by a “foreign donor funded project” as defined, is currently zero-rated in terms of section 11(2)(q) read with section 8(5B). The proposed amendment is to further regulate the zero-rating of the international donor funding received by the project only to the extent that the zero-rating has been approved by the Minister after consultation with the Minister of Foreign Affairs, by Notice in the *Gazette*.

CLAUSE 82

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

Subclause (a): The proposed amendment is due to the fact that public benefit organisations became partially taxable in terms of the year of assessment commencing after 1 April 2006.

Subclause (b): The proposed amendment is to clarify that the supply of training or education as envisaged in 12(h)(i)(cc)(A) and (B) and not the promotion thereof, is exempt from VAT.

Subclauses (c) and (d): The proposed amendment is of a textual nature by the deletion of the word “or” at the end of sub item (E) and the inclusion of the word “or” at the end of subparagraph (ii).

CLAUSE 83

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

Subclauses (a) and (d): Vendors have 5 years to claim input tax from the date on which a tax invoice for that supply should have been issued as contemplated in section 20(1), i.e. within 21 days from the date of the supply. However, instances exist where the vendor will not be in possession of a tax invoice, as the provisions of section 20(1) are not applicable. The proposed amendment ensures that, where a vendor is not required to be in possession of a tax invoice, in respect of the

acquisition of goods or services, the vendor may deduct input tax from the amount of output tax attributable to a later tax period which ends no later than five years after the end of the tax period during which —

- goods were entered for home consumption in terms of the Customs and Excise Act;
- second-hand goods were acquired or goods as contemplated in section 8(10) were repossessed;
- the agent should have notified the principal as contemplated in section 54(3); or
- in any other case, the vendor for the first time became entitled to such deduction and for which a tax invoice is not required for the claiming of such deduction.

Example:

A vendor, registered on category C, purchases fixed property from a non vendor and pays transfer duty (on 1 October 2006). As the transaction is not a vatable transaction, the vendor will not be in possession of a tax invoice. In terms of the proposed amendment to the proviso to section 16(2), the vendor will be entitled to claim the notional input tax within 5 years after the end of the tax period during which the vendor for the first time became entitled to such deduction i.e. the vendor has 5 years from the October 2006 tax period to submit the input tax claim. The last tax period in which the vendor may therefore submit the input tax claim is in the October 2011 tax period.

Subclause (b): Where a vendor awards a prize or winnings, the vendor will be entitled to claim an amount limited to the VAT incurred. In the case of second-hand goods, the vendor will be entitled to a deduction of the notional input tax. The proposed amendment is to clarify that the vendor who awards a prize or winnings is also, as from 1 February 2006, entitled to a deduction limited to the input tax, i.e. VAT, transfer duty or stamp duty paid. The proposed amendment therefore extends the deduction to not only the VAT, but also to the transfer duty and stamp duty paid.

Subclause (c):
The proposed amendment allows a vendor who accounted for output tax on the overpayment/excess amount in terms of section 8(27) and subsequently refunds the overpayment to its customer, to deduct as input tax, the amount equal to the tax fraction of the excess amount.

CLAUSE 84

Value-Added Tax: Amendment of section 17 of the Value-Added Tax, 1991

Subclause (a): The proposed amendment is of a textual nature by replacing the incorrect reference.

Subclause (b): Entertainment expenses are generally denied as input tax. The purpose of section 17(2)(a) of the VAT Act is to unblock entertainment expenses. Section 17(2)(a)(ii) only allows a vendor to claim input tax on personal subsistence in respect of the vendor's employees or office holders, who are by reason of their duties, away from their usual working-place or their usual place of residence. However, vendors are often required to pay for the costs (which include VAT) in respect of meals, refreshments and accommodation of self-employed natural persons, which the vendor contracts with to render services.

The proposed amendment to section 17(2)(a)(ii) is intended to extend the current provision of personal subsistence, being that of a meal, refreshment or accommodation, to self employed natural persons. This will now entitle vendors who are required to pay costs (which include VAT) for the personal subsistence of self employed natural persons, to deduct input tax on such expenses. This will only apply where the self employed natural persons are by reason of the contractual obligations with the vendor obliged to spend any night away from their usual place of residence and usual working place.

Subclause (c): The proposed amendment is to ensure that a foreign donor funded project is only entitled to claim input tax in respect of entertainment and other expenses prohibited in terms of section 17(2) to the extent that the international donor funding received from the international donor has been approved by the Minister in consultation with the Minister of Foreign Affairs to be zero-rated in terms of section 11(2)(q) by Notice in the *Gazette*.

CLAUSE 85

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

The proposed amendment is consequential upon the insertion of section 11(1)(mA) to the VAT Act, where a vendor supplies fixed property, or the right to use or the granting of permission to use fixed property under any rental agreement or any other agreement at the zero rate to a registered vendor (i.e. a CCAE or an IDZ operator) in a customs controlled area. In addition, the CCAE or IDZ operator must make an output tax adjustment where goods or services are not acquired wholly for consumption, use or supply in the course of making taxable supplies within a customs controlled area.

Example:
Where fixed property (land together with a factory) was purchased by a CCAE to be used in the course of making taxable supplies, and the factory is partially being used for residential purposes/accommodation for one of the CCAE's employees (security guard). The CCAE must make an output tax adjustment in respect of the portion which is used for making exempt supplies.

CLAUSE 86

Value-Added Tax: Amendment of section 22 of the Value-Added Tax, 1991

Subclause (a): The proposed amendment alters the grammatical error.

Subclause (b): The proposed amendment is of a textual nature by deleting the word “or” at the end of subparagraph (i) of the proviso.

Subclause (c): Where a vendor registered on the invoice basis claimed input tax on supplies and fails to pay the supplier within 12 months, the vendor is required to account for output tax in terms of section 22(3) of that portion of the amount that remains unpaid. An anomaly exists within the VAT Act as currently, no output adjustment is required where the vendor de-registers for VAT purposes, has not paid the supplier of the goods or services, has claimed input tax but has not accounted for output tax due to the fact that the 12 month period has not expired. The proposed amendment will ensure that output tax is accounted for at the time the vendor ceases to be a vendor in terms of section 8(2) and when that vendor has not fully paid the supplier of the goods or services.

Subclause (d): The proposed amendment is to ensure that where the vendor has already accounted for the tax payable as required in terms of section 22(3), the second proviso will not be applicable.

CLAUSE 87

Value-Added Tax: Amendment of section 31 of the Value-Added Tax, 1991

In terms of section 32(5), SARS is not allowed to issue another assessment once an assessment has been issued and the vendor has accepted or not objected to the assessment. The proposed amendment will allow SARS to issue additional assessments to the extent that it is found that the vendor has not complied with the provisions of the VAT Act. This authority to issue additional assessments will be akin to the authority SARS has in issuing additional assessments in terms of the Income Tax Act.

CLAUSE 88

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

Subclauses (a), (b) and (c): The proposed amendments provide for the treatment of *de minimis* refunds.

CLAUSE 89

Value-Added Tax: Amendment of Schedule 1 of the Value-Added Tax, 1991

See notes on **2010 FIFA WORLD CUP**

CLAUSE 90

Uncertificated Securities Tax: Amendment of section 1 of the Uncertificated Securities Tax Act, 1998

The proposed amendment is pursuant to the term "local authority" becoming redundant as various Acts applicable to the local sphere of Government now refer to "municipality". The proposed amendment aligns the definition of a "municipality" with that of the Income Tax Act, 1962.

CLAUSE 91

Uncertificated Securities Tax: Amendment of section 5A of the Uncertificated Securities Tax Act, 1998

Currently the liability to pay UST and the responsibility to effect payment in terms of section 5A of the Act lies with the person acquiring beneficial ownership or who cancels or redeems securities.

The proposed amendment is to provide for this person (client) to effect payment of UST through—

(1) a participant, where the CSDP holds securities for a non-controlled client; or

(2) a member (broker) which will cover a controlled client arrangement.

CLAUSE 92

Uncertificated Securities Tax: Amendment of section 7 of the Uncertified Securities Tax Act, 1998

The proposed amendment is consequential upon the proposed amendment to section 5A set out in clause 123 and regulates the timing of payment of UST by the member or participant to the Commissioner.

CLAUSE 93

Unemployment Insurance Act: Amendment of section 3 of the Unemployment Insurance Act, 2001

The proposed amendment is textual in nature.

CLAUSE 94

Unemployment Insurance Act: Amendment of section 14 of the Unemployment Insurance Act, 2001

In 2003 the Unemployment Insurance Act, 2001 was amended to effectively exclude those unemployed who receive a monthly State old-age pension (SOAP) in terms of the Social Assistance Act, 1992. The amendment essentially reinforced an already existing disparity between the Unemployment Insurance Contributions Act, 2002, and the Unemployment Insurance Act, 2001 in that the Unemployment Insurance Act denies benefits to SOAP pensioners although they will still be liable to contribute to the fund in terms of the fund in terms of the Unemployment Contributions Act if employed.

Consequently the Minister announced in the 2005 Budget Review that it is proposed that efforts be made to properly align the Unemployment Insurance Contributions Act with the Unemployment Insurance Act in order to ensure that all parties paying into the system will receive full benefits.

As the benefits paid in terms of the Unemployment Insurance Act are directly linked to the contributions made by an employee and the period over which such contributions were made, the proposed amendment now enables a working individual who is receiving a SOAP and who is liable for Unemployment Insurance Fund contributions to also be eligible for benefits from the fund should that individual become unemployed despite the fact that the individual is in receipt of a SOAP.

CLAUSE 95

Amendment of section 145 of the Revenue Laws Amendment Act, 2003

The value determination formula for domestically produced goods was eliminated with effect from 1 July 2001 and duties were levied thereafter on the invoice price of dutiable items. On 22 December 2003 section 61(1)(*d*A) was promulgated. It provides for the value for excise duty purposes of digital video discs (DVD’s), recorded compact discs, audio tapes and video tapes. However, the provisions of section 61(1)(*d*A) were not made retrospective.

The proposed amendment is aimed at making the provisions of section 69(1)(*d*A) retrospective in order to clarify the legal position relating to what value was applicable for assessing the excise duty for the period 1 July 2001 until its promulgation.

CLAUSE 96

Amendment of section 62 of the Revenue Laws Amendment Act, 2004

The proposed amendment provides for an effective date.

CLAUSE 97

Amendment of section 26 of the Taxation Laws Amendment Act, 2005

The proposed amendment extends the deadline by which the shares issued in exchange for a right held in a non proprietary exchange must be issued. In addition, the effective date of the provision which deems the rights in a non proprietary exchange to be one and the same as the shares in the company assuming all the functions of the non proprietary exchange received in exchange does not cover tax years of holders of these rights ending during the period from 1 July 2005 to 31 December 2005. The proposed amendment corrects this oversight.

CLAUSE 98

Amendment of the index of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

The proposed amendment is textual in nature.

CLAUSE 99

Amendment of section 8 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

This amendment clarifies that the Small Business Amnesty relief only relates to employees' tax and unemployment insurance contributions in respect of any remuneration paid by that applicant to persons employed in that applicant's business and not to non-business employees.

CLAUSE 100

Income Tax: Amendment of section 11 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

The proposed amendment is textual in nature.

CLAUSE 101

Income Tax: Amendment of section 23 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

The proposed amendment is textual in nature.

CLAUSE 102

Income Tax: Amendment of section 30 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

The proposed amendment is of a consequential nature.

CLAUSE 103

Income Tax: Amendment of section 54 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

The proposed amendment is textual in nature.

CLAUSE 104

Income Tax: Amendment of section 61 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

The proposed amendment is textual in nature.

CLAUSE 105

Income Tax: Amendment of Schedule 1 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

*See notes on **REFINEMENT OF PUBLIC BENEFIT ORGANISATIONS (PBO) TAXATION*** **& PARTIAL TAXATION OF RECREATIONAL CLUBS**

CLAUSE 106

Special Tax Measures Relating to 2010 FIFA World Cup South Africa

Schedules 1 and 2 see notes on **2010 FIFA WORLD CUP**

CLAUSE 107

Short title

This clause provides for the short title of the Bill.