REPUBLIC OF SOUTH AFRICA

# EXPLANATORY MEMORANDUM

# ON THE

# SMALL BUSINESS TAX AMNESTY AND AMENDMENT OF TAXATION LAWS BILL, 2006

[W.P. 1 —'06]

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## INTRODUCTION

The Small Business Tax Amnesty and Amendment of Taxation Laws Bill, 2006, introduces a tax amnesty for small business and introduces amendments to the Transfer Duty Act, 1949, the Estate Duty Act, 1955, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Value-Added Tax Act, 1991, the Tax on Retirement Funds Act, 1996, the Uncertificated Securities Tax Act, 1998, and the Local Government: Municipal Structures Act, 1998.

## SMALL BUSINESS TAX AMNESTY

Small businesses play an important role in stimulating economic activity, job creation, poverty alleviation and the general improvement of living standards. Many small businesses operate informally, were historically marginalised and were excluded from the economic mainstream, thus remaining outside of the tax system. These small businesses are now keen to regularise their tax affairs but an obstacle is their past non-compliance and the resultant potential tax liabilities, penalties and interest.

SARS' tax-base broadening efforts and "walkabouts" in informal business areas have indicated that numerous small businesses are not on register or have not made full disclosure to SARS and would like the opportunity for regularisation without fear of tax liabilities arising out of past non-compliance. This also includes taxi operators who want to participate in the taxi recapitalisation program.

The Minister of Finance, therefore, announced in the 2006 Budget that Government will introduce a tax amnesty for small business.

The purpose and objective of the tax amnesty is, therefore, to:

- broaden the tax base;
- facilitate the normalisation of the tax affairs of small businesses;
- increase and improve the tax compliance culture; and
- facilitate participation in the taxi recapitalisation programme.

*Persons who may apply for amnesty*

Any individual, unlisted company, close corporation, trust, co-operative or insolvent or deceased estate of an individual which meets certain requirements may apply for tax amnesty. The requirements are that—

- the individual or entity must have carried on a business;
- the gross income (turnover) of the business (or businesses if the individual or entity carried on more than one business) during the 2006 year of assessment was not more than R10 million;
- in the case of a company or close corporation all the shares or members' interests were held directly by individuals throughout the 2006 year of assessment;
- in the case of a trust all the beneficiaries of that trust throughout the 2006 year of assessment must have been natural persons.

For purposes of the amnesty, the "2006 year of assessment" is defined as the year of assessment which ended during the period of 12 months from 1 April 2005 to 31 March 2006.

Small businesses which are unregistered for tax purposes at the end of the 2006 year of assessment or which are registered taxpayers but whose income from, supplies made or employment taxes due in respect of small business activities have not been declared or has been understated during any year of assessment preceding the 2006 year of assessment will benefit from the amnesty.

*Method of application*

An applicant must apply for amnesty with the Commissioner on a form and at addresses to be prescribed by the Commissioner. Application forms must be submitted at any time during the period 1 August 2006 to 31 May 2007.

*Information to be submitted together with tax amnesty application*

The applicant must, together with the application for tax amnesty (or within such later period as the Commissioner may allow) furnish—

- an income tax return for the 2006 year of assessment; and
- a statement of all assets (at cost) and liabilities of that applicant as at the end of the 2006 year of assessment.

If it is not possible for the applicant to provide full particulars of any actual amounts in the application or in any return or statement relating to the application, the applicant may provide a reasonable estimate of those amounts. If an estimate is used this must be clearly indicated.

*Amnesty Levy*

The amnesty levy is based on a sliding scale rate and is applied to the taxable income of the applicant for the 2006 year of assessment to the extent that the taxable income is attributable to any amount derived by the applicant from the carrying on of business.

The rates to be applied in the calculating of the tax amnesty levy are—

- 0% of so much of the taxable income as does not exceed R35 000;
- 2% of so much of the taxable income as exceeds R35 000 but does not exceed R100 000;
- 3% of so much of the taxable income as exceeds R100 000 but does not exceed R250 000;
- 4% of so much of the taxable income as exceeds R250 000 but does not exceed R500 000;
- 5% of so much of the taxable income as exceeds R500 000.

***Example***

*Facts: Mr. A is employed by company B and earns employment (salary) income of R200 000 for the 2006 year of assessment. During this period Mr. A also conducted the business of selling household chemicals to clients after hours. He started the business in 2001 and has never disclosed it to SARS. The turnover of this business*

*is R400 000 for the 2006 year of assessment. His expenses in relation to his business amount to R100 000 for that year. At the end of the 2005 year of assessment Mr. A had an assessed loss of R20 000. Mr. A furthermore earned rental income of R5 000 on the use of his holiday cottage for a month by a friend during the 2006 year of assessment.*

Calculation of the tax amnesty levy

Taxable income for carrying on business:

R400 000 less R100 000 (expenses) = **R300 000**

0% up to R35 000 = R0
2% of amount over R35 000 and up to R100 000 = R1 300
3% of amount over R100 000 and up to R250 000 = R4 500
4% of amount over R250 000 and up to R300 000 = R2 000
**Total tax amnesty levy** = **R7 800**

- The employment (salary) income of R200 000 will not be taken into account for purposes of calculating the tax amnesty levy.
- The rental income of R5 000 will not be taken into account for purposes of calculating the tax amnesty levy as it is not attributable to the carrying on of business.
- The assessed loss of R20 000 for the 2005 year of assessment will not be set off against Mr. A's taxable income for the 2006 year of assessment.

*Other conditions to qualify for tax amnesty*

Tax amnesty will only apply if—

- the applicant pays the full amount of the tax amnesty levy within 12 months from the date of approval or a longer period as the Commissioner may allow;
- the applicant made full disclosure of any information or amounts required in the—
  - application;
  - income tax return for the 2006 year of assessment; and
  - statement of assets and liabilities as at the end of the 2006 year of assessment.
- any estimates made by the applicant are not materially incorrect.

Tax amnesty will not apply if the Commissioner has, before the submission of the application, formally notified the applicant of an audit, investigation or other enforcement action relating to any failure by that applicant to comply with any Act in respect of which application for tax amnesty is made. This exclusion falls away if the Commissioner has, before the submission of the application for tax amnesty, formally notified the applicant that—

- the notice of audit, investigation or other enforcement action has been withdrawn; or
- the audit or investigation has been concluded.

*Evaluation process*

A separate unit within SARS, with regional presence, will be established to process all applications on a confidential basis. To this end, the secrecy provisions of the Income Tax Act, 1962, are extended to cover applications for tax amnesty.

*Scope of the tax amnesty relief*

If an application for tax amnesty is successful, the applicant is granted relief from the payment of—

- income tax in terms of the Income Tax Act, in respect of any amounts received by or accrued to (or deemed to have been received by or accrued to) the small business in all years of assessment preceding the 2006 year of assessment;
- employees' tax in terms of the Fourth Schedule to the Income Tax Act, in respect of remuneration as defined in that Schedule paid to employees during the qualifying period;
- value-added tax in terms of the Value-Added Tax Act, in respect any supply or importation of goods or services, during the qualifying period;
- withholding tax on royalties in terms of the Income Tax Act, in respect of any amount paid to a non-resident during the qualifying period;
- secondary tax on companies in terms of the Income Tax Act, in respect of any dividend declared or deemed to be declared in all years of assessment preceding the 2006 year of assessment;
- contributions payable in terms of the Unemployment Insurance Contributions Act, in respect of remuneration, as defined in that Act, during the qualifying period; and
- levies payable in terms of the Skills Development Levies Act, in respect of any leviable amounts as contemplated in that Act, during the qualifying period.

The applicant will also not be liable for the payment of any additional taxes, interest and penalties which relate to the amounts for which relief has been granted.

The Commissioner may extend the date for submission of any returns to be furnished by an applicant in terms of any Act to which the tax amnesty relates and may further waive the penalty for the late submission of that return.

The Commissioner may further also waive any additional tax, penalties and interest charged to an applicant in terms of any Act to which the tax amnesty relates on any amounts relating to returns due after the qualifying period.

A successful applicant will also not be subjected to criminal prosecution in consequence of any offence committed in terms of any Act to which the tax amnesty relates to the extent that relief has been granted to that applicant.

*Exclusion from the tax amnesty relief*

The tax amnesty does not apply in respect of any tax, levy, contribution, interest, penalty or additional tax which—

- had already been paid by the applicant before the submission of the application;
- becomes payable as a result of any return, declaration or information submitted to SARS before the submission of the application; or

- is payable by the applicant in terms of an assessment issued by SARS before the submission of the application;
- relates to value-added tax not paid as a result of a false declaration of the acquisition, import or export of goods or services that did not actually occur.

*Review of Commissioner's decision*

An applicant whose application for tax amnesty is denied by the Commissioner may object and appeal against that decision in terms of the normal dispute resolution procedures of the Income Tax Act, 1962.

*Treatment of deductions and losses going forward*

If tax amnesty is granted to an applicant, that applicant may not—

- for purposes of determining that applicant's liability for income tax after the qualifying period, utilise any assessed loss or assessed capital loss arising during the qualifying period;
- for purposes of calculating that applicant's liability for secondary tax on companies, set off the excess of any dividends which accrued to the applicant during any dividend cycle ending during the qualifying period against any dividends declared by the applicant in any dividend cycle ending after the qualifying period;
- for purposes of calculating that applicant's liability for value-added tax after the qualifying period, claim a deduction of any input tax as defined in section 1 of the Value-Added Tax Act, 1991, or any other deduction as contemplated in section 16(3) of that Act which relates to any supply to that applicant during any tax period ending during the qualifying period.

*Reporting by the Commissioner and Minister*

The Commissioner must provide the following information relating to the tax amnesty process to the Minister of Finance and the Auditor-General—

- the number of applications received and the number of applications approved and rejected;
- the number of new taxpayers registered (per tax type) as a result of the tax amnesty;
- the total amount of all tax amnesty levies payable by all applicants; and
- the number of new taxpayers registered with the Commissioner (per tax type) that are classified as active taxpayers on 31 March 2008 and 31 March 2009, respectively.

This information must be provided in a form which does not disclose the identity of any applicant. The information must be submitted at a time as agreed between the Commissioner and the Minister of Finance and Auditor-General. The Minister of Finance must report to Parliament on the above information

*Regulations*

A person who satisfies the requirements discussed under the heading *"Persons who may apply for tax amnesty"* above, will be prohibited from applying for tax amnesty relief to the extent that any amount of tax, levy, contribution, interest, penalty or additional tax—

- is payable or becomes payable by the applicant in consequence of any information which was furnished to the Commissioner by the applicant or a

representative of the applicant in any return or declaration or otherwise before the submission of the application;

- is payable by the applicant in terms of an assessment issued by the Commissioner before the submission of the application.

In an effort to regularize the tax affairs of small businesses who find themselves in the circumstances described above, the Minister may by regulation prescribe the circumstances upon which the Commissioner may waive in whole or in part any amount of additional tax, penalty or interest payable in respect of any year of assessment, dividend cycle, tax period or month ending during the qualifying period.

The Minister may also make regulations regarding any ancillary or incidental administrative or procedural matter that it is necessary to prescribe for the proper implementation or administration of the tax amnesty provisions contained in Chapter 1.

## REGIONAL SERVICES LEVIES AND REGIONAL ESTABLISHMENT LEVIES

As announced by the Minister of Finance in his 2005 Budget Review, the regional services levies are to be repealed with effect from 1 July 2006. This measure provides significant direct tax relief to business, amounting to R7 billion for 2006/07 and totalling R24 billion over the Medium Term Expenditure Framework period. The administrative burden will be significantly lowered for all businesses and its removal will effectively lower the costs of job creation. The power to levy and claim levies in terms of the Regional Services Council Act, 1985 and the (KwaZulu-Natal) Joint Services Board Act, 1990, vests in district and metropolitan municipalities. This power is assigned to these municipalities in terms of section 93(6) of the Local Government: Municipal Structures Act, 1998. In order to effectively repeal the RSC levies, this section should be repealed thereby withdrawing the power of district and metropolitan municipalities to levy and claim these levies.

The repeal of Section 93(6) is deemed to have come into operation on 1 July 2006.

## AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF THE VALUE-ADDED TAX ACT, 1991

Currently where a local authority (municipality) charges municipal rates, that charge does not form part of the municipality's taxable activities in terms of paragraph (c) of the definition of "enterprise" in section 1 of the VAT Act. Consequently, municipalities may not claim any input tax on expenses incurred in connection with the services provided to the public at large, which are funded out of rates income. For example, the provision of fire services, street lighting, road infrastructure, public amenities such as parks and gardens, and the maintenance of those facilities. A result of the existing dispensation is that it complicates the administration of VAT in a municipality in respect of the apportionment of input tax.

It was therefore announced in the Minister's Budget speech on 15 February 2006 that municipal property rates will be zero-rated for VAT purposes with effect from 1 July 2006. Municipal property rates were always regarded to be in respect of a supply, however, it never formed part of the municipality's taxable supplies, except where a flat rate charge in respect of municipal rates and other services was made by certain municipalities. Section 8(6)*(a)* of the VAT Act, as it read prior to the proposed deletion, deemed the supplies in that case to be subject to VAT at the standard rate. Municipal rates are now brought into the VAT net as a charge for

taxable supplies by the municipality, which fall within paragraph *(a)* of the definition of "enterprise" in section 1 of the VAT Act. The aim of the proposed amendments is primarily to unlock input tax related to non-taxable or "out of scope" supplies which municipalities could not claim prior to 1 July 2006. In addition, the budget proposal sought to simplify the municipality's accounting and tax records.

Section 67 of the VAT Act provides that municipalities may increase their contract price for goods or services which were previously exempt or out of scope for VAT purposes. However, as the municipality will now be able to claim input tax which it previously could not, municipalities might not find it necessary to increase their prices. In some cases, the input tax which previously formed a part of the cost of the supply may put the municipality in a position where prices could be decreased. This is also partly because the services provided by municipalities are in any event generally subsidised with the municipal rates.

In order to achieve these aims, a number of amendments to the VAT Act had to be effected. The proposed amendments intend to bring all the activities of the municipality within the scope of the ordinary test for an "enterprise", except for those activities which are specifically exempt in terms of section 12 of the VAT Act (e.g. bus transport and rental of residential housing).

A Regulation for approval by the Minister in terms of either section 74(1) or (2) of the VAT Act, is proposed to set out the arrangement for the purposes of the general administration of the Act and consequential transitional matters arising for municipalities, as a result of the deletion of paragraph *(c)* of the definition of "enterprise" as defined in section 1 of the Act.

The activities presently listed in Regulation 2570 dated 21 October 1991, such as caravan parks, hiking trails, nurseries, game farms, etc. are presently only taxable if the municipality is able to at least break even on the associated costs of making those supplies. The effect of the proposed amendments for the activities listed in Regulation 2570 is that the activities become taxable at the standard rate, as it falls within the enterprise with effect from 1 July 2006 without having to meet any profitability or breakeven requirement.

The proposal is achieved through the following amendments:

- The deletion of paragraph *(c)* and the deletion of the specific exclusion of a municipality in paragraph *(a)* of the definition of "enterprise" in section 1 of the VAT Act. The list of activities contained in Regulation 2570 dated 21 October 1991 will become obsolete;
- The insertion of a definition for municipal rate;
- The insertion of a new zero-rating provision (section 11(2)*(w)* of the VAT Act) which applies in respect of municipal rate charges; and
- The blocking of all input tax adjustments on assets which were acquired prior to 1 July 2006, which will now be applied in a taxable activity.

### *Definition of a "designated entity"*

A "municipal entity" as defined in section 1 of the Local Government: Municipal Systems Act, 2000, does not fall within the definition of a "municipality" as defined in section 1 of the VAT Act. The proposed amendment includes a municipal entity in the definition of a "designated entity" in section 1 of the VAT Act. Therefore, a municipal entity will be deemed in terms of section 8(5) of the VAT Act to supply services at the standard rate to the municipality or public authority respectively where

that payment is not in respect of an actual supply in terms of section 7(1)*(a)* of the VAT Act.

***Definition of an "enterprise"***

The proposed amendment is to ensure that, as far as possible, all the activities of the municipality (except for those which are exempt under section 12 of the VAT Act) are brought within the ambit of paragraph *(a)* of the definition of "enterprise". Since it is proposed that a municipality's activities be included in paragraph *(a)* of the definition with effect from 1 July 2006, there will no longer be a need for specific enterprise rules for municipalities. It is therefore proposed that paragraph *(c)* of the definition of "enterprise" be deleted.

The proposed amendment will ensure that the municipality levies VAT at the standard rate on all supplies, which are not otherwise zero-rated under section 11 or exempt under section 12 of the VAT Act. The municipality will, in turn, be entitled to claim the input tax incurred in carrying on those taxable activities under the normal rules for claiming input tax. However, there is an exception, in that no input tax adjustment will be allowed in terms of section 18(4) of the VAT Act where the municipality applies goods and services which it acquired on or before 1 July 2006 for taxable supplies on or after that date. It is also proposed that no future adjustments on any change in use of the said goods or services in terms of sections 18(2), (4) and (5) of the VAT Act will be required, as long as those goods or services continue to be used in the municipality's enterprise.

Where a municipality imposes a penalty or fine, e.g. traffic fines, in respect of an unlawful activity, that charge is not taxable, as it is not in respect of any supply of goods or services by the municipality or provincial authority (as the case may be). Fines are generally levied in terms of provincial or national laws, or municipal by-laws, where the administration thereof is assigned to municipalities.

The collection of license fees in terms of the Road Traffic Act will not be in the course or furtherance of the municipality's enterprise, as the actual charging/levying of the license fee is not in respect of the supply of any goods or services made by the municipality, but rather in terms of the authority of the Province (a public authority). However, where the municipality is paid/refunded a certain percentage of the licence fee collected on behalf of the Province, the municipality is liable to account for VAT at the standard rate on that amount, as it is in respect of the collection service which the municipality renders to the Province.

Where the municipality has the authority to levy fees for licenses, permits, or similar charges for access to facilities for its own account, that charge will be taxed at the standard rate of 14%.

Furthermore, where the Minister is satisfied that an activity of a municipal entity is of a regulatory nature and the Commissioner, in pursuance of a decision of the Minister, has notified that "municipal entity" accordingly, the supply of goods or services in respect of that activity by that municipal entity will not be in the course or furtherance of an enterprise, and therefore not subject to VAT.

***The term "local authority" is replaced by the term "municipality"***

The proposed amendment is due to the term "local authority" becoming redundant as various Acts applicable to the local sphere of Government, now refer to "municipalities". The proposed amendments to sections 1 (definitions of "donation",

"grant" and "person"), 8(5), 8(5A), 10(14), 11(2)(n), 11(2)(s), 15(2)*(a)*, 15(2A), 23(3)*(a)*, 23(3)*(b)*, 46*(c)*, 48(1)*(a)*, 48(7) the proviso to 46, 48 and paragraph 5 of Schedule 1, are consequential upon the deletion of the definition of "local authority" and the insertion of the definition of "municipality" in section 1 of the VAT Act.

***Definition of a "municipality"***

A "**municipality"** is defined as being an organ of the State within the local sphere of government, which exercises legislative and executive authority within an area determined in terms of the Local Government: Municipal Demarcation Act, 1998, and which has the power to levy a municipal rate in terms of section 2 of the Local Government: Municipal Property Rates Act, 2004, even if the power might not have been invoked. Therefore, all district municipalities are also included in the definition of municipality as they all have the power to levy rates even though they may not be levying rates because they do not have a district management area in their present municipal area. However, a municipal entity will also not be a "municipality" as defined in section 1 of the VAT Act.

It is important to note that a municipality does not include any public entity listed in the Schedules to the Public Finance Management Act, 1999 ("PFMA"). Therefore, it is clear that an entity which is listed in the PFMA cannot also be a "municipality" as defined in section 1 of the VAT Act.

***Definition of "municipal rate"***

It is proposed to insert a definition for a "**municipal rate**" which means the amount levied in terms of section 2 of the Local Government: Municipal Property Rates Act, 2004 (Act No. 6 of 2004) by a municipality on 'rateable property' as defined in section 1 of that Act. This is to ensure that only the amount of property rates raised by the municipality is subjected to the zero rate and not the other charges for goods or services supplied by the municipality (e.g. water. electricity, entrance fees, sewage, etc).

A municipal rate does, however, not include:—

(a) a flat rate charged by the municipality to an owner of rateable property for rates and other supplies such as, electricity, gas, water, drainage, removal or disposal of sewage or garbage or goods or services that are incidental to or necessary for the supply of such goods or services; or

(b) a rate levied in respect of goods or services as listed in (a) above.

The result will be that in the case where the municipality charges a flat rate as mentioned in (a) or a rate mentioned in (b) respectively, it will be taxable at the standard rate of 14%.

## CHAPTER 1

CLAUSES 1 - 13

***Small Business Tax Amnesty***

See notes under SMALL BUSINESS TAX AMNESTY.

## CHAPTER II

CLAUSE 14

***Transfer duty: Amendment of section 2 of the Transfer Duty Act, 1949***

Transfer duty is levied in terms of section 2 of the Transfer Duty Act on the acquisition of fixed property in South Africa. Currently, the rates for property acquired by natural persons are—

- 0% on the first R190 000 of the value of the property;
- 5% on the value between R190 001 up to R330 000; and
- 8% on the value above 330 000.

Given the substantial increases in property prices over the past few years, the Minister of Finance has proposed that the exempt (zero-rated) threshold for transfer duty be increased to R500 000. It is also proposed that the 8% rate apply in respect of amounts in excess of R1 million. The new graduated rate structure will therefore be as follows:

- 0% on the first R500 000 of the value of the property;
- 5% on the values between R500 001 up to R1 million; and
- 8% on values above R1 million.

The rate for persons other than natural persons is currently 10%. It is proposed that this rate be aligned with the maximum rate for natural persons of 8%.

The new rate structure will apply in respect of acquisitions of property on or after 1 March 2006.

CLAUSE 15

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

The proposed amendment is of a textual nature as the reference to a divisional council has become obsolete.

CLAUSE 16

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

A divorced spouse married out of community of property can not acquire the sole ownership in the whole or any portion of property registered in the name of his or her divorced spouse exempt from transfer duty where that property or portion is transferred to that divorced spouse as a result of the dissolution of their marriage. The proposed amendment will ensure that transfer duty will not be payable on the acquisition of property as a result of the death of a spouse or divorce irrespective of whether the marriage was in or out of community of property.

CLAUSE 17

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

As proposed by the Minister of Finance in his 2006 Budget Review, the estate duty exemption will be increased from R1,5 million to R2,5 million with effect from 1 March 2006. The amendment gives effect to this proposal.

CLAUSE 18

***Fixing of rates of normal tax***

*Income Tax: Rates of normal tax*

Rates of normal tax payable by all persons are enacted by this clause and Schedule 1 to the Bill.

*Persons other than companies*

The rates for persons (other than companies) apply in respect of the year of assessment ending on 28 February 2007 and are provided for in paragraph 1 of Schedule 1. More specifically, the rates for—

- persons (other than companies) and special trusts are provided for in paragraph 1*(a)* of Schedule 1 and consist of a progressive rate structure ranging between 18 per cent on the lowest portion of taxable income (amounts up to R100 000) and 40 per cent which is reached on the portion of taxable income above R400 000; and

- trusts (other than special trusts) are provided for in paragraph 1*(b)* of Schedule 1 and are fixed at a single rate of 40 per cent on all taxable income.

*Companies*

The rates for companies apply in respect of years of assessment, i.e. the financial year of the company concerned, ending during the 12-month period from 1 April 2006 to 31 March 2007, and are provided for in paragraph 2*(a)* to *(h)* inclusive, of Schedule 1.

Those rates are as follows:

*(a)* Taxable income derived otherwise than—
   (i) by a small business corporation or an employment company;
   (ii) from gold mining;
   (iii) from long-term insurance business;
   (iv) by a non-resident through a branch or agency in the Republic; or
   (v) by a qualifying company enjoying tax holiday status:
   29 cents per R1. However, in the case of a company which mines for gold and which is exempt from secondary tax on companies in terms of an option exercised by it, 37 cents per R1 of its non-gold mining taxable income (paragraph 2*(a)* of Schedule 1).

*(b)* Taxable income derived by a company which qualifies as a small business

corporation as defined in section 12E:

(i) 0 cents in respect of taxable income up to R40 000

(ii) 10 cents per R1 of taxable income exceeding R40 000, but up to R300 000, and

(iii) 29 cents per R1 of taxable income exceeding R300 000

(paragraph 2*(b)* of Schedule 1).

*(c)* Taxable income derived by an employment company as defined in section 12E: 34 cents per R1 of taxable income (paragraph 2*(c)* of Schedule 1).

*(d)* Taxable income derived by a company from gold mining: an amount determined in accordance with one of the following formulae—

(i) where such company is not exempt from secondary tax on companies:

$$y = 35 - \frac{175}{x}\text{; or}$$

(ii) where such company is exempt from secondary tax on companies:

$$y = 45 - \frac{225}{x}\text{,}$$

as provided for in paragraph 2*(d)* of Schedule 1.

*(e)* Taxable income in the form of “recoupments” of capital expenditure accruing to companies which are or have been gold mining companies: the average rate of tax, determined as provided, or 29 cents per R1, whichever is the higher (paragraph 2*(e)* of Schedule 1).

*(f)* Taxable income derived from long-term insurance business:

(i) 30 cents per R1 in respect of the insurer’s individual policyholder fund; and

(ii) 29 cents per R1 in respect of the insurer’s company policyholder fund and corporate fund

(paragraph 2*(f)* of Schedule 1).

*(g)* Taxable income (excluding from gold mining, long-term insurance business, or a qualifying project enjoying tax holiday status, or derived by a small business corporation or an employment company) derived by a non-resident which carries on trade through a branch or an agency within the Republic: 34 cents per R1 (paragraph 2*(g)* of Schedule 1).

> ***Example 1:***
>
> *Facts.* Company is incorporated in South Africa but maintains its place of effective management in Foreign Country. Company generates R100 000 of taxable income through a retail sales branch located in South Africa. No treaty for the avoidance of double taxation exists between South Africa and Foreign Country.
>
> *Result.* Even though Company maintains its effective place of management outside South Africa, the 34 per cent rate described in paragraph 2*(g)* does not apply to the R100 000 of taxable income because Company is a South African resident for income tax purposes by virtue of its South African incorporation.
>
> ***Example 2:***
>
> *Facts.* The facts are the same as Example 1, except that South Africa and Foreign Country have entered into a treaty for the avoidance of double taxation. The treaty determines the residence of a company based on the location of that company's place of effective management.
>
> *Result.* Company does not qualify as a South Africa resident for income tax purposes because the treaty views Company as a resident of Foreign Country. The 34 per cent rate described in paragraph 2*(g)* applies to the R100 000 of taxable income because Company is a non-resident for income tax purposes and that income is derived through a South African branch. STC is not payable by the Company as it is not a resident.

*(h)* Taxable income derived by a qualifying company which has been granted tax holiday status in terms of section 37H of the Income Tax Act, 1962: zero cents per R1 (paragraph 2*(h)* of Schedule 1).

For purposes of paragraph 2 of Schedule 1, income derived from mining for gold shall include any income derived from silver, osmiridium, uranium, pyrites or other minerals which may be won in the course of mining for gold, and any other income which results directly from mining for gold.

CLAUSE 19

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

This amendment is consequential upon the amendment of paragraph *(a)* of the definition of "dividend" by the Revenue Laws Second Amendment Act, 2005.

## CLAUSE 20

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

The proposed amendment increases the primary rebate from R6 300 to R7 200. This change means that the tax threshold for individuals under age 65 is increased to R40 000 and for individuals at least 65 years of age is increased to R65 000.

## CLAUSE 21

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

Section 8 of the Income Tax Act determines the taxable portion of an allowance or advance paid by a principal to a recipient. This taxable portion, however, does not include any allowance or advance to the extent that it was actually expended by the recipient on *inter alia* travelling on business. Section 8 contains a deeming provision relating to the distance travelled by a taxpayer to avoid the need to maintain exact details of business travel in the form of a logbook. In terms of this deeming provision the first 16 000 kilometres travelled by a person in a year is deemed to be private travel. The deemed private travel is deducted from the distance travelled in a year (limited to a total of 32 000 kilometres) and the balance is deemed to constitute business travel. The rate per kilometre applied to determine the amount expended on business travel is based on a cost table fixed by the Minister in respect of different categories of vehicles.

The deduction of deemed business expenses against a motor vehicle allowance has increased substantially over the years. As mentioned by the Minister of Finance in his 2005 Budget Review, this generous allowance in the current formula creates an unfair bias in the structuring of salary packages with undue benefits accruing especially to higher income earners. As part of the package of reform in this area, the Minister proposed that the deemed private kilometres be increased from 16 000 to 18 000 and this amendment gives effect to that proposal.

## CLAUSE 22

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

Section 9B of the Income Tax Act provides for the circumstances in which amounts received or accrued from the disposal of listed shares are deemed to be of a capital nature. This section applies in respect of all taxpayers, whether natural persons or companies. Section 9B(8), however, only applies in respect of companies. This section provides that amounts included in the income of a company as a result of the application, disposal or distribution of a share in a manner contemplated in section 22(8)*(b)* (for example as a result of a donation of a share), must be deemed to be an amount which accrued to the company as a result of the disposal of the share. There is no rationale for this provision applying only in respect of companies and it is proposed that it be extended to also apply in respect of natural persons and other entities.

## CLAUSE 23

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

*Subclauses (a), (b) and (c):* The interest and dividend exemption is currently fixed at R15 000 for taxpayers under 65 years of age and R22 000 for taxpayers aged 65 years and older. The Minister of Finance proposed in his Budget Review this year that the interest and dividend income exemption be raised with effect from 1 March 2006 to R16 500 for taxpayers under the age of 65 and to R24 500 for taxpayers age 65 and over. Currently, up to R2 000 of this exemption may be applied to interest and dividends from foreign sources and the balance applies in respect of domestic interest. The Minister further proposed that this amount be increased to R2 500.

*Subclauses (d) and (e):* Any amount received by or accrued to or in favour of any person from the State in terms of the Regional Industrial Development Programme which came into operation on 1 May 1991, or by way of a grant in terms of the Simplified Regional Industrial Development Programme, which came into operation on 1 October 1996, shall be exempt from normal tax. These old manufacturing support schemes were replaced by the Department of Trade and Industry with a range of new programs announced by the Department of Trade and Industry in September 2000 and references to those obsolete programmes are deleted.

## CLAUSE 24

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

Currently, small business corporations enjoy certain tax benefits, i.e. a beneficial rate structure, an immediate 100 per cent write off in respect of manufacturing assets and an accelerated write off in respect of other assets. A small business corporation is defined in section 12E of the Income Tax Act, 1962, and one of the criteria is that the gross income for the relevant year of assessment does not exceed R6 million.

The Minister of Finance proposed in the 2006 Budget Review that the turnover limit for small business corporations will be increased from R6 million to R14 million. The amendment gives effect to this proposal.

## CLAUSE 25

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

Government introduced the learnership tax allowance in 2002 to encourage on the job training and to enhance skills development in the Republic. This allowance, which is set to expire in October 2006, has boosted the number of learnerships. The Minister of Finance proposed in the 2006 Budget Review that the learnership allowance be extended to October 2011, in line with the extension of the national Skills Development Strategy to 2010. Furthermore, the Minister proposed that the maximum allowance upon the entering into a learnership be increased from R17 500 to R20 000 for existing employees and from R25 000 to R30 000 for new employees. Similarly, it was proposed that the maximum allowance upon completion of all learnerships be increased from R25 000 to R30 000.

The Minister further proposed that, given the additional expenses associated with employing disabled persons as learners, a more favourable learnership tax

allowance be introduced with effect from 1 July 2006 in respect of disabled learners. In terms of the proposed amendments, an employer will be allowed to deduct an initial allowance of 150 per cent of the annual salary of an existing learner employee with a disability (up to a maximum of R40 000) and 175 per cent for an unemployed learner with a disability (up to a maximum of R50 000). The allowance for disabled persons completing a learnership will be 175 per cent of the employee's annual salary (up to a maximum of R50 000).

CLAUSE 26

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

*Subclause (a)*: Section 24I of the Income Tax Act was amended by the Revenue Laws Amendment Act, 2005, to *inter alia* align the translation of exchange items at the end of the tax year with Generally Accepted Accounting Practice. With this amendment the translation rule relating to a forward exchange contract which is an affected contract was erroneously omitted and it is, therefore, proposed that it be reinserted with effect from the date of the 2005 amendment.

*Subclauses (b) and (c):* Section 24I of the Income Tax Act was amended by the Revenue Laws Amendment Act, 2005, to *inter alia* extend the relief measures contained in section 24I(10) to also include foreign currency loans and advances between connected persons which were previously dealt with under the discontinued provisions of section 24I(7A). With this amendment to subsection (10), the proviso thereto was erroneously omitted and it is, therefore, proposed that it be reinserted with effect from the date of the 2005 amendment. A consequential amendment is proposed to section 24I(7A).

CLAUSE 27

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

As was proposed by the Minister of Finance in the 2006 Budget Review that the annual donations tax exemption will be increased from R30 000 to R50 000 with effect from 1 March 2006. This amendment gives effect to this proposal.

CLAUSE 28

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

As mentioned by the Minister of Finance in the 2005 and 2006 Budget Reviews, the provisions relating to the motor vehicle allowances are amended as the generous allowance in the formula created an unfair bias in the structuring of salary packages with undue benefits accruing especially to higher income earners. Although the proposed amendments to section 8 of the Income Tax Act address these concerns, the full amount of tax payable on the non-business related portion of the travel allowance only becomes payable on assessment. To ensure that the correct amount of income tax is collected through the PAYE system during the year, it is proposed that the percentage of the monthly motor vehicle allowance which should be subject to PAYE be increased from 50% to 60%. The amendments give effect to this proposal.

CLAUSE 29

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

Employees who receive free or discounted residential accommodation are subject to fringe benefit taxation. This form of fringe benefit taxation is based on a formula which is partly based on prior year salary less R20 000. As proposed by the Minister of Finance in his 2006 Budget Review, the amount of R20 000 will be doubled to R40 000 and the amendment gives effect to this proposal.

CLAUSE 30

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

Cross-border travel benefits up to R500 for transport business employees are not subject to fringe benefit taxation. As proposed by the Minister of Finance in his 2006 Budget Review, the R500 monetary cap rule will be deleted as obsolete. The amendment gives effect to this proposal.

CLAUSE 31

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

No value will be placed on any taxable benefit resulting form the provision of medical treatment listed in any category of the prescribed minimum benefits determined by the Minister of Health, which is provided to the employee (or his or her spouse or children) in terms of a scheme or programme of that employer which does not constitute the carrying on of the business of a medical scheme, who are beneficiaries of a medical scheme registered under the provisions of the Medical Schemes Act, 1998, if the total cost of any treatment provided in terms of that programme is recovered from that medical scheme.

CLAUSE 32

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

In terms of paragraph 5 of the Eighth Schedule, a natural person has an annual exclusion of R10 000 in respect of capital gains or capital losses during a year of assessment. This effectively means that after setting off all capital gains and losses for the year, any balance remaining (whether a gain or loss) which is less than R10 000 is disregarded. This annual exclusion increases to R50 000 in the year that a person dies.

The Minister of Finance proposed in the 2006 Budget Review that the annual exclusion will increase from R10 000 to R12 500 and in the year of death of a

taxpayer increase from R50 000 to R60 000. The amendments give effect to this proposal.

CLAUSE 33

***Income Tax: Amendment of paragraph 45 of the Eighth Schedule to the Income Tax Act, 1962***

Paragraph 45 of the Eighth Schedule to the Income Tax Act provides for an exclusion of the first R1 million capital gain or loss realised from the disposal of a primary residence of the taxpayer. The Minister of Finance proposed in the 2006 Budget Review that this exclusion will be increased to R1,5 million with effect from 1 March 2006. The amendment gives effect to this proposal.

CLAUSE 34

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

Paragraph 57 of the Eighth Schedule to the Income Tax Act provides for the exclusion of the first R500 000 of any capital gain realised from the disposal of an asset of or interest in a small business in certain circumstances. The Minister of Finance announced in his Budget Review this year that this amount will be increased to R750 000. This amendment gives effect to that proposal.

CLAUSE 35

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

In 2005 anti-avoidance measures were introduced in order to prevent multinationals from utilising the participation exemption for capital gains with little or no consideration remaining within the South African jurisdiction. The measures cover situations where the consideration on disposal of foreign shares is distributed *in specie*. However, a distribution of cash would not trigger the anti-avoidance rules. It is proposed that subparagraph (3) be amended in order to cover the distribution of all forms of consideration under the anti-avoidance rule. Furthermore, it is proposed that subparagraph (4) be amended to ensure that the company to which distributions were made, which qualified for the STC exemption contained in section 64B(5)*(f)* or the participation exemption in section 10(1)*(k)*(ii)*(dd)* of the Income Tax Act, also be subject to the anti-avoidance rules on the disposal of the distribution received.

CLAUSE 36

***Customs and Excise: Amendment of Schedule No. 1 to the Customs and Excise Act, 1964***

This clause provides for the amendment of Schedule No. 1 to the Customs and Excise Act. These amendments are reflected in Schedule 2 to this Bill. These amendments give effect to the taxation proposals which were tabled by the Minister

of Finance during his Budget Speech this year and contain the rates of duty in respect of alcoholic and tobacco products.

## CLAUSE 37

***Customs and Excise: Continuation of certain amendments of Schedules Nos. 1 to 6 and 10 to the Customs and Excise Act, 1964***

This clause provides for the continuation of the amendments to the Schedules to the Customs and Excise Act, which were effected by the Minister of Finance during the 2005 calendar year, and amendments published on 31 March 2006.

## CLAUSE 38

***Stamp Duties: Amendment of item 14 of Schedule 1 to the Stamp Duties Act, 1968***

Currently item 14 of Schedule 1 to the Stamp Duties Act provides that stamp duty is not payable if the duty calculated on a lease or agreement of lease does not in aggregate exceed R200 over the period of the lease. In order to reduce the compliance burden for taxpayers entering into lower-value rental agreements and the administrative burden on SARS, the Minister of Finance proposed in the 2006 Budget Review that this exemption level will be increased to R500. The amendment gives effect to this proposal. The amendments are deemed to have come into operation on 1 March 2006 and apply in respect of any lease agreement executed on or after that date.

## CLAUSE 39

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

Currently participatory interests in a collective investment scheme which is a trust are not subject to Stamp Duty. The proposed amendment aligns the treatment of collective investment schemes which are Open Ended Investment Companies with that of the Uncertificated Securities Tax Act, 1998. See the proposed amendment to section 6 of the Uncertificated Securities Tax Act.

The proposed amendments will result in participatory interests in all Collective Investment Schemes (Unit Trusts and Open Ended Investment Companies) being exempt from stamp duty. The amendments are deemed to have come into operation on 1 July 2006 and apply where such marketable security was transferred or acquired on or after that date.

## CLAUSE 40

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

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.

## CLAUSE 41

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

The proposed amendment is to clarify that it was always intended that the granting of an option falls within the ambit of a financial service, which is exempt from VAT in terms of section 12*(a)*.

## CLAUSE 42

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

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.

It is proposed that section 8(6)*(a)* and *(b)* be deleted due to paragraph *(c)* of the definition of "enterprise" in section 1 of the VAT Act being deleted and municipal rates being drawn into the VAT net. The result is that where a single charge, i.e. a flat rate (e.g. for municipal rates, electricity, water, etc) is levied by the municipality, the full amount charged will be subject to VAT at the standard rate of 14%. The proposed addition of the proviso to section 8(15) is intended to clarify that the single charge levied by the municipality cannot be apportioned between standard and zero rate supplies. These amendments are deemed to have come into operation on 1 July 2006.

The proposed amendment to section 8(23) is consequential upon the deletion of paragraph *(c)* of the definition of "enterprise" in section 1. This amendment is deemed to have come into operation on 1 July 2006.

## CLAUSE 43

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

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
*Subclause* (1)*(a):* The proposed amendment is consequential upon the deletion of the definition of "local authority" and the introduction of the definition of "municipality" in section 1.
*Subclause* (1)*(b):* The proposed amendment is consequential upon the deletion of section 8(6)*(a)* and *(b)* of the VAT Act.

The amendments are deemed to have come into operation on 1 July 2006.

CLAUSE 44

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

*Subclause* (1)*(a):* In his 2002 Budget Review the Minister of Finance announced the Government's policy framework as regards environmentally friendly fuels.

The Minister announced that biofuels would—
- Enjoy a tax concession in respect of the general fuel levy;
- Enjoy the same concessions (i.e. rebates and drawbacks) as other fuels when used for certain purposes specified in any item to Schedule No. 4,5 and 6 to the Customs and Excise Act, 1964;
- Attract the same rate of excise duty applicable to other fuels;
- Be subject to the Road Accident Fund (RAF) levy if used in vehicles operated on public roads.

The proposed amendment aligns the VAT Act to the provisions of the Customs and Excise Act, 1964, in respect of the references used for certain fuel levy goods. The proposed amendment is also due to the supply of leaded petrol no longer being permitted as from 1 January 2006. The supply of certain fuel levy goods, which now also includes biodiesel, will be subject to VAT Act at the zero rate. The proposed amendment is deemed to have come into operation on 1 April 2006.

*Subclause* (1)*(b):* Goods which consist of anti-knock preparations, which are based on lead compounds, are currently zero-rated for VAT purposes. However, the proposed amendment to delete the zero-rating of these goods is due to the supply of leaded petrol no longer being permitted as from 1 January 2006. Also see subclause (1)*(a)*. The proposed amendment is deemed to have come into operation on 1 April 2006.

*Subclause* (1)*(c):* The proposed amendments aligns the VAT Act to the provisions of the Customs and Excise Act, 1964, in respect of illuminating kerosene. The proposed amendment is deemed to have come into operation on 1 April 2006.

*Subclause* (1)*(d)*, *(e)* and *(g):* See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
The proposed amendment zero rates the municipal rate that is levied by the municipality.
The proposed amendments are deemed to have come into operation on 1 July 2006.

*Subclause* (1)*(f)*: The proposed amendment is of a textual nature.

CLAUSE 45

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

*Subclause* (1)*(a):* See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
The proposed amendment is due to the deletion of paragraph *(c)* of the definition of "enterprise" in section 1 of the VAT Act. The proposed amendment will result in a hostel or boarding establishment which was operated at a loss by a "municipality" now being taxable at the standard rate, for VAT purposes as "commercial accommodation" as defined in section 1 of the VAT Act.

The proposed amendment is deemed to have come into operation on 1 July 2006.

*Subclause* (1)*(b):* The proposed amendment refers to the appropriate reference in the Income Tax Act.

CLAUSE 46

***Value-Added Tax: Amendment of section 15 of the Value-Added Tax Act, 1991***

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
The proposed amendments are due to the term “local authority” being replaced by “municipality”. Only a “municipality” as defined in section 1 of the VAT Act is allowed to account for VAT on the payments basis. All other persons (e.g. municipal entities, etc.) who previously fell within the definition of a “local authority”, but do not now fall within the definition of a “municipality” will be required to change to the invoice basis.
The proposed amendments are deemed to have come into operation on 1 July 2006.

CLAUSE 47

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

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
The proposed amendment ensures that the municipality does not claim input tax in respect of assets on which an adjustment in terms of section 18(4) of the VAT Act was blocked in terms of proviso (v) to that section. Therefore where a municipality supplies any assets to which the proviso (v) to section 18(4) of the VAT Act applies, the municipality will be liable to account for output tax on that supply, but will not be entitled to claim input tax in terms of section 16(3)*(h)* of the VAT Act. The same rule applies where a complete change in use of those goods or services occurs on or after 1 July 2006 in terms of section 18(1) of the VAT Act (from taxable to exempt purposes). The proposed amendment is deemed to have come into operation on 1 July 2006 and applies to goods and services acquired by a municipality before 1 July 2006.

CLAUSE 48

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

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
The proposed amendment is due to the term “local authority” being replaced by “municipality”. It is therefore proposed that the reference to section 8(6)*(a)* of the VAT Act be deleted. This provision allows a municipality to claim the input tax on goods or services that are acquired for the purposes of providing sporting or recreational facilities or public amenities to the public.
The proposed amendment is deemed to have come into operation on 1 July 2006.

## CLAUSE 49

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

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
Sections 18(2) and 18(5) of the VAT Act provide that a municipality is required to make an annual input tax or output tax adjustment in the case of capital goods or services used only partially for taxable supplies. The provisions are aimed at ensuring that where capital goods and services are used for mixed purposes, the input tax which may be claimed must be in proportion to the extent to which those assets are applied for taxable use in the municipality's enterprise over the lifetime of the assets. The adjustments are required where the input tax apportionment percentage applied by the municipality during the year varies by more than 10% from the percentage applied in the previous year.

The proposed amendments provide that the adjustments under sections 18(2) and 18(5) of the VAT Act will not apply in the case of a municipality where:

- the capital goods or services were acquired prior to 1 July 2006; or
- the capital assets were acquired after 1 July 2006, but input tax thereon was denied under proviso (v) to section 18(4) of the VAT Act.

Furthermore, proviso (v) to section 18(4) of the VAT Act was inserted to deny input tax where a municipality is required to return those same assets to a taxable environment in the future. The reasoning behind this is that the municipality would have previously enjoyed the benefit of an input tax credit on those assets (or the equivalent thereof, as the VAT cost would have been taken into account in the budget appropriation to that municipality), and therefore a further input tax credit would not be allowed on those assets if they are subsequently applied for taxable use.

The effect of the proposed amendment is therefore to treat the capital goods and services used partially for taxable supplies after 1 July 2006 in such a way that the annual variation in the extent of taxable use will not create an output tax or input tax adjustment event in respect of the assets mentioned above. An output tax liability will only arise when the asset is eventually sold, donated, exchanged (which also includes a transfer to an exempt division in terms of section 18(1) of the VAT Act, e.g. public transport division). The proposed amendments are deemed to have come into operation on 1 July 2006.

## CLAUSE 50

***Value-Added Tax: Amendment of section 27 of the Value-Added Tax Act, 1991***

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
In light of government's efforts to ease small businesses' administrative burden, it is proposed to increase the annual turnover limited to qualify as a small scale farmer falling within Category D or a small vendor falling within Category F from R1 million to R1,2 million. The proposed amendment is deemed to have come into operation on 1 July 2006 and applies in respect of any tax period commencing on or after that date.

CLAUSE 51

***Value-Added Tax: Insertion of section 40B in the Value-Added Tax Act, 1991***

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.
As a result of uncertainty in the past as to what constitutes a “transfer payment”, some municipalities applied the zero rate of tax to the deemed supply which arose in terms of section 8(5) of the VAT Act upon receipt of certain payments. For example, where a municipality received an “equitable share” payment under the annual Division of Revenue Act, the payment gives rise to a deemed supply under section 8(5) of the VAT Act, which does not qualify for zero-rating in terms of section 11(2)*(p)* of the VAT Act as it read on 31 March 2005. As the municipality does not make an actual supply of goods or services in terms of section 7(1)*(a)* of the VAT Act in return for that payment, it is proposed that the VAT assessed on such payments qualifies to be reduced under this provision. In some of these cases, the incorrect application of the law has been corrected by the Commissioner by the issuing of assessments and the amounts due on these assessments are wholly or partly outstanding. If the tax due is to be paid by the Department which made the incorrectly treated “transfer payment” to the municipality, additional funds would have to be made available to the municipality to pay the tax, which would result in a circular flow of funds in the Government sphere.

In order to address this situation, section 40B of the VAT Act proposes that upon written application, the Commissioner must issue a reduced assessment in respect of certain amounts of tax, additional tax, penalty and interest which have been assessed and which are payable by a municipality. The reduced assessment only applies where, and to the extent that, the amount payable arose as a result of the incorrect application of the zero-rate in terms of sections 8(5) and 11(2)*(p)* of the VAT Act on an actual supply of goods or services made on or before 31 March 2005, and the amount is still outstanding on that date. This is where the municipality failed to charge VAT at the standard rate in terms of section 7(1)*(a)* of the VAT Act because it assumed that the payment in respect of those supplies qualified as a “transfer payment” as defined in section 1.

The amount of the reduced assessment may not exceed the net balance of VAT which remains payable on 31 March 2005 by the municipality so that where any amount due to that municipality arose in any tax period subsequent to the tax period in which the assessment was raised and has been set off against the outstanding debt, or if any part of that amount has otherwise been recovered by SARS, that amount will not be taken into account. The reduced assessment may therefore not give rise to a refund of any tax, additional tax, penalty or interest paid in respect of the outstanding amount for any period prior to 1 April 2005.

In order to prevent the Commissioner from issuing assessments where no assessments have been raised before 1 April 2005 on the municipality, in regard to the incorrect application of the zero rate in terms of sections 8(5) and 11(2)*(p)* of the VAT Act for the period prior to 1 April 2005, it is proposed that the Commissioner may not raise any assessment to recover those amounts.

On the other hand, to prevent the claiming of refunds where the municipality has incorrectly paid output tax in terms of section 7(1)*(a)* of the VAT Act at the standard rate instead of the zero rate in terms of sections 8(5) and 11(2)*(p)* of the VAT Act on a “transfer payment”, it is proposed that the Commissioner may not refund any

amount of tax, penalty or interest incorrectly paid in respect of any period prior to 1 April 2005.
The proposed amendment is deemed to have come into operation on 1 July 2006.

***Example 1***

A municipality (vendor) supplies management services to the Department of Tourism. VAT should have been charged at 14% in respect of the actual services supplied in terms of section 7(1)*(a)* of the VAT Act, but both parties were under the mistaken impression that the payment received by the municipality was a zero-rated "transfer payment." SARS raised an assessment against the municipality in the amount of R50 000 in March 2003. Since that date, SARS has recovered R35 000 of that amount by offsetting VAT refunds which were due to that municipality. The municipality still has a VAT liability of R15 000 plus penalty and interest thereon as at 31 March 2005. In terms of section 40B(2) of the VAT Act, the remaining tax liability of R15 000, plus the penalty and interest thereon must be reduced to nil by the issuing of a reduced assessment by the Commissioner, if written application is made by the municipality in this regard. This is because the entire tax liability relates to the incorrect application of the law referred to in that section.

***Example 2***

If in the case of the municipality in example 1, SARS had not raised an assessment, in respect of the VAT payable on the consideration paid for the management services supplied, which should have been levied, in terms of section 7(1)*(a)* of the VAT Act, by 31 March 2005, the Commissioner may not make any assessment to correct the previously incorrect application of the zero rate (section 40B(3) of the VAT Act).

CLAUSE 52

***Value-Added Tax: Amendment of paragraph 5 of Schedule 1 to the Value-Added Tax Act, 1991***

See notes under AMENDMENTS RELATING TO MUNICIPALITIES FOR PURPOSES OF VALUE-ADDED TAX.

CLAUSE 53

***Value-Added Tax: Amendment of paragraph 7 of Schedule 1 to the Value-Added Tax Act, 1991***

*Subclause* (1)*(a):* See discussion on clause 54(1)*(a)* above.
The proposed amendment to paragraph 7 of Schedule 1 to the Value-Added Tax Act, 1991, aligns the Value-Added Tax Act with the provisions of the Customs and Excise Act in respect of the importation of fuel levy goods which now also includes biodiesel, and which are exempt from VAT on importation. The proposed amendment is deemed to have come into operation on 1 April 2006.

*Subclause* (1)*(b):* Goods which consist of anti-knock preparations, which are based on lead compounds, are currently zero-rated for VAT purposes. However, the proposed amendment to delete the zero-rating of these goods is due to the supply of leaded petrol no longer being permitted as from 1 January 2006. Also see subclause 54(1)*(a)*. The proposed amendment is deemed to have come into operation on 1 April 2006.

*Subclause* (1)*(c):* The proposed amendment aligns the VAT Act to the provisions of the Customs and Excise Act, 1964, where applicable in respect of goods consisting of illuminating kerosene.

## CLAUSE 54

***Tax on Retirement Funds: Amendment of section 2 of the Tax on Retirement Funds Act, 1996***

As the Minister of Finance announced in the 2006 Budget Review, changes to the taxation of retirement funds are under consideration and a discussion document will be released for public comment. However, to help South Africans accumulate adequate savings for retirement, the Minister proposed that the rate of tax on retirement funds will be reduced from 18 per cent to 9 per cent with effect from 1 March 2006. The amendment gives effect to this proposal.

## CLAUSE 55

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

The proposed amendment is to clarify that a change in the beneficial ownership of a security occurs when a company acquires or redeems its own securities.

## CLAUSE 56

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

The proposed amendments to section 5 and 5A of the Uncertificated Securities Tax Act (UST) are in recognition of the fact that dividends and rights are on occasion ceded separately from the ownership of the full security.

The taxable amount on which UST is payable in respect of every change in beneficial ownership where the full beneficial ownership in a security acquired will be the greater of—

- the amount declared by the person acquiring such security; or
- if no amount is so declared, or if the amount so declared is less than the lowest price of the securities on the date of the relevant transaction, the closing price of those securities on the date of the relevant transaction.

Where any of the rights or entitlements in the beneficial ownership of a security is acquired, the amount on which UST will be payable by the person who acquires those rights or entitlements, will be the greater of—

- the amount of the consideration declared by the person who acquires those rights or entitlements; or
- the fair market value of those rights or entitlements on the date of acquisition thereof.

The proposed amendments will apply to every change in beneficial ownership in any security effected by a participant on or after 1 July 2006 and for other transactions not effected by a member, on or after 1 January 2006.

CLAUSE 57

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

See the notes to clause 66 above.

CLAUSE 58

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

The proposed amendment is to exempt changes in beneficial ownership in participatory interest in all listed collective investment schemes regulated in terms of the Collective Investment Schemes Control Act, 2002; which potentially faces double tax of Uncertificated Securities Tax/Transfer Duty. The first level of tax being at the collective investment scheme level and the other at the level of the holders of participatory interests (unit holders). This potential double charge is inconsistent with the treatment of unlisted collective investment schemes, which are not companies, which are subject to only one level of tax at the collective investment scheme level.

This result should be that participatory interests in all Collective Investment Schemes (Unit Trusts and Open Ended Investment Companies) will be exempt from Uncertificated Securities Tax. This exemption will apply to collective investment schemes in securities, property, participation bonds or declared schemes. The proposed amendment is deemed to have come into operation on 1 July 2006 and applies in respect of any change in beneficial ownership in any security on or after that date.

CLAUSE 59

***Regional Services Levies: Amendment of section 93 of the Local Government: Municipal Structures Act, 1998***

See notes on REGIONAL SERVICES LEVIES AND REGIONAL ESTABLISHMENT LEVIES**.**

CLAUSE 60

***Income Tax: Amendment of Schedule 1 to the Taxation Laws Amendment Act, 2005***

To rectify an unintended error in the tax formulae (as contained in paragraph 2*(d)* of Schedule 1) to be applied to the taxable income of a gold mining company for the purposes of determining that company's rate of normal tax.

CLAUSE 61

***Transitional mineral and petroleum provisions***

South Africa's investment regime for oil and gas exploration/production is currently governed by the OP 26 lease and subleases. These leases and subleases contain tax incentives that override the Income Tax Act, including a tax stabilisation regime that freezes the Income Tax as of 1977. This regime seeks to encourage long-term investment into 'high risk" exploration.

The OP26 leases expire on 30 June 2007 (with the subleases expiring on or before that date). However, the Petroleum Agency lacks the power to extend these leases or to provide the same tax incentives in terms of exploration/production rights granted pursuant to the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) ("MPRDA"). As a result, holders of OP 26 leases or subleases currently lose the benefit of their tax incentives when converting into exploration/production rights granted pursuant to the MPRDA. Wholly new entrants into the MPRDA similarly cannot receive the benefit of tax incentives. This overall lack of tax incentives act as a disincentive for conversion from OP 26 leases and subleases (as well as detracting from wholly new exploration/production).

In order to remedy this situation, Schedule 3 carries over the OP 26 tax incentives into the exploration/production rights granted pursuant to the MPRDA. Holders of pre-existing mineral rights in terms of OP26 will now be able to retain the OP 26 tax incentives when converting those rights into exploration or production rights of the MPRDA. Wholly new entrants into South African oil and gas exploration/production will similarly receive the tax terms of the standard OP26 sublease system when obtaining exploration/production rights of the MPRDA.

The 2006 Budget Review envisages a whole new tax legislative regime for oil and gas by the close of the year. This new regime will renew key aspects of OP 26 tax terms with greater clarity and enhanced transparency. Hence, this schedule is transitional in nature, acting merely as a stop-gap until the new tax legislative regime for oil in gas is in place. This Schedule will accordingly remain in effect until the earlier of 1 May 2009 or a date to be prescribed by legislation.

CLAUSE 62

***Short title, commencement and savings***

This clause provides the short title and commencement date of the Bill.