REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

TAXATION LAWS AMENDMENT BILL, 2009

(SUBMITTED TO THE STANDING COMMITTEE ON FINANCE
10 SEPTEMBER 2009)

[W.P. –- '09]

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1. 1 INCOME TAX: RATES AND THRESHOLDS (Appendix I)

Table I: Current rates for individuals and special trusts:

Taxable Income	Rate of Tax
Not exceeding R122 000	18 per cent of taxable income
Exceeding R122 000 but not exceeding R195 000	R21 960 plus 25 per cent of the amount by which the taxable income exceeds R122 000
Exceeding R195 000 but not exceeding R270 000	R40 210 plus 30 per cent of the amount by which the taxable income exceeds R195 000
Exceeding R270 000 but not exceeding R380 000	R62 710 plus 35 per cent of the amount by which the taxable income exceeds R270 000
Exceeding R380 000 but not exceeding R490 000	R101 210 plus 38 per cent of the amount by which the taxable income exceeds R380 000
Exceeds R490 000	R143 010 plus 40 per cent of the amount by which the taxable income exceeds R490 000

Table II: Proposed rates for individuals and special trusts:

Taxable income	Rate of tax
Not exceeding R132 000	18 per cent of the taxable income
Exceeding R132 000 but not exceeding R210 000	R23 760 plus 25 per cent of amount by which taxable income exceeds R132 000
Exceeding R210 000 but not exceeding R290 000	R43 260 plus 30 per cent of amount by which taxable income exceeds R210 000
Exceeding R290 000 but not exceeding R410 000	R67 260 plus 35 per cent of amount by which taxable income exceeds R290 000
Exceeding R410 000 but not exceeding R525 000	R109 260 plus 38 per cent of amount by which taxable income exceeds R410 000
Exceeds R525 000	R152 960 plus 40 per cent of amount by which taxable income exceeds R525 000

Table III: Current rate for trusts (no change proposed):

Taxable Income	Rate of Tax
All taxable income	40 per cent of the taxable income

Table IV: Current rate for companies (no change proposed):

Taxable Income	Rate of Tax
All taxable income	28 per cent of the taxable income

Table V: Current rates for small business corporations:

Taxable Income	Rate of Tax

Not exceeding R46 000	0 per cent of taxable income
Exceeding R46 000 but not exceeding R300 000	10 per cent of the amount by which the taxable income exceeds R46 000
Exceeding R300 000	R25 400 plus 28 per cent of the amount by which the taxable income exceeds R300 000

Table VI: Proposed rates for small business corporations:

Taxable Income	Rate of Tax
Not exceeding R54 200	0 per cent of taxable income
Exceeding R54 200 but not exceeding R300 000	10 per cent of the amount by which the taxable income exceeds R54 200
Exceeding R300 000	R24 580 plus 28 per cent of the amount by which the taxable income exceeds R300 000

Table VII: Current rates for registered micro businesses (no change proposed):

Taxable turnover	Rate of tax
Not exceeding R100 000	0 per cent of taxable turnover
Exceeding R100 000 but not exceeding R300 000	R1 per cent of amount by which taxable turnover exceeds R100 000
Exceeding R300 000 but not exceeding R500 000	R2 000 plus 3 per cent of amount by which taxable turnover exceeds R300 000
Exceeding R500 000 but not exceeding R750 000	R8 000 plus 5 per cent of amount by which taxable turnover exceeds R500 000
Exceeds R750 000	R20 500 plus 7 per cent of amount by which taxable turnover exceeds R750 000

Table VIII: Current rates for gold mining companies (no change proposed):

Taxable Income	Rate of Tax
On gold mining taxable income	See formula in paragraph 4*(b)* of Appendix I
On non gold mining taxable income	28 per cent of the taxable income
On non gold mining taxable income if exempt from STC	35 per cent of the taxable income
On recovery of capital expenditure	Greater of average rate or 28 per cent of the taxable income

Table IX: Current rate for PBO company and trusts (no change proposed):

Taxable Income	Rate of Tax
All taxable income	28 per cent of the taxable income

Table X: Current rate for employment companies (no change proposed)

Taxable Income	Rate of Tax
All taxable income	33 per cent of taxable income

Table XI: Rate for company personal service providers

Taxable Income	Rate of Tax
All taxable income	33 per cent of taxable income

Table XII: Current rates for long-term insurance companies (no change proposed)

Taxable Income	Rate of Tax
Taxable income of individual policyholder fund	30 per cent of taxable income
Taxable income of company policyholder fund	28 per cent of taxable income
Taxable income of corporate fund	28 per cent of taxable income

Table XIII: Current rate for non-resident companies (no change proposed):

Taxable Income	Rate of Tax
All taxable income from South African source	33 per cent of taxable income

Table XIV: Proposed rates for retirement lump sum withdrawal benefits

Taxable income from benefits	Rate of tax
Not exceeding R22 500	0 per cent of taxable income
Exceeding R22 500 but not exceeding R600 000	18 per cent of taxable income exceeding R22 500
Exceeding R600 000 but not exceeding R900 000	R103 950 plus 27 per cent of taxable income exceeding R600 000
Exceeding R900 000	R184 950 plus 36 per cent of taxable income exceeding R900 000

Table XV: Proposed rates for retirement lump sum benefits

Taxable income from benefits	Rate of tax
Not exceeding R300 000	0 per cent of taxable income
Exceeding R300 000 but not exceeding R600 000	R0 plus 18 per cent of taxable income exceeding R300 000
Exceeding R600 000 but not exceeding R900 000	R54 000 plus 27 per cent of taxable income exceeding R600 000
Exceeding R900 000	R135 000 plus 36 per cent of taxable income exceeding R900 000

Table XVI: Current rebates

Description	Amount
Primary rebate	R8 280
Secondary rebate	R5 040

Table XVII: Proposed rebates

Description	Amount
Primary rebate	R9 756
Secondary rebate	R5 400

Income Tax: Monetary thresholds subject to periodic legislative change:

Table XVIII: General savings thresholds

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Broad-based employee share schemes		
Maximum exemption for shares received by an employee in terms of a broad-based employee share plan	Definition of "qualifying equity share" in section 8B(3)	R50 000
Maximum deduction for shares issued by an employer in terms of a broad-based employee share plan	The proviso to section 11(IA)	R10 000
Exemption for interest and certain dividends		
Exemption for foreign dividends and interest from a source outside the Republic which are not otherwise exempt	Section 10(1)*(i)*(xv)*(aa)*	R3 500
In respect of persons 65 years or older, exemption for interest from a source within the Republic which are not otherwise exempt	Section 10(1)*(i)*(xv)*(bb)*(A)	R30 000
In respect of persons younger than 65 years, exemption for interest from a source within the Republic which are not otherwise exempt	Section 10(1)*(i)*(xv)*(bb)*(B)	R21 000
Annual donations tax exemption		
Exemption for donations made by entities	Section 56(2)*(a)* and the proviso thereto	R10 000
Exemption for donations made by individuals	Section 56(2)*(b)*	R100 000
Capital gains exclusions		
Annual exclusion for individuals and special trusts	Paragraph 5(1) of Eighth Schedule	R17 500
Exclusion on death	Paragraph 5(2) of Eighth Schedule	R120 000
Exclusion in respect of disposal of primary residence (based on amount of capital gain or loss on disposal)	Paragraph 45(1)*(a)* of Eighth Schedule	R1,5 million
Exclusion in respect of disposal of primary residence	Paragraph 45(1)*(b)* of Eighth	R2 million

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
(based on amount of proceeds on disposal)	Schedule	
Maximum market value of all assets allowed within definition of small business on disposal when person over 55	Definition of “small business” in paragraph 57(1) of Eighth Schedule	R5 million
Exclusion amount on disposal of small business when person over 55	Paragraph 57(3) of Eighth Schedule	R750 000

Table XIX: Retirement savings thresholds

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Deductible retirement fund contributions		
Pension fund monetary ceiling for contributions	Proviso to section 11*(k)*(i)	R1 750
Pension fund monetary ceiling for arrear contributions	Paragraph *(aa)* of proviso to section 11*(k)*(ii)	R1 800
Retirement annuity fund monetary ceiling for contributions (if also a member of a pension fund)	Section 11*(n)(aa)*(B)	R3 500
Retirement annuity fund monetary ceiling for contributions (if not a member of a pension fund)	Section 11*(n)(aa)*(C)	R1 750
Retirement annuity fund monetary ceiling for arrear contributions	Section 11*(n)(bb)*	R1 800
Permissible lump sum withdrawals upon retirement		
Pension fund monetary amount for permissible lump sum withdrawals	Paragraph (ii)*(dd)* of proviso to paragraph *(c)* of definition of “pension fund” in section 1	R50 000
Retirement annuity fund monetary amount for permissible lump sum withdrawals	Paragraph *(b)*(ii) of proviso to definition of “retirement annuity fund” in section 1	R50 000

Table XXI: Deductible business expenses for individuals

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Car allowance		
Ceiling on vehicle cost	Section 8(1)*(b)*(iiiA)*(bb)*(A)	R400 000
Ceiling on debt relating to vehicle cost	Section 8(1)*(b)*(iiiA)*(bb)*(B)	R400 000

Table XXII: Employment-related fringe benefits

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Exempt scholarships and bursaries		

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Annual ceiling for employees	Paragraph (ii)*(aa)* of proviso to section 10(1)*(q)*	R100 000
Annual ceiling for employee relatives	Paragraph (ii)*(bb)* of proviso to section 10(1)*(q)*	R10 000
Exempt termination benefits	Section 10(1)*(x)*	R30 000
Medical scheme contributions		
Monthly ceiling for schemes with one beneficiary	Section 18(2)*(c)*(i)*(aa)* and paragraph 12A(1)*(a)* of Seventh Schedule	R625
Monthly ceiling for schemes with two beneficiaries	Section 18(2)*(c)*(i)*(bb)* and paragraph 12A(1)*(b)* of Seventh Schedule	R1 250
Additional monthly ceiling for each additional Beneficiary	Section 18(2)*(c)*(i)*(cc)* and paragraph 12A(1)*(c)* of Seventh Schedule	R380
Awards for bravery and long service	Paragraphs *(a)* and *(b)* of further proviso to paragraph 5(2) of Seventh Schedule	R5 000
Employee accommodation	Paragraph 9(3)*(a)*(ii) of Seventh Schedule	R54 200
Accommodation for expatriate employees	Paragraph 9(7B)(ii) of Seventh Schedule	R25 000
Exemption for de minimis employee loans	Paragraph 11(4)*(a)* of Seventh Schedule	R3 000
Additional employer deductions for Learnerships		
Monetary ceiling of additional deduction for the employer when utilising a learnership agreement with an employee	Section 12H(i)	R30 000
Monetary ceiling of additional deduction for the employer in the case of an employee completing a learnership agreement	Section 12H(2) and (3)	R30 000
Monetary ceiling of additional deduction for the employer involving a learnership agreement with an employee with a disability	Section 12H(4)	R20 000

Table XXIII: Depreciation

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Small-scale intellectual property	Paragraph *(aa)* of proviso to section 11*(gC)*	R5 000
Urban Development Zone incentive	Section 13*quat*(10A)	R5 million

Table XXIV: Miscellaneous

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Low-cost housing		
Maximum cost of residential unit where that residential unit is an apartment in a building	Paragraph *(a)* of definition of "low-cost residential unit" in section 1	R250 000
Maximum cost of residential unit where that residential unit is a building	Paragraph *(b)* of definition of "low-cost residential unit" in section 1	R200 000
Industrial policy projects		
Maximum additional investment allowance in the case of greenfield projects with preferred status	Section 12I(3)*(a)*	R900 million
Maximum additional investment allowance in the case of other greenfield projects	Section 12I(3)*(a)*	R550 million
Maximum additional investment allowance in the case of brownfield projects with preferred status	Section 12I(3)*(b)*	R550 million
Maximum additional investment allowance in the case of other brownfield projects	Section 12I(3)*(b)*	R350 million
Maximum additional training allowance (per employee)	Section 12I(5)*(a)*	R36 000
Maximum additional training allowance in the case of industrial policy projects with preferred status	Section 12I(5)*(b)*(i)	R30 million
Maximum additional training allowance in the case of other industrial policy projects	Section 12I(5)*(b)*(ii)	R20 million
Minimum cost of manufacturing assets for greenfield projects	Section 12I(7)*(a)*(i)*(aa)*	R200 million
Amounts to be taken into account in determining whether an industrial project constitutes a brownfield project	Section 12I(7)*(a)*(i)*(bb)*(A) Section 12I(7)*(a)*(i)*(bb)*(B)	R30 million R200 million
Venture capital companies		
Annual deduction limit (natural persons)	Section 12J(3)(a)	R750 000
Lifetime deduction limit (natural persons)	Section 12J(3)(a)	R2.25 million
36 months minimum investment (in respect of the acquisition of qualifying shares in a junior mining company)	Section 12J(6A)(a)(i)	R150 million
36 months minimum investment (in respect of the acquisition of qualifying shares in companies other than junior mining companies)	Section 12J(6A)(a)(ii)	R30 million
After 36 months least 80 per cent of the expenditure incurred by a venture capital company in respect of qualifying shares in a junior mining company assets with a book value not exceeding the amount indicated immediately after issue	Section 12J(6A)*(b)*(i)	R100 million
After 36 months, at least 80 per cent of the expenditure incurred by a venture capital company in respect of qualifying shares in company, other than a	Section 12J(6A)*(b)*(ii)	R10 million

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
junior mining company, with assets with a book value not exceeding the amount indicated.		
Presumptive turnover tax		
A person qualifies as a micro business for a year of assessment where the qualifying turnover of that person for that year does not exceed the amount indicated	Paragraph 2(1) of Sixth Schedule	R1 million
Maximum of total receipts from disposal of immovable property and assets of a capital nature by micro business	Paragraph 3*(e)* of Sixth Schedule	R1.5 million
Minimum value of individual assets and liabilities in respect of which a micro business is required to retain records	Paragraphs 14*(c)* and *(d)* of Sixth Schedule	R10 000
Public benefit organisations		
PBO trading income exemption	Section 10(1)*(cN)*(ii)*(dd)*(ii)	R150 000
Deduction of donations to transfrontier parks	Section 18A(1C)*(a)*(ii)	R1 million
Housing provided by a PBO: maximum monthly income of beneficiary household	Paragraph 3*(a)* of Part I of Ninth Schedule and paragraph 5*(a)* of Part II of Ninth Schedule	R7 500
Recreational clubs		
Club trading income exemption	Section 10(1)*(cO)*(iv)*(bb)*	R100 000
Prepaid expenses		
Maximum amount of deferral	Paragraph *(bb)* of proviso to section 23H(1)	R80 000
Small business corporations		
Maximum gross income	Section 12E(4)*(a)*(i)	R14 million
Housing associations		
Investment income exemption	Section 10(1)*(e)*	R50 000

Table XXV: Administration (Taxation Laws Second Amendment Bill)

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Investment income exempt from provisional tax		
In the case of natural persons below age 65	Paragraph 18(1)*(c)*(ii) of Fourth Schedule	R20 000
In the case of natural persons over age 65	Paragraph 18(1)*(d)*(i) of Fourth Schedule	R120 000
S.I.T.E. threshold	Items *(a)* and *(b)* of paragraph 11B(2) and items *(a)*, *(b)*(ii) and *(b)*(iii) of paragraph 11B(3) of Fourth Schedule	R60 000

Description (The contents of this column are solely for convenience and shall be of no force or effect)	Reference to Income Tax Act, 1962	Monetary amount
Threshold in respect of automatic appeal to High Court	Section 83(4B)*(a)*	R50 million

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2. INCOME TAX: INDIVIDUALS AND EMPLOYMENT

2.1. TRAVEL (CAR) ALLOWANCES: REPEAL OF DEEMED KILOMETRE METHOD

[Clause 11 (1)(a); Applicable provision: Deletion of the further provision to section 8(1)*(b)*(ii)

I. Background

Taxpayers can deduct the cost of travelling on business against vehicle travel allowances. The Income Tax specifically treats commuting expenses (i.e. travelling between home and the workplace) as non-deductible. This exclusion is consistent with the principle that taxpayers cannot deduct expenses that have a private purpose and which are common to most workers (such as work clothes, alarm clocks and home lunches brought to work). This exclusion is also a fundamental aspect of income tax systems around the world.

To the extent that taxpayers are travelling on business (excluding commuting), taxpayers can claim a deduction against vehicle travel allowances based on the actual distance travelled (the log book method) or a deeming approach based on the total kilometres travelled (the deemed kilometre method). Under the deemed kilometre method, business travel of 14 000 kilometres is assumed if the taxpayer has driven at least 32 000 kilometres for the year at issue. If the total kilometres fall below 18 000 kilometres no business travel is deemed.

II. Reasons for change

A. Statistical background

Tables 1, provides a summary of the car allowances paid to taxpayers and Table 2 provides a breakdown of expenses claimed against travel allowances. Table 1 illustrates the total use of the car allowance amongst taxpayers by taxable income group during the tax years 2002/03 and 2004/05. Tables 2 provides information on amounts allowed against travel allowances. These tables demonstrate that 90 per cent of those who received a travel allowance claimed with an average claim of 77 per cent of the average allowances received for 2002/03. During 2004/05, 88 per cent of those who received a travel allowance claimed against the allowance with an average claim of 77 per cent of the average allowances received.

Table 1: Travel allowances - total

	2002/03 *[95.1% assessed]*		2004/05 *[87.0% assessed]*	
Individual taxpayers - Travel allowances - 3710 taxable income	**Number of taxpayers**	**Amount allowed per taxpayer Rand**	**Number of taxpayers**	**Amount allowed per taxpayer Rand**
< 0 – 150 000	292,666	24,629	233,828	24,951
150 001 – 200 000	91,857	40,605	92,736	39,990
200 001 – 300 000	102,776	54,132	126,357	52,235
300 001 – 400 000	42,165	68,644	61,483	69,408
400 001 +	46,741	87,192	75,129	90,816
Total	576,205	40,734	589,533	46,195

Table 2: Travel allowances – expenses allowed

	2002/03 *[95.1% assessed]*		2004/05 *[87.0% assessed]*	
Individual taxpayers - Travel expenses fixed cost - 4014: taxable income	**Number of taxpayers**	**Amount allowed per taxpayer Rand**	**Number of taxpayers**	**Amount allowed per taxpayer Rand**
< 0 – 150 000	252,364	23,042	189,871	24,508
150 001 – 200 000	86,473	31,709	85,850	32,876
200 001 – 300 000	96,411	38,472	115,356	39,222
300 001 – 400 000	39,565	44,554	57,475	47,002
400 001 +	43,088	52,262	69,094	55,575
Total	517,901	31,436	517,646	35,819

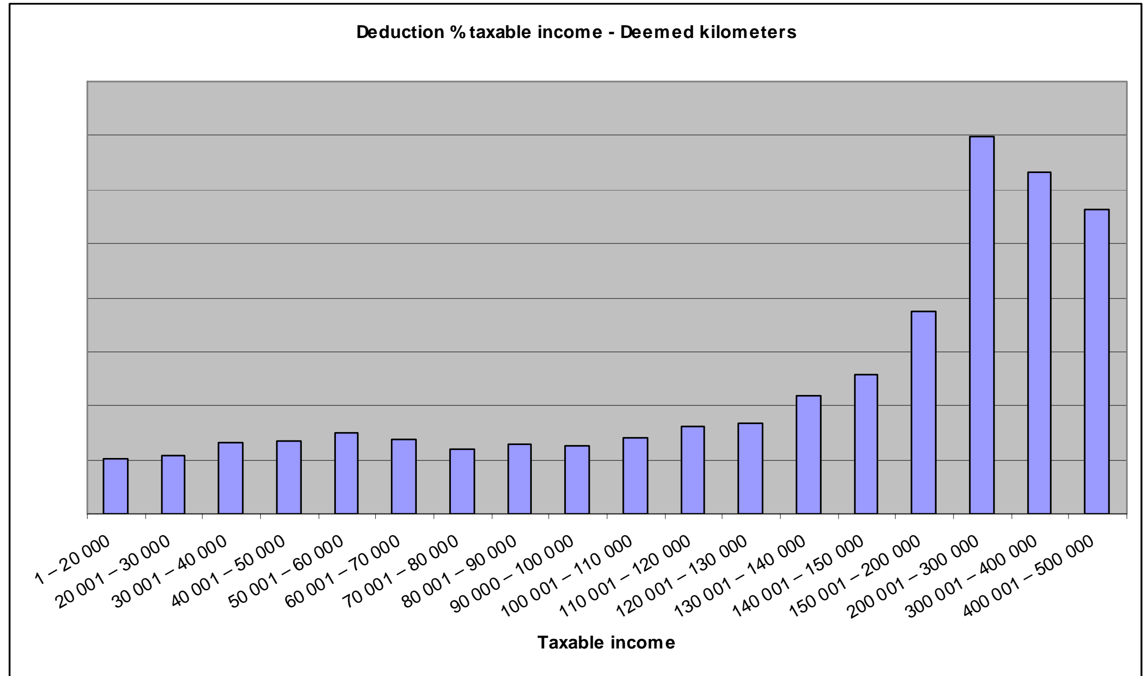
Table 3 provides a breakdown of the total vehicle expenses allowed to individuals versus other significant deductions allowed (i.e. medical and retirement funding). This table demonstrates that the deductions allowed per taxpayer against car allowances greatly exceeded the deductions claimed for contributions towards pension funds and for medical expenses. During 2004/05, 1.54 million taxpayers were allowed R12.23 billion deductions for pension fund contributions whilst 517 646 taxpayers were allowed R18.54 billion against car allowances.

Table 3: Aggregate deductions allowed to natural persons

	2002/03 *[95.1% assessed]*		2004/05 *[87.0% assessed]*	
Individual taxpayers - Deductions	**Number of taxpayers**	**Amount allowed per taxpayer Rand**	**Number of taxpayers**	**Amount allowed per taxpayer Rand**
Current pension fund contributions	1,425,455	**6,887**	1,538,094	**7,949**
Current retirement annuity fund	1,097,949	**4,561**	1,214,332	**5,299**
Medical expenses (total)	1,165,392	**7,170**	1,291,518	**8,583**
Travel expenses - fixed cost	517,901	**31,436**	517,646	**35,819**
Travel expenses - actual cost	19,857	**24,848**	13,832	**28,289**
Other	177,000	**20,642**	132,486	**29,895**
Sub Total (%)	97.7%	98.7%	97.8%	99.0%
Total	4,507,215		4,813,005	

Figure 1 illustrates the distributional impact of the deductions against travel allowances. These allowances essentially add a regressive element to the income tax system by providing higher benefits to wealthier taxpayers (and by implication for more expensive motor vehicles).

Figure 1



Source: Tax Statistics (2008)

B. Case against the deemed kilometre method

The case against the deemed kilometre method appears compelling. This method was created to simplify compliance and enforcement. However, this method has seemingly become a method for claiming commuting expenses (as a salary sacrifice) by anyone who drives more than a certain number of kilometres per annum. The net effect is an incentive for longer distance driving, which acts against environmental objectives. It is also questionable whether many of the kilometres claimed were actually driven for business purposes.

Concerns about the deemed kilometre method have already led to previous legislative measures. These concerns were the basis for the increase in the deemed private use from 14 000 kilometres annually to 16 000 kilometres in 2005/06 and to 18 000 kilometres in 2006/07.

III. Proposal

In view of the above, it is proposed that the deemed kilometre method be repealed. Taxpayers who are required to use their personal vehicles for business purposes will continue to be able to claim business travel expenses by way of the logbook method. The rules for company car fringe benefits may have to be revisited should it be necessary to align these rules with the policy intent of the above mentioned reforms.

IV. Effective date

The proposed amendment will be effective for all years of assessment commencing on or after 1 March 2010.

2.2. UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS

[Clauses 31 and 66; Applicable provisions: section 18(2)(c) and paragraph 12A(1) of the Seventh Schedule]

I. Background

Taxpayers may deduct their contributions to registered medical schemes. These contributions may be for the benefit of the taxpayer, his or her spouse and any other dependant as defined in the Medical Schemes Act, 1998. Deductions for medical scheme contributions are subject to monthly ceilings that are subject to annual adjustment.

Employer contributions to employee medical schemes are generally added to the taxable income of the employee. However, an exemption exists for amounts contributed to registered medical schemes. This exemption has the same ceilings as the monthly deduction ceilings available if the taxpayer claimed the deductions as described above.

II. Reasons for change

The dual medical scheme taxpayer deduction and employer fringe benefit exemptions give rise to undue complexities and evasion. For example, a taxpayer may claim the medical scheme deduction in his or her annual personal income tax return even though the same taxpayer has already obtained the benefit of the monthly exemption by way of direct employer contributions. While this practice is illegal, the current rules create a situation where enforcement may be compromised.

III. Proposal

It is proposed that the fringe benefit exclusion for medical scheme contributions be removed. The net effect of this change is to require employees to claim a deduction of medical scheme contributions, regardless of whether these contributions are made by the employee or by the employer on behalf of the employee. It should be noted that the net tax effect of the change will be neutral for both employers and employees.

IV. Effective date

The proposed amendment will be effective for all years of assessment commencing on 1 March 2010.

2.3. RETIREMENT LUMP SUM BENEFIT CALCULATIONS

[Applicable provisions: Appendix I: Paragraph 10]

I. Background

Two main categories exist for lump sum benefits paid by retirement funds. Lump sum benefits may be paid upon retirement (or death) or prior to retirement (e.g. due to resignation or divorce). In 2007, the exemption amount was set at R300 000 (without regard to prior years of service) for lump sums upon retirement, and the complex averaging formula for lump sum benefits upon retirement was removed in favour of a special rates table.

In 2008, the exemption for pre-retirement lump sum benefits was set at R22 500 for 2009/10 (in lieu of the long standing pre-existing threshold of R1 800). It was also announced that the complex averaging formula of section 5(10) applicable to pre-retirement lump sum benefits would be modified in favour of a simplified table.

II. Reasons for change

Although not technically part of the proposed legislation, it was publicly announced that pre-retirement lump sums would utilise a simplified table (*in lieu* of the complex averaging formula of section 5(10) that is similar to that used for retirement lump sums). The new table was said to be effective from 1 March 2009 (which coincides with the commencement of the year of assessment for natural persons). Both the pre-retirement and the retirement tables are reflected in the rate schedules contained in the explanation for Rates and Thresholds (Tables XII and XIII) in this explanatory memorandum.

III. Proposal

A. General Rule

The proposed legislation brings into effect the 2008 announcement. Also as announced, lump sum benefits will be taxed on *an accumulated* basis (i.e. subsequent lump sum benefits will be added and taxed at higher marginal rates). The accumulative nature of the system will generally be the same for both pre-retirement and retirement lump sums in terms of the rate tables. Moreover, the use of the pre-retirement exemption (currently at R22 500) and of the retirement exemption (currently at R300 000) will become part of the tables, thereby also becoming part of the accumulative system. However, pre-effective date lump sum calculations (including the pre-effectve date R120 000 or other exemptions) will not form part of the accumulative system.

Stated differently, tax on a given pre-retirement lump sum will be determined by (1) accumulating that pre-retirement lump sum and all lump sum benefits received or accrued under the new system; (2) applying the pre-retirement lump sum rate table (see paragraph 10(a)(i) of Appendix I to the Taxation Laws Amendment Bill,

2009) to that accumulated amount; and (3) subtracting a “hypothetical” amount of tax on all lump sums received prior to the pre-retirement lump sum at issue (this “hypothetical” amount being determined by applying the current rate table to all lump sum benefits previously received). The accumulation of the amounts will take place on a withdrawal-by-withdrawal basis. These rules will be mirrored in the case of retirement lump sum benefits.

Example 1 (deduction mechanism/pre-retirement).

Facts: Nthoki is a member of two pension funds when she resigns. Nthoki initially receives a R250 000 pre-retirement lump sum from the first fund. Nthoki subsequently receives another R350 000 pre-retirement lump sum from the second fund.

Result: In respect of the first fund lump sum, the first R22 500 is taxed at rate of zero per cent, and the remaining R227 500 is taxable at rate of 18 per cent. The result is tax payable of R40 950. In respect of the second R350 000 lump sum, this amount is effectively taxed at a rate of 18 per cent, resulting in tax payable of R63 000.

Example 2 (mixing of pre-retirement and retirement lump sums).

Facts: The facts are the same as above, except that Nthoki receives an additional R100 000 lump sum on retirement.

Result: The R100 000 is effectively taxed at a rate of 27 per cent after taking into account the prior pre-retirement lump sums, resulting in tax payable of R27 000.

B. Retrenchment pre-retirement withdrawals

If taxpayers are involuntarily retrenched, it is accepted that money may have to be withdrawn from employment retirement savings funds to cover the shortfall. Should these circumstances arise, these withdrawals will be treated similar to a retirement event. Withdrawals following job losses will therefore benefit from the retirement table and the R300 000 exemption amount. The accumulation principle will fully apply to these withdrawals.

IV. Effective date

The proposed amendment will be effective for all years of assessment commencing on or after 1 March 2010

2.4. MINOR BENEFICIARY FUNDS

[Clauses 7(1)(*j*), 13(1)(*b*), 59(1)(*c*); Applicable provisions: Deletion of paragraph (eC) of the section 1 “gross income” definition; section 10(1)(gE); Deletion of (iv) of the proviso to paragraph 3 of the Second Schedule]

I. Background

A. Regulatory control

Until recently, trusts administered by the Master of the High Court were the chosen vehicle used for providing funds to minor beneficiaries (i.e. those without nominees or suitable guardians). Most of these beneficiaries come from families

of lesser means (e.g. mine workers and low income employees). However, lack of oversight led to mismanagement and misappropriation of funds.

In order to remedy these problems, legislative changes were made so that regulation of minor beneficiary funds partially shifted to beneficiary funds subject to supervision by the Financial Services Board (see Financial Services Laws General Amendment Act, 2008 (Act No. 22 of 2008). As a regulatory matter, these beneficiary funds can only receive fund benefits as contemplated in section 37C of the Pension Funds Act, 1956 (Act No. 24 of 1956), which mainly entail payments from employer-provided retirement funds and payments from an employer-provided group life policy. The new legislative regime for beneficiary funds came into effect on 1 November 2008.

The determination of whether amounts flow into a minor beneficiary fund on the death of an employer-fund member is purely a decision of the trustees of the employer fund. As a regulatory matter, it is envisioned that minor beneficiary funds are relied upon only as a last resort (i.e. where no other suitable guardian, trust or other mechanism exists). All funds for the benefit of a minor beneficiary will be released upon that member reaching majority.

B. Tax consequences

When a member of a retirement fund dies before retirement, a lump sum tax charge arises if the heirs withdraw the funds on death, but no charge arises if the retirement fund continues to pay ongoing annuities to the heirs. This deferral for annuities promotes the continued existence of funds within retirement savings vehicles, thereby discouraging lump sum withdrawals. Like retirement fund annuities, post-death annuities grow tax-free but trigger pay-as-you-earn (PAYE) withholding as the annuity pays out to the heirs.

The 2008 tax amendments sought to place minor beneficiary funds on par with annuities on death because these funds are typically available to minor beneficiaries on a limited basis (proof of maintenance of life needs such as food, shelter, clothing and education). Under this annuity rollover paradigm, the transfer of retirement funds on death to a minor beneficiary fund would not be taxed, and growth within the fund would be tax-free. However, PAYE withholding will arise as the minor beneficiary fund distributes funds to minor beneficiaries. The 2008 amendments would have taken effect from 1 March 2009.

II. Reasons for change

While the annuity paradigm for minor beneficiary funds is consistent with the overall philosophy for the taxation of retirement funds, the annuity paradigm gives rise to practical difficulties. Most minor fund beneficiaries are of lesser means and typically expected to receive total income below the annual taxable threshold, even after minor beneficiary fund payouts are fully taken into account. Preliminary estimates indicate that 80 to 90 per cent of these beneficiaries would fall below the threshold. Hence, the compliance and enforcement costs associated with PAYE do not economically justify the ultimate taxes due. The computer system required to run nil returns are especially problematic due to the low annual returns associated with minor beneficiary funds (most funds generating a yield pegged to interest rates).

III. Proposal

In order to simplify compliance and administration, payouts by minor beneficiary funds will no longer be subject to tax. However, lump sum taxation will be imposed on the death of a retirement fund member.

IV. Effective date

The proposed amendments will generally come into effect from 1 March 2009 and apply for lump sums awarded on or after that date. However, the 1 March 2009 effective date will not apply for purposes of the upfront taxation of transfers to beneficiary funds occurring from that date until 1 September 2009 (the date of the introduction of the Bill). These beneficiary funds will receive exemption on entry and payout so parties are not prejudiced by recent changes to the law.

2.5. REMEDIAL RECOGNITION OF PRE-1998 BENEFITS FOR PUBLIC SERVANTS

[Clause 56(1)(*b*); Applicable provision: Formula C of paragraph 1 of the Second Schedule]

I. Background

Government Employees Pension Fund ("GEPF") lump sum pension benefits became taxable in 1998, but lump sums remain outside the tax net to the extent these sums relate to pre-1998 periods (see formula C of paragraph 1 of the Second Schedule). Certain Public Service Coordinating Bargaining Council resolutions provide for recognition of pensionable service of government employees if their service was previously not recognised due to discrimination (as a result of race, gender or temporary employment). These resolutions have the authority of law by virtue of Rule 10.5 of the Government Employees Pension Law of 1996 (Proclamation No. 21 of 1996). This remedial recognition often relates to pre-1998 periods.

II. Reasons for change

Despite overall remedial recognition of prior pensionable service, pre-1998 Government employee pensionable service subject to previous discrimination remains unfairly treated in a tax sense. These sums should theoretically be eligible for formula C pre-1998 lump sum tax relief as if these amounts arose directly during the pre-1998 period. This failure to provide formula C relief is also inconsistent with the current pre-1998 formula C exclusion for recent recognition of pre-1998 services undertaken by non-statutory force members (Rule 10.6 of the Government Employees Pension Law of 1996 (Proclamation No. 21 of 1996)).

III. Proposal

For purposes of the formula C exclusion, the proposed amendment will take into account pre-1998 service that is recognised to reverse discrimination (as provided for in Rule 10.5). This formula C tax exclusion applies even though the recognition by the board of the fund occurs after 1 March 1998.

IV. Effective date

The proposed amendment will be effective for lump sums received or accrued on or after 1 March 2009.

2.6. TREATMENT OF UNREALISED GAINS ON DEATH

[Clause 71; Applicable provision: Paragraph 40 of the Eighth Schedule]

I. Background

For purposes of the capital gains tax, a deceased person is deemed to dispose of all assets (except for assets transferred to a spouse and for assets consisting of domestic life insurance policies or of retirement savings) to the deceased estate for proceeds equal to the market value of the assets. The assets are valued at the date of death. The net result is to trigger capital gain or loss for the deceased person on that person's final return.

In terms of acquiring assets from the deceased, the deceased estate is treated as having acquired the assets at a cost equal to the market value on date of death (i.e. is deemed to have obtained a base cost step up or step down by virtue of the deemed disposal on death). When the deceased estate disposes of these assets to heirs and legatees, the transaction is treated as a rollover event. The estate is treated as having disposed of those assets and for proceeds equal to the tax cost to the deceased estate (i.e. the market value on date of death). The heir or legatee is then deemed to have acquired the assets at the same cost.

II. Reasons for change

The current rules do not properly cater for assets transferred from the deceased directly to heirs or legatees (i.e. without being passed-through the deceased estate). While the deceased is taxed on all assets (except those listed), only assets passing through a deceased estate are stepped-up to market value on death. No step-up exists for direct transfers to heirs, legatees and trustees, thereby creating the potential for double taxation.

III. Proposal

All assets of the deceased that are subject to a deemed disposal at market value on death should receive a stepped-up cost for the transferee, not just assets transferred to a deceased estate. Therefore, comparable step-up cost rules will be added for assets directly received by heirs and legatees.

IV. Effective date

The proposed amendment comes into effect for all years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

2.7. LEARNERSHIP ALLOWANCE SIMPLIFICATION

[Clause 23; Applicable provision: 12H]

I. Background

A. Basic regime

Section 12H provides an additional deduction for employers over and above the normal remuneration deduction. This additional deduction is intended as an incentive for training employees in a regulated environment in order to encourage skills development and job creation. Training contracts that qualify for the deduction are learnerships registered with a sector education and training authority (SETA) or contracts of apprenticeship registered with the Department of Labour. The additional deduction comprises of both a commencement and completion allowance.

The commencement allowance takes two forms. The allowable deduction is always the lesser of two amounts. If the learner is already employed by the employer and a learnership contract is concluded, the deduction is the lesser of either R20 000 or 70 per cent of the annual remuneration of the learner. If the learner was not previously employed by the employer at time of registration, the deduction is the lesser of either the learner’s yearly remuneration or R30 000. The annual remuneration rule was inserted in order to prevent employers from utilising extremely low salaried individuals mainly in order to secure tax benefits.

A completion allowance may be claimed upon successful completion of the learnership equal to the lesser of the learner’s annual remuneration or R30 000. The same basic principles apply to this allowance as the commencement allowance.

B. Special rules:

1. Learners with disabilities

Enhanced deductible allowances exist for learners with disabilities. These rules assist employers to overcome financial obstacles in employing individuals with disabilities. The allowance for this category of learners operates in the same manner as the basic regime. However, the monetary value of the deductible amounts is higher. If the learner was already employed by the employer before the conclusion of the learnership contract, the deduction is the lesser of R40 000 or 150 per cent of the learners’ annual remuneration. If the learner was not previously employed by the employer, the deduction is the lesser of R50 000 or 175 per cent of the learner’s annual remuneration. The completion allowance is the lesser of R50 000 or 175 per cent of the leaner’s annual remuneration.

2. Learnership terminations and assumption of learnerships

The whole allowance is recouped if the learnership is terminated prior to its expiry. The only exceptions are when the learner is dismissed due to incompetence or if the learner becomes physically incapacitated because of ill health or injury. If a second employer takes over a learnership from another employer, the second employer cannot claim the allowance, and the commencement allowance is recouped by the first employer.

3. Multi-year learnerships

Apprenticeships are of a longer duration than learnerships and therefore require special rules. In the first year, the employer may claim a commencement allowance. In the completion year (if the candidate is successful), the employer may claim successive commencement allowances for subsequent years. The employer may also deduct the completion allowance multiplied by the number of years in the learnership.

II. Reasons for change

While the aim of the legislation is to encourage skills development and job creation, the complexity of the legislation is acting as a barrier to employer usage. The legislation is difficult to understand and contains too many variables. Employers (especially smaller employers) are hesitant to claim the learnership allowance because the compliance cost of administering the program seems to overshadow the benefits. The legislation accordingly needs to be simplified so that the allowance is accessible to all employers.

III. Proposal

A. General rule

In view of the above, the variables associated with the basic legislation will be drastically reduced. The revised legislation will contain two basic thresholds – a commencement allowance of R30 000 and a completion allowance of R30 000. The calculations with reference to the learner's annual remuneration will be eliminated. Recent evidence indicates that the Department of Labour prescribe minimum salaries for learners and these minimums will prevent employers from utilising extremely low-paid employees mainly to secure tax benefits.

A comparable simplification of variables will also be employed for learners with disabilities. Learners with disabilities will benefit from the basic regime outlined above with a R20 000 uplift. As a result, learners with disabilities will be eligible for a commencement allowance of R50 000 and a completion allowance of R50 000.

B. Employee terminations and assumption of learnerships

As stated above, if a learner terminates learnership mid-stream, a recoupment arises under current law unless the termination is caused by death or ill-health. However, this rule fails to account for practical realities in the market place. Many learners change employment for better pay or better opportunities, thereby

triggering a recoupment even though the change was outside the employer's control. Some of these employment changes even entail the assumption of learnerships by the new employer in terms of section 17(5) of the Skills Development Act, 1998 (Act No. 97 of 1998).

In order to ensure that employers are not punished for events outside their control, the recoupment rule will be dropped. Instead, learnerships of less than 12 full months will be eligible only for a *pro rata* amount of the commencement allowance (regardless of the reason that the learnership falls short of the 12-month period). In addition, if a learnership falls over two years of assessment, the commencement allowance is allocated pro rata between both years based on the calendar months applicable to each year. The commencement allowance will be determined by multiplying the commencement amount by the total calendar months of learnership over 12.

As a result of the pro rata rule, the first employer will be eligible for a pro rata proportion of the commencement allowance upon a learner's shift to a new employer (but none of the completion allowance since the initial employer no longer has control over the learner's successful completion). The new employer seeking to assume the responsibility of a learnership pursuant to section 17(5) of the Skills Development Act will also be eligible for the remaining pro rata portion of the learnership (and all of the completion allowance).

Example

Facts: Employer X concludes a learnership contract with a learner. At the end of month six of the contract, the learner leaves employment with Employer X and takes up employment with Employer Y. The learner subsequently completes the learnership with Employer Y (in accordance with section 17(5) of the Skills Development Act). Assume the learner does not have any disabilities and that the learnership spans a single year of assessment for both Employer X and Employer Y.

Result: The commencement amount is divided pro rata between Employer X and Employer Y (each based on a 6/12 ratio). Therefore, Employer X is entitled to a commencement allowance of R15 000 (half of R30 000), and Employer Y is entitled to a commencement allowance of R15 000 (the other half of R30 000). Employer Y is also entitled to claim the completion allowance of R30 000 (i.e. the full amount).

C. Simplification of multi-year learnerships

The deduction for multi-year learnerships will be simplified in order to provide for enhanced upfront benefits. The commencement allowance will now be allowed in respect of each successive year of the learnership (rather than the current situation where a single commencement amount is allowed in the first year with all subsequent commencement amounts deferred until the end). The completion allowance remains as before. In the final year of the contract, the completion amount is multiplied by the number of years) of the learnership. For purposes of this calculation, only full 12 month periods are taken into account.

The new rules will also have the added benefit of assisting initial employers of multi-year learnerships if learners change employment. Under the revised rule, the initial employer will obtain a commencement allowance attributable to the learner's initial multi-year period of employment with the subsequent employer obtaining the remaining share of the commencement allowance. As under existing law, the subsequent employer will obtain the sole benefit of the completion allowance.

Example 1

Facts: Employer (a calendar year taxpayer) concludes a three and a half year learnership with a learner at the beginning of January 2010. The learner completes the learnership as anticipated. Assume the learner does not have any disabilities.

Result: In each of 2010, 2011, 2012 and 2013, Employer may claim the full R30 000 commencement allowance. In 2013, Employer may further claim the R90 000 completion allowance (the basic R30 000 amount multiplied by three). There is no completion allowance claimable for the 6 month period served in 2013 because this period does not constitute a full 12 month period.

Example 2

Facts: The facts are the same as in Example 1, except that the learner abandons his learnership at the end of February 2013 (i.e. before completion in June).

Result: In each of 2010, 2011 and 2012, Employer may claim the full R30 000 commencement allowance. In 2013, Employer may receive a commencement allowance of R5 000 (for the two out of 12 month learnership effort). Employer may not claim any of the completion allowance because the learner failed to complete the learnership.

Example 3

Facts: Employer X (a calendar year taxpayer) concludes a three-year learnership agreement with a learner at the beginning of January 2010. The learner shifts employment to Employer Y (a calendar year taxpayer) at the end of June 2011. The learner subsequently completes the learnership with Employer Y. Assume the learner does not have any disabilities.

Result: In 2010, Employer X may claim the full R30 000 commencement allowance. In 2011, Employer X may claim R15 000 of the commencement allowance and Employer Y claiming the R15 000 remainder. At the close of 2012, Employer Y may claim the final R30 000 commencement allowance as well as a R90 000 completion allowance (the basic R30 000 amount multiplied by three).

C. New legislation

The Skills Development Amendment Act, 2008 (Act No. 37 of 2008) amends certain items applicable to learnerships. In particular:

The remaining sections of the Manpower Training Act, 1981 (Act No. 56 of 1981) will be repealed (including contracts of apprenticeship under that Act); and

Learnerships under section 1 of the Skills Development Act will specifically include apprenticeships (with artisans also given envisioned learnership coverage under that Act).

The amendments contained in the Skills Development Act will come into operation on a date determined by the Minister of Labour by notice in the Gazette. No changes will be required to include apprenticeships (and artisans) because these items will automatically fall within the current section 12H learnership definitions.

IV. Effective date

The proposed amendments will generally be effective for years of assessment ending on or after 1 January 2010.

2.8. EMPLOYER-PROVIDED POST-RETIREMENT MEDICAL SCHEME COVERAGE

[Clause 28; Applicable provision: 12M)]

I. Background

Employers provide various types of retirement benefits as a mechanism of attracting and retaining employees. One form of retirement benefit is for the employer to fully or partially cover medical scheme contributions of employees after retirement. This benefit can be very expensive and risky for employers because medical inflation may exceed general inflation and because chronic illnesses can be protracted.

In order to eliminate this risk, some employers seek to fully settle this liability. As a practical matter, employers with this objective may either: (i) pay the retired employee a direct lump sum payment, or (ii) purchase an annuity from an insurer with a once-off lump sum payment.

II. Reasons for change

The tax treatment of employers providing for a one-off payment in full cancellation of post-retirement medical scheme contributions is uncertain. This uncertainty exists for both direct one-off payments and payments to insurers. First, these payments may be viewed as a non-deductible capital expense because the release of the liability provides an enduring benefit. Second, even if of a revenue nature, the deduction for an upfront payment may be required to be spread over the period of the benefit (in this instance, the estimated remaining lives of the retired employees).

No policy reason exists for a wholesale denial of deductions in these circumstances. The cost of post-retirement medical scheme coverage is an ancillary cost of doing business. The one-off payment is not comparable to an investment reserve.

III. Proposal

The lump sum payment of post-retirement medical scheme contributions to retired employees (or their spouses/dependants) will be deductible when paid. The lump sum can be paid directly to retired employees (or their spouses/dependants) or to an insurer for the benefit of retired employees (or their spouses/dependants). The purpose of this provision is to provide a deduction for these payments where no upfront deduction otherwise exists.

If a lump sum payment is made directly to an employee, the employee assumes the responsibility of covering future medical scheme payments. This payment by the employer is now fully deductible by the employer. A deductible lump sum of this nature may also be made to an insurer for policies solely covering retired employees (and their dependents). If payment is made to a policy only partly relating to medical scheme coverage, the deductible upfront portion only relates to the amount dedicated to medical scheme coverage.

Under some policies, some employers may be expected to make future top-up payments to insurers to cover shortfalls necessitated by medical inflation. However, in order to claim the deduction, the insurer needs to assume at least the mortality risk in relation to the insured ex-employee. Mortality risk refers to the risk concerning the longevity of the ex-employee. For instance, an employer may take out a policy on the premise that the relevant ex-employee will only live to the age of 75 years. The person then lives, contrary to expectations, to the age of 90. For the purpose of the proposed deduction, the risk of covering the unforeseen 15 years in these circumstances must fall on the insurer and not the employer (nor on a person connected to the employer).

It is understood that insurance policies of this nature come in two basic forms. Some policies pay the medical scheme directly. Other policies reimburse the employer as medical scheme contribution come due.

IV. Effective date

The amendment will apply to all post-retirement medical scheme lump sums paid on or after 1 September 2009.

2.9. DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS TO RETIREMENT ANNUITY FUNDS

[Clause 14(1)(*i*); Clause 18(1) of the Administration Act; Applicable provisions: Section 11*(n)* and paragraph 2(4)(bA) of the Fourth Schedule]

I. Background

A member of a retirement annuity fund is allowed to deduct a certain level of contributions to that fund. Conversely, a taxable fringe benefit arises to the extent an employer pays a retirement annuity fund contribution for the benefit of an employee. This result exists because the contribution is viewed as the payment of an employee’s debt, and the payment of debt by an employer for the benefit of an employee (without reimbursement) is viewed as a taxable fringe benefit.

II. Reasons for change

Although retirement annuity fund contributions potentially constitute an allowable deduction when those contributions are made directly by an individual member, an anomaly exists if the individual benefits from direct employer contributions. The employer contribution gives rise to a taxable fringe benefit, but no corresponding deduction is allowed. In essence, the deduction exists only if the employee makes a contribution.

III. Proposal

The proposed amendment provides a deduction for any retirement annuity fund contribution in the hands of an employee even if paid by the employer on the

employee's behalf. In effect, the tax system will be neutral as to who makes the retirement contribution. If the employee receives salary and makes a contribution, the salary is part of gross income with an allowable deduction for employee contributions. If the employer directly pays the contribution on the employee's behalf, the contribution is again part of gross income (as a taxable fringe benefit) for the employee, and the employee will remain eligible to deduct the contribution. The proposed amendment will be fully taken into account for pay-as-you-earn withholding.

IV. Effective date

The proposed amendment will be effective for years of assessment commencing on or after 1 March 2010.

2.10. PAYOUTS OF EMPLOYER PENSION SURPLUSES

[Clauses 11(1)(b) (c) and 32; Applicable provisions: section 8(4)*(a) and (b)* and deletion in subsection 1 of paragraph (a) to the proviso *(a)* of section 20(1)]

I. Background

The payment of an actuarial surplus to an employer is presently treated as gross income without exception. This gross income is triggered when the surplus payment to the employer is approved by the pension board pursuant to section 15E of the Pensions Fund Act, 1956 (Act No. 24 of 1956). Assessed losses and the balance of assessed losses from previous years may not be used to offset an employer's gross income from the receipt of an actuarial surplus.

II. Reasons for change

As a general matter, an employer's receipt of an actuarial surplus should give rise to gross income because pension funds typically stem from deductible contributions or from tax-free or tax-preferred growth. However, circumstances may arise when an employer acquires the surplus in consequence of a non-deductible payment. For instance, an employer may acquire a pension fund surplus as part of an overall business acquisition with the allocable cost for the pension surplus being a non-deductible capital expenditure. Taxation of the pension surplus payout in this latter circumstance effectively gives rise to double taxation.

III. Proposal

In view of the above, it is proposed that gross income resulting from the payment of an actuarial surplus to an employer be reduced to the extent the employer made a non-deductible expenditure to acquire (or otherwise in respect of) that surplus. All non-deductible payments in relation to the fund will trigger the same

tax-free treatment. The net result is to ensure that the employer surpluses are subject to only one level of tax in the hands of the employer and no more.

Another issue is the inability to use assessed losses and the balance of assessed losses, against gross income resulting from payment of an employer surplus. While this rule was designed to prevent timing manipulations, further information concerning the ability to make these withdrawals has come to light. The law relating to pension funds (as well as its administrative application) is fairly restrictive (being limited mainly to prevent retrenchments or to resolve liquidations), thereby preventing undo manipulation. The anti-loss rule is accordingly repealed.

Example 1

Facts: Employer X makes contributions for several years to a pension fund. The total amount of these contributions is R600 000. The pension fund grows tax-free to R1 Million. An amount of R40 000 was contributed by the employer in excess of the deductible section 11(l) ceiling. A surplus is later received by the employer in the amount of R 100 000.

Result: The amount received of R 40 000 will be tax free. The remaining R60 000 forms part of gross income.

Example 2

Facts: Employer X makes contributions for several years to a pension fund. The deductible amount of these contributions is R600 000. The pension fund grows tax-free to R1 million. Employer Y buys the enterprise and pays R 120 000 for the pension fund surplus (a non deductible capital expenditure). The pension fund later pays out an employer surplus amount of R150 000 to Employer Y.

Result: Of the amount received by Employer Y, R120 000 will be tax-free. The remaining R30 000 forms part of gross income.

IV. Effective date

This amendment is effective for years of assessment ending on or after 1 January 2009.

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3. INCOME TAX: BUSINESS

3.1. EXEMPTION FOR CERTIFIED EMISSION REDUCTIONS

[Clause 26; Application section: 12K]

I. Background

The Kyoto Protocol, the main environmental instrument of the United Nations Framework Convention on Climate Change (UNFCCC), has been ratified by 189 countries including South Africa. The Kyoto Protocol provides mechanisms to ensure that developed countries (as listed in Annexure 1 of the UNFCCC)) can meet their emission reduction targets. At the same time, the Clean Development Mechanism (CDM) ensures participation of developing countries in a global carbon reduction market. The Kyoto Protocol financing and technology transfer is

accomplished through CDM projects which are available only within developing countries. These CDM projects focus on development in renewable energy, energy efficiency and other related fields designed to achieve emission reductions.

A key feature of CDM projects is the demonstration of additionality, which means that the project participants must demonstrate that the envisaged project would not have been viable without Kyoto Protocol support:

Emissions (environmental) additionality: This element ensures any emissions reduction is additional to what would occur without the proposed project;

Financial additionality: This element ensures that any public funding from Annexure 1 countries for the CDM project is additional and not a diversion of pre-existing official development assistance;

Investment additionality: This element ensures that the investment project would not take place without a CDM project;

Legal additionality: This element ensures that the project is additional to what is already mandated by laws or regulations; and

Technical additionality: This element ensures that superior technology is used that would not have been possible to transfer to the developing country without the CDM project.

If these elements are satisfied, the Kyoto Protocol allows for these CDM projects to yield GHG reduction credits (commonly known as carbon emission reduction credits) in the form of certified emission reductions (CERs). These CERs are technically saleable to and usable only by developed countries for the purpose of meeting legally binding Kyoto Protocol emissions reductions obligations. CERs effectively operate as a concomitant revenue source for CDM projects, thereby seeking to make otherwise marginal projects viable.

II. Reasons for change

There has been only limited uptake of CDM projects within South Africa. This lack of uptake mainly stems from high financial (and bankable) hurdle rates given the risks associated with CDM project activities.

The South African government fully recognises that climate change is a global environmental market failure that requires a considered international and domestic policy response. The global nature of climate change arises from the fact that a ton of carbon emitted anywhere in the world (by developing or developed countries) has the same effect on temperatures globally. South Africa's greenhouse gas emissions rank within the top 20 in the world, contribute 1.8 per cent to global emissions and are responsible for 42 per cent of Africa's emissions (primarily due to South Africa's heavy reliance on coal for electricity and its sizeable use of motor vehicles versus other forms of transport).

In terms of tax, the disposal of CERs is largely untested, thereby creating further uncertainty for CDM projects. The default interpretation is to treat the disposals of CERs as ordinary revenue from trading stock. While this tax result could theoretically be applied, taxation of CERs at full ordinary rates will add a prohibitive cost for otherwise marginal CDM projects given their high financial

hurdle rates. Hence, as part of South Africa's domestic policy response to climate change, tax relief is required to overcome the market failure associated with environmental protection.

III. Proposal

A. Overview

An income tax incentive is proposed for any person holding CDM project registration whilst that person implements the project. The incentive applies to the disposal of CERs issued in respect of that project. In essence, amounts received or accrued upon disposal (or anticipated disposal) of these CERs are exempt for purposes of normal tax and capital gains tax. This exemption includes *"in specie"* distributions.

B. Qualifying Criteria

By way of background within the South African context, treatment of an activity as a CDM project requires both South African approval and UNFCCC registration. More specifically, South African approval is obtained from the Department of Energy (referred to in UN parlance as the "Designated National Authority"). UN registration is provided by the UNFCCC Executive Board of the Clean Development Mechanism after validation by the UNFCCC approved Designated Operational Entity ("DOE").

CERs represent emission reductions that are verified and certified by the DOE. After verification and certification, CERs ultimately only exist once issued by the UNFCCC Executive Board of the Clean Development Mechanism.

Example 1

Facts: Foreign Company owns all shares of South African Company. By virtue of South African Company's involvement in a CDM project, the UNFCCC Executive Board issues CERs worth R5 million to the South African Company on 10 June 2010. South African Company disposes of these CERs to Foreign Company and receives R10 million on 10 July 2012.

Result: The mere receipt of CERs (worth R5 million at the time) by South African Company from the UNFCCC Executive Board is a non-event under common law principles. The disposal by South African Company of the CERs will be exempt by virtue of section 12K. Because no taxable income results from the disposal of CERs, the expenditure incurred by South African Company will not qualify for a deduction under section 11(a). Similarly, because there is no receipt of taxable income, the value of the CERs held by South African Company will not be taken into account under section 22 as closing or opening stock.

Example 2

Facts: The facts are the same as Example 1, except South African Company sells the future rights to the Foreign Company on 1 September 2009 for R3 million (*in lieu* of the 10 July 2012 sale).

Result: Because the payment of R3 million is in respect of a disposal for delivery at a future date, the section 12K exemption implicitly includes the R3 million anticipated disposal.

C. Value-added Tax ("VAT") treatment of supplying CERS

Questions have been raised as to how the disposal of CERs should be treated for VAT purposes owing to the newness of the CERs concept. Upon review, it is believed that the supply of the CERs is a supply of "services" (as opposed to the supply of "goods"). The CER itself should fall into the ambit of a "right" or "a facility" or "advantage" envisaged in the definition of services. Internationally, countries like the UK and Sweden treat the supply of the CERs as the supply of services. The OECD also regards CERs as equivalent to services.

Because all CERs will be exported (being useful only for Annex 1 (industrialised) countries, the supply of CERs by persons operating CDM projects will by default (in terms of the normal VAT rules) be zero rated. Because CERs would be viewed as services, the documentary requirements are fairly liberal (i.e. being less stringent than that of exported goods).

IV. Effective date

The proposed amendment will be effective for the disposal of CERs occurring on or after 11 February 2009 in respect of CDM projects registered on or before 31 December 2012. The exemption contains the 2012 sunset clause to coincide with the expiry of the Kyoto Protocol.

3.2. SPECIAL ALLOWANCE FOR ENERGY EFFICIENCY SAVINGS

[Clause 27; Applicable provision: 12L]

I. Background

The primary energy sources in South Africa are fossil-fuel based. Energy derived from fossil fuel has a negative effect on the environment and current electricity prices do not reflect these environmental costs. Given the need to address the challenges relating to climate change and to improve energy use, it has become necessary to find ways to improve energy efficiency. Energy efficiency savings can indeed be viewed as one of the low-hanging fruits to help address the concerns relating to climate change and energy security.

II. Reasons for change

In the context of energy efficiency savings, the conversion by taxpayers of old technologies to new ones often involves a substantial amount of capital expenditure. The perceived long pay-back period tends to discourage business from making upfront investments relating to energy efficiency savings. Given the contribution that energy efficiency savings can make towards a reduction in the demand of energy (especially electricity) and resulting reduction in CO_2 emissions (given the fossil fuel intensive nature of energy production in South Africa), it is deemed appropriate to encourage greater levels of energy efficiency savings.

III. Proposal

It is proposed that taxpayers be entitled to claim a notional allowance for all forms of energy efficiency savings resulting from activities in the production of income. This notional allowance will enable the taxpayer to capture the full profit from energy efficient savings during each year in which incremental energy efficiency savings is initially realised.

The allowance for each year of incremental savings is determined as follows:

(Energy efficiency savings x applied rate) ÷ 2

For purposes of the formula, it is expected that energy efficiency savings will be determined by an accredited measurement & verification professional using standardised baseline methodology. All forms of energy efficiency savings will be taken into account. All these forms of energy efficiency savings will be expressed in kilowatt hours equivalent (kWh) to achieve uniformity. This energy efficiency savings is determined by measuring energy use against an initial baseline, as set by a measurement and verification professional.

Also for purposes of the formula, the applied rate is the lowest feed-in-tariff rate at the beginning of the year of assessment expressed in rands per kWh determined in terms of Regulatory Guidelines set by the National Energy Regulator. Given that the lowest feed-in tariff rate is higher than the current rate per kWh for electricity generated from fossil fuel, the overall formula is divided by 2. The Minister may change this denominator. It would have been theoretically been possible to use the average actual electricity rate (rand per kWh) for each taxpayer, but this approach would have resulted in unnecessary administrative and differential benefits.

The energy efficiency savings certificate is the key pre-requisite for the allowance. The certificate must contain the pre-determined energy-use baseline, the annual energy efficiency savings expressed in kilowatt hours equivalent (kWh), and the revised baseline. All this information must be authenticated and issued by an institution, board or body as determined by the regulations.

All the criteria and methodology used to determine the baseline and energy efficiency savings must be in terms of regulations issued by the Minister of Energy after consultation with the Minister of Finance and the Minister of Trade and Industry. The regulations will be based on the *International Performance Measurement and Verification Protocol* of the Efficiency Valuation Organisation.

IV. Effective date

The amendment comes into operation on a date determined by the Minister of Finance by notice in the *Gazette*.

3.3. DIVIDENDS TAX: GENERAL PRINCIPLES

I. Background

The Secondary Tax on Companies (STC) is a tax that is levied with reference to the amount of dividends "declared" by a company reduced by dividends "accrued" to that company. The liability for STC falls on the company distributing the dividend (as opposed to the shareholder receiving the dividend).

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

- The first phase entailed the reduction of the STC tax rate to 10 per cent, as well as a modest revision of the tax base (i.e. the definition of "dividend") on which the STC relies. The initial elements of this phase were effected by the Revenue Laws Amendment Act, 2007.

- The second phase entails the replacement of the STC with a new tax on company dividends to be levied at a shareholder level (known as the Dividends Tax). The initial outline of the tax was drafted into law in 2008 with a revised version contained in this round of legislation (this revised version of the Dividends Tax was wholly reprinted in this amendment act for ease of reading).

II. Reasons for change

A. Need for the shift from a company-level tax to a shareholder-level tax

Internationally, company dividends are generally taxed at the shareholder level (as opposed to the company-level). This difference from the STC gives rise to the following collateral problems:

- firstly, because the STC reduces the accounting profits of South African resident companies, these companies are at a disadvantage compared to their international counterparts which do not bear any adverse accounting profit reduction when paying dividends;

- secondly, because the STC is levied at a company-level, tax treaty limits on the rate of tax which may be imposed on dividends have no effect; and

- foreign investors are generally unfamiliar with STC and its mechanics, thereby causing uncertainty for foreign investors.

As a result, the combined effect of these difficulties is an increased cost of equity financing.

B. Need for a change to the tax base

Problems exist with the tax base upon which the STC relies. More specifically, the dividend definition in section 1 draws its meaning from the term "profits" (i.e. a

dividend expressly or implicitly requires a reduction in profits), but the term “profits” itself is never expressly defined in the Income Tax Act. It is understood that the term “profits” draws its meaning from company law and accounting principles. This mixture of accounting, company law and tax complicates the tax system and creates opportunities for avoidance.

III. Proposal

A. Basics of the Dividends Tax

[Clause 53; Applicable provisions; sections 64D, 64E and 64F]

The Dividends Tax will (in line with international norms) be levied at a shareholder level. The tax will apply only in respect of dividends paid by South African resident companies and will be levied at a rate of 10 per cent. The person entitled to the benefit from the dividend will be the party ultimately liable for the tax (subject to withholding solely for collection purposes – see notes on DIVIDENDS TAX: WITHHOLDING)

The Dividends Tax will be imposed on the date when the dividend is paid by the company (which is the date when the dividend accrues to the shareholder). Thus, accrual will not coincide with mere dividend declaration. Consequently, in a listed share context, the accrual of a dividend to a shareholder will generally take place sometime after the dividend is declared.

The Dividends Tax provides for special valuation rules in relation to dividends *in specie*. If a company distributes a dividend of this nature, the amount of the dividend is deemed to be equal to the market value of the property distributed. The market value of the assets distributed is determined either: (i) on the date of approval of the distribution, in the case of listed companies, or (ii) the date of distribution in the case of unlisted companies.

The Dividends Tax is subject to exemptions. More specifically, the beneficial owner of a dividend will be exempt from the Dividends Tax if the beneficial owner is:

(a) a South African company;
(b) the Government, a provincial administration or a municipality;
(c) a public benefit organisation;
(d) a trust;
(e) an institution, board or body that conducts research, provides services to the State or the general public or that promotes commerce, industry or agriculture as contemplated in section 10(1)*(c*A*)*;
(f) a retirement fund, (e.g. a pension fund or provident fund) or a medical scheme;
(g) a parastatal contemplated in section 10(1)*(t)*;
(h) a shareholder in a registered micro business,; or
(i) a natural person upon receipt of an interest in a residence contemplated in paragraph 51 of the Eight Schedule.

The above list of exemptions is much broader than the exemptions currently existing for the STC. For instance, dividends paid to retirement funds are now exempt, thereby providing a further stimulus for retirement savings. More notably, all dividends paid from one South African company to another are now exempt without regard to whether those companies are within the same group of companies or not. This South African company-to-company exemption represents an essential element of a classical model of taxing dividends.

It should be noted that the 10 per cent rate of Dividends Tax can be reduced due to tax treaties. This reduction generally occurs only if the shareholder accruing the dividend owns a minimum percentage of shares in the company paying the dividend (typically between 10 and 25 per cent). In view of the fact that the Dividends Tax will only come into effect after South Africa's applicable tax treaties are renegotiated, treaty relief will at most reduce the rate of tax on dividends to 5 per cent.

Example 1

Facts: Individual owns all the shares of Company 1, Company 1 owns all the shares of Company 2; and Company 2 owns all the shares of Company 3. Company 3 pays a dividend of R20 000 to Company 2, Company 2 pays a R20 000 dividend to Company 1; and Company 1 pays a R20 000 dividend to Individual.

Result: The dividends between the companies are not subject to any Dividends Tax. The Dividends Tax applies only once the amount is paid to Individual.

Example 2

Facts: Company X is a listed company on the JSE. Company X has issued one million ordinary shares. Of these ordinary shares, 500 000 are held by natural persons who are residents; 300 000 are held by South African retirement funds; 120 000 are held by South African companies, and 80 000 are held by nonresidents. Company X pays a dividend of R5 per share.

Result: The dividends paid to resident natural persons are subject to the Dividends Tax. The dividends paid to retirement funds and South African companies are exempt. Nonresidents theoretically may be entitled to tax treaty benefits but their separate requisite share interests in Company X are probably insufficient to qualify for treaty relief (falling short of the 10-to-25 percentage).

B. Transitional arrangements

[Applicable provisions: Clauses 51(1)(a) and 53; sections 64B(1) and 64J]

1. Comparison of the STC and Dividends Tax timing rules

As a general matter, the company liability for STC arises when dividends are declared. This company liability is reduced when that company accrues dividends from other companies. The purpose of this offset (commonly known as STC credits) is to ensure that the STC arises only once in respect of the same economic profits when distributed through various chains of company shareholders.

The STC credit system requires dividends accrued to be offset against dividends declared. This offset is achieved through the concept of a dividend cycle. A dividend cycle ends on the date that a dividend declared by the company accrues to the shareholder. A new dividend cycle starts on the following day. If the amount of STC credits exceeds the amount of dividends declared by that company, the excess is carried forward to the next dividend cycle.

On the other hand, the liability for the Dividends Tax arises when the dividend is paid to non-exempt beneficial owners of dividends. For the first five years after the effective date of the Dividends Tax, unused STC credits can be used as an offset against dividends paid.

2. Co-ordination between the STC and the Dividends Tax

Special transitional rules exist between the STC and the Dividends Tax to prevent double taxation (or under-taxation). The STC applies to dividends declared before the effective date of the Dividends Tax, even if paid after that effective date. These dividends will not be subject to the Dividends Tax. In addition, the last dividend cycle ends on the day before the Dividends Tax system becomes effective (this latter ending of the cycle cuts off further STC credits under the old system with new STC credits arising only under the terms of the Dividends Tax).

3. Use of STC credits against the Dividends Tax

Relief is proposed for dividends paid by companies that have unused STC credits after the effective date of the Dividends Tax. This relief ensures that profits previously subject to the STC are not subject to another tax (i.e. the Dividends Tax) when subsequently passing through resident companies. The total STC credits of a company are the cumulative amount of dividends which accrued (or are deemed to have accrued) to the company up to the last dividend cycle under the STC system (and which exceeded the dividends declared up to the last day of that dividend cycle). As discussed above, the last dividend cycle ends on the day before the Dividends Tax becomes effective.

Dividends paid on or after the effective date of the Dividends Tax by companies with STC credits will always reduce the balance of their STC credits. For purposes of administrative convenience, STC credits will be exhausted first (i.e. a company will not be entitled to pay a dividend which does not reduce STC credits). Moreover, STC credits of a resident company may be increased (i.e. transferred from one company to another) if a dividend is paid to that company from another resident company. This increase of STC credits will be possible only if the company paying the dividend has provided the recipient shareholder of the dividend with prior written notice of the amount by which its STC credit has been allocated to that shareholder (otherwise the STC credits are simply lost).

STC credits must be allocated on a *pro rata* basis amongst all shareholders within the same class entitled to the dividends, irrespective of whether those shareholders are exempt from the Dividends Tax. However, notification of the STC credit transferred will only be required if the recipient of the dividend is a

resident company. STC credits will work themselves up through a chain of South African resident companies.

STC credits have a five year cut-off after the effective date. More specifically, all STC credits remaining (if any) will terminate on the fifth anniversary of the effective date of the Dividends Tax.

Example 1

Facts: Company X, an unlisted company, declares dividends on 1 July 2010. The dividends are paid to shareholders on 15 October 2010. Assume that the new Dividends Tax comes into effect on 1 October 2010.

Result: The dividends are subject to STC because they are declared prior to the effective date. Payment after the effective date in this instance is irrelevant.

Example 2

Facts: Company X, a listed company, declares dividends on 1 July 2010 subject to the condition that the dividend will be payable to shareholders registered on the company's share register on 1 August 2010. Dividends are paid on 31 October 2010. Assume that the new Dividends Tax comes into effect on 1 October 2010.

Result: The dividends are subject to STC because they are declared and accrue prior to the effective date. Payment after the effective date in this instance is irrelevant.

Example 3

Facts: Company X has two shareholders (SA Pension Fund and Individual). SA Pension Fund and Individual each hold 50 per cent of the shares of Company X. Company X has R400 of STC credits (i.e. Company X has retained R400 of dividends previously subject to STC). Company X distributes R600 to its shareholders by way of a dividend.

Result: Of the R600 dividend, the Dividends Tax does not apply to the first R400 by virtue of the existing STC credits. Of the remaining R200, R100 is allocated to each shareholder. This means that R100 of the dividend (i.e. that is paid to Pension Fund) will be exempt, and the other R100 (i.e. that is paid to Individual) will be taxed at 10%.

Example 4

Facts: Company X has two resident shareholders (Company Y and Individual). Company Y and Individual each hold 50 per cent of the shares of Company X. Company X has R400 of STC credits (i.e. has retained R400 of dividends previously subject to STC). Company X distributes a total of R600 to both of its shareholders by way of a dividend.

Result: Of the R600 dividend, the Dividends Tax does not apply to the first R400 by virtue of the existing STC credits. Of the remaining R200, R100 is allocated to each shareholder (meaning that the R100 paid to Company Y is exempt and the other R100 paid to Individual is subject to the Dividends Tax). The R400 of STC credits is similarly apportioned with Company Y receiving R200 of STC credits on notification by Company X (thereby providing relief from Dividends Tax when Company Y pays dividends).

C. Revised definitions

Clause 47(1)(g) and (h); Applicable provisions; section 1 ("contributed tax capital" and "dividend" definitions)

1. New definition of "dividend"

For purposes of the Dividends Tax, a new dividend definition will be added to the Act. This new definition treats any amount transferred (or applied) by a company to (or for the benefit of) a shareholder by virtue of a share as a dividend. An amount transferred would include an operating or liquidating distribution, or any amount paid in redemption, cancellation or otherwise in consideration for shares surrendered (e.g. through a buyback). The amount transferred may consist of money as well as the market value of every other form of property (i.e. dividends *in specie*).

The definition contains four exclusions. Firstly, dividends do not include amounts resulting in a reduction of contributed tax capital (see below). Secondly, dividends do not include situations where a company transfers its own shares (i.e. issues its own shares as a distribution). The transfer of a company's own shares is not within the dividend definition on the basis that this form of transfer does not result in an outflow of overall value from the company (all underlying assets remain with the distributing company). Thirdly, an open market purchase by a listed company of its own shares on the JSE is not a dividend (because, as a practical matter, the purchaser cannot distinguish this purchase from any other JSE market purchase). Fourthly, dividends do not include redemptions of a participatory interest in a foreign collective investment scheme.

2. Definition of "foreign dividend"

The new rules above apply only to domestic dividends. The rules for foreign dividends will be revised before the Dividends Tax comes into effect.

3. New definition of "contributed tax capital" ("CTC")

a. Basic rules

The CTC of a company is a notional amount derived from the value of any contribution made to a company as consideration for the issue of shares by the company. CTC will be reduced by any amount that is allocated by the company in a subsequent transfer to one or more shareholders.

As a general rule, the CTC of a company is based on amounts received by or accrued to a company as consideration for the issue of shares by the company. For instance, if an individual contributes an asset worth R100 to a public company in an offer of shares to the public, R100 is added to CTC. Applying basic principles, an amount received by or accrued to a company as consideration for the issue of shares would mainly include cash or the value of an asset received by or accrued to the company. CTC would also include the value of services provided by a person to the company as consideration for a share issue or the cancellation of a loan account owed by the company as consideration for the issue of shares.

As a transitional measure, the share capital and share premium of a company immediately before the effective date of the Dividends Tax will generally operate

as the “starting” CTC. However, amounts of share capital and share premium that would have constituted a dividend had they been distributed immediately before the effective date of the Dividends Tax are excluded from “starting” CTC. In other words, “starting” CTC does not include “tainted” share capital or share premium.

In order for a transfer from a company to a shareholder to constitute a reduction of CTC (and accordingly fall outside the “dividend” definition), the definition of CTC requires that the company directors (or other persons with comparable authority) determine that the transfer constitutes a transfer of CTC. Without this determination (which could, for example, take the form of a company resolution), no reduction of CTC can occur (and the amount transferred would constitute a dividend subject to the Dividends Tax). In order for this determination to be valid, the determination must be made immediately before the transfer.

b. Class-by-class and pro rata shareholder rules

If a company has issued several classes of shares, CTC must be maintained separately on a per class basis. Therefore, CTC created by virtue of an ordinary share issue cannot be allocated or reallocated to preference shares. Similarly, distributions in respect of preference shares cannot be used to reduce the CTC associated with ordinary shares. If a company makes a distribution out of CTC in respect of a given class of shares, the CTC distributed will be allocated *pro rata* to all of the shareholders of that class.

Example

Facts: Company X has two ordinary shareholders (Shareholders A and B) and one preferred shareholder (Shareholder C). Shareholder A owns 25 ordinary shares and Shareholder B owns the other 75 ordinary shares. Company X has CTC of R150 in respect of its preference shares and R380 in respect of its ordinary shares. As part of a written company resolution when making a distribution to its ordinary shareholders of R200 (R50 to Shareholder A and R150 to Shareholder B), Company X decides to allocate R60 of the ordinary share CTC to the ordinary distribution.

Results: The amount of CTC that is transferred to shareholders A and B will be calculated as follows:

CTC transferred to A = 25 per cent x 60 = R15
CTC transferred to B = 75 per cent x 60 = R45

Hence, shareholder A receives a dividend of R35 (i.e. R50 less R15 of CTC). Shareholder B receives a dividend of R105 (i.e R150 less R45 of CTC). The dividend portion of the distributions is subject to the Dividends Tax, and the CTC portion is viewed as capital distributions that fall within the Capital Gains Tax.

4. CTC and company reorganisation rollovers

The company reorganisation rules [restoring amendments made in the Revenue Laws Amendment Act, 2000] of sections 41 through 47 potentially require special adjustments for the CTC calculation (similar to other rules such as base cost, cost price and allowances). More specifically, special CTC rules apply in the case of asset-for-share transactions under section 42, amalgamation transactions under section 44 and unbundling transactions under section 46.

a. CTC and Section 42 asset-for-share rollovers

Section 42 asset-for-share rollover transactions give rise to special CTC calculations in two sets of circumstances. Firstly, these special CTC rules apply if the person disposing of the asset holds 20 per cent or more of the equity shares and voting rights of the company at the close of the day on which the asset is disposed of. Secondly, the rules will apply if the person disposing of the asset is a natural person who will be engaged on a full time basis in the business of the company (or of a controlled group company in relation to that company) of rendering a service. These rules apply regardless of whether the asset disposed of constitutes a capital asset or trading stock. In both circumstances, the amount of CTC will be the "tax cost" of the asset, irrespective of its market value.

Example

Facts: Individual X contributes an asset in terms of a section 42 asset-for-share transaction. Company Y issues shares to Individual X in exchange. At the close of the transaction, Individual X holds 30 per cent of the shares in Company Y. The base cost of the asset in the hands of Individual X is R10 immediately before the transaction. The market value of the asset is R100.

Result: The amount of CTC that is contributed to Company Y is equal to the base cost of the asset to Individual X (i.e. R10) and not its market value (i.e. R100). The CTC rules essentially mimic the other section 42 base cost, cost and cost price rules. Hence, in the case of a section 42 rollover to a listed company where the transferor fails to hold the 20 per cent threshold, the resulting CTC from a capital asset contribution is equal to the market value (not rollover base cost) of the asset.

b. CTC and section 44 amalgamations

A section 44 amalgamation transaction involves the disposal by an "amalgamated" (or target) company of all its assets to a "resultant" (or acquiring) company. The outcome of the transaction is that the existence of the target company is terminated (i.e. the target company is "merged" into the resultant company). As a necessary consequence, the effect of an amalgamation transaction should be that the CTC of the target company should be added to the CTC of the resultant company. However, if the target company transfers CTC to its shareholders as part of the transaction, that portion of the CTC so transferred will not "roll over" into the resultant company.

Example 1 (simple amalgamation)

Facts: Target Company and Acquiring Company are completely independent from one another with neither company holding any shares in the other. Target Company disposes of all of its assets to Acquiring Company in terms of a section 44 amalgamation transaction. The CTC in Target Company is R200, and the CTC in Acquiring Company is R300. As a result of the transaction, the existence of Target Company is terminated.

Result: The resulting CTC in Acquiring Company will be R500 (i.e. R200 plus R300).

Example 2 (amalgamation preceded by a CTC transfer)

Facts: The same as Example 1, except that Target Company makes a cash distribution of R80 to its shareholders as part of the amalgamation. This transfer includes a R50 CTC allocation.

> ***Result:*** Only R150 of the CTC in Target Company will be "rolled over" to Acquiring Company. The resulting CTC in Acquiring Company will therefore be R450 (i.e. R150 plus R300).

Special considerations exist if the acquiring company holds shares in the target company immediately before the amalgamation transaction. In these circumstances, the CTC in the target company cannot simply be added to the CTC in the acquiring company. The amount of CTC in the target company must first be reduced by the percentage shareholding that the acquiring company holds in the target company immediately before the amalgamation. Effectively, this means that only a pro-rated portion of the CTC in the target company is "rolled over" to the acquiring company. Without this rule, CTC could effectively be transferred to a shareholder (which cannot be achieved *via* an operating distribution or by a liquidating distribution). This pro-rated portion is calculated as follows:

$$\text{Amount of CTC of target company that is transferred to acquiring company} = \frac{\text{Value of shares in target company held by shareholders other than acquiring company}}{\text{value of all shares in target company}} \times \text{CTC of target Company at time Of its termination}$$

> **Example 3**
>
> ***Facts:*** Target Company disposes of all of its assets to Acquiring Company in terms of an amalgamation transaction. Acquiring Company holds 10 per cent of Target Company immediately before the transaction (with the remaining 90 per cent held by other shareholders). As a result of the transaction, the existence of Target Company is terminated. The CTC in the Target Company is R400, and the total value of the Target Company shares is R1 000.
>
> ***Result:*** The amount of CTC of Target Company that is transferred to Acquiring Company is calculated as follows:

$$\text{Amount of CTC in Target Company rolled over to Acquiring Company} = \frac{R900}{R1000} \times R400$$

$$= R360$$

c. CTC and section 46 unbundling transactions

A section 46 unbundling transaction essentially involves one company (i.e. the unbundling or "parent" company) distributing the shares held in another company (i.e. the unbundled or "subsidiary" company). In the case of an unbundling, the CTC in the parent (i.e. unbundling) company will need to be allocated between the parent company and the subsidiary (i.e. unbundled) company according to their relative market values. The historic CTC of the unbundled subsidiary will generally be lost. This rule is similar to the rules for the determination of the base cost of the shares that are unbundled to shareholders of the unbundling company.

Example 1

Facts: Parent Company owns all the shares in Subsidiary. The CTC in Parent Company is R750, and the CTC in Subsidiary is R500. Parent Company has a value of R1 000 (excluding the value of Subsidiary) and Subsidiary has a value of R500 (together they have a value of R1 500). All the shares of Subsidiary are unbundled to the Parent Company shareholders.

Result: The CTC in Parent Company of R750 must be reduced to R500 (i.e. R1 000 / R1 500 x R750). The old CTC in Subsidiary of R500 is simply lost. Instead, Subsidiary obtains new CTC of R250 (R500/R1 500 x R750) based on the former Parent Company CTC.

The unbundling transaction CTC calculation becomes slightly more complicated if a portion of the shares in the unbundled company is held by parties other than the unbundling parent company immediately before the unbundling. In these circumstances, a *pro rata* portion of the CTC attributable to the shares held by these outside parties is preserved.

Example 2

Facts: Parent Company owns 900 shares of Subsidiary with the remaining 100 shares held by Individual X. The CTC in Parent Company is R4 000, and the CTC in Subsidiary is R800. Parent Company has a value of R15 000 (excluding the value of Subsidiary) and Subsidiary has a value of R5 000. All 900 shares of Subsidiary held by Parent Company are unbundled to the Parent Company shareholders. Individual X retains the 100 shares previously held.

Result: The CTC in Parent Company of R4 000 must be reduced to R3 000 (i.e. R15 000/R20 000). In terms of the old CTC in Subsidiary of R800, only R80 is retained by virtue of Individual X's interest ((100 Individual X shares / 1 000 total shares x R800); the remaining R720 is simply lost. Subsidiary additionally adds R1 000 of CTC (R5 000 / R20 000 x R4 000) based on the former Parent Company CTC. In total, Subsidiary has R1 080 of CTC upon completion of the unbundling.

IV. Effective date

The Dividends Tax will become effective on a date determined by the Minister of Finance (at least three months after publication) by notice in the Government Gazette.

3.4. DIVIDENDS TAX: WITHHOLDING

[Clause 53; Applicable provisions: Sections 64G; 64H, 64K, 64L and 64M]

I. Background

The main object of the Dividends Tax is to convert the current system of imposing tax on companies (pursuant to the Secondary Tax on Companies) to a system of imposing tax on company shareholders. While the new system is better aligned with international practice, the new system requires a different method of tax collection.

One key feature of the new system (i.e. Dividends Tax) relates to the withholding mechanism. The old system (i.e. STC) was based on the collection of tax from the company declaring the dividend. This ease of collection stemmed from the fact that the tax charge fell on the company paying the dividend. The new system depends on the type of shareholder receiving the dividend. The withholding mechanism of the new system accordingly must cover a wide range of shareholders, some of which are taxable, exempt, or entitled to a reduced rate in terms of a treaty.

In essence, the new system initially requires the company declaring the dividend to withhold the Dividends Tax on payment. However, liability for withholding shifts if the dividend is paid to regulated intermediaries so that the primary withholding obligation falls on the regulated intermediary. The withholding tax for both the paying company and the regulated intermediary can also be eliminated or reduced upon timely receipt of a written declaration that the beneficial owner is entitled to exemption or tax treaty relief.

II. Reasons for change

It is proposed that the Dividends Tax provisions be enacted long before the effective date so as to provide the impacted parties with sufficient time to adjust their compliance systems. Another purpose of this early release is to allow for legislative adjustments based on comments received as new compliance systems are established.

Upon review of the initially proposed withholding mechanism, it has become apparent that the withholding rules under the Dividends Tax need to be revised. Issues existed as to the role of intermediaries and the most efficient means of claiming exemption or treaty relief. In order to address these issues, the withholding regime has been substantially modified.

III. Proposal

The revised withholding mechanism is twofold. Depending on the facts, withholding may be required either: (i) by the companies declaring and paying dividends, or (ii) by regulated intermediaries in respect of dividends declared by other companies. Regulated intermediaries are mostly involved in respect of dividends arising from listed shares because regulated intermediaries are typically the only parties who are aware who the registered shareholders of listed companies are (especially in the case of uncertificated shares). However, regulated intermediaries may also hold listed paper shares. Regulated intermediaries include central securities depository participants (“CSDP”), brokers (i.e. authorised users or approved nominees), collective investment schemes in securities (“CIS in securities”) and listed investment services providers (“LISP”).

A. Withholding obligation by companies declaring and paying dividends

1. Overview

A company declaring and paying a dividend will generally be liable to withhold Dividends Tax at a rate of 10 per cent of the dividend paid. The amount so withheld must be paid to SARS by the last day of the month following the month in which that dividend was paid. However, a company will not have the liability to withhold if the company (i) has received a declaration of exemption from the Dividends Tax in respect of the beneficial owner of a dividend or (ii) makes a payment to certain entities. In addition, a company may be only required to withhold at a reduced rate if the company has received a declaration of treaty relief in respect of the beneficial owner.

2. Withholding liability relief

a. Declarations

A company declaring and paying a dividend must not withhold Dividends Tax if the company has a written declaration that of the beneficial owner is entitled to a dividend exempt from the Dividends Tax. If the registered owner of the shares in respect of which the dividend is paid is the beneficial owner of the dividend, the registered owner (as beneficial owner) must submit the declaration. However, if the registered owner is not the beneficial owner of the dividend, the registered owner must submit the declaration of the beneficial owner to the company paying the dividend to enable the beneficial owner to benefit from an exempt dividend.

Similarly, a company declaring and paying a dividend must withhold Dividends Tax at a reduced rate if the company has a written declaration that the beneficial owner is entitled to tax treaty relief. The required process of declarations for tax treaty relief is the same as the process for receiving declarations for exemption (except for the additional requirement of submitting the received declaration to SARS.

b. Form and Timing of declaration

The declaration forms in the case of a claim for exemption or treaty reduced rate will be prescribed by the SARS. In order for these forms to be effective for purposes of withholding, these forms must be submitted to the company (or regulated intermediary) by a specified due date. If forms are submitted after the due date, withholding must occur in full despite an applicable exemption or treaty reduction.

If the company paying the dividend is the withholding agent, the company dividend must set a due date before which the declaration form must be submitted. If the company does not set a date, the declaration will be valid if received by the company by the date of payment of the dividend (i.e. accrual to the beneficial owner). In other words, the declaration of the beneficial owner must be submitted at the earlier of the date set by the company or the date of payment of the dividend.

It should be noted that late submission of the declaration form does not mean that the amount of Dividends Tax withheld from the dividend becomes a final tax.

Late declaration forms can still be used in order to claim refunds (see segment C below).

Example

Facts: Company X declares a dividend on 1 March 2013 and does not set a date for the submission of exemption or reduced rate declarations. Company X pays a dividend to Company Y (a non-resident company) and Company Z (a resident company) on 1 April 2013. Company Y submits the declaration of entitlement to a tax treaty reduced rate on 5 April. Company Z submits a declaration of exemption on 30 March.

Result: Company X is not liable to withhold the tax on the dividend paid to Company Z because Company Z is exempt from tax by virtue of Company Z's status as a resident company and because Company Z has submitted the declaration before the date of payment of the dividend (the required date since Company X failed to set a date). Company X must withhold the full amount of tax in respect of the dividend paid to Company Y despite Company Y's treaty status because Company Y did not submit the declaration in a timely manner. Company Y can still claim a refund (see below).

c. Other exemptions

In addition to the above, a company paying a dividend can take into account automatic exemptions from withholding without receipt of a declaration form. This form of withholding exemption arises in two circumstances:

- If the company paying a dividend pays the dividend to a regulated intermediary (with the regulatory intermediary assuming the withholding obligation – "Withholding obligation by regulated intermediaries"); or
- If the company paying the dividend forms part of the same group of companies (as defined in section 41) as the company receiving the dividend.

Example

Facts: Holding Company owns all the shares of Subsidiary, both of whom are South African tax residents. Subsidiary pays dividends to Holding Company.

Result: Subsidiary has no obligation to withhold in respect of dividends paid to Holding Company. No declaration forms are required to receive this exemption.

B. Withholding obligation by regulated intermediaries

As discussed above, a company declaring and paying a dividend to a regulated intermediary is automatically exempt from withholding (without the need for a declaration form). The regulated intermediary then becomes liable for withholding from the dividend declared and paid by the other party. These circumstances mainly arise when listed companies declare and pay dividends because listed shares are typically reflected in the share registers kept by various regulated intermediaries.

The rules for withholding in respect dividends paid by regulated intermediaries are similar to the withholding rules for dividends paid and declared by companies. Regulated intermediaries are required to withhold unless these intermediaries

receive a timely declaration for exemption or treaty reduction. The rules relating to declarations are the same as those outlined above (see "Withholding obligation by companies declaring and paying dividends).

Regulated intermediaries also receive an automatic exemption (i.e. an exemption without the need for a declaration) when paying dividends to another regulated intermediary. The latter intermediary then has the withholding obligation.

Example

Facts: Company X pays a dividend to CSDP 1 (i.e. a regulated intermediary). CSDP1 pays the same dividend to CSDP 2 (i.e. a regulated intermediary). CSDP 2 pays the dividend to Company X, a South African resident.

Result: Company X and CSDP 1 will be automatically exempt from withholding (without being required to receive a timely declaration) because both entities are making payment to a regulated intermediary. CSDP 2 is entitled to exemption from withholding if CSDP 2 receives a timely declaration from Company X.

C. Refunds of Dividends Tax withheld due to late declarations

If the declaration for exemption or treaty reduction is not received by the date required, amounts withheld in respect of that dividend may still be refundable. In order for these amounts to be refundable, the declaration of the beneficial owner must be submitted within a period of three years after payment of the dividend (refunds are not permitted for declarations submitted after this date). The manner in which the refund mechanism operates depends on whether the withholding was performed by the company paying and declaring the dividend or by a regulated intermediary.

1. Refunds in respect of dividends declared and paid by companies

If a refund is claimed in respect of amounts withheld by the company declaring and paying the dividend, the company is the party responsible for paying the refund to the beneficial owner. These refunds can be funded from one of two sources.

The primary source relates to withholding from future dividends paid by the company. More specifically, if the company pays another dividend within one year after the submission of the (late) declaration, the company must refund the amount out of future amounts of dividends tax withheld.

To the extent that refunds cannot be drawn from withholding arising from future dividends within the one year period, the company can claim a refund of the shortfall from SARS (with the company then paying that amount to the person entitled to the refund). However, the company may not recover any amount from the SARS if the claim for the refund is made after four years from the date of payment of the dividend.

Example 1

Facts: Company X has five shareholders, four of whom are individuals and one is Company Y (a South African company). All shareholders hold an equal 20 per cent share interest in Company X. Company X declares a dividend of 300 000 on 10 April 2012 (providing R60 000 to each shareholder before subtraction of the Dividends Tax). Company Y fails to submit a timely declaration indicating Company Y's entitlement to exemption. Company Y submits the declaration on 18 May 2012 (in respect of the dividend, which was paid on 10 May 2012). Company X declares a further dividend of R100 000 on 10 January 2013, which is paid on 30 January 2013.

Result: Because the late submission of the declaration, Company X must withhold the R6 000 from the R60 000 dividend declared to Company Y. However, Company Y can claim a refund because the declaration was submitted within three years after the dividend was paid. Company Y can refund the full R6 000 once Company X withholds dividends tax from the R100 000 declared to its shareholders in early 2013 because Company X can retain R6 000 of the withholding tax otherwise due to SARS.

Example 2

Facts: The facts are the same as Example 1, except that the 2013 taxable dividend amount only to R20 000.

Result: Company X can only draw upon R2 000 withholding otherwise due to SARS as a source of refunds. Assuming no other dividends are paid by Company X in 2013, Company X must seek recovery from SARS for the remaining R4 000 refundable amount.

2. Refunds in respect of dividends paid by regulated intermediaries

If a refund is claimed in respect of amounts withheld by a regulated intermediary paying the dividend, the regulated intermediary is the party responsible for paying transmitting the refund to the beneficial owner. Unlike withholding by companies paying and declaring dividends, these refunds can be funded from only one source.

This source is withholding tax from future dividends paid by the regulated intermediary. More specifically, if the regulated intermediary pays another dividend, the regulated intermediary must make the refund from amounts required to be withheld after the request for a valid refund is received. The dividends from which the amount of tax must be refunded by the regulated intermediary need not relate to the same company that paid the dividends in respect of which the tax was withheld. In the case of regulated intermediary withholding, no right of recovery exists against SARS.

Example

Facts: Company X (a listed company) declares dividends of R5 million to Pension Fund. Pension Fund owns 2 per cent of Company X's shares. Pension Fund fails to submit its declaration for exemption on time. Regulated Intermediary accordingly withholds 10 per cent of the dividend (i.e. R500 000) from the amount paid to Pension Fund. One week later, Regulated Intermediary pays a R20 million dividend on behalf of Company Y. Looking at the Company Y dividend in isolation, Regulated Intermediary must withhold R1.8 million.

Result: Regulated Intermediary can utilise the R1.8 million otherwise due to SARS as a source of refunding Pension Fund. It makes no difference that the refund relates to a Company Y dividend as opposed to a Company X dividend.

D. Specialised entities

[Clauses 39 and 53; Applicable provisions: Section 25BA and 64I]

Both collective investment schemes in securities and long-term life insurers are subject to unique rules in respect of the Dividends Tax. Both sets of entities are economically acting on behalf investors whilst having a more independent stake than a mere nominee.

1. Collective investment schemes in securities

The Dividends Tax does not contain special rules in respect of collective investment schemes in securities other than the treatment of these schemes as regulated intermediaries. The unique treatment of collective investment schemes stems from the flow-through treatment added by this amendment act (see notes on **Collective Investment Schemes in Securities: Conduit Principles**). More specifically, flow-through treatment will apply if the dividend received by the CIS is distributed to its unit holders within one year after receipt by the CIS. If the CIS fails to distribute within this one-year time limit, the CIS will be taxed.

Example

Facts: Listed Company pays dividends to various persons, including CIS. CIS receives R15 million of these dividend on 10 March 2011. On 1 June 2011, CIS distributes these dividends to the CIS unit holders, of which 80 per cent consist of individuals and 20 per cent consist of companies. All CIS unit holders are residents.

Result: Listed Company is not required to withhold any amount because the payment is made to a collective investment scheme (which is viewed as a regulatory intermediary). CIS is required to withhold dividends tax from amounts payable to the unit holders with potential exemption for the amounts paid to the companies (depending on whether timely declarations are received).

2. Long-term insurers

Long-term insurers operating under the four funds system require special rules because the system is based on the trustee principle. The untaxed and company and the corporate policyholders funds all represent taxpayers who are exempt under the dividends tax. However, dividends allocated to the individual policyholder fund represent amounts conceptually within the dividends tax system.

In terms of the overall system, dividends paid to long-term insurers are exempt from withholding like any other company accruing dividends (i.e. with the exemption based on a timely declaration). The insurer will be responsible for paying the dividends tax in respect of dividends allocable to the individual policyholder fund.

IV. Effective date

The Dividends Tax will become effective on a date determined by the Minister of Finance (at least three months after publication) by notice in the Government Gazette.

3.5. DIVIDENDS TAX: PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING

[Clauses 34, 69 and 72; Applicable provisions: section 22B; paragraphs 19 and 43A of the Eighth Schedule]

I. Background

The Dividends Tax imposes a 10 per cent tax on dividends paid to a person who is a beneficial owner of the dividend. The tax is imposed at the shareholder level. Certain shareholders are exempt from the Dividends Tax, including South African companies.

Proceeds from the disposal of shares held as capital assets are subject to the capital gains tax at effective rate of 10 per cent for individuals and 14 per cent for companies. Consideration from the sale of shares held as trading stock is subject to income tax at 40 per cent in the case of individuals and at 28 per cent in the case of companies.

II. Reasons for change

The Dividends Tax can give rise to arbitrage opportunities for company shareholders. In particular, an incentive exists for company shareholders intending to sell shares to rather convert sale proceeds/consideration to dividends. As a general matter, this conversion eliminates capital gains subject to a 14 per cent (50 per cent of 28 per cent) rate. In some instances, this conversion may eliminate ordinary revenue.

The conversion of taxable sale proceeds to exempt dividends requires some basic mechanics. In the simplest case, the target company being sold can distribute excess profits to the selling shareholders. These pre-sale dividends will reduce the selling price (thereby reducing sale proceeds/consideration for purposes of the tax calculation). Pre-sale dividends of this nature may involve distributions by the target company of excess cash or of assets unwanted by the purchaser.

Oftentimes, however, the target company does not have excess cash or assets that are unwanted by the purchaser. In these instances, the conversion of capital gains to pre-sale dividends will require indirect support from the purchaser. This indirect support can be in a variety of forms, including:

- The prospective buyer can make a contribution to the target company in exchange for target company shares so the contribution proceeds can be distributed as a pre-sale dividend; or

- The target company can take out a loan from the purchaser or that is guaranteed, secured or otherwise initiated by the prospective purchaser so the loan proceeds can be distributed as a pre-sale dividend.

While an argument could be made that pre-sale dividends are a mere accumulation of profits that could have been distributed previously, this argument becomes suspect once the cash funding is coming from the purchaser. Purchaser-funded pre-sale dividends economically amount to sale proceeds and will be utilised almost exclusively to undermine the South African tax base.

III. Proposal

This proposal seeks to deny the company shareholder arbitrage advantage arising from arrangements involving pre-sale dividends that are directly or indirectly funded by purchasers. This proposal falls into three parts: (i) dividend conversions to capital gain proceeds, (ii) dividend conversions to trading stock gross income, and (iii) refinement of the anti-capital loss pre-sale dividend rule.

A. Dividend conversion to capital gains proceeds

This proposal seeks to prevent the conversion of taxable capital gain proceeds to exempt pre-sale dividends. This rule essentially applies when a person disposes of shares in a target company if four conditions exist:

1. the person disposing of the shares is a domestic company;
2. that person holds at least 50 per cent of the shares in a domestic target company;
3. that person received a dividend in respect of the target company shares 18 months prior to or as part of the disposal; and
4. the target company is viewed as having received pre-funding from the purchaser.

Pre-funding will be deemed to exist in two general circumstances. First, pre-funding will be deemed to exist if, 18 months before the disposal, the purchaser of the disposed shares contributed funds to the target company in exchange for target company shares. Second, pre-funding will be deemed to exist if the target company borrows funds 18 months before the disposal and the borrowing is: (i) obtained from the purchaser or (ii) guaranteed or secured by the purchaser, and if the circumstances of (i) or (ii) arise "by reason of or in consequence of" the share disposal. The target company subject to this borrowing limitation includes any company in which that target company directly or indirectly holds more than 50 per cent of the equity share capital. For purposes of both sets of pre-funding rules, the purchaser undertaking the impermissible lending, guaranteeing or securing includes any connected person in relation to that purchaser immediately before the share disposal.

Example

Facts: Parent Company owns all the shares in Subsidiary, which have been held for many years. Parent Company's shares in Subsidiary have a base cost of R3 million and a market value of R5 million. Subsidiary borrows R2 million (guaranteed by Purchaser) and

distributes R2 million to Parent Company as a dividend. Immediately after the dividend, Parent Company sells the Subsidiary shares to Purchaser for R3 million.

Result: In the absence of the pre-sale dividend rule for capital gains, the dividend of R2 million would be exempt in the hands of Parent company. The proceeds from the sale of subsidiary would also have no capital gains since the sale proceeds do not exceed the subsidiary's base cost (once the pre-sale dividend is taken into account). With the pre-sale dividend rule, the R2 million dividend paid to the Parent Company will be additional proceeds in the hands of Parent Company, thereby triggering R2 million of gains subject to capital gains tax.

B. Trading stock dividends

The rule for trading stock mirrors the rule for capital gains. This rule for trading stock prevents the conversion of gross income into exempt pre-sale dividends. If the pre-sale dividend rule for trading stock applies, the dividend received by the company disposing of the target company shares will be included in the disposing company's income. This rule will apply in addition to the case law on dividend stripping (see CIR v Nemojim (Pty) Ltd, 45 SATC 241).

C. Anti-capital loss rule

The anti-capital loss rule of paragraph 19 of the Eighth Schedule will remain as a backstop. This rule ensures that taxpayers selling shares may not benefit from artificial losses generated by pre-sale dividends. However, under the new test, the application period for the rule is reduced from 24 to 18 months, and this anti-capital loss rule only applies to dividends exempt under section 64F of the Dividends Tax regime.

IV. Effective date

The Dividends Tax will become effective on a date determined by the Minister of Finance (at least three months after publication)by notice in the Government Gazette.

3.6. DIVIDENDS TAX: VALUE EXTRACTION TAX

[Clause 54; Applicable provisions: Sections: 64O; 64P; 64Q; 64R;]

I. Background

A. Current STC liability for deemed dividends

As discussed previously, the liability for STC falls on the company distributing the dividend. In an attempt to avoid liability for STC, companies sometimes seek to distribute amounts through other guises, such as making loans to shareholders that will never be repaid. However, the STC has provisions designed to prevent these disguised extractions. Dividends are accordingly deemed when a domestic company enters into certain transactions with one or more shareholders, thereby triggering STC. Most notably, deemed dividends can arise from:

- a company loan or advance to a shareholder;
- the cancellation or reduction of a company loan previously made to a shareholder;
- cross-border over-payments and underpayments subject to section 31 transfer pricing adjustments;
- the movement of a domestic company's tax residence to a foreign location; and
- payments of interest viewed as dividends in respect of hybrid debt instruments.

These anti-avoidance rules not only target company transactions with their shareholders but also connected persons. More precisely, the anti-avoidance rules cover all persons who are connected in relation to the shareholders.

B. Exemptions

The deemed dividend rules contain a number of exemptions. Most notably, these exemptions include:

- amounts viewed as remuneration;
- loans with an interest rate of not less than the "official rate of interest";
- intra-group transactions;
- transfers to controlled group companies; and
- transfers to employee share scheme trusts.

II. Reasons for change

Even though the Dividends Tax applies at a shareholder-level, essentially the same incentive exists to avoid dividend treatment. Consequently, the Dividends Tax still needs anti-avoidance rules to prevent company extractions of value that seek to circumvent taxable dividend treatment.

In considering these anti-dividend avoidance rules, it is recognised that the current deemed dividend rules are too broad. Anti-avoidance rules should not apply to transactions supported by non-tax commercial realities.

III. Proposal

A. Overview

Companies undertaking value extraction transactions will be subject to the new Value Extraction Tax at a rate of 10%. Value extractions exist to the extent that value is extracted from a company in the forms specified below, but only to the extent that value extraction is not already viewed as an actual dividend.

Unlike the dividends tax, the value extraction tax falls on the company undertaking the transaction, not the party benefiting from the extraction. The company payor therefore operates as the party liable for any value extraction taxes ultimately due. This means that no withholding mechanism is required. If a value extraction exists, the company must pay the tax by the last day of the month following the month in which the value extraction is undertaken.

B. Imposition triggers

The value extraction tax arises only in respect of domestic companies seeking to extract value without declaring dividends (foreign companies are outside of South African taxing jurisdiction). Transactions described as “value extraction” fall into four categories:

1. Loans or advances provided by a company to a connected person at below-market interest rates;

2. Release or relief of company loans previously made to connected persons;

3. Company settlement of a debt owed by a connected person to a third party;

4. Offshore movement of a company‘s residence status.

A company is liable for the payment of Value Extraction Tax once value is extracted from it as a result of the above transactions. The company must pay the tax by the last day of the month following the month in which value extraction is effected. Failure to pay the tax within the required period will result in interest being charged on the outstanding amount.

1. Loans or advances at below-market-related rate

Unlike the deemed dividend rules under the STC, the Value Extraction Tax will not fall on the principal amount. The charge will only fall upon the interest differential between the market-related rate and what the borrower actually charged. In terms of these rules, the market-related rate in respect of a loan or advance provided to a natural person or a trust is the official rate of interest as defined in the Seventh Schedule.

The market-related rate of interest for companies in respect of Rand denominated loans or advances is the average South African repurchase rate plus one percentage point. The market-related rate in respect of loans or advances denominated in foreign currency is the rate of interest equal to the average of the equivalent of the South African repurchase rate that applies in respect of that currency plus one percentage point.

The market-related comparison is made per annum for each year based on the averages for that year. In all cases, the triggering date for the value extraction tax falls on the last day of the year of assessment for company effecting the value extraction.

Example 1

Facts: Individual is a connected person to Company X (a company with a financial year ending at the end of February). Company X provides Individual with a loan of R1 million at an average rate of interest of 6 per cent per annum. The loan is provided on 15 March 2012. The average official interest rate is 10 per cent.

Result: The Value Extraction Tax is charged on an amount equal to 4 per cent of the loan. This amounts to R40 000. This liability is triggered at the end of February 2013.

Example 2

Facts: The facts are the same as Example 2. The Company X loan remains outstanding in an amount of R900 000 at an average 6 per cent but the average official rate increased to 12 per cent.

Result: The Value Extraction Tax again applies. This time the difference is based on a 6 per cent differential (12 per cent less 6 per cent) as applied to the R900 000 amount outstanding.

2. Release or relief from company loans

Under the second prong, value extraction arises when a company cancels a portion or the whole loan amount previously granted by the company to a connected person. The amount of this form of value extraction equals the loan amount cancelled. This form of value extraction is triggered on the day the loan amount is cancelled.

Example

Facts: Individual owns all the shares of Company (i.e. Individual and Company are connected persons). Individual owes Company an amount of R500 000. On 15 June 2012, Company reduces the loan owing by R300 000.

Result: The loan reduction amount triggers a R300 000 value extraction. This extraction occurs on 15 June 2012 (with the Value Extraction Tax due by the end of July 2012).

3. Settlement of third-party debts

If a company settles a debt obligation to the third party on behalf of person that is connected to the company, the settlement gives rise to a value extraction transaction to the extent that the connected person has no obligation to repay the amount to the company. The extraction amount is the value of the amount

settled. The triggering date for this form of value extraction is the day of the settlement.

Example

Facts: Individual owns all the shares of Company (i.e. Individual and Company are connected persons). Individual owes R100 000 to Manufacturing Ltd with this loan amount guaranteed by Company. Individual defaults on the loan with Company settling the full loan amount pursuant to the guarantee. The settlement payment is made on 10 March 2012. The guarantee provides Company with a right of recovery from Individual for the paid amount.

Result: Company's payment of the R100 000 amount does not trigger any value extraction due to Company's right of recovery from Individual. However, if Company later waives the right of recovery, this waiver (i.e. release from debt) will be viewed as a taxable value extraction.

4. Movement of company residence offshore

A value extraction transaction arises if a South African company moves its tax residence offshore. This form of value extraction occurs when a company relocates its place of effective management to a foreign jurisdiction. This form of value extraction is largely based on the net value of the company. More specifically, the charge falls upon the gross value of the company's assets after deducting the company's liabilities (and after deducting of the company's aggregate CTC). The company's liabilities implicitly include taxes owed. The value extraction determination and triggering date arises on the day before the company ceases to be a South African tax resident.

Example

Facts: South African Company relocates all of its operations and place of effective management to Country X on 15 August 2011. On 14 August 2011, before the relocation, Company has assets with a gross value of R100 million. Company X also has liabilities of R20 million and contributed tax capital of R25 million.

Result: The relocation triggers a value extraction on 14 August 2011. The value extraction amount equals R45 million (R100 million less R30 million less R25 million).

C. Exemptions

The Value Extraction Tax is subject to two sets of exemptions. The first set mirrors the dividends tax exemptions. A second set of exemptions is unique to the Value Extraction Tax. The scope of these exemptions are broader than the exemptions available under the deemed dividend rules under the STC so as to ensure that the new regime does not hinder commercially-motivated transactions.

1. Exemptions mirroring exemptions under the Dividends Tax

As discussed above, the first set of exemptions mirror those found in the Dividends Tax. These exemptions exist if the value extraction "is effected in favour of" the following:

- a South African resident company;

- a sphere in the South African government (i.e. national, provincial or local);
- an approved public benefit organisation (as contemplated in section 30(3);
- a pension, provident, retirement annuity or other similar benefit fund;
- an exempt South African public entity; or
- an environment rehabilitation trust (as contemplated in section 37A)

In terms of the Value Extraction Tax, determining who the extraction "is effected in favour of" depends on the nature of the value extraction. The main focus of exemptions in respect of loans or advances is on the borrower (be they below market, cancelled or settled). If the borrower is exempt, as per the above, the exemption applies. It should be noted that the application of treaty relief is determined the same way.

Example 1

Facts: Individual owns all the shares of Company X and Company Y. Company X lends Company Y R10 million without interest. The market-related rate is 10%.

Result: The loan or advance is effected in favour of Company Y. Because Company Y is an exempt person, the Value Extraction Tax does not apply despite the lack of interest. The result will still be the same if Company X were to subsequently cancel the loan obligation owed by Company Y.

Example 2

Facts: Individual owns all the shares of Company X, and Company X owns all the shares of Company Y. Company Y lends R5 million without interest to Individual. The market-related rate is 10%. The Company Y loan is made at the instance of Company X.

Result: The exemptions to the Value Extraction Tax do not apply because the loan is effected in favour of Individual. The fact that Company Y is making the loan at the instance of Company X is irrelevant.

Special rules exist in the case of South African companies that shift their residence abroad. In these circumstances, the value extraction is deemed to be effected in favour of a non-resident that is not a shareholder in the emigrating company. The net effect is that no exemptions or treaty relief from the Value Extraction Tax exists when a company migrates offshore.

D. Additional exemptions for Value Extraction Transactions

1. Trade financing

A company that provides goods or services to the public may in the ordinary course of that business provide loans or advances to members of the public. This form of financing would be performed to assist customers to purchase the company's goods or services (commonly known as vendor financing). Because loans offered to public customers could conceivably fall within the Value Extraction Tax, these loans or advances will be exempt if these loans or advances are made by the company in the ordinary course of trade of providing goods or services.

2. Money lending businesses

Money lending institutions, such as banks and micro-lendors, may make loans or advances to connected persons as part of the overall money lending operation. This situation is similar to the trading financing situation outlined above. Accordingly, money lenders are not viewed as undertaking value extraction transactions with connected persons if the loan or advanced was made by the company in the ordinary course of the money lending business.

3. Loans or advances to employee trusts

In order to facilitate employee share ownership, many companies utilise employee trust relationships. In the typical structure, the company provides a loan to the employee trust on favourable terms so that the trust has funds to purchase the company's shares. The employer is typically one of the beneficiaries in the trust, thereby making the two parties connected persons.

The deemed dividend rules of the STC contains a special exemption for loans or credit to employee trusts. This exemption is mirrored in the Value Extraction Tax. Therefore, favourable terms in respect of a loan or a credit to an employee trust will not give rise to the Value Extraction tax. For this exemption to apply, the loan or credit must be provided to the trust to enable the trust to purchase shares in the company. In addition, the trust must be expected to re-sell those shares to the employees of the company.

4. Downward loans or advances

a. Loans or advances by a holding company to a subsidiary

As a commercial matter, loans or advances by a holding company to a subsidiary should not be viewed as value extraction. The holding company is not denuded of value; the value is simply moved from direct to indirect control. This movement is more akin to a capital contribution.

In order to ensure that the Value Extraction tax does not apply in these circumstances, a special exemption is added for downward loans. More specifically, this exemption applies if the company making the loan or advance (i.e. the creditor) directly or indirectly owns at least 20 per cent of the equity shares in the company receiving the loan or advance (i.e. the debtor). Moreover, the debtor may not hold own any shares in the creditor or other group company.

Example

Facts: Holding Company, a South African resident, owns all the shares of Subsidiary, a foreign resident. Subsidiary does not hold shares in Holding Company. Holding Company makes an interest-free loan to Subsidiary.

Result: Despite the favourable terms of the loan, the loan does not give rise to the Value Extraction Tax because the loan constitutes an acceptable downward loan.

b. Group loans to a non-group subsidiary

Downward loans can also arise in the context of a group of companies (as defined in section 1) with the group making a loan or advance to a subsidiary on favourable terms. These loans again do not extract value from the group, but merely shift value from direct to indirect control. This form of loan is accordingly exempt if: (i) the group directly or indirectly owns at least 20 per cent of the equity shares in the subsidiary, and (ii) the subsidiary does not hold any shares in any other group company.

Example

Facts: Holding Company, a South African resident, owns all the shares of Subsidiary 1, a South African resident, and Subsidiary 2, a foreign resident. Neither subsidiary directly or indirectly owns any shares in Holding Company. Subsidiary 1 makes an interest-free loan to Subsidiary 2.

Result: Despite the favourable terms of the loan, the loan does not give rise to the Value Extraction Tax because the loan constitutes an acceptable downward loan. The group (as defined in section 1) owns shares in Subsidiary 2, and Subsidiary 2 does not own any shares in any other group company.

IV. Effective date

The Dividends Tax will become effective on a date determined by the Minister of Finance (at least three months after publication) by notice in the Government Gazette.

3.7. COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS

[Clauses 7(1)(*a*) to (*f*), (*k*), (*u*), (*v*), (*zG*); 9, 13(1)(*c*), (*e*) to (*g*); 39; 45; 47; 48; 49; 51(*f*); 75; Applicable provisions: Section 1; collateral sections 6*quat*(1A)*(e)*; 10(1)(*h*), 10(1)(*i*A), 10(1)(*i*B) and 10(1)*(k)*(i)*(bb)*, sections 25BA; 38; 41; 42(1)(*b*); 44(1)(*b*) of "qualifying interest" definition; 64B(5)(j) and paragraph 61 of the Eighth Schedule]

I. Background

A collective investment scheme ("CIS") in securities (formerly referred to as a unit trust) is an investment vehicle operating on behalf of portfolio unit holders. Although technically treated as a company for Income Tax purposes, a number of rules exist to ensure that the CIS is effectively free from tax at the CIS level. When receiving ordinary revenue, the amount received by the CIS will be exempt from income tax as long as the CIS distributes that amount (with the generic trust deed requiring the distribution to occur within 12 months of receipt). Capital gains of the CIS are simply exempt (and are in practice, not distributed).

Portfolio unit holders of a collective investment scheme are generally viewed as receiving taxable dividends when the CIS distributes ordinary revenue to those unit holders. The unit holders also receive capital gains when disposing of those

units to other parties (or when surrendering those units back to the CIS if the CIS is distributing capital growth in exchange).

II. Reasons for change

A distribution by a CIS out of ordinary revenue is treated as a taxable dividend without reference to the underlying character of the source of income giving rise to that distribution. However, special provisions often exist that indirectly allow flow-through benefits. For instance, if a CIS receives interest and distributes that amount to foreign unit holders, the foreign unit holders receive exemption as if those holders had directly received the interest. Domestic unit holders that receive amounts derived from interest similarly enjoy the annual interest exemption (currently set at R21 000 below age 65 and at R30 000 from age 65 and above) as if the interest were earned directly.

The difficulty with the current paradigm is that the special provisions just described do not always exist. For instance, long-term life insurance companies receive one form of allocation under the four funds deduction formula when taxable dividends are received; whereas, interest produces a different result. However, no special provisions exist to treat dividends as interest for purposes of the formula even though the underlying amounts represent a CIS distribution derived from interest.

III. Proposal

It is proposed that distributions from a CIS in securities follow conduit/flow-through principles roughly akin to a trust. Deemed taxable dividend treatment in respect of a CIS distribution derived from income will be eliminated.

Stated differently, ordinary revenue distributions by a CIS in securities will be treated as if the underlying amounts (e.g. interest and foreign dividends) received by the CIS will flow directly to the CIS unit holders. If a distribution is made to multiple unit holders and the distribution contains amounts derived from multiple sources of revenue, these sources of revenue are allocated pro rata.

Flow-through treatment, however, will apply only if the ordinary revenue received by the CIS is distributed to its unit holders within one year after the ordinary revenue is received by the CIS. This one-year limit is consistent with the terms contained in the CIS generic trust deed. If the CIS fails to distribute within this one-year time limit, the CIS will be taxed on the ordinary revenue as if received and accrued at the end of the one-year period. Subsequent distributions to CIS unit holders of these taxed amounts will be free from tax.

Example

Facts: In 2010, CIS receives R3 million of ordinary revenue from the following sources: (i) R1 million from local interest, (ii) R1 million from local dividends, and (iii) R1 million from foreign dividends. The CIS has various unit holders, including: South African individuals, South African companies and foreign companies. All amounts received by the CIS are distributed within six months after receipt (in accordance with the CIS trust deed). Assume all distributions pre-date the Dividends Tax.

Result: The underlying sources of the R3 million amount are allocated equally among the unit holders (i.e. 1/3rd local interest, 1/3rd local dividends and 1/3rd foreign dividends). These amounts are proportionally allocated to each unit holder as if received directly. Hence, South African individual unit holders can use the annual interest exemption against the allocable interest, and foreign company unit holders can receive the allocable interest tax-free. South African company unit holders are eligible for Secondary Tax on Company credits (see section 64B(3)) in respect of allocable local dividends. In terms of CIS distributions stemming from foreign dividends, both South African individual unit holders and South African company unit holders are eligible for section 6quat rebates. Foreign company unit holders are free from tax in terms of allocable foreign dividends because foreign-to-foreign transactions are largely outside South African taxing jurisdiction.

Whilst the CIS will generally lose its identity as a company under the revised regime, the CIS will retain its company status for two limited purposes. Firstly, the CIS will be deemed to be a company for purposes of the “connected person” test because the “connected person test for trusts is too broad (i.e. all beneficiaries are connected, meaning that all CIS unit holders would otherwise be connected). The CIS will also be treated as a company for reorganisation purposes so that the CIS can remain eligible for Part III of Chapter II rollover treatment.

IV. Effective date

The amendments apply in respect of amounts received or accrued during years of assessment of CISs commencing on or after 1 January 2010

3.8. TELECOMMUNICATIONS LICENSE CONVERSION

[Clauses 46 and 77; Applicable provisions: section 40D and paragraph 67D of the Eighth Schedule]

I. Background

Generally, capital gains tax is levied on the disposal of an asset. An asset is broadly defined and includes a license (which, in essence, constitutes property of an intangible nature). The term “disposal” is similarly broad in nature, covering any variation in rights.

II. Reasons for change

Telecommunications licenses are regulated by the Independent Communications Authority of South Africa (ICASA). Under the current system, the old telecommunications licenses were technologically specific. This meant that the services which mobile telecommunications service providers offered were mutually exclusive from the services provided by non-mobile telecommunications service providers. In an effort to promote a more open and competitive environment, ICASA has sought to eliminate the system of exclusive rights granted to certain telecommunications companies for the provision of fixed communications or mobile cellular communications. In effect, all licenses will be comprehensive – covering both fixed and mobile telecommunication operations.

This conversion from existing narrow licenses to new comprehensive licenses has occurred pursuant to the direction of ICASA under the broad mandate of section 93 of the Electronic Communications Act 36 of 2005 ("ECA"). The conversions occurred pursuant to Government Gazette 31803 of 16 January 2009. At issue is the tax impact of this required conversion. In particular, this conversion will be subject to capital gains tax because the conversion is a variation in rights. The regulatory nature of this variation does not alter the analysis.

III. Proposal

The industry-wide conversion under Section 93 of the ECA will no longer be treated as a taxable event for capital gains tax purposes. The conversion is outside the control of the relevant parties and re-arranges telecommunication rights for the industry as a whole. The conversion should instead be viewed as a rollover event (with the tax attributes of the existing licenses generally rolled over into the new licenses) so that all gains and losses are deferred until the converted licenses are subject to a subsequent disposal.

More specifically, rollover treatment will be achieved by creating a dual set of rules (one for capital gains purposes and the other for deprecation purposes under the normal tax). Both sets of rules will cover a simple conversion of an existing license to a new license as well as the conversion of multiple existing licenses to a new license and the conversion of a single license into multiple licenses. No provisions are necessary for telecommunications licenses as trading stock.

A. No capital gain/loss

The disposal of existing licenses caused by the conversion will be deemed to occur at an amount equal to the pre-existing base cost. This deeming rule eliminates all capital gain or loss.

B. No recoupment for depreciable licenses

Even if the existing license was subject to depreciation (i.e. under section 11(gD) as added by the 2008 Revenue Laws Amendment Act), the conversion will not trigger any recovery or recoupment.

C. Expenditure capital gains tax/depreciation cost rollover:

The expenditure incurred in respect of an existing license is deemed to be the expenditure incurred for the converted license. If multiple existing licenses are converted, the expenditure of all these licenses is aggregated for purposes of the converted license. If a single license is converted to multiple licenses, the expenditure for these licenses is split pro rata based on the relative values of the new licenses. Comparable rules exist for depreciation cost under the normal tax.

D. Timing rules

The timing rules for each existing license cannot be combined without adding serious complexities. Therefore, unlike the company reorganisation rules, the

expenditure to acquire the converted license is deemed to be incurred on the day immediately after the required conversion. The net impact of this rule is to eliminate the various 2001 capital gains effective date rules (e.g. valuation and time-apportionment). On a similar note, all converted licenses are depreciable (under section 11(gD)) with a useful life beginning from the date of conversion. This rule applies even if the converted license was acquired before the introduction of section 11(gD).

Example

Facts: Telecommunications Company owns two existing telecommunications licenses – Pre-existing License A and Pre-existing License B. Pre-existing License A was acquired for R40 million on 1 April 1998 and has a useful life of 15 years. Pre-existing License B was acquired for R80 million on 1 January 2008 and has a useful life of 20 years. In 2008, R4 million is claimed as a depreciation allowance in respect of Pre-existing License B (by virtue of section 11(gD) which was introduced in 2008). On 16 January 2009, both licenses were converted into new Combined License under section 93 of the ECA. The new license has a 20-year useful life.

Result: The section 93 conversion does not trigger any capital gain or recoupment. Combined License has a capital gains expenditure (and a depreciable cost) of R116 million (R40 million plus R80 million less the R4 million previously amortised). The depreciation of the R116 million amount is based on a 20-year useful life starting from the day immediately after conversion (i.e. 17 January 2009).

IV. Effective date

These amendments apply to telecommunications license conversions occurring on or after 1 January 2009.

3.9. INTERNATIONAL SUBMARINE TELECOMMUNICATIONS CABLES

[Clauses 14(1)(*b*)-(e) and 20(a)-(b); Applicable provisions: Amendment to sections 11*(f)* and 12D(1)]

I. Background

A. Factual background

South African communications companies are seeking to obtain access to international submarine telecommunications cables ("submarine cable") situated off the coasts of Africa. These cables are currently controlled by foreign persons. South African access to these cables will enhance the quality of domestic telecommunications services and also reduce the high bandwidth costs that currently exist in the South African market.

Parties interested in participating in the cable may either obtain joint ownership in a submarine cable or an indefeasible right of use ("IRU") in the submarine cable. Capacity access in privately owned submarine cable arrangements is usually obtained on an IRU basis; while capacity access in partnership arrangements is usually obtained by joint ownership (i.e. the ownership percentage is equal to the

capacity ownership). The IRU arrangement is by far the most common form of obtaining access to a submarine cable.

An IRU is a right to use capacity in a submarine cable without ownership. The IRU holder is generally required to contribute an upfront capital premium and to pay ongoing amounts for the operation and maintenance of the cable during the lifetime of the cable. International accounting standards generally view an IRU as a right of use; whereas, U.S. accounting standards view an IRU as a service. An IRU typically has a 20-year term.

B. Applicable tax provisions

Taxpayers generally may deduct a 5 per cent allowance in respect of the cost incurred to acquire new and unused section 12D "affected assets." Affected assets include a telephone line or cable used for transmitting telecommunication signals. Affected assets within the allowance must be new and unused.

Special rules apply to determine the deduction of an allowance in respect of a premium or consideration of a similar nature paid for the right of use of certain tangible and intangible assets. The allowance is spread proportionately over the shorter of (i) the useful life of the right of use or occupation of the asset or, (ii) 25 years. The allowance is not allowed if the payment is tax-exempt in the hands of the recipient.

II. Reasons for change

The above interests in a submarine cable are not deductible over time. This lack of a deduction makes little sense because a write-off is warranted given the economic depreciation over time. This economic depreciation is fully recognised by international accounting standards.

Joint ownership interests in submarine cables presumably are not deductible because these interests arguably fall outside the term "affected assets" under section 12D. The term "affected asset" is limited to a "telephone line or cable used for transmitting telecommunication signals" (whereas the cable at issue involves the internet). IRUs are not deductible because the recipient of the premium are foreign persons in respect of foreign sourced income (i.e. the income is exempt in the hands of the recipient).

III. Proposal

It is proposed that section 12D should be amended to provide for a deduction of an allowance in respect of the cost of acquiring electronic communications lines or cables in respect of direct joint ownership. This write-off will be set at 5 per cent per annum.

The word "electronic communications" includes "electronic communications" as defined in the Electronic Communications Act 36 of 2005 (i.e. "the emission, transmission or reception of information, including without limitation, voice, sound, data, text, video, animation, visual images, moving images and pictures, signals or a combination thereof by means of magnetism, radio or other electromagnetic waves, optical, electromagnetic systems or any agency of a like nature, whether with or without the aid of tangible conduct, but does not include content service").

It is also proposed that the deduction for a premium in respect of an IRU be allowed even though the income is exempt in the hands of a foreign recipient. However, this allowance applies only if the IRU has a legal term of at least 20 years. This deviation from the exempt recipient prohibition is added because little avoidance exists given the 20-year spreading of the deduction and because the premium provides the same result as the 5 per cent depreciation write-off for owned assets. While the exempt prohibition in section 11*(f)* remains important to prevent anti-avoidance, it has come to Government's attention that the prohibition is overly broad, thereby giving rise to unintended anomalies. This prohibition will have to be revisited in the near future.

In order to ensure that this proposal is limited to IRUs (i.e. international underwater lines or cables), this proposal applies only to lines or cables that are "substantially the whole of which is located outside the territorial waters of the Republic". Under this wording, the landing of these international lines or cables will be permissible because all IRUs contain onshore incidental linkages.

IV. Effective date

The amendment is effective for transmission lines or cables brought into use for the first time on or after 1 January 2009.

3.10. IMPROVEMENTS ON LEASED GOVERNMENT LAND

[Clause 14(1)(*g*)Applicable provision: Section 11*(g)*]

I. Background

If a lessee makes improvements in respect of land or a building owned by the lessor, the lessee can deduct the improvement over time. More precisely, the cost of the improvement is generally deductible over the lessee's right of use or occupation (with a 25 year maximum). These improvements also trigger gross income for the lessor of the land on which the improvements are effected.

However, the deduction for the lessee does not apply if the improvement does not constitute income for the lessor (for instance, if the lessor is tax-exempt). The only exception to this prohibition of deductions is for improvements effected pursuant to a Public Private Partnership agreement.

II. Reasons for change

The various spheres of government (especially municipalities) often seek to have improvements effected on their land as a means of upgrading infrastructure. This form of upgrade is typically effected through the use of a lease arrangement. However, given that government is exempt from income tax, government ownership prevents the lessee from deducting the improvements.

While the prohibition against deducting improvements for exempt lessors exists to prevent avoidance, the prohibition is undermining other governmental objectives.

The need for changing the prohibition in this regard has already been recognised by allowing for the deductibility of improvements in the case of Public Private Partnership agreements.

III. Proposal

The prohibition against deducting improvements for exempt lessors will no longer apply if: (i) the lessor is leasing land or buildings, owned directly by government (national, provincial or municipal) or indirectly by government (through institutions exempt in terms of section 10(1)(cA) and section 10(1)(t)), and (ii) the lease is of a duration of 20 years or more. The 20-year rule prevents taxpayers from accessing the deduction of the cost of improvements over the term of a shorter term lease (e.g. via sale-leasebacks) in order to indirectly shorten the depreciation period (which usually lasts for a 20-year period for most buildings).

IV. Effective date

The proposed amendment will be effective for improvements brought into use on or after 1 January 2009.

3.11. DEPRECIATION ON IMPROVEMENTS

[Clauses 16, 18, 19, 20 (1)(c), 22, 24 and 44; Applicable provisions: Sections 11D, 12B, 12C, 12D(2), 12F, 12I and 37B of the Income Tax Act]

I. Background

Many provisions within the Income Tax Act provide for an annual depreciation allowance in respect of assets. Many of these provisions cover both underlying assets as well as improvements.

II. Reasons for change

The specific language in the depreciation rules is inconsistent in so far as improvements are concerned. Some of the rules specifically provide for a deprecation allowance in respect of improvements whilst others do not. A further problem is the inconsistent treatment of depreciation for improvements in the sections that do explicitly provide for the allowance. For instance, the depreciation allowance for improvements sometimes lacks the “new and unused” requirement. In other cases, the eligibility of the improvement is linked to the “new and unused” nature of the underlying asset.

III. Proposal

In order to facilitate consistency, the proposed amendments will clarify that the depreciation allowance equally applies to improvements associated with underlying assets. Depreciation of improvements should be determined as if the improvement were a stand-alone asset. For instance, if the depreciation provision

at issue requires the underlying asset to be "new and unused" the improvement itself must be "new and unused" if that improvement is to be depreciable (but the improvement need not be associated with a "new and unused" underlying asset).

IV. Effective date

The above amendments are effective for expenditures incurred in respect of years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.12. ADJUSTING RING-FENCING OF LOSSES FOR LEASING

[Clause 35(a); Applicable provision: 23A(1) ("rental income" definition)]

I. Background

The Income Tax Act provides depreciation allowances or deductions for various business assets and expenses. Losses arising from these items may be set off against the taxpayer's income derived from trade or other income. If the losses exceed income, the losses are carried forward to a subsequent year and are set off against income derived in that year.

Section 23A of the Income Tax Act limits the amount of deductions that may be set off against taxable income from letting certain depreciable assets, e.g. plant, machinery, rolling stock and aircraft ("affected assets"). Depreciable assets let in terms of operating leases are generally not affected assets and the limitation does not apply to them (i.e. the provision mainly applies to financial leases and banking and financing companies).

II. Reasons for change

Depreciation deductions in terms of section 23A can only be offset against "rental income." The set-off of assessed losses against any other income (including income from proceeds from the sale of affected assets) is not allowed. As a result, assessed losses in the case of a sale or discontinuance of that business are often permanently lost. This runs counter to the underlying policy, which is solely to ensure that excess financial leasing losses are not used against income from other activities (as a form of passive temporary tax-shelter). Stated differently, section 23A ring-fencing is designed to prevent timing benefits, not to prevent deductions outright.

III. Proposal

Excess depreciation losses from the lease of "affected assets" can now freely be used against the income associated with those assets. In other words, ring-fenced losses should be fully permitted against trade associated with the leased assets, including:

- any recoupments in terms of section 8(4) relating to prior deductions in respect of affected assets; and
- any amounts derived from the disposal of affected assets.

IV. Effective date

This amendment comes into effect for years of the assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.13. CROSS-ISSUE AVOIDANCE – REMEDYING UNINTENDED ANOMALY

[Clause 37; Applicable provision: 24B]

I. Background

When a company issues shares as consideration for assets, the company is generally treated as having incurred an expenditure equal to the lesser of: the assets received or the issued shares (both of which are measured at their post-transaction value). However, if a company issues its own shares for the issue of shares by a second company, both companies will be deemed not to have incurred any expenditure.

The difference in both scenarios stems from the fact that the former scenario typically gives rise to tax; whereas, a dual issue of shares is tax-free. Tax expenditure should arise only to the extent the transaction contains pre-existing tax-recognised expenditure or tax is recognised in the transaction. In the case of a cross-issue, the newly issued shares start with a zero expenditure (e.g. base cost), and no tax is recognised in the transaction.

II. Reasons for change

A. Share cross-issue anomalies

The prohibition against cross-issues has long contained rules to prevent taxpayers from adding steps or parties in order to artificially side-step the prohibition. For instance, if a company issues shares for cash from a second company with the second company simultaneously issuing shares for cash with the first company, both sets of shares will be deemed to have zero expenditure. Similarly, if a company issues shares to a second company in exchange for the second company issuing shares to a wholly subsidiary of the first company, both sets of shares will again be deemed to have zero expenditure.

In 2008, the technical language seeking to prevent indirect cross-issues was changed to ensure that cross-issues were fully targeted as intended. Under the new language, a cross-issue exists if one company issues shares “by reason of or in consequence of” the issue of shares by another. The only escape hatch from this form of cross-issue is the separation of share issues by more than 18 months.

While this change sought to close the debate on whether certain artificial schemes could allegedly side-step the cross-issue prohibition, the change has created unintended anomalies, thereby adversely impacting commercial transactions. More specifically, different share issuances may be loosely connected to one another without containing any potential for avoidance.

Additionally, section 24B appears to create a problem when forming a multiple chain of companies. More specifically, assume a person transfers assets in exchange for shares of a newly formed company, and the newly formed company transfers the same assets to a newly formed wholly owned subsidiary, the revised cross-issue allegedly applies to create zero expenditure for the shares issued by the wholly owned subsidiary. This zero expenditure arises because the wholly owned subsidiary is arguably issuing shares "by reason of or in consequence of" the share issue by the first company (i.e. the second share issue would not have occurred but for the first).

The change to the cross-issue rule was never intended to impact a multiple formation. The assets transferred will typically qualify as recognised tax expenditure (or trigger recognition of tax). Therefore, a specific carve-out will be required.

B. Debt cross-issue anomalies

The anti-cross issue rules go beyond shares and cover the cross-issue of debts and debt-for-shares. These rules again create a deemed nil expenditure. This treatment raises certain obstacles for commercial transactions. For instance, if Group Company A acquires newly issued shares in Group Company B on loan account, the debt-for-share rule applies so that loan account is viewed as having a deemed expenditure of nil. Therefore, settlement of the loan results in tax for Group Company B (the holder of the creditor interest in the loan).

III. Proposal

A. Share cross-issue anomalies

In view of the broad ambit of the phrase "by reason of or in consequence of" introduced under the 2008 amendment, the phrase will be withdrawn. The language of section 24B will revert to the previous "direct or indirect" standard.

The zero expenditure rule for cross-issues will also expressly not apply to transfers down a chain of multiple controlled group companies (i.e. 70 per cent owned subsidiaries). This exception applies on condition that the consideration received by the controlled group company is not used to acquire shares issued by a company other than a lower-tier controlled group company of the controlled group company. If this exception applies, the receipt of issued shares by a controlled group company in a chain of transfers will not give rise to a deemed nil expenditure.

Example

> ***Facts:*** Individual transfers land to Newco in exchange for shares issued by Newco. Newco then immediately transfers the land to wholly owned Newco Subsidiary in exchange for shares issued by Newco Subsidiary.

Result: Even though the shares of Newco Subsidiary are arguably issued as a consequence of the first share issue by Newco, the exception to the nil expenditure rule for cross-issues applies. Newco Subsidiary's shares held by Newco are deemed to have an expenditure equal to the lesser of the land received or the Newco Subsidiary shares issued (both of which are measured after the land-for-Newco Subsidiary transaction).

B. Debt cross-issue anomalies

Because these types of transactions are akin to a deferred cash transfer (which would appropriately provide base cost/cost, the pre-existing debt cross-issue rules will be repealed. The revised regime will be limited solely to share-for-share cross issues.

IV. Effective date

The amendments mainly operate as a technical correction to last year's changes to section 24B. The amendments are accordingly backdated to that date (i.e. the coming into operation on 21 October 2008 in respect of shares or debt instruments acquired, issued or disposed of on or after that date).

3.14. TRANSFER OF A PRIMARY RESIDENCE FROM A COMPANY OR TRUST

[Clauses 9(b), 51(1)(g) 74; Applicable provisions: section 7 of the Transfer Duty; section 64B(5) and paragraph 51 of the Eighth Schedule of the Income Tax]

I. Background

The distribution of assets (including a domestic residence) by a company in a liquidation, wind-up or deregistration to a natural person generally constitutes a disposal for capital gains tax (CGT) purposes at both the company and shareholder levels. The distribution also constitutes a dividend for secondary tax on companies (STC) purposes, and the acquisition of the residence triggers transfer duty for the natural person.

II. Reasons for change

Prior to 2001, many natural persons historically utilised companies or trusts to purchase their domestic residence. This form of holding avoided the imposition of transfer duty without adverse tax consequences. CGT was introduced in 2001, thereby creating a potential dual level charge. The residential property company anti-avoidance rules (introduced in 2002) also eliminated the transfer duty benefits of the company/trust holding structure. STC-free treatment for capital profits was additionally limited to pre-2001 capital profits. In view of these changes and to enable the individuals to benefit from the primary residence exclusion, a limited window period was granted to provide the opportunity to transfer a residence out of a pre-existing company/trust structure. This window period eliminated all CGT, STC and transfer duty adverse consequences. This window period has long since expired. Upon review, it has been determined that

many taxpayers should have availed themselves of this window period relief but have failed to do so.

III. Proposal

Tax relief granted under the previous window period of opportunity will be restored for another window period. However, under the renewed relief, the distribution will operate as a roll-over so that all gains or losses will be deferred. The new roll-over rule replaces the previously granted market value step-up. Companies or trusts will qualify for relief under these provisions on similar terms as granted under the previous window period. Like the old regime, the distribution of a primary residence by a company or trust will be exempt from Transfer Duty and STC. However, to the extent the Dividends Tax falls within the renewed window period, the distribution will be exempt from the Dividends Tax.

IV. Effective date

This provision will operate for a window period of opportunity of approximately two years. More specifically, this relief will apply to transfers from 11 February 2009 and ending on or before 31 December 2011.

3.15. SHELF COMPANY START UPS AND SMALL BUSINESS RELIEF

[Clauses 21 and 63; Applicable provision: Section 12E(4) and paragraph 3(f) of the Sixth Schedule]

I. Background

Qualifying companies (and individuals) may account for income tax by using the turnover tax system. A special income tax dispensation also exists for companies that qualify as a small business corporation. Both dispensations contain a number of preconditions. Of particular note is the anti-multiple shareholding prohibition, which is designed to prevent the splitting of a single large (ineligible) business into multiple small (qualifying) businesses. Under this prohibition, a company is generally prevented from qualifying for either special tax dispensation if their shareholders (or members) hold shares (or have an equity interest) in any other company at any time during the year of assessment. *De minimis* interests in portfolio equity holdings (and similar interests) have no adverse impact in respect of the prohibition.

II. Reasons for change

As a theoretical matter, a dormant shelf company should be able to engage in start up operations as a qualifying small business corporation or as a micro business (just like a newly formed company). However, practical realities undermine this objective. When new owners purchase a dormant shelf company, the selling owner of the shelf company typically owns equity in other dormant companies (especially sellers that keep multiple dormant shelf companies on

hand). This multiple shareholding by the seller precludes the newly transferred shelf company from qualifying for micro business or small business corporation relief.

Admittedly, the anti-multiple shareholding prohibition only has a one-year impact (i.e. the prohibition applies only during the shelf company's year of assessment in which the shelf company ownership is transferred). However, no policy reason exists for preventing small business relief for this one-year period. The one-year prohibition also means that micro business shelf companies must submit a normal income tax return for one year before being able to be taxed under the turnover tax system.

III. Proposal

It is proposed that the micro business and the small business corporation definitions be amended so that the anti-multiple shareholding prohibition does not apply during the initial dormant period of a company's existence. This dormant period exists as long as the company does not trade or hold assets the total market value of which exceeds R5 000. This suspension of the prohibition will remedy the concern outlined above, thereby promoting shelf company start-ups without impacting acquisitions of operating small business companies.

IV. Effective date

The above amendments are deemed to be effective for years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.16. OIL AND GAS INCENTIVES AND ANCILLARY TRADES

[Clauses 84, 85 and 86; Applicable provision: Paragraphs 1, 3 and 5 of the Tenth Schedule]

I. Background

A. Tenth Schedule benefits

The Tenth Schedule provides tax incentives to oil and gas companies, such as an additional allowance for exploration and production expenditure. The Tenth Schedule also provides an opportunity for companies to enter into a fiscal stability agreement with the Minister of Finance. This fiscal stability agreement freezes the rate of normal tax (and the secondary tax on companies) for oil and gas companies against potential future increases and protects oil and gas companies against the potential future loss of Tenth Schedule benefits. Most aspects of the Tenth Schedule are limited to “oil and gas income” (and income from the refining of gas).

B. Oil and gas company definition

A qualifying "oil and gas company" must: (i) hold an oil and gas right, (ii) engage in exploration or production in terms of an oil and gas right, or (iii) engage in refining of gas derived in respect of any oil and gas right held by that company. Most notably, a qualifying oil and gas company may not engage in any trade other than the activities just described (such as engaging in foreign oil and gas trades (i.e. oil and gas trades not associated with South African oil and gas rights)). "Oil and gas income" is defined as any receipts, accruals or gains derived by an oil and gas company in respect of an oil and gas right, including the leasing or disposal of that right.

II. Reasons for change

The "oil and gas company" definition is narrowly defined and takes an all-or-nothing approach. A company engaging in any trade that is not stipulated in the oil and gas company definition prevents the benefits of the Tenth Schedule. This prohibition applies even to ancillary trades normally associated with oil and gas exploration and production. These ancillary trades include the leasing of excess building space, the purchase and sale of oil to cover contractual short-falls and management fees from managing oil and gas joint ventures. No reason exists to prevent the application of the Tenth Schedule merely because a company engages in ancillary trades normally associated with oil and gas exploration and production.

III. Proposal

The definition of "oil and gas company" should be changed so as to eliminate the all-or-nothing approach. The prohibition against impermissible trades will be dropped. Instead, the "oil and gas income" definition will be narrowed so that the benefits of the Tenth Schedule will be limited to oil and gas production (as well as the leasing or disposal of oil and gas rights).

The special rules for treating gas refining as a permissible trade will no longer be necessary because non-exploration and non-production activities will now be permitted. Gas refining will be permitted like any other non-exploration and non-production activity (gas refining will not receive any special Tenth Schedule benefit). However, assessed losses will be allowed as an offset against gas refining income in respect of a local "oil and gas right" as defined.

IV. Effective date

The amendment is effective for years of assessment ending on or after 1 January 2010 (i.e. the general effective date).

3.17. VENTURE CAPITAL COMPANY REFINEMENTS

[Clause 25; Applicable provision: 12J]

I. Background

In 2008, an investment incentive was added to the Income Tax Act that seeks to encourage retail investment in VCCs that are mainly directed toward investments in smaller businesses and junior mining companies. In order to qualify as a VCC, the company must meet requirements as to form, structure and allocation of expenditures, amongst others.

All of the requirements just-described demand upfront approval from SARS. However, certain requirements must be satisfied immediately while others need not be satisfied until 36 months after approval. The 36-month deferral period provides newly-created VCCs time to find suitable investment expenditures relating to smaller businesses and junior mining companies.

II. Reasons for change

The upfront SARS approval process for VCCs is impractical when read in conjunction with the 36-month deferral period. SARS cannot be expected to provide upfront verification as to whether a particular company will satisfy various investment expenditure allocation requirements after a 36-month period. Satisfaction of the post-36 month verification requirements can only be determined after the 36 month period begins. Review of the incentive has also revealed other smaller anomalies.

III. Proposal

A. Revised framework for SARS approval and withdrawal

The SARS approval process for the VCC incentive will be revised to eliminate the predictive aspects currently required of SARS. More specifically, SARS will only be required to provide upfront approval of the form, structure and other aspects of the VCC that can be determined from the beginning. SARS will no longer be required to provide upfront approval of the investment expenditure allocation requirements. Instead, failure to satisfy the investment expenditure requirements will only be taken into account from the 36-month period onward (see below).

B. Revised upfront SARS approval requirements

Under the revised system, SARS will approve a company as a VCC under the following conditions—

1. the company is a South African resident;
2. the sole object of the company is the management of investments in qualifying companies;
3. the company's shares are unlisted;
4. the company is not more than 50 per cent controlled by another company;

5. the company's tax affairs are in order and the company has complied with all the laws administered by SARS;
6. the company (together with any connected person) may not control any qualifying (small business or junior mining) investee company; and
7. the company must be licensed in terms of section 7 of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002).

These requirements are essentially the same as existing law with one new requirement pertaining to the sole object of the VCC as a manager of qualifying investments. The purpose of this rule is to ensure that a deductible investment into the VCC is not misdirected given the elimination of certain other requirements. It should be noted that the VCC can still engage in other activities ancillary to its sole purpose (such as the leasing of excess office space or investing in short-term debt instruments or preference shares for temporarily liquid capital.

In addition, the prohibition against non-qualifying company income has been slightly relaxed. Under the revised rule, no more than 20 per cent of the gross income of the company can be derived from investment income (dividends, royalties, rental from immovable property, annuities and proceeds from investment or trading in financial instruments, marketable securities or immovable property) other than dividends from qualifying shares and proceeds from investment in qualifying shares. The revised 20 per cent range (as opposed to the previous 10 per cent range) is more in line with the 80 per cent require expenditure rules (see below). Moreover, satisfaction of this rule no longer requires upfront SARS approval. This rule only comes into play upon subsequent breach, thereby triggering a subsequent withdrawal (before or after the 36-month period).

C. Revised activation of the 36-month requirements

As under current law, the investment expenditure requirements apply only from the 36-month period after the approval of the VCC by SARS. However, SARS will no longer be required to provide upfront approval in this regard. Instead, SARS will be required to withdraw approval from the date of the approval if non-compliance exists after the 36-month period and the corrective steps acceptable to SARS are not taken within the period specified by SARS. The requirement that the VCC must commit at least 10 per cent of its expenditure to the qualifying shares of a company with a book value not exceeding R5 million was also withdrawn.

D. Removal of deferred investee company requirements

The rules for qualifying investee companies also contain certain requirements that are triggered only after an 18-month deferral period (or after 36 months in the case of junior mining investee companies). These requirements also create problems for SARS given their predictive nature. In order to remedy these deficiencies, these predictive aspects will be removed.

The investee company will no longer have to be engaged in a trade (other than an impermissible trade) within 18/36 months after the VCC's investment. Henceforth, the investee company must simply not be engaged in an

impermissible trade. Secondly, the investee company will no longer be required to spend the sums received from the VCC within an 18/36 month period. Only the prohibition against investment income exceeding 20 per cent of the investee company's gross income will apply from the moment of the VCC investment. On its own, the 20 per cent prohibition effectively prevents VCCs from investing in passive companies (without resort to the deleted requirements).

E. Deductible entity investments in the VCC

Under current law, listed companies (and section 41 group company members) may receive a deduction for their VCC investments up to 10 per cent of the equity shares in the VCC. Any excess investment is permitted but not deductible. The purpose of this 10 per cent requirement is to ensure diversification in VCC ownership.

The proposed amendment increases the percentage limit to 40 per cent. The purpose of this increase is to cater for anchor company investors. These anchor investors provide a level of security that act as a catalyst for attracting smaller retail investors.

IV. Effective date

The amendments will be effective from 1 July 2009 (the same date as the VCC incentive as a whole).

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4. INCOME TAX: INTERNATIONAL

4.1. CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS

[Clause 12; Applicable provision: section 9D]

I. Background

Section 9D is an anti-avoidance provision that is generally aimed at preventing South African residents from shifting tainted forms of taxable income outside South African taxing jurisdiction by investing through a CFC. The main targets of concern are mobile (passive and business) income as well as diversionary foreign business income (i.e. suspect structures that can easily lead to transfer pricing avoidance). As a general rule, an amount equal to the net "tainted" income of a CFC is attributed to and included in the taxable income of South African shareholders. The main category of income falling outside of the "tainted" categorisation relates to amounts attributable to a foreign business establishment of the CFC.

In 2006, a special rulings system was introduced to provide SARS with the authority to grant various waivers from "tainted income" treatment on a case-by-case basis (with the purpose of properly balancing commercial practices against objective avoidance rules). The rationale for this special rulings system was to

create a series of informal rules on a case-by-case basis so as to obtain more facts that would later be developed into objective legislation. More specifically, this section empowers SARS to issue rulings that:

1. Allow aggregation of related CFC group structures and employees as well as equipment and facilities for purposes of the foreign business establishment rule;
2. A diversionary transaction waiver for centrally located operations;
3. A diversionary transaction and passive income waiver for high taxed income; and
4. A foreign financial instrument holding company waiver for services that are comparably taxed between two foreign countries.

II. Reasons for change

The problem with the special rulings process for CFCs is that SARS administers the law and is not a policy body. The special rulings tend to border more on the latter. In addition, as stated above, the special ruling process was designed to be a short-term solution for gathering facts that would assist in drafting appropriate legislation. In the process of gathering the facts, the following anomalies have been identified:

- The foreign business establishment contains ambiguities giving rise to the potential for tax avoidance;
- The foreign business establishment test needs refinement with regard to the group company sharing (of structures and employees, as well as equipment and facilities);
- The high-taxed income rulings exemption needs further refinement in terms of simplicity and anti-avoidance;
- The foreign financial services rulings exemption has never been utilised since its inception in 2006, thereby raising the question of whether this waiver is superfluous; and
- The special rulings process for CFCs creates administrative difficulties in respect of compliance and enforcement.

III. Proposal

The main purpose of the amendments is to convert the special CFC rulings exemptions into objective legislation in order to remedy the problems just described. The amendments also clarify certain ambiguities within the foreign business establishment definition.

A. *Foreign business establishment definition – basic rules*

1. Basic Rules

The foreign business establishment definition will be clarified and tightened to ensure that the foreign business establishment relied upon is economically meaningful. As an initial matter, the definition will be revised so as set out the

conceptual framework. Under this opening framework, a foreign business establishment must consist of a fixed place of business located in a country outside the Republic as long as that fixed place of business is used for the carrying of business for not less than a year (e.g. as opposed to occasional sales or other intermittent transactions). The one-year test allows for a one-year back or forward determination.

In addition to the opening framework, a foreign business establishment must satisfy four additional components. Three of these components relate to the nature of the business and the fourth relates to purpose.

In terms of the first three components relating to the nature of the business, the fixed place must have a minimum specified structure, employees, equipment and facilities. These components are largely the same as current law but have been more clearly broken down and adjusted slightly to resolve minor issues. For instance, the law will be clarified to ensure that these components are located in the same country as the fixed place of business.

As for the final component relating to purpose, the current "bona fide" test will be replaced. Under the present formula, a *bona fide* business non-tax purpose is sufficient even if that purpose is *de minimis* in relation to the tax consequences. Under the new formulation, the business purpose must be the sole or main reason that the fixed place of business is located in the country at issue as opposed to the purpose of avoiding South African tax.

Example 1

Facts: South African resident owns all the shares of CFC. CFC is tax resident of Country B. Both companies have financial years ending on 31 December. CFC began operating through a fixed place of business in Country B on 1 June 2009 through 15 April 2012. The fixed place of business has the required level of structure, employees, equipment and facilities throughout this period.

Result: Assuming business purpose is not an issue, the Country B activities will satisfy the business establishment test from 1 June 2009 through 15 April 2012. For purposes of 2009, it makes no difference that the activity existed for only part of the year because the activity will continue through 2010. Similarly, for purposes of 2012, it makes no difference that the activity existed for only part of the year because the activity stems from the 2011 period.

Example 2

Facts: South African resident owns all the shares of CFC. CFC is a tax resident in Country B. CFC has a shared office, equipment and facilities with 50 other companies owned by different non-connected parties. CFC has employees who work in the office two days every month performing sales-related and purchase-related negotiations over the phone on behalf of South African resident. None of these employees have signing authority to acquire or sell beyond a nominal threshold. The two employees work for the CFC no more than 30 days in a year.

Result: The activities of CFC within Country B are insufficient to qualify as a foreign business establishment. Setting aside whether the activities can potentially satisfy the structure, employee and facilities components, the CFC is simply not carrying on a business within Country B.

2. Single country groups

Because many groups separate the activities of a single business into different legal structures, the revised foreign business establishment definition allows for certain activities of foreign controlled companies to be taken into account (without

continued reliance on a SARS ruling). More specifically, qualification of a CFC fixed place of business as a foreign business establishment allows for structures, employees, equipment and facilities of another company to be taken into account if:

- those items are located in the same foreign country as the fixed place of business of the CFC;
- the other foreign controlled company is subject to tax either by virtue of residence, place of effective management or other criteria of a similar nature in the same country as the fixed place of business at issue; and
- the other company is part of the same section 1 "group of companies" (i.e. have a 70 per cent share linkage) as the CFC at issue.

Example

Facts: South African company owns all of the shares in three CFC A, B and C. All of these CFCs are tax residents in Country X by virtue of incorporation and effective management. All three CFCs have a stake in a single business to provide services within Country X. CFC A owns a building that has an office committed to the business; CFC B has ten employees committed to the business; and CFC C owns the substantial equipment and facilities committed to the business. The building, the employees, equipment and the facilities are all located in Country X.

Result: All the interests of CFC A, B and C can be pooled for purposes of determining whether the single service business qualifies as a foreign business establishment. This pooling is allowed because the building, employees, equipment and facilities are all located in the same country, this country is the country of residence for all three companies and all three companies are part of the same group (as defined in section 1).

B. High-taxed CFC net income exemption

High-taxed controlled foreign companies will no longer give rise to CFC income attribution (without reliance on a SARS ruling). The purpose of this high-taxed exemption (like the prior exemption within the special rulings process) is to disregard tainted CFC income if little or no South African tax is at stake once South African (section 6quat) tax rebates are taken into account. Unlike the rulings exemption, the new exemption exempts all CFC income (not merely categories of "tainted"income).

To be viewed as high-taxed, the "net income" of the CFC as an aggregate must be subject to a global level of foreign tax of at least 75 per cent of the amount of tax that would have been imposed had the CFC been fully taxed in South Africa. The 75 per cent threshold matches the UK's CFC high-taxed exemption (i.e. the threshold of South Africa's biggest investor). For purposes of this 75 per cent threshold, the global-level of foreign tax takes into account foreign taxes on income imposed by all foreign spheres of government (national, provincial and local). This global amount takes into account all income tax treaties, rebates, credits or other rights of recovery. This global foreign tax is also calculated after disregarding foreign tax carryover and carryback losses as well as group losses.

Example 1

Facts: South African Company owns all of the shares of CFC. CFC is a tax resident of Country X. CFC generates income of R800 000 as determined under Country X tax law. The actual foreign tax imposed is at a rate of 25 per cent. In terms of South African tax law, the CFC income (both tainted and untainted) would be translated into R600 000.

The comparison is made as follows:

R800 000 at 25% in CFC country	R200 000 foreign tax
R600 000 at 28%	R168 000 hypothetical
South African tax	

Result: Because the foreign tax paid in country of the CFC is more than 75% tax paid in South Africa, CFC will be deemed to have a net income of zero by virtue of the high-tax exemption.

Example 2

Facts: South African Company owns all the shares of CFC. CFC is a tax resident in Country X and has most of its operations located in the same country. CFC also operates a branch located in Country Y. CFC generates income of R900 000 as defined under Country X and Y tax law (R600 000 is sourced in Country X and R300 000 is sourced in Country Y). In terms of South African tax law, and the amount of income (both tainted and untainted) of CFC would be translated into R1 million. CFC pays Country X tax at a rate of 25 per cent and Country Y tax at a rate of 30 per cent. All Country X credits for Country Y taxes are limited to 25 per cent.

The comparison is made as follows:

R900 000 at 25% Country X initial tax	R225 000
R200 000 at 30% in Country Y	R60 000
Less Country X credits for Country Y taxes	R50 000
	R235 000

Result: The hypothetical South African tax is R280 000 (28% of R1 million). Because the R235 000 amount exceeds 75 per cent of the R280 000 hypothetical South African tax, CFC will be deemed to have a net income of zero by virtue of the high-tax exemption.

Example 3

Facts: South African Company owns all the shares of CFC 1, and CFC 2 owns all the shares of CFC 2. Both CFCs are located in Country X. CFC 1 generates income of R800 000 as defined under Country X tax law, and CFC 2 generates a net loss of R300 000. By virtue of the system of group taxation in Country X, the losses of CFC 2 can be offset against the CFC 1 income. In terms of South African tax law, the income amount for CFC 1 (both tainted and untainted) would be translated into an amount of R700 000 with CFC 2 generating a net loss. The actual foreign tax imposed on CFC 1 is at a rate of 25 per cent.

The comparison is made as follows:

R800 000 (ignoring the R300 000 loss) at 25%	R200 000
R700 000 @ 28% in South African	R196 000

Because the R200 000 hypothetical foreign tax amount exceeds 75 per cent of the R196 000 hypothetical South African tax, CFC will be deemed to have a net income of zero by virtue of the high-tax exemption.

C. Financial services rulings exemption

The special ruling provisions relating to financial services waiver will be deleted due to the lack of use. This waiver is also inconsistent with CFC anti-avoidance philosophy as a whole (because the tax comparison is based on a comparison of foreign country taxation without regard to the hypothetical South African tax).

D. Diversionary income rulings exemption

Going forward, the only remaining item within the special CFC rulings process is the exemption for otherwise taxable diversionary transactions. No change is envisioned in this area at the present stage until further information can be obtained.

In terms of this remaining rulings area, the timing of the rulings request will be clarified. In order to obtain rulings relief, the relevant parties must submit their application for relief before the close of the year of assessment (i.e. requests for retroactive relief will not be granted). This change ensures that the rulings waiver does not interfere with the normal audit process.

IV. Effective date

The proposed amendments will generally be effective for CFC income in respect of a CFC's foreign tax ending in the year of assessment ending on or after 1 January 2008. The changes to the rulings process (including the deletions) will be effective for all applications not accepted by SARS by 1 September 2009.

4.2. DIVIDENDS TAX: FOREIGN PORTFOLIO DIVIDENDS

[Clauses 7(1)(*m*), 13 (1)(h) and (*i*), 53; Applicable provisions: Sections 1 ("listed share" definition); 10(1)(*k*)(ii), 64D(1)("dividend" definition), 64F; 64N]

I. Background

Foreign dividends are generally taxed at marginal rates (i.e. up to 40 per cent for individuals and 28 per cent for companies). However, this general rule of taxation contains several exemptions. One exemption exists for foreign dividends declared by foreign companies with a dual listing (one listing on the JSE and another on a recognised foreign exchange.

II. Reasons for change

The exemption applicable to foreign dividends of dual listed foreign companies was introduced to ensure that all shares listed on the JSE were subject to an equal tax playing field (be they domestic or foreign companies). With impending Dividends Tax reform (i.e. the change from the Secondary Tax on Companies to the Dividends Tax), it is questionable whether the current tax exemption for dual listed foreign companies can be maintained without creating a disincentive for domestic dividends (the latter of which will now generally be subject to a 10 per cent charge at the shareholder level).

III. Proposal

The current exemption for dual listed foreign companies will be eliminated. Foreign portfolio dividends distributed by dual listed companies will instead be subject to a 10 per cent charge pursuant to the Dividends Tax (similar to the new

rule for domestic dividends). In order for this charge to apply, the foreign company shares generating the dividends must be shares listed on the JSE.

Dividends from foreign shares listed on the JSE will receive the same exemptions as dividends from domestic shares listed on the JSE (e.g. dividends paid to South African companies will be exempt upon timely receipt of a declaration). In addition, to the extent foreign dividends are paid directly to foreign shareholders, these foreign dividends will similarly be exempt because these dividends fall outside South African taxing jurisdiction.

The Dividends Tax withholding rules for these foreign JSE-listed shares will be the same as for domestic shares listed on the JSE. Therefore, withholding in respect of these foreign shares will almost exclusively be performed by regulated intermediaries (e.g. central securities depository participants).

Dividends of dual listed foreign companies may also be subject to withholding taxes from the country in which the foreign company is a tax resident. If circumstances of this nature exist, these foreign withholding taxes give rise to tax rebates (i.e. tax credits). These rebates will be useable as an offset against the 10 per cent charge imposed under the Dividends Tax. Rebates stemming from these foreign withholding taxes may not exceed the Dividends Tax charge (i.e. 10 per cent).

The rules relating to other foreign dividends will largely remain in place. These other foreign dividends are generally subject to tax at ordinary rates subject to pre-existing exemptions. Moreover, dividends from non-JSE listed shares in a dual listed foreign company are treated like any other foreign dividend.

IV. Effective date

The Dividends Tax will become effective on a date determined by the Minister of Finance (at least three months after publication) by notice in the Government gazette.

4.3. REPEAL OF FOREIGN LOOP EXEMPTION

[Clauses 13(1)(*h*) and 51(1)(*c*); Applicable provisions: 10(1)*(k)*(ii)*(aa)* and 64B(3A)*(d)*]

I. Background

Shareholders receiving or accruing foreign dividends are generally subject to tax at marginal rates (i.e. up to 40 per cent for individuals and 28 per cent for companies). However, this general rule of taxation contains several exemptions. One exemption exists for foreign dividends distributed out of profits that were directly or indirectly subject to tax in South Africa before the distribution (because these dividends have already been subject to tax under the STC).

A related set of rules also exist for the STC. Under these rules, STC credits can flow through a loop structure in certain instances so as to prevent double application of the STC. This flow-through treatment generally requires a direct

tracing of South African dividends through the loop structure. However, an automatic deemed tracing rule exists for a South African company that is at least directly or indirectly owned through a foreign intermediary as long as no other resident has a greater interest.

II. Reasons for change

The current exemption applicable to foreign dividends distributed from profits already subject to tax in South Africa was introduced *inter alia* because of the Dividend Access Trust (DAT) mechanism. The DAT was prompted by the Reserve Bank in respect of various South African companies re-domiciling abroad. The purpose of the DAT was to prevent an ongoing outflow of currency from South Africa.

A recent review of the facts relating to the DAT suggests that the exemption for foreign dividends previously subject to direct or indirect South African tax may have been misplaced. Dividends relating to a DAT mechanism never leave South African shores (even momentarily). In effect, the DAT mechanism utilises a mix of domestic preference subsidiary share dividends (paid through both a domestic special purpose company and a domestic trust) so that funds are routed directly to South African residents.

Admittedly, other structures do exist. Ministerial approved loops may exist when South African residents enter into joint ventures with non-residents. The South African Reserve Bank may also accept the existence of a loop for a short period (typically no more than 12 months) if a South African resident acquires a foreign group that contains pre-existing South African subsidiaries/businesses. Outside these parameters, loop structures are largely illegal.

III. Proposal

The revised understanding of the DAT mechanism calls into question the need for providing tax relief in respect of loop structures. Most other loops are illegal. In respect of legally sanctioned loops outside the DAT, these loops are largely tolerated - not preferred. Hence, it is proposed that any existing tax relief for loop structures be repealed given the potential risk to the tax base that these structures pose.

STC loop relief will generally remain until the Dividends Tax comes into effect. However, the automatic presumption for 10 per cent in lieu of tracing will be repealed immediately as the presumption is no longer of practical use and could give rise to avoidance. Therefore, in order to get loop relief in terms of STC credits, companies will always need to provide proof of tracing.

Example

Facts: South African Company 1 holds 30 per cent of Foreign Company, which in turn owns all the shares of South African Company 2. South African Company 2 distributes dividends to Foreign Company, and Foreign Company distributes dividends to South African Company 1.

Result: The loop structure exemption for the receipt and accrual of foreign dividends is repealed, but these foreign dividends are still exempt by virtue of the participation exemption (which requires a minimum 20 per cent interest in the foreign company distributing the dividend). South African Company can potentially receive STC credits from

the loop structure as long as the foreign dividends can be traced as being derived from South African Company 2 dividends. The 10 per cent automatic deemed tracing rule no longer applies.

IV. Effective date

The proposed amendment will be effective along with the Dividends Tax. Hence, this amendment will come into effect on a date dertemined by the Minister of Finance (at least three months after publication) by notice in the Government Gazette.

4.4. DEDUCTIONS RELATING TO OFFSHORE SHORT-TERM INSURANCE RESERVES

[Clause 40; Applicable provision: section 28]

I. Background

As a general matter, deductions are not allowed for reserve funds or capitalised amounts. However, an exception to this rule exists for short-term insurers. Taxpayers engaged in short-term insurance operations can deduct certain estimated liabilities arising from the short-term insurance business. This calculation takes into account amounts required by the Financial Services Board as a guideline with the Commissioner empowered to make adjustments. As a technical matter, it appears that the rules relating to these deductions for estimated short-term insurance liabilities equally apply to domestic and foreign insurance operations.

II. Reasons for change

As a general matter, few offshore short-term insurance businesses should fall within the South African tax net. Most offshore short-term insurance operations controlled by South African companies will be conducted through foreign subsidiaries for a variety of reasons (e.g. regulation and the need for limited liability). Foreign subsidiaries engaged in foreign operations are generally not subject to South African tax unless that subsidiary qualifies as a controlled foreign company and that subsidiary is engaged in an insurance business so as to be viewed as a "foreign financial instrument holding company." To be viewed as a "foreign financial instrument holding company", the short-term insurance business must either: (i) not be regularly conducting business with unconnected clients, or (ii) generate more than 50 per cent of the principal trading income and gain from connected persons.

Given the narrow circumstances in which the South African tax system applies to offshore short-term insurance operations, it is highly questionable whether special relief for offshore short-term insurance estimated liabilities should exist. The short-term insurance companies at issue are likely to be suspect from a tax compliance point of view. Moreover, the co-ordination role between SARS and

the applicable regulator (existing for on-shore insurance businesses) will most likely be absent.

III. Proposal

CFCs engaged in offshore short-term insurance operations that give rise to tainted CFC income will be allowed to reduce their net income for short-term insurance liabilities in only limited circumstances. The purpose of these rules is to ensure that these offshore insurance reserves can be audited in a viable way.

More specifically, CFCs can only deduct reserves that are related to the carrying on of a short-term insurance business outside South Africa. The nature of these deductions is similar to the deductions available for local short-term insurance operations with a few additional hurdles. Firstly, these amounts must be required by the short-term insurance law of the country in which the CFC is subject to tax by virtue of residence, domicile or place of effective management. Secondly, these amounts must be consistent with the liabilities contemplated in section 32(1)(a) and (b) of the Short–Term Insurance Act as if incurred in the Republic. Lastly, these amounts, like their domestic counterpart, will be subject to adjustments at the Commissioner's discretion.

In addition to the above, the above offsets entail a certain level of administrative compliance as a pre-requisite. Stated differently, information supporting these offsets must be provided to SARS in the form, manner, time and place as required by SARS.

IV. Effective date

The proposed amendment will be effective for years of assessment commencing on or after 1 September 2009.

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5. INCOME TAX: SPECIALISED ENTITIES AND CIRCUMSTANCES

5.1. AGRICULTURAL TRUSTS

[Clause 81; Applicable provision: Paragraph 3*(h)* of Part I of the Ninth Schedule]

I. Background

The Marketing Act, 1968 (Act No. 59 1968) established Agricultural Control Boards. These Agricultural Control Boards fell under the indirect auspices of the Department of Agriculture. As indirectly controlled government parastatals, the Agricultural Control Boards qualified for tax exemption in terms of section 10(1)*(cA)*(i) the Income Tax Act. In 1996, the new Marketing of Agricultural Products Act, 1996 (Act No. 188 1996) came into force and repealed the Marketing Act, thereby resulting in the conversion of the Agricultural Control Boards into Agricultural Trusts.

The main purpose of the Agricultural Trusts is to promote South African agriculture in the areas of research, training, transformation services and other areas. The trusts are funded mainly by levies (statutorily imposed by the Department of Agriculture) and investment income. The Department of Agriculture continues to retain control over certain trustee positions, trustee rules amendments and certain cash flows (e.g. levies). In terms of the memorandum of understanding between the Agricultural Trusts and the Department of Agriculture, the Agricultural Trusts are required to spend at least 20 per cent of their income towards transformation services.

II. Reasons for change

The Agricultural Trusts by virtue of their legal status as trusts do not qualify for tax exemption in terms of section 10(1)*(cA)*(i) the Income Tax Act (unlike the former Agricultural Control Boards). In order for these Agricultural Trusts to qualify for tax exemption under current law, these trusts must fall under the exemption for public benefit organisations in respect of certain activities that qualify for tax exempt status. Most of the activities of the Agricultural Trusts qualify for relief, such as research (e.g. marketing and scientific) and training. However, transformation services for emerging farmers technically do not qualify for tax exempt status.

III. Proposal

In order to restore the complete exemption for entities mandated by the Department of Agriculture, transformation services for emerging farmers should qualify for tax exempt status. This exemption is related to the exemption for efforts to assist with land reform.

IV. Effective date

The effective date for this amendment is 1 September 2009.

5.2. FSB CONSUMER EDUCATION FOUNDATION

[Clauses 82 and 83; Applicable provisions: Paragraph 4(*p*) of Part I and paragraph 3 of Part II of the Ninth Schedule]

I. Background

A. Functions of the FSB and the FSB Consumer Education Foundation (the “Foundation”)

The Financial Services Board (“FSB”) is a juristic person established in terms of section 2 of the Financial Services Board Act, 1990 (Act No. 97 of 1990) (“the FSB Act”). In terms of section 3 of the FSB Act, one of the functions of the FSB is “to promote programmes and initiatives by financial institutions and bodies representing the financial services industry to inform and educate users and potential users of financial products and services” (section 3*(c)* of the FSB Act).

The Foundation is a trust that has been formed by the FSB pursuant to the powers conferred by the FSB Act to accept funds for consumer education programmes. The Foundation receives and channels these funds to activities as agreed upon with the FSB. In terms of its legislative mandate, the FSB is required to use these funds to conduct educational programmes relating to financial services and products for the benefit of the public (or to appoint service providers to conduct these services).

B. Tax status of the FSB and the Foundation

The FSB is exempt from income tax, and donations to the FSB are generally not deductible unless the FSB conducts a public benefit activity which has been approved in terms of Part II of the Ninth Schedule. The Foundation is approved as an exempt public benefit organisation, but donations to the Foundation are similarly not tax deductible.

II. Reasons for change

The Foundation is an entity formed by the FSB to obtain voluntary funding on its behalf. This voluntary funding mechanism was chosen as the preferred course of action over a compulsory system (the latter of which would have generated tax deductible contributions under the general deduction formula of section 11*(a)*). While the Income Tax Act makes donations to organisations that fund section 10(1)*(cA)*(i) exempt entities (such as the FSB) tax deductible, the deduction for donations to these funding organisations applies only if the section 10(1)*(cA)*(i) entity carries on a public benefit activity approved under Part II of the Ninth Schedule. The activities of the FSB in this instance do not satisfy Part II even though many other educational activities fall within the Part II approved list.

III. Proposal

The FSB is required by law to perform educational programmes for financial services and products. In order to assist the FSB in raising funds to perform these duties, the provision or promotion of education programmes with respect to financial services and products will be deductible (i.e. listed under Part II of the Ninth Schedule) as long as those activities are carried on under the auspices of an entity listed under Schedule 3A of the Public Finance Management Act, 1999 (Act No. 1 of 1999) (i.e. a regulatory entity listed under that Act). This change will allow donations to the Foundation to become deductible.

IV. Effective date

The effective date for this amendment is 1 September 2009.

5.3. TAX RELIEF FOR PUBLIC BENEFIT ORGANISATIONS AND RECREATIONAL CLUBS: RETROSPECTIVE APPROVAL

[Clause 41(1)(b) and 42; Applicable provisions 30(1) and 30A]

I. Background

On 15 July 2001, a revised system of tax exemption for public benefit organisations (PBOs) was introduced. A consequential amendment was also introduced that provides the Commissioner with discretionary powers to retroactively approve: (i) pre-existing PBOs if these PBOs applied before 31 December 2004, or (ii) newly formed PBOs if the latter apply before the last day of their first year of assessment.

With regard to recreational clubs, a revised system of tax exemption for recreational clubs was introduced in 2006. As with the revised system of exemption for PBOs, a consequential amendment was introduced that provides the Commissioner with discretionary powers to retroactively approve: (i) pre-existing clubs if these clubs applied before 31 March 2009, or (ii) newly formed clubs if the latter apply before the last day of their first year of assessment.

II. Reasons for change

Many PBOs and clubs applying for exemption do so after several years of activity. This delay may stem from a lack of expertise or due to an over-emphasis on starting activities. Failure to seek prompt approval then keeps the relevant parties from subsequently seeking relief on a going forward basis because of concerns about the potential tax liability from pre-existing activities.

III. Proposal

If a PBO or recreational club applies for tax exempt status, it is proposed that the Commissioner be given discretionary powers to retroactively approve tax exemption status. In order to obtain this relief, the Commissioner must be satisfied that the relevant PBO or club was substantially within its given status in terms of existing law (i.e. satisfied the current definitional requirements for being a PBO or club).

IV. Effective date

The effective date for these amendments is years of assessment ending on or after 1 January 2009.

5.4. TRANSITIONAL PERIOD FOR REVISED TAXATION OF CLUBS

[Clause 95; Applicable provision: Section 10 of the Revenue laws Amendment Act, 2006]

I. Background

Before 2006, recreational clubs enjoyed complete tax exemption, even if the club was partially involved in trading activities. In 2006, a system of partial taxation for clubs was introduced, whereby core club activities remained exempt but trading activities (and certain other non-core activities) became taxable. The new partial taxation regime also created formalised rules in order to apply for exemption. The new partial taxation regime generally came into operation in 2007, except for pre-existing clubs which became subject to the partial taxation regime from 1 April 2009.

II. Reasons for change

Recreational clubs have not come forward to register under the new regime as expected. The failure to come forward stems from a variety of causes, including a lack of expertise in tax matters among clubs. Concerns have accordingly been raised that the new regime will effectively trigger full taxation for most pre-existing clubs – a result that was never intended.

III. Proposal

In order to allow for a smooth transition period, it is proposed that the full exemption for clubs applicable prior to 2006 be extended until 30 September 2010. This implies that clubs previously enjoying exemption prior to 2007 can continue to enjoy this exemption until the new deadline date of 30 September 2010. The new partial tax regime will then apply to clubs as from the first day of year of assessment commencing on or after 1 October 2010. However, clubs obtaining approval under the new club regime before 30 September 2010 will fall under the new regime (but remain under the old regime until the year of assessment before the year of assessment that the new regime applies).

IV. Effective date

The effective date for this amendment is years of assessment commencing on or after 1 April 2007.

5.5. *DE MINIMIS* THRESHOLDS FOR BODIES CORPORATE, SHARE BLOCK COMPANIES AND HOME OWNERS ASSOCIATIONS

[Clause 13(1)(*a*); Applicable provisions: 10(1)*(e)*]

I. Background

Bodies corporate, share block companies and homeowners associations are partially exempt. More specifically, their levies are completely exempt and these entities have an exempt monetary threshold of R50 000 in respect of other amounts.

II. Reasons for change

The monetary exemption thresholds are not entirely clear. The current wording may suggest an all-or-nothing approach. It is also uncertain how these thresholds apply if an entity has various categories of otherwise impermissible income.

III. Proposal

It is accordingly proposed that the monetary threshold for these other amounts be clarified. Amounts other than levies under the threshold should be exempt even if the total exceeds R50 000. Therefore, all otherwise impermissible amounts should be aggregated in respect of the threshold.

IV. Effective date

It is proposed that the effective date for this amendment be years of assessment ending on or after 1 January 2009.

5.6. CONVERTED SECTION 21 COMPANIES

[Clauses 17 and 41(1)(*a*); Applicable provision: 11E (1) and 30 (1)

I. Background

The Income Tax Act provides a number of benefits to certain forms of section 21 companies. For example PBOs and recreational clubs, receive exemption for much of their income.

II. Reasons for change

A number of tax benefits are restricted to companies “incorporated and formed” as section 21 companies. Hence, these benefits do not apply if a company was initially formed or incorporated as a for-profit company and later converted to a section 21 company. No reason exists for this distinction.

III. Proposal

It is proposed that benefits related to section 21 companies should apply to all section 21 companies, whether they were initially formed and incorporated as section 21 companies or not.

IV. Effective date

The effective date for these amendments is 1 January 2008.

5.7. FILM CASH SUBSIDIES

[Clause 13(1)(*k*); Applicable provision: 10(1)*(zG)*)]

I. Background

The Department of Trade and Industry provides subsidies in order to promote film production within South Africa. These subsidies typically have a R10 million ceiling per film. The tax system underpins this grant with tax-free treatment for receipt and accrual of this subsidy.

II. Reasons for change

The exemption applies to subsidy amounts received or accrued by a person. However, this subsidy cannot be passed on without triggering tax. This inability to pass the subsidy along is problematic given the practical mechanics relating to the subsidy as imposed by the Department of Trade and Industry.

As a condition for the subsidy, the Department of Trade and Industry informally requires the use of the special purpose vehicle. The special purpose vehicle is needed as a separate mechanism for tracing all film funds associated with the subsidy. The use of this special purpose vehicle, however, undermines the tax-free treatment because transmission of the subsidy to the ultimate beneficiaries (e.g. to the investors) typically triggers tax.

III. Proposal

The proposed amendment allows the incentive to cater for subsequent transfers to investors. Accordingly, the payment of the subsidy to any film owner will be tax-free.

IV. Effective date

The amendment will be effective for all receipts and accruals occurring on or after 1 September 2009.

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6. OTHER TAXES

6.1. ESTATE DUTY: PORTABLE SPOUSAL DEDUCTION

[Clause 5; Applicable provision: Section 4A of the Estate Duty Act]

I. Background

In terms of the Estate Duty, an automatic deduction is allowed (currently at R3.5 million) from the net value of an estate in order to calculate the dutiable amount. Each spouse receives the deduction in his or her own estate. Unused amounts are not transferable.

II. Reasons for change

Married couples often seek to maximise the R3.5 million deduction per spouse through one or more structures (e.g. trusts). The purpose of these structures is to ensure that R7 million of assets (i.e. R3.5 million per spouse) can be passed to the married couple's heir (e.g. children) free of Estate Duty. These structures create compliance costs and other complications. Moreover, many taxpayers cannot easily afford the use of an estate planning expert required to create these structures.

III. Proposal

The proposed amendment seeks to make the automatic deduction portable between spouses. Therefore, the estate of the surviving spouse will benefit from a double deduction at the time of the surviving spouse's death (currently at R3.5 million), less the amount used by the estate of the predeceased spouse (which can never exceed the R3.5 million amount). If the deceased is a surviving spouse of one or more marriages, the deduction is merely doubled as if the surviving spouse had survived only one marriage. Amounts subtracted for previously used automatic deductions are limited to one pre-deceased spouse of the executor of the surviving spouse's estate. If a deceased spouse has multiple concurrent spouses, the R3.5 million amount will be divided equally among the surviving spouses.

The responsibility rests on executor of the estate claiming the deduction to prove what amount, if any, was used in the predeceased spouse's estate. For this purpose, it will be necessary to retain the estate duty return that was submitted by the estate of the predeceased spouse. If the return associated with the predeceased estate is not presented, no additional automatic deduction may be claimed. SARS cannot be expected to keep these prior returns, many of which may date back many years.

Example 1

Facts: Mr X is married to Mrs X. Mr X passes away. The net value of Mr X's total estate is nil (because all of Mr X's assets have been transferred to Mrs X upon death). Mrs X then passes away. The net value of her estate is R10 million.

Result: No portion of the Section 4A deduction available to Mr X was used. Mrs X's estate is therefore entitled to a total section 4A deduction of R7 million (if a copy of Mr X's estate duty return is properly submitted).

Example 2

Facts: Mr X is married to Mrs X. Mr X passes away. The net value of Mr X's total estate is R500 000 (after spousal death transfers), all of which is transferred to various children (with a R500 000 automatic deduction utilised to eliminate any estate duty). Mrs X passes away. The net value of her estate is R10 million.

Result: Mrs X's estate is entitled to a total section 4A deduction of R7 million, minus the R500 000 amount used by the estate of Mr X. Mrs X's estate is thus entitled to a deduction of R6.5 million (if a copy of Mr X's estate duty return is properly submitted).

Example 3

Facts: Mr X is married to Mrs X. Mr X passes away. The net value of Mr X's total estate is nil (because all of Mr X's assets have been transferred to Mrs X upon death). Mrs X then marries Mr Z. Mrs X then passes away. The net value of her estate is R6 million with R5 million being transferred to her children. The estate duty impact of the transfer is nil because her estate fully utilises the section 4A deduction (attributable to her estate and the estate of the Mr X). Mr Z then dies with an estate of R4 million, leaving the full amount to his children.

Result: The estate of the former Mr Z is entitled to a total section 4A deduction of R3.5 million. The executor of the estate does not submit the return of the estate of the former Mrs X because the section 4A amount utilised by that estate exceeds R3.5 million.

Example 4

Facts: Mr X is the spouse of Ms A, Ms B and Ms C in a customary marriage. Mr. X passes away with the estate utilising an automatic section 4A deduction of R500 000. Ms. A then passes away. The net value of her estate is R4 million.

Result: Ms A's estate duty will be entitled to the standard R3.5 million automatic deduction plus a additional R1 million amount due to the customary marriage. The additional amount represents 1/3rd amount of the remaining R3 million amount attributable to Mr. X's estate.

IV. Effective date

The proposed amendment is effective for any estate of a person who dies on or after 1 January 2010.

6.2. TRANSFER DUTY: INDIRECT TAX TREATMENT OF SHARE BLOCK COMPANIES

[Clauses 1 and 2; Applicable provisions: section 1 ("fair value" and "property" definitions) and section 3(1A) of the Transfer Duty]

I. Background

A. Fractional ownership of immovable property

Fractional ownership schemes in respect of South African immovable property basically have two different forms:

- The buyer acquires an undivided interest in immovable property, or
- The buyer acquires a share in a company, which owns the immovable property.

If the buyer acquires an undivided interest in immovable property, the buyer acquires a real right in the immovable property and is endorsed as a co-owner on the title deed of the immovable property (as long as the real right is registered at the deeds office). If the buyer acquires a share in a company (which owns the immovable property), the buyer acquires a personal right vis-à-vis a real right. The buyer's personal right entitles the buyer to a specified use in the immovable property.

B. Share Block Company

A company that operates a share block scheme is referred to as a share block company, within the confines of the Share Blocks Control Act (No. 59 of 1980). A share block scheme is specifically defined in the Act as: ". . . any scheme in terms of which a share confers a right to or an interest in the use of immovable property".

Any company is presumed to operate a share block scheme if any share in the company confers a right to (or an interest in) the use of immovable property (section 4 of the Share Blocks Control Act). It follows that even an unregistered share block company can be classified as a share block company for the purposes of the Share Blocks Control Act.

C. Value-added Tax (VAT)

VAT is levied on the supply of goods or services made by a vendor. The definition of 'goods' includes, 'immovable property'. Immovable property in turn is defined to include: "….any share in a share block company which confers a right to or an interest in the use of immovable property…" It follows that a sale of a share in a share block company is subject to VAT if the seller is a vendor.

D. The Transfer Duty Act

The Transfer Duty Act is mainly designed to tax the acquisition of immovable property (falling outside the VAT). As an anti-avoidance measure, Transfer Duty also applies to the acquisition of shares in companies mainly consisting of immovable property dedicated to residential use. To be within this definition, the fair value of the immovable property in that company must comprise more than 50 per cent of the aggregate fair market value of all assets held by that company. For purposes of the 50 per cent calculation, dwelling-houses, holiday homes, apartments or similar abodes and land dedicated to residential use are viewed as immovable property, but hotels, apartments and similar structures of at least five units are excluded.

II. Reasons for change

There is a gap between the VAT and Transfer Duty where share block companies are concerned. A sale of a share in a share block company (which is akin to immovable property) may escape indirect taxation if certain conditions prevail. For

example, if a share in a share block company is sold by a non-vendor shareholder, the sale falls outside of the VAT. The sale of the share also falls outside the ambit of the Transfer Duty if the company is not a residential property company.

One circumstance in which this gap may arise is in the case of a share block company offered as fractional ownership. The initial sale by the developer will be subject to VAT as fixed property, but the subsequent sales will generally fall outside the Transfer Duty. Most fractional share interests are in respect of an apartment complex, hotel or structure of five units or more.

III. Proposal

A share in a share block company is economically equivalent to a direct interest in immovable property and should be treated as such for purposes of the Transfer Duty. This treatment should apply regardless of the nature and percentage of immovable property held by the company. Once applicable, the fair value of the share block company will be measured without regard to liabilities, and the seller will become jointly liable for any unpaid transfer duty. Both these requirements are consistent with the rules for residential property companies.

It should be noted that the proposal does not simply cover a 'registered' share block company. A company that is not registered in terms of the Share Blocks Control Act can also be caught by this proposal if deemed to be a share block by virtue of section 4 of the Act (due to the conferral of a right to or an interest in the use of immovable property).

The net impact of these changes is to ensure that shares in a share block company block are treated like sectional title interests. The sale by the developer will trigger VAT; subsequent transfers will be subject to the Transfer Duty.

IV. Effective date

The proposal will apply to all acquisitions in respect of a share in a share block company occurring on or after 1 September 2009.

6.3. VALUE-ADDED-TAX: IMPACT OF VALUE-ADDED TAX ON RE-ORGANISATIONS

[Clause 91(1)(*b*); Applicable provision: 8(25)]

I. Background

The VAT contains relief measures for transactions that fall into the ambit of the Income Tax reorganisation rollover provisions (i.e. section 42, 44, 45 or 47 of the Income Tax Act). This VAT relief effectively deems the seller and buyer (both being vendors) to be one and the same person. The effect is that a reorganisation for VAT purposes is deemed to be a non-event (no VAT is charged on the supply and no adjustments in terms of section 16(3)(h) and section 18A are applicable).

II. Reasons for change

Concerns exist that current VAT relief for reorganisations is too broad. Of particular concern are the intra-group section 45 rules, which effectively can be viewed as a wholesale adoption of the group concept into VAT for all supplies (even the day-to-day supply of trading stock).

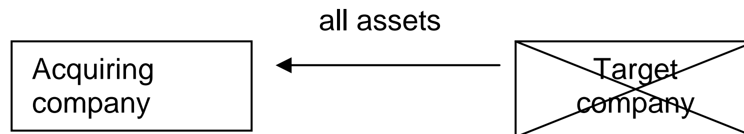
III. Proposal

In light of the concern above, it is proposed to amend the VAT reorganisation provisions. The VAT reorganisation provisions will only apply to a supply contemplated in section 42 or section 45 if that supply is a going concern. If a single transfer of trading stock or a capital asset occurs under a section 42 or a section 45 transaction, the normal VAT rules will apply. The rules for section 44 amalgamations and section 47 liquidations will remain in place because both sets of relief currently require all assets of a vendor to be transferred. Effectively, the relief available under the reorganisation provisions is limited to going concern transfers (similar to the going concern rules of section 11(1)(e)).

IV. Effective date

These provisions will be come into operation for any supply occurring on the date of promulgation of this Bill.

Example 1



Facts: Acquiring Company (resultant company) acquires all the assets in Target Company (amalgamated company) in an amalgamation and Target Company deregisters after the transaction. Acquiring Company and Target Company are vendors that make 100 per cent taxable supplies and have a 1 January to 31 December 2009 financial year. The section 44 amalgamation transaction takes place on 1 July 2009.

Result: In terms of section 8(25) of the VAT Act, the transaction is a non-event. Hence, no VAT consequences arise as a result of the amalgamation.

Example 2

Facts: The facts are the same as above except subsequent to the amalgamation, Acquiring Company converted Building A, obtained from Target Company into offices that were let to another company. Target Company utilised this fixed property for 30 per cent residential use. Acquiring Company utilised the building for 15 per cent residential purposes and 85 per cent taxable use (this was determined using the total floor space method of apportionment). The market value of the building at the time of this change in use was R1 million. The building was acquired for R570 000 by Target Company.

Result: The amalgamation transaction itself was a non-event but a Sector 18 adjustment applies at year end. Since Acquiring Company has increased the taxable use of the building from 70 per cent in Target Company's hands to 85 per cent in Acquiring

Company's hands, the change in use provisions will apply. Acquiring Company can claim additional input tax.

14/114 x R570 000 (adjusted cost) x (85 – 70) % = R10 500.

Hence, Acquiring Company is entitled to claim R10 500 as input tax credits.

Example 3

Facts: The facts are the same as example 1, except a different building is involved, which relies on the turnover method.

	Acquirer	**Target**
Before section 44 transaction (at 30 June 2009):		
- Taxable turnover	R55 m	R40 m
- Exempt turnover	R45 m	R60 m
	R100 m	R100 m

	Resultant*
After section 44 transaction (at 31 Dec 2009):	
- Taxable turnover	R150 m
- Exempt turnover	R250 m
	R400 m

Year end apportionment ratio for Acquiring Co. = 38 per cent (150 /400)	
Adjusted cost of second Building B (mixed use)	R1 m
Open market value of second Building on the date of amalgamation	R3 m

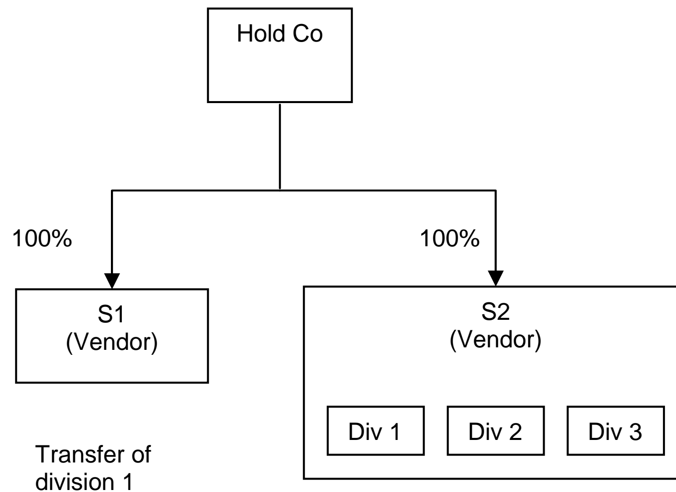
***** represents the combined turnover of both companies plus growth factor

Result: The amalgamation transaction itself was a non-event but the Section 18 adjustment applies at year end. Acquiring Company must account for a change in use. This change in use of 17 per cent (55 -38 per cent) is applicable to Building B of Acquiring Company.

R1 m (adjusted cost) x (55 – 38) % = R170 000.

Output tax on R170 000 = R20 877 (R170 000 x 14/114). Acquiring Company must declare R20 877 Output tax to SARS.

Example 4



Facts: Hold Co. has two wholly owned subsidiaries, S1 and S2 (both are vendors). Before the transaction, S1 has a 50 per cent taxable enterprise (based on the most recent apportionment ratio calculated) and S2 has an 80 per cent taxable enterprise (based on the most recent apportionment ratio calculated). S2 also has three divisions (1, 2 and 3) that are not separately registered for VAT. These divisions are all property leasing businesses (commercial and residential). S2 cancels all the leases of division 1 and thereafter disposes of all the assets of division 1 to S1.

***Result**:* Since the transaction is not a disposal of an enterprise as a going concern, section 8(25) of the VAT Act is not applicable. The supply by S2 is subject to the normal VAT rules.

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7. SPECIAL MEASURES RELATING TO THE SHARING OF GENERAL FUEL LEVY REVENUE

[Clause 109; Schedule 1]

I. Background

Regional services council (RSC) and regional establishment levies were repealed with effect from 1 July 2006.

The primary reason for repeal of these levies was to alleviate the administrative burden on businesses. In addition to this inefficiency, there was also inequity in that some municipalities received a disproportionate amount of revenue. Johannesburg and Cape Town, for example, benefited unfairly simply because most head offices are located in those centres.

Following the repeal of the RSC and JSB levies, municipal property rates were zero rated. This resulted in a cash flow benefit for municipalities in that they may

claim more input tax. In addition, all category A and C municipalities received an additional on-budget grant to make up for the revenue shortfall.

II. Reasons for change

To ensure a more secure non-discretionary source of funding, it is proposed to replace the on-budget grant to category A municipalities (to partly compensate for the loss in revenue as a result of the scrapping of the RSC and JSB levies) with a more direct source of revenue. Category C municipalities will continue to receive an on budget grant.

III. Proposal

It is proposed that from 2009/10, 23 per cent of the revenues from the general fuel levy be earmarked for metropolitan (Category A) municipalities. The distribution of this revenue among various metropolitan municipalities is to be phased in over four years. Ultimately, it is envisaged that the distribution of this revenue will be based on fuel sales in each metropolitan municipality.

IV. Effective date

The above amendment is deemed to have come into operation on 1 April 2009.

CLAUSE BY CLAUSE EXPLANATION

CLAUSE 01

Transfer Duty: Amendment of section 1

See notes on **TRANSFER DUTY: INDIRECT TAX TREATMENT OF SHARE BLOCK COMPANIES**

CLAUSE 02

Transfer Duty: Amendment of section 3

See notes on **TRANSFER DUTY: INDIRECT TAX TREATMENT OF SHARE BLOCK COMPANIES**

CLAUSE 03

Transfer Duty: Amendment of section 9

Subclause (a): A number of the reorganisation rollover provisions are elective. Historically, taxpayers seeking to utilise these provisions had to make an affirmative election to obtain the desired rollover relief. In 2008, the election mechanism, in the context of income tax, was reversed. As a result of this reversal, the applicable rollover provisions apply unless the parties elect otherwise. The purpose of this reversal was to simplify compliance because most taxpayers would normally prefer rollover treatment but for unusual circumstances.

This reversal of the election mechanism, however, was not properly carried through to the Transfer Duty Act or to the Securities Transfer Tax Act. Both Acts currently provide exemption in terms of the reorganisation provisions based on the assumption that an election has to be made for the applicable reorganisation provisions to apply. It is therefore proposed that the language of the provisions of these Acts that deal with reorganisations be revised in light of the 2008 amendments reversing the election mechanism in the context of income tax.

Subclause (b): See notes on **TRANSFER OF A PRIMARY RESIDENCE FROM A COMPANY OR TRUST**

CLAUSE 04

Transfer Duty: Repeal of section 9A

This provision is repealed due to obsolescence.

CLAUSE 05

Estate Duty: Substitution of section 4A

See notes on **ESTATE DUTY: PORTABLE SPOUSAL DEDUCTION**

CLAUSE 06

Fixing of rates of normal tax and amendment of certain amounts for purpose of Act 58 of 1962

See notes on **INCOME TAX: RATES AND THRESHOLDS**

CLAUSE 07

Income Tax: Amendment of section 1

Subclauses (a) to (f): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclauses (g) and (h): See notes on **DIVIDENDS TAX: GENERAL OVERVIEW**

Subclause (i): See notes on **PAYOUTS OF EMPLOYER PENSION SURPLUSES**

Subclause (j): See notes on **MINOR BENEFICIARY FUNDS**

Subclause (k): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclauses (l) and (m): See notes on **DIVIDENDS TAX – GENERAL OVERVIEW**

Subclause (n): In 2008, two new retirement definitions were added: one for retirement fund lump sum benefits (i.e. lump sums received upon retirement or death) and one for retirement fund lump sum withdrawal benefits (i.e. lump sums received before retirement due to various causes such as retrenchment, job change and divorce). The proposed amendment adds a single definition ("lump sum benefit") for referring to both forms of benefits.

Subclause (o): The proposed amendment deletes the term "superannuation" because this definition of retirement fund savings is not used in South African parlance. Other changes include the removal of a superfluous "or" as well as the correction of cross-references.

Subclause (p): The proposed amendment corrects an error in numbering.

Subclause (q): The proposed amendment is a stylistic change to the divorce aspect of the definition of "pension preservation fund." The amendment makes the language consistent with the style of the other aspects of the definition.

Subclause (r): The proposed amendment corrects an error in numbering.

Subclause (s): In 2008, legislative changes were made to clarify which forms of movement between the different types of retirement fund are taxable versus which are tax-free. As a theoretical matter, a tax-free movement takes place if the savings being moved move to the same or higher level of restrictiveness (see paragraph 6 of the Second Schedule). Consequently, for example, taxpayers may move savings from a retirement annuity fund to another retirement annuity fund. Savings within pension funds (and pension preservation funds) may be moved to other pension funds (and pension preservation funds) as well as to retirement annuity funds. Savings within provident funds (and provident preservation funds) may be moved to any other form of retirement fund.

The proposed amendment aligns paragraph (b)(ii) of the proviso to the definition of "pension preservation fund" (which applies in the context of divorce) with the principles set out above. More specifically, savings in both provident funds (plus provident preservation funds) and pension funds (plus pension preservation funds) may be transferred to pension preservation funds free of tax. Savings in retirement annuity funds cannot, however, be transferred to pension preservation funds without tax.

Subclause (t): The proposed amendment corrects an error in numbering.

Subclauses (u) and (v): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclauses (w) and (x): This amendment remedies an error in numbering.

Subclause (y): Refer to subclause (s) above.

Subclause (z): Refer to subclause (s) above.

Subclauses (zA), (zB) and (zC): These amendments remedies errors in numbering.

Subclause (zD): The proposed amendments clarify that the "retirement date" for triggering various retirement savings rules in the case of death occurs "on the death of the member."

Subclauses (zE) and (zF): The proposed amendments remedy errors in numbering.

Subclause (zG): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

CLAUSE 08

Income Tax: Amendment of section 5

The proposed amendments are collateral to the pre-retirement and retirement lump sum changes. The references in the section 5(10) averaging formula are merely updated to reflect these changes.

CLAUSE 09

Income Tax: Amendment of section 6*quat*

See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

CLAUSE 10

Income Tax: Amendment of section 7

The proposed amendment treats all pre-retirement withdrawals from retirement savings as income accrued to the member (as opposed to the recipient) if the withdrawal stems from a maintenance order under section 37D(1)(*d*)(iA) of the Pension Funds Act. The recurrent nature limitation has been dropped. The

amendment is based on the principle that taxpayers should not receive relief under the lump sum formula for forced payments of maintenance in arrears.

CLAUSE 11

Income Tax: Amendment of section 8

Subclause (a): See notes on **TRAVEL (CAR) ALLOWANCES: REPEAL OF DEEMED KILOMETRE METHOD**

Subclauses (b) and (c): See notes on **PAYOUTS OF EMPLOYER PENSION SURPLUSES**

CLAUSE 12

Income Tax: Amendment of section 9D

Subclause (a): See notes on **CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS**

Subclause (b): The initial cross-reference is no longer law, however, because the definition has been removed, the substance of the definition has been reinserted without the reinsertion of the definition itself.

Subclauses (c) to (e): See notes on **CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS**

CLAUSE 13

Income Tax: Amendment of section 10

Subclause (a): See notes on **DE MINIMIS THRESHOLDS FOR BODIES CORPORATE SHARE BLOCK COMPANIES AND HOMEOWNERS ASSOCIATIONS**

Subclause (b): See notes on **MINOR BENEFICIARY FUNDS**

Subclause (c): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclause (d): See notes on **RATES AND THRESHOLDS**

Subclauses (e), (f) and (g): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclause (h): See notes on **REPEAL OF FOREIGN LOOP EXEMPTION**

Subclause (i): See notes on **DIVIDENDS TAX: FOREIGN PORTFOLIO DIVIDENDS**

Subclause (j): See the clause-by-clause note relating to section 7(11). This exemption is no longer necessary because section 7(11) fully re-allocates the amount from the recipient to the member.

Subclause (k): See notes on **FILM CASH SUBSIDIES**

CLAUSE 14

Income Tax: Amendment of section 11

Subclause (a): This provision is repealed because it is obsolete in view of the enactment of section 24J.

Subclauses (b), (c), (d), and (e)): See notes on **INTERNATIONAL SUBMARINE TELECOMMUNICATIONS CABLES**

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

Subclause (g): See notes on **IMPROVEMENTS ON LEASED GOVERNMENT LAND**

Subclause (h): The proposed amendment updates a cross-reference in light of proposed changes to the Second Schedule.

Subclause (i): See notes on **DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS TO RETIREMENT ANNUITY FUNDS**

CLAUSE 15

Income Tax: Amendment of section 11A

Section 11A allows taxpayers to claim their pre-start up expenses even though a trade has not yet commenced. All deductions under section 11A are ring-fenced so as to useable only against present and future income from the same trade. The deductions allow cover all items listed in section 11 (other than section 11(x) which refers to deductions outside section 11(x)). When enacted in 2003, these deductions included all interest deductions relating to section 24J instruments because section 24J was previously only a timing provision (the deduction being granted by virtue of section 11(a) or (bA). Late in 2004, amendments were made so that section 24J shifted from a mere timing provision to a stand-alone deduction and income provision. A corresponding amendment to section 11A, however, was inadvertently omitted, thereby excluding section 24J from section 11A start-up relief. The cross-references to section 24J will accordingly be included section so as to restore the intent of the initial legislation.

CLAUSE 16

Income Tax: Amendment of section 11D

See notes on **DEPRECIATION ON IMPROVEMENTS**

CLAUSE 17

Income Tax: Amendment of section 11E

See notes on **CONVERTED SECTION 21 COMPANIES**

CLAUSE 18

Income Tax: Amendment of section 12B

See notes on **DEPRECIATION ON IMPROVEMENTS**

CLAUSE 19

Income Tax: Amendment of section 12C

See notes on **DEPRECIATION ON IMPROVEMENTS**

CLAUSE 20

Income Tax: Amendment of section 12D

Subclause (a): See notes on **INTERNATIONAL SUBMARINE TELECOMMUNICATIONS CABLES**

Subclauses (b) and(c): See notes on **DEPRECIATION ON IMPROVEMENTS**

CLAUSE 21

Income Tax: Amendment of section 12E

See notes on **SHELF COMPANY START UPS AND SMALL BUSINESS RELIEF**

CLAUSE 22

Income Tax: Amendment of section 12F

See notes on **DEPRECIATION ON IMPROVEMENTS**

CLAUSE 23

Income Tax: Substitution of section 12H

See notes on **LEARNERSHIP ALLOWANCE SIMPLIFICATION**

CLAUSE 24

Income Tax: Amendment of section 12I

Subclauses (a) and (b): See notes on **DEPRECIATION ON IMPROVEMENTS**

Subclause (c): In 2008, an additional allowance incentive was enacted in terms of section 12I for the benefit of brownfield and greenfield industrial policy projects. This allowance is the successor to the former incentive for strategic industrial projects in terms of section 12G. Both provisions provide sizeable allowances upon approval by a joint departmental National Treasury and Trade and Industry adjudication committee. The current section 12I incentive contains rules to prevent taxpayers from splitting a single project into multiple sub-projects so to make artificial multiple claims for the same project. This rule against dividing a single project into multiple projects, however, applies so as to prevent the application of by a new section 12I brownfield project that is associated with a prior Greenfield section 12G project (even though both projects should be viewed as distinct from each other). The prohibition against integrally related section 12G and 12I projects will accordingly be dropped.

Subclause (d): Section 12I(7)(b) contains two requirements relating to tax compliance of a company that wishes to qualify for the section 12I allowance.

Section 12I(7)(*b*)(i) requires the submission of a declaration of good standing as to tax compliance, and section 12I(7)(b)(ii) requires the submission of a certificate obtained from the Commissioner confirming tax compliance. On the basis that both requirements seek to achieve the same objective, it is proposed that the requirement to make submission of the declaration (as required by section 12I(7)(b)(i)) be deleted as superfluous.

CLAUSE 25

Income Tax: Amendment of section 12J

See notes on **VENTURE CAPITAL COMPANY REFINEMENTS**

CLAUSE 26

Income Tax: Insertion of section 12K

See notes on **CERTIFIED EMISSION REDUCTIONS: TRADABLE CARBON CREDITS**

CLAUSE 27

Income Tax: Insertion of section 12L

See notes on **SPECIAL ALLOWANCE FOR ENERGY EFFICIENCY SAVINGS**

CLAUSE 28

Income Tax: Insertion of section 12M

See notes on **EMPLOYER-PROVIDED POST-RETIREMENT MEDICAL AID**

CLAUSE 29

Income Tax: Amendment of section 13*quat*

Sub-subclause (a): The proposed amendment deletes an obsolete reference.

Sub-subclause (b): The proposed amendment corrects a cross-reference.

CLAUSE 30

Income Tax: Insertion of section 15A

A recent Tax Court judgment regarding the recognition of mining stockpiles as trading stock has given rise to the concern that taxpayers may attempt to exclude mining stockpiles from trading stock for tax purposes while an appeal against the judgment is underway.

The proposed amendment is aimed at ensuring that such mining stockpiles continue to be reflected as trading stock in terms of section 22 of the Act at a value that is not less than that used for accounting purposes. This check against

the accounting treatment of mining stockpiles is intended to maintain the *status quo* based on information supplied by the mining industry.

CLAUSE 31

Income Tax: Amendment of section 18

See notes on **UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS**

CLAUSE 32

Income Tax: Amendment of section 20

See notes on **PAYOUTS OF EMPLOYER PENSION SURPLUSES**

CLAUSE 33

Income Tax: Amendment of section 20A

The proposed amendment corrects an overly narrow cross-reference.

CLAUSE 34

Income Tax: Insertion of section 22B

See notes on **DIVIDENDS TAX PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING**

CLAUSE 35

Income Tax: Amendment of section 23A

Subclause (a): This proposed amendment adjusts the exclusion so that the language of the exclusion is consistent with a comparable exclusion in section 11D.

Subclause (b): See notes on **ADJUSTING RING-FENCING OF LOSSES FOR LEASING**

CLAUSE 36

Income Tax: Amendment of section 23I

This amendment corrects a reference to a definition.

CLAUSE 37

Income Tax: Amendment of section 24B

See notes on **CROSS-ISSUE AVOIDANCE – REMEDYING UNINTENDED ANOMALY**

CLAUSE 38

Income Tax: Amendment of 24I

Section 24I(3)(c) regulated the timing of the accrual of a discount or the incurral of a premium in respect of a forward exchange contract in cases where a loan, advance or debt in a foreign currency was recorded on transaction date at the forward rate but the related expense or asset was recorded at spot rate. The option of recording a loan, advance or debt in a foreign currency at forward rate on transaction date for tax purposes is no longer available. Currently, all loans, advances and debts in a foreign currency must be translated at the spot rate on transaction date for tax purposes. It is, therefore, proposed that the obsolete section 24I (3)(c) be deleted.

CLAUSE 39

Income Tax: Insertion of section 25BA

See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

CLAUSE 40

Income Tax: Amendment of section 28

See notes on **DEDUCTIONS RELATING TO OFFSHORE SHORT-TERM INSURANCE RESERVES**

CLAUSE 41

Income Tax: Amendment of section 30

Subclause (a): See notes on **CONVERTED SECTION 21 COMPANIES**

Subclause (b): See notes on **TAX RELIEF FOR PUBLIC BENEFIT ORGANISATIONS AND RECREATIONAL CLUBS – RETROSPECTIVE APPROVAL**

CLAUSE 42

Income Tax: Amendment of section 30A

See notes on **TAX RELIEF FOR PUBLIC BENEFIT ORGANISATIONS AND RECREATIONAL CLUBS – RETROSPECTIVE APPROVAL**

CLAUSE 43

Income Tax: Amendment of section 36(11)

Subclauses (a) to (c): The 2008 amendments to section 36(11)(d), initially intended as a relief measure, places mining companies in a less advantageous position by extending the period of depreciation to 20 years (i.e. at 5 per cent per annum). This amendment was intended to come with other correlative changes that would have offset these disadvantages. Therefore, all 2008 housing amendments applicable to mining will be withdrawn.

Subclause (d): The current wording of section 36(11)(e), limits deductions claimed for expenditure incurred to acquire a mining right to exclude expenditure incurred to maintain a mining right (i.e. expenditure for social and labour plans). The proposed amendment will be extended to cover social and labour plan expenditure, however, exclude Environmental rehabilitation costs as these costs are specifically addressed in section 37A. The proviso under the current wording also requires a spreading of the deduction over the remaining period of the mining license. This proviso is being deleted because the proviso is inconsistent with financial accounting.

CLAUSE 44

Income Tax: Amendment of section 37B

See notes on **DEPRECIATION ON IMPROVEMENTS**

CLAUSE 45

Income Tax: Amendment of section 38

See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

CLAUSE 46

Income Tax: Insertion of section 40D

See notes on **TELECOMMUNICATIONS LICENSE CONVERSION**

CLAUSE 47

Income Tax: Amendment of section 41

Subclause (a): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclause (b): The proposed amendment is a style change. Reorganisation definitions should be contained in section 41, not in the substantive provisions.

CLAUSE 48

Income Tax: Amendment of section 42

Subclause (a): The proposed amendment is a style change. Reorganisation definitions should be contained in section 41, not in the substantive provisions.

Subclause (b): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

CLAUSE 49

Income Tax: Amendment of section 44

Subclause (a): The proposed amendment is a style change. Reorganisation definitions should be contained in section 41, not in the substantive provisions.

Subclause (b): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclause (c): The proposed amendment corrects the style of a cross-reference.

CLAUSE 50

Income Tax: Amendment of section 47

Section 47 does not generally apply to liquidations into a parent company if that company is exempt from tax. The purpose of this prohibition is to prevent the rollover deferral rules of section 47 from being turned into an outright exemption. The proposed amendment extends the prohibition to exempt mining rehabilitation companies and exempt bodies corporate. This change is consistent with similar prohibitions found in respect of other re-organisation rollovers.

CLAUSE 51

Income Tax: Amendment of section 64B

Subclause (a): See notes on **DIVIDENDS TAX: GENERAL OVERVIEW**

Subclauses (b), (c) and (d): See notes on **REPEAL OF FOREIGN LOOP EXEMPTION**

Subclause (e): Micro business exempt dividends should be limited (see subclause (g))

Subclause (f): See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

Subclause (g):

For purposes of section 64B(5)(k), see notes on **TRANSFER OF A PRIMARY RESIDENCE FROM A COMPANY OR TRUST**

For purposes of section 64B(5)(l), this amendment is associated with the 2008 introduction of the presumptive turnover tax. The amendment exempts up to R200 000 of dividends.

Subclause (h): The proposed amendment deletes obsolete language (i.e. language associated with the transition into section 29A).

CLAUSE 52

Income Tax: Amendment of section 64C

Subclause (a): The proposed amendment excludes listed shares from being taken into account for purposes of determining whether a person is a shareholder for purposes of section 64C. Transactions with listed shares are removed from the ambit of section 64C because the governance rules associated with listed shares effectively prevent disguised dividends. As a result, if a listed company makes a loan to an unconnected listed shareholder at rates below the required section 64C rate, section 64C does not apply because the listed shareholder is not viewed as a shareholder for purposes of section 64C.

Subclause (b): The deemed dividend rules contain an exemption for intra-group transactions. Due to recent changes, the deemed dividend exemption for intra-group transactions now requires profits to be added to the intra-group payee to the extent profits of the intra-group payor are reduced. This additional rule ensures that the intra-group exemption operates only as a deferral mechanism (with the new profits giving rise to potential Secondary Tax on Companies sometime in the future).

The wording of the amendment, however, has caused confusion because the wording seems to require some addition to the profits of the payee even if no reduction occurs for the deemed dividend payor. This issue mainly arises in the case of intra-group loans, none of which require an adjustment to profits (neither as a subtraction for the payor or an addition for the payee). The wording of this profit adjustment requirement will accordingly be amended to clarify that an addition for the payee will be required if (and only if) a reduction exists for the payor.

Subclause (c): As a commercial matter, loans or advances by a holding company to a subsidiary should not be viewed as a deemed dividend. The holding company is not denuded of value; the value is simply moved from direct to indirect control. This movement is more akin to a capital contribution.

In order to ensure that the deemed dividends do not arise in these circumstances, a special exemption is added for downward loans. More specifically, this exemption applies if the company making the loan or advance (i.e. the creditor) directly or indirectly owns at least 20 per cent of the shares in the company receiving the loan or advance (i.e. the debtor). Moreover, the debtor may not own any shares in the creditor or in another group comapny.

Example 1

Facts: Holding Company, a South African resident, owns all the shares of Subsidiary, a foreign resident. Subsidiary does not directly or indirectly own shares in Holding Company. Holding Company makes an interest-free loan to Subsidiary.

Result: Despite the favourable terms of the loan, the loan does not give rise to deemed dividends because the loan constitutes a downward loan.

Downward loans can also arise in the context of a group of companies (as defined in section 1) with the group making a loan or advance to a subsidiary on favourable terms. These loans again do not extract value from the group, but merely shift value from direct to indirect control. This form of loan is accordingly exempt if: (i) the group directly or indirectly owns at least 20 per cent of the shares in the subsidiary, and (ii) the subsidiary does not own any shares in the group.

Example 2

Facts: Holding Company, a South African resident, owns all the shares of Subsidiary 1, a South African resident, and Subsidiary 2, a foreign resident. Neither subsidiary directly or indirectly owns any shares in Holding Company. Subsidiary 1 makes an interest-free loan to Subsidiary 2.

Result: Despite the favourable terms of the loan, the loan does not give rise to deemed dividends because the loan constitutes an acceptable loan. The group (as defined in section 1) owns shares in Subsidiary 2, and Subsidiary 2 does not own any shares in the group.

CLAUSE 53

Income Tax: Substitution of PART VIII of Chapter II

See notes on **DIVIDENDS TAX: FOREIGN PORTFOLIO DIVIDENDS, DIVIDENDS TAX: GENERAL OVERVIEW, DIVIDENDS TAX: WITHHOLDING REFINEMENTS**

CLAUSE 54

Income Tax: Insertion of PART IX of Chapter II

See notes on **VALUE EXTRACTION TAX**

CLAUSE 55

Income Tax: Amendment of section 102

See notes on **DIVIDENDS TAX: WITHHOLDING REFINEMENTS**

CLAUSE 56

Income Tax: Amendment of paragraph 1 of the Second Schedule

Subclause (a): See notes on **RETIREMENT LUMP SUM BENEFIT CALCULATIONS**

Subclause (b): See notes on **REMEDIAL RECOGNITION OF PRE-1998 BENEFITS FOR PUBLIC SERVANTS**

CLAUSE 57

Income Tax: Substitution of paragraph 2 of the Second Schedule The proposed amendment corrects various anomalies reflected in the core charging provision applicable to lump sum benefits.

Subparagraph (1)(a): No changes to this subsection (which is the charging provision applicable to lump sums received or accrued on retirement) are proposed.

Subparagraph (1)(b): This subsection is the charging provision applicable to pre-retirement lump sum withdrawals. It applies to lump sum withdrawals on divorce, transfers between funds and all other pre-retirement lump sum withdrawals.

Divorce transfers (subitem (iA)): The proposed amendment provides a closer linkage between pension-related divorce orders and deductions from minimum individual reserves contemplated in section 37D(1)(d) of the Pension Funds Act. The first set of rules (under sub-item (AA)) covers attribution of withdrawals back to the member for pre-existing rules relating to divorces granted before 13 September 2007. The second set of rules (under sub-item (BB)) takes into account the “clean-break” principle (where the funds are immediately divided) applicable to divorces granted on or after 13 September 2007.

Fund transfers (subitem iB)): The proposed amendment taxes all transfers from a retirement fund to another retirement fund, with the date of accrual occurring on the date of transfer. (Exceptions to this principle are found in paragraph 6(b), i.e. if savings within a fund move to another fund of equal or greater restrictiveness).

All other transfers (subitem (ii)): The proposed amendment taxes all other pre-retirement lump sum benefits (e.g. upon resignation) in the same manner as under pre-existing law.

CLAUSE 58

Income Tax: Amendment of paragraph 2B of the Second Schedule

The proposed amendment clarifies the relationship between pre-existing law and the revised system of taxation of retirement lump sums in the context of divorce. Amounts deducted from the minimum individual reserve in the context of divorce are taken into account under the newly revised paragraph 2(1)(b)(iA). Amounts not so deducted are subject to pre-existing law (i.e. are taxable to the member only upon the member’s accrual (e.g. retirement or resignation).

CLAUSE 59

Income Tax: Amendment of paragraph 3 of the Second Schedule

Subclause (a): The proposed amendment changes the style to make the provision easier to read.

Subclause (b): The proposed amendment adds a missing word.

Subclause (e): See notes on **MINOR BENEFICIARY FUNDS**

CLAUSE 60

Income Tax: Amendment of paragraph 4 of the Second Schedule

Subclause (a): The proposed amendment clarifies the applicable stakeholders in the case of pre-13 September 2007 divorces versus divorces granted from that date. More specifically, the rules need to account for the fact that the member takes into account lump sum withdrawals in terms of pre-existing rules; whereas, the revised clean-break principle requires the recipient spouse to take into account the lump sum withdrawals. The amendment is effective for the period in respect of which the clarification is required (i.e. 1 November 2008 to 29 February 2009).

Subclause (b): The proposed amendment deletes paragraph 4 of the Second Schedule with effect from 1 March 2009, because this paragraph is no longer required from this date.

CLAUSE 61

Income Tax: Substitution of paragraph 5 of the Second Schedule

The proposed amendment provides a unified set of rules for allowable deductions in respect of retirement fund lump sum benefits (i.e. amounts outside the base for determining the lump sum tax calculation upon retirement). These deductions are as follows:

Subparagraph (a): Taxpayers can deduct from the lump sum calculation all amounts contributed to retirement saving that did not benefit from deduction on contribution.

Subparagraph (b): The division of retirement savings pursuant to divorce is deducted the lump sum calculation.

Subparagraph (c): Taxpayers can deduct amounts transferred to various retirement savings vehicles (e.g. pension funds and pension preservation funds).

Subparagraph (d): Amounts transferred to an unclaimed benefit fund can be deducted if those amounts were previously subject to tax.

Subparagraph (e): Pre-1998 accrued retirement benefits can be deducted from lump sums in respect of government employees.

These deductions are allowed as long as these deductions were not previously taken into account in terms of prior lump sums. Moreover, deductions may not exceed the gross lump sum (i.e. the calculation cannot yield a negative number).

CLAUSE 62

Income Tax: Substitution of paragraph 6 of the Second Schedule

The proposed amendment provides a unified set of rules for allowable deductions in respect of retirement fund lump sum withdrawal benefits (i.e. amounts outside

the base for determining the lump sum tax calculation in respect of pre-retirement withdrawals). These deductions are as follows:

Subparagraph (a): Fund-to-fund transfers in respect of a single member or in the context of divorce will be deductible (i.e. outside lump sum taxation) as long as the fund transfer move the fund to an equal or more restrictive fund (e.g. a provident-to-pension fund transfer but not a pension-to-provident fund transfer).

Subparagraph (b):

Subitem (i): Taxpayers can deduct from the lump sum calculation all amounts contributed to retirement saving that did not benefit from deduction on contribution.

Subitem (ii): The division of retirement savings pursuant to divorce is deducted the lump sum calculation) stemming from an election as contemplated in section 37D(4)(b)(ii)(cc) of the Pension Funds Act.

Subitem (iii): Taxpayers can deduct amounts transferred to various retirement savings vehicles (e.g. pension funds and pension preservation funds).

Subitem (iv): Amounts transferred to an unclaimed benefit fund can be deducted if those amounts were previously subject to tax.

Subitem (v): Pre-1998 accrued retirement benefits can be deducted from lump sums in respect of government employees.

These deductions are allowed as long as these deductions were not previously taken into account in terms of prior lump sums. Moreover, deductions may not exceed the gross lump sum (i.e. the calculation cannot yield a negative number).

CLAUSE 63

Income Tax: Amendment of paragraph 3 of the Sixth Schedule

See notes on **SHELF COMPANY START UPS AND SMALL BUSINESS RELIEF**

CLAUSE 64

Income Tax: Amendment of paragraph 2 of the Seventh Schedule

See notes on **UNIFICATION OF EMPLOYMENT-RELATED MEDICAL SCHEME CONTRIBUTIONS**

CLAUSE 65

Income Tax: Amendment of paragraph 9 of the Seventh Schedule

See notes on **INCOME TAX: RATES AND THRESHOLDS**

CLAUSE 66

Income Tax: Amendment of paragraph 12A of the Seventh Schedule

See notes on **UNIFICATION OF EMPLOYMENT - RELATED MEDICAL SCHEME CONTRIBUTIONS**

CLAUSE 67

Income Tax: Amendment of paragraph 5 of the Eighth Schedule

See notes on **INCOME TAX: RATES AND THRESHOLDS**

CLAUSE 68

Income Tax: Amendment of paragraph 13 of the Eighth Schedule

This amendment adds a missing cross-reference.

CLAUSE 69

Income Tax: Amendment of paragraph 19 of the Eighth Schedule

See notes on **DIVIDENDS TAX: PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING**

CLAUSE 70

Income Tax: Amendment of paragraph 25 of the Eighth Schedule

This amendment remedies an error with numbering.

CLAUSE 71

Income Tax: Amendment of paragraph 40 of the Eighth Schedule

See notes on **TREATMENT OF UNREALISED GAINS ON DEATH**

CLAUSE 72

Income Tax: Insertion of paragraph 43A in the Eighth Schedule

See notes on **DIVIDENDS TAX: PRE-SALE DIVIDENDS/DIVIDENDS STRIPPING**

CLAUSE 73

Income Tax: Amendment of paragraph 45 of the Eighth Schedule

Under current law, taxpayers may exclude up to R1,5 million of any capital gain on the sale of a primary residence. As discussed in this year’s Budget Review, it is proposed that taxpayers now be eligible: (i) for a complete exclusion in respect of the disposal of a primary residence where the proceeds from the disposal do not exceed R2 million, or (ii) an exclusion of up to R1,5 million of capital gain for primary residences where the proceeds from the disposal exceed R2 million. The R1.5 million gain rule therefore always applies whilst the R2 million gross rule is a safe harbour for smaller homes.

CLAUSE 74

Income Tax: Substitution of paragraph 51 of the Eighth Schedule

See notes on **TRANSFER OF A PRIMARY RESIDENCE FROM A COMPANY OR TRUST**

CLAUSE 75

Income Tax: Amendment of paragraph 61 of the Eighth Schedule

See notes on **COLLECTIVE INVESTMENT SCHEMES IN SECURITIES: CONDUIT PRINCIPLES IN RESPECT OF ORDINARY DISTRIBUTIONS**

CLAUSE 76

Income Tax: Amendment of paragraph 64 of the Eighth Schedule

See notes on **EXEMPTION FOR CERTIFIED EMISSION REDUCTIONS**

CLAUSE 77

Income Tax: Insertion of paragraph 67D in the Eighth Schedule

See notes on **TELECOMMUNICATIONS LICENSE CONVERSION**

CLAUSE 78

Income Tax: Amendment of paragraph 74 of the Eighth Schedule

Subclause (a): The current formulation of "capital distribution" under the Eighth Schedule excludes any dividend that is not taxable by virtue of section 64B(5)(c). Section 64B(5)(c) excludes from the dividend definition pre-2001 capital profits and pre-1993 profits (both of which amount to effective date relief for STC). The section 64B(5)(c) definition will no longer be relevant when the new Dividends Tax is enacted because the concept of profits will be eliminated. The reference to section 64B(5)(c) will accordingly be deleted.

Subclause (b): The Secondary Tax on Companies (STC) will be replaced with a new Dividends Tax. As a result, the definition of a dividend will become obsolete through the replacement of a new definition contained in the Revenue Laws Amendment Act, 2009 (to be effective when the new Dividends Tax becomes effective). The "distribution" definitions within the Eighth Schedule accordingly need to be realigned with the new dividend definition. In essence, the new distribution definition will mirror the new dividend definition except that the new capital distribution will apply regardless of whether the amounts transferred constitute "contributed tax capital" (unlike the dividend definition which excludes contributed tax capital). To the extent, the distribution is out of contributed tax capital, the distribution qualifies as a capital distribution (see revised "capital distribution definition"); otherwise the distribution constitutes a dividend (see revised "dividend" definition).

CLAUSE 79

Income Tax: Amendment of paragraph 75 of the Eighth Schedule

Company distributions in specie constitute a disposal event that trigger capital gains or capital losses. The current wording specifically includes "interim dividends." In light of the fact that an interim dividend constitutes a distribution under current law (and will similarly constitute a distribution when the new Dividends Tax comes into effect), the current reference to an interim dividend will be deleted as superfluous.

CLAUSE 80

Income Tax: Amendment of paragraph 80 of the Eighth Schedule

This proposed amendment corrects formatting.

CLAUSE 81

Income Tax: Amendment of paragraph 3 of part I of the Ninth Schedule

See notes on **AGRICULTURAL TRUSTS**

CLAUSE 82

Income Tax: Amendment of paragraph 4 of part I of the Ninth Schedule

See notes on **FSB CONSUMER EDUCATION FOUNDATION**

CLAUSE 83

Income Tax: Amendment of paragraph 3 of part II of the Ninth Schedule

See notes on **FSB CONSUMER EDUCATION FOUNDATION**

CLAUSE 84

Income Tax: Amendment of paragraph 1 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVES AND ANCILLARY TRADES**

CLAUSE 85

Income Tax: Amendment of paragraph 3 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVES AND ANCILLARY TRADES**

CLAUSE 86

Income Tax: Amendment of paragraph 5 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVES AND ANCILLARY TRADES**

CLAUSE 87

Customs and Excise: Amendment of section 47B

The air passenger departure tax was last adjusted for inflation in 2005. The Minister of Finance has therefore proposed an increase in the air passenger tax from R60 to R80 in respect of international departing passengers travelling to Botswana, Lesotho, Namibia and Swaziland, and from R120 to R150 for all other international flight destinations.

The rate changes for Botswana, Lesotho, Namibia and Swaziland will be published by way of notice in the Gazette, and the rate change from R120 to R150 for other countries is contained in this Bill.

This amendment comes into operation on 1 October 2009. The new rates will not, however, apply to flight tickets purchased and issued before this Bill is promulgated.

CLAUSE 88

Customs and Excise: Amendment of Schedule No.1 This clause provides for the amendment of Schedule No. 1 to the Customs and Excise Act, 1964 referred to in Annexure C of the 2009 Budget Review. Amendments contain the rates of duty in respect of alcohol and tobacco products. These amendments are deemed to have come into operation on 11 February 2009.

CLAUSE 89

Customs and Excise: Continuation of certain amendments of Schedules

This clause provides for the continuation of the amendments to the Schedules to the Customs and Excise Act, 1964, which were effected by the Minister of Finance during the 2008 calendar year. The proposed amendment also brings the Ministerial decree into permanent legislation.

CLAUSE 90

Banks Act: Amendment of section 54 of the Banks Act, 1990

This proposed amendment is to cater for the repeal of Stamp Duty Act and the introduction of the Securities Transfer Tax Act, 2007. The proposed amendment also updates the reference to the Commissioner for SARS (as opposed to the prior reference to the Commissioner for Inland Revenue).

CLAUSE 91

Value-Added Tax: Amendment of section 8

Subclause (a): This amendment takes into account the fact that some vendors may be required to deregister for VAT in light of the amendments to sections 23(1) and 23(3) of the VAT Act (i.e. the income from R20 000 to R50 000 as a threshold requirement). If the vendor deregisters for VAT, a deemed supply is made in terms of section 8(2) of the VAT Act. The proposed amendment

stipulates that the Minister of Finance may prescribe (by way of regulation) the period in which the tax on this deemed supply may be paid.

Subclause (b): See notes on **IMPACT OF VALUE-ADDED TAX ON RE-ORGANISATIONS**

CLAUSE 92

Value-Added Tax: Amendment of section 18

The proposed amendment specifies a time of supply rule for a vendor who reduces or increases the taxable use or application of goods or services if the vendor ceases to be a vendor prior to any date stipulated in section 18(6). The time of supply for this reduction or increase is now deemed to take place immediately before the vendor ceased to be a vendor (i.e. the day before the cessation).

CLAUSE 93

Value-Added Tax: Amendment of section 23

This clause provides for the increase of the voluntary registration VAT threshold from R20 000 to R50 000, effective only as of the 1 March 2010. This increase takes into account inflation and deters claims for registration for VAT by artificial businesses.

CLAUSE 94

Taxation Laws: Amendment of schedule 3 of the Taxation Laws Amendment Act, 2004

In 2004, pre-existing government mineral lease arrangements were renewed despite the change in regulatory paradigm caused by the Mineral and Petroleum Resources Development Act. At that time, this continuation of lease arrangements was re-set to continue until 1 May 2009 when the new royalty charge on mineral and petroleum was anticipated. With the deferral of the Mineral and Petroleum Resources Royalty Act being until 1 March 2010, the rules for continuing current lease arrangements should be extended until the same date.

CLAUSE 95

Revenue Laws: Amendment of section 10 of the Revenue Laws Amendment Act, 2006

See notes on **TRANSITIONAL PERIOD FOR REVISED TAXATION OF CLUBS**

CLAUSE 96

Diamond Export Levy: Amendment of section 1

This amendment clarifies that the meaning of “value” is determined with reference to the Customs and Excise Act in respect of exported diamonds.

CLAUSE 97

Securities Transfer: Amendment of section 8 of the Securities Transfer Tax

A number of the reorganisation rollover provisions are elective. Historically, taxpayers seeking to utilise these provisions had to make an affirmative election to obtain the desired rollover relief. In 2008, the election mechanism, in the context of income tax, was reversed. As a result of this reversal, the applicable rollover provisions apply unless the parties elect otherwise. The purpose of this reversal was to simplify compliance because most taxpayers would normally prefer rollover treatment but for unusual circumstances.

This reversal of the election mechanism, however, was not properly carried through to the Transfer Duty Act or to the Securities Transfer Tax Act. Both Acts currently provide exemption in terms of the reorganisation provisions based on the assumption that an election has to be made for the applicable reorganisation provisions to apply. It is therefore proposed that the language of the provisions of these Acts that deal with reorganisations be revised in light of the 2008 amendments reversing the election mechanism in the context of income tax.

CLAUSE 98

Mineral and Petroleum: Amendment of section 5 of the Mineral and Petroleum Resources Royalty

Subclauses (a) to (b): In order to simplify compliance and enforcement, the proposed amendments eliminate two unnecessary differences between "income" under the Income Tax Act versus "income" and the earnings before interest and taxes (EBIT) calculation required by the Mineral and Petroleum Resources Royalty Act. Both differences do not justify the burden of maintaining two sets of calculations. Firstly, the "direct" limitation for EBIT deductions will be removed because this limitation unfairly penalises mining companies with a central head office operating multiple mines. Secondly, the EBIT calculation limits recoupments on disposals of capital expenditure assets to amounts previously deducted (e.g. amounts previously depreciated) in respect of those disposed assets. Whereas, the Income Tax Act treats all amounts received or accrued on disposal of capital expenditure assets as a recoupment regardless of previous deductions (see paragraph (j) of the gross income definition contained in section 1 of the Income Tax Act). While the EBIT limitation in respect of recoupments was designed to assist taxpayers, this small difference requires a complex set of additional calculations and maintenance records on cost that many mining operations fail to have. The EBIT recoupment limitation is accordingly removed in favour of the full recoupment rule of the Income Tax Act.

Subclause (c): The proposed amendment clarifies the link of a deduction to an expenditure incurred. The amendment expenditure incurred to effect the disposal of a mineral resource to transport, insurance and handling.

Subclause (d): The proposed amendment eliminates a superfluous cross-reference

CLAUSE 99

Mineral and Petroleum: Amendment of section 6 of the Mineral and Petroleum Resources Royalty

The proposed amendment clarifies that the calculation of gross sales disregards the transport, insurance and handling expenditure that is incurred to effect the disposal of a mineral resource.

CLAUSE 100

Mineral and Petroleum: Amendment of section 9 of the Mineral and Petroleum Resources Royalty

The Mineral and petroleum Resources Royalty Act provides rollover relief if an extractor disposes of a mineral resource that forms part of a disposal of a going concern. In terms of these rollover rules, the disposal is ignored, and the recipient of the mineral resource is subject to a royalty charge when the recipient subsequently disposes of the mineral resource. While these rules provide relief, it has been suggested that these rollover rules are too restrictive.

It is accordingly proposed that royalty rollovers be added to match Income Tax reorganization rollovers with one important caveat. In order to access the newly proposed royalty rollover rules, both the transferor and transferee must qualify as registered persons under the Mineral and Petroleum Resources Royalty (Administration) Act immediately after the reorganization id that registration qualification stems from the holding of rights granted pursuant the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2008). This registration caveat ensures that enforcement effort need not be extended to a new category persons who would otherwise fall outside the narrow pool of persons already subject to Mineral and Petroleum Resources Royalty Act.

CLAUSE 101

Mineral and Petroleum: Amendment of section 10 of the Mineral and Petroleum Resources Royalty

The proposed amendment is a collateral amendment that emanates form the amendment into section 4 of the Administration Act. In terms of section 4 of the Administration Act as revised, the members of the unincorporated body must elect to be a person for both the Royalty Act and the Royalty Administration Act (and not to merely make an election for registration.

CLAUSE 102

Mineral and Petroleum: Amendment of section 18 of the Mineral and Petroleum Resources Royalty

The date of coming into operation of the Mineral and Petroleum Resources Royalty Act, 2008 has been deferred from 1 May 2009 to 1 March 2010. The proposed amendments defer certain sections in this Act for purposes of deferring liability for the royalty and administrative efficiency. For instance, provisions in the Act that trigger the royalty (or relate to liability for the royalty) in respect of

transferred mineral resources have been postponed to 1 March 2010. Moreover, registered persons may conclude Fiscal Stability Agreements with the Minister of Finance as early as 1 November 2009. However, such agreements only apply in respect of mineral resources transferred on or after 1 March 2010.

CLAUSE 103

Mineral and Petroleum: Amendment of schedule 2 to the Mineral and Petroleum Resources Royalty

The proposed amendment specifically adds gypsum to Schedule 2 and clarifies the first saleable point of Platinum Group Metals and Uranium Oxide.

CLAUSE 104

Revenue Laws: Amendment of section 6 of the Revenue Laws Amendment Act, 2008

This amendment remedies an incorrect cross reference.

CLAUSE 105

Revenue Laws: Amendment of section 18 of the Revenue Laws Amendment Act, 2008

See notes under clause 102.

CLAUSE 106

Revenue Laws: Amendment of section 29 of the Revenue Laws Amendment Act, 2008.

The effective date of the UDZ amendments under the current wording applies in respect of an erection, extension, addition or improvement that occurs on or after 21 October 2008. This wording is, however, problematic and should be based on the “brought into use” concept. The proposed amendment does not specify an applicable effective date. The proposed amendment will therefore apply in respect of any building, part thereof or improvement thereto that is brought into use on or after 21 October 2008.

CLAUSE 107

Revenue Laws: Amendment of section 55 of the Revenue Laws Amendment Act, 2008

See notes on Clause 51 (1)*(a)*.

CLAUSE 108

Revenue Laws: Amendment of section 59 of the Revenue Laws Amendment Act, 2008

The proposed amendment sets the effective date at 1 August 2008 for the pre-existing fund-to-fund transfer relief so that these rules are aligned to section 14

transfers occurring under the Pensions Funds Act. The newly proposed fund-to-fund transfer rules apply from 1 March 2009.

CLAUSE 109

Special measures relating to the sharing of fuel levy revenue

See notes on **SPECIAL MEASURES RELATING TO THE SHARING OF GENERAL FUEL LEVY REVENUE**

CLAUSE 110

Special zero-rating in respect of goods or services supplied by Cricket South Africa

It is proposed that the supply of goods and services by Cricket South Africa in respect to the staging of the 2009 International Premier League event in the Republic be subject to value-added tax at the zero rate to the extent that the consideration for that supply is received from the Board of Cricket Control of India. The proposed amendment comes into operation on 1 March 2009

CLAUSE 111

Short title and commencement