NATIONAL
TREASURY

REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

TAXATION LAWS AMENDMENT BILL, 2013

24 October 2013

[W.P. –- '13]

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EXPLANATION OF MAIN AMENDMENTS

1. INCOME TAX: INDIVIDUALS, SAVINGS AND EMPLOYMENT

1.1. BURSARIES OR SCHOLARSHIPS TO EMPLOYEE RELATIVES

[Applicable provision: Section 10(1)(q)]

I. Background

An income tax exemption exists for any “bona fide” bursary or scholarship that is granted by an employer to an employee or a relative of that employee. Different rules apply depending on whether the bursary or scholarship has been awarded to the employee or the relative.

For the exemption to apply in the case of employee bursaries or scholarships, the employee must undertake to reimburse the employer if the employee fails to complete his or her studies for reasons other than death, ill-health or injury. If a bursary or scholarship is awarded to a relative of the employee, the exemption will apply only if the employee’s remuneration does not exceed R100 000 during the year of assessment and the amount of the bursary or scholarship does not exceed R10 000 (collectively referred to as “the monetary limits”).

II. Reasons for change

Government seeks to support and encourage the private sector in the provision of education and training. In particular, Government seeks to encourage employers to provide bursaries and scholarships to their employees and their relatives. However, the monetary limits associated with bursaries and scholarships granted to relatives have not kept pace with inflation and the ever increasing costs of education.

Moreover, these monetary limits assume uniformity in education that does not exist. There are significant differences between the cost structures of basic education versus further education. Subsidies and other forms of financial support are also far more readily available for basic education, meaning that the income tax does not need to provide the same level of support as is required for further education.

III. Proposal

It is proposed that the monetary limits be increased for bursaries and scholarships to relatives of qualifying employees:

1. The first monetary limit in respect of qualifying employees will be increased from R100 000 to R250 000.

2. The second monetary limit of R10 000 is to remain in respect of bursaries and scholarships in the case of qualifications up to and including NQF level 4 (also known as matric or grade 12) as set by the South African Qualifications Authority (SAQA). However, a separate monetary limit of R30 000 is to be introduced in respect of any further education.

IV. Effective date

The proposed amendments are effective as from 1 March 2013 and will be applicable in respect of years of assessment commencing on or after that date.

1.2. ALIGNMENT OF THE TAX TREATMENT OF INDIVIDUAL – BASED INSURANCE POLICIES

[Applicable provisions: Section 10(1)(gG) and new paragraph 12C of the Seventh Schedule, sections 10(1)(gL) and 23(r)]

I. Background

As a general matter, there are currently two forms of disability insurance plans that are offered to individuals – capital protection and income protection. The tax outcomes of each differ in terms of premiums and payouts. Disability policies are offered to salaried workers, employers and self-employed business-owners (including professionals).

In the case of capital protection plans, cover exists to protect individuals against the loss of the individual's income earning capacity (e.g. through loss of a limb or mental capacity). In plans of this kind, no deduction is available in respect of premiums paid, but there is no tax payable in respect of insurance policy pay-outs.

In the case of income protection plans, cover exists to protect individuals against the loss of future income (focusing on the negative income impact of the disability rather than the disability itself). In plans of this kind, premiums are deductible but tax fully applies on policy payouts.

II. Reasons for change

The distinction between disability capital protection and income protection is unfortunate. The net benefit of these plans is often economically the same with the terminology easily blurred to suit the client's tax needs. The unique tax treatment of disability plans aimed at income protection is also questionable when the overall tax treatment of individual insurance is considered. Both life and disability insurance essentially have the same objective – to protect the financial future of an individual and his or her family through insurance against an adverse personal event (death or disability).

The amount of cover chosen is designed ultimately for future "income" protection whether the payments come in the form of a lump sum for reinvestment (with reinvestment earnings providing the desired safety) or as an annuity. In the end, life and disability plans premiums are essentially expenses of a personal nature. Policy proceeds are mainly designed to protect personal lifestyles, not to fund business continuation. Even if some funds are ultimately applied for business continuation, policy proceeds for business should be deductible when applied – not the initial insurance premiums (being too remote from the trade itself with the premiums essentially acting as disguised "deductible" reserve for expenses that are often personal in nature).

III. Proposal

It is proposed that life and disability premiums and pay-outs be treated in the same manner for tax purposes regardless of whether the policy is aimed at capital or income protection. The key aspect of these plans is the personal nature of the contingency involved, not the potential use of funds (a use which may or may not be deductible at a later date). Going forward, premiums paid by natural persons in respect of life, disability and severe illness policies will no longer be deductible per se if the policies are aimed at income protection. However, all pay-outs on life, disability and severe illness policies will be tax-free, irrespective of whether the payout takes the form of a lump sum or an annuity. The same dispensation will apply in the case of disability policies, so that annuities payable in respect of a disability policy will be free from tax.

Some employers pay a premium in respect of an employer-provided insurance policy for the benefit of employees. The premiums will be deductible for the employer, as long as the premiums are taxed as a fringe benefit in the hands of employees. With the employee being taxed on the premium (with no subsequent deduction available), the policy pay-outs will be tax-free.

Lastly, the system will operate cleanly going forward. There will be no transitional period for current policy holders, meaning that premiums going forward will no longer be eligible for deduction even if the plans are pre-existing. On the other hand, all policy pay-outs will be tax-free even if the policy previously generated deductible premiums.

IV. Effective date

The proposed amendments are effective as from 1 March 2015 and will be applicable in respect of expenditures incurred as well as receipts and accruals in respect of years of assessment commencing on or after that date.

1.3. ROLLOVER TREATMENT FOR EXCESS DEDUCTIBLE DONATIONS

[Applicable provision: Sections 18A(1)

I. Background

Government provides incentives to encourage donations by persons to certain organisations (e.g. public benefit organisations, government, quasi-government and biodiversity projects). These deductible donations are generally limited to 10 per cent of the taxable income of the donor for the year of assessment in which the donation occurs. The excess donation is permanently lost.

II. Reasons for change

As a conceptual matter, the existence of deductions for donations operates as a rough form of earmarking, whereby taxpayers can effectively earmark income tax otherwise expended through the general process. Even though this form of earmarking is typically supported in modern tax systems, many tax systems have a ceiling so that this form of earmarking is limited. In the case of South Africa, the limitation is 10 per cent (as outlined above).

While Government remains committed to the 10 per cent limitation, concerns exist that the 10 per cent limitation has an unduly harsh impact in the case of large donations, especially if one or more large assets are involved. Government has recognised this concern by allowing for the spreading of expenditure over a 10 year period if land is effectively donated to Government for conservation purposes (i.e. for use as a national park or nature reserve). In other cases, taxpayers can arrange their affairs so as to spread large donations over multiple years. The question is whether taxpayers should be forced to restructure their donations in such a fashion merely to meet the vagaries of tax law.

III. Proposal

In order to mitigate the need for structuring donations, the hard cut-off aspect of the 10-per cent limitation will be removed. Donations in excess of 10 per cent will no longer be fully lost as a deductions. Instead, the excess will be rolled over and allowed as a deductible deduction in the subsequent year of assessment (subject to the 10 per cent rule). If any excess remains, the excess can be further rolled over again.

Example:

Year 1:

Taxable income	R1million
Allowable donation as a deduction	R100 000
Actual donations made	R150 000
Deduction claimed	R100 000
Amount rolled over	R50 000

Year 2:

Taxable income	R1.5million
Allowable donation as a deduction	R150 000
Actual donations made	R0
Deduction claimed (incl. roll over)	R50 000
Amount rolled over	R0

IV. Effective date

In respect of donations, the proposed amendment is effective as from 1 March 2014 and will be applicable in respect of donations paid or transferred during years of assessment commencing on or after that date.

1.4. REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS

[Applicable provisions: Sections 11(k) and 11(l), new paragraph 2(l) of the Seventh Schedule]

I. Background

A. General

Government has long encouraged South Africans to save for their retirement through tax incentives when making retirement contributions. In particular, the aim of these incentives is to encourage income-earners to save for their retirement so as to reduce their vulnerability in old age. There are currently three main forms of retirement funds: pension funds, provident funds and retirement annuity funds. Pension and provident funds are employer-formed funds, and retirement annuity funds are generally funded by separate individuals.

B. Employer (i.e. pension or provident) funds

1. Employer contributions

As a matter of legislation, taxable employers may deduct contributions to a pension, provident or benefit fund, in an amount at least equal to 10 per cent of the “approved remuneration” of covered employees. In addition, SARS has the discretion to allow a greater percentage, and in practice, a 20 per cent threshold is accepted without specific SARS permission. Tax-exempt entities are not concerned with the deduction and do not view the above limits as any restraint to contributions. The value of the contribution will include amounts allocated in the fund towards risk benefits and administrative costs.

Unlike other 'in kind' benefits, employer contributions to pension and provident funds do not form part of the taxable income of employees. In short, employer contributions to a pension or provident fund do not lead to fringe benefit taxation for employees (regardless of whether the employer is a taxable or tax-exempt entity).

2. Employee-member contributions

In the main, member taxpayers may claim a tax deduction up to a maximum of 7.5 per cent of “retirement-funding employment” income in respect of contributions to a pension fund, commonly referred to as 'pensionable income'. However, provident fund members may not claim a tax deduction in respect of their own contributions (leaving only a 20 per cent employer contribution).

C. Individual (retirement annuity) funds

Retirement annuity funds largely exist for separate individuals seeking to fund their own retirement. These individuals may be utilising these funds as a supplement to their employer-provided retirement savings or these funds may act as the chief form of retirement savings in the case of the self-employed, partners in a partnership (or joint venture), or a form of simplified fund on behalf of multiple persons associated with a small business.

Members making contributions to these funds are generally eligible to deduct amounts up to 15 per cent of 'non-retirement-funding-income', commonly referred to as 'non-pensionable income'. 'Non-pensionable income' in general amounts to the individual's total income less any 'pensionable income' and allowable deductions. Employers making contributions to these funds on behalf of an employee-member may also deduct these contributions, but these contributions are added to the employee-member’s income. This additional employee-member income may also be deductible (as part of the overall 15 per cent limit as if the employee contributed these sums directly).

II. Reasons for change

The aim of the current retirement savings-regime is to encourage individuals to save towards achieving an adequate level of retirement income. However, the regime is fragmented, leading to differences in tax treatment and annuitisation requirements between funds. A consistent treatment is preferred where the same result follows irrespective of the method of funding. Furthermore, the various tax deduction limits in the current regime applicable to employers and individuals do not always produce an equitable result. The regime is unintentionally generous in the case of the employees of tax-exempt employers and high-income-earning individuals. It follows that the deduction limits should be revisited.

III. Proposal

A. Member contributions

Going forward, individual members making a contribution will receive a uniform deduction for these contributions regardless of the approved fund involved (i.e. regardless of whether the contribution is to a pension, provident or retirement annuity fund). Under this revised approach, deductible contributions will be subject to an annual percentage limit and a monetary limit.

1. **Percentage limit**: Deductions in respect of contributions made by the member will be allowed up to 27.5 per cent on the greater of “remuneration” or “taxable income” (excluding retirement lump sums). Potential reliance on taxable income means that self-employed individuals can make deductible contributions (or that formally employed individuals can make individual contributions based on amounts above remuneration if earning income from other sources).

2. **Monetary limit:** No member may deduct contributions in excess of an annual limit of R350 000. This limit ensures that wealthy individuals do not receive excessive deductions (*vis-à-vis* lower income individuals who do not have the means to contribute much to these funds).

Contributions in excess of the annual limits may be rolled over to future years where the amounts will again be deductible together with contributions made in that year, but subject to the limits applicable in that year. However, as per existing legislation so as to avoid double taxation, if any contributions have not been deducted as at retirement, the nominal value will be available to be set off against any lump sum income prior to the tax calculation, or will be available at assessment to reduce the tax payable in respect of compulsory annuities.

B. Employer contributions

1. Employer deduction

Employer contributions to all approved retirement funds (South African) will be deductible against income under a specific deduction provision. The deduction will effectively be unlimited. Unlike the current position where employer contributions to benefit funds (friendly society and medical scheme) are included in the specific deduction provision, the general tax position will apply in future. Restated, the employer will have to claim a deduction for contributions made to a medical scheme for the benefit of employees in terms of the general tax deduction provision.

In certain cases (particularly in respect of defined benefit funds) employer contributions are allocable in the fund to both current and retired employees. The employer deduction will be available regardless of whether the fund allocates the contribution to a current or a retired employee. However, no fringe benefit will arise in the case of an employer contribution allocable by a retirement fund to a retired member of the fund.

2. Employee fringe benefit

In future, any contributions made by an employer to an approved South African retirement fund for the benefit of an employee-member will be taxed as a fringe benefit in the hands of the member. The value of the fringe benefit for tax purposes will depend on whether the contributions are made to a defined benefit fund or a defined contribution fund.

a. If the contributions are made to a defined contribution fund, the contribution allocable to the employee will be includible as a taxable fringe benefit for that employee as at the cash value of the contribution.
b. If the contributions are made to a defined benefit fund, the value of the fringe benefit will be determined through a special formula (see **VALUATION OF FRINGE BENEFIT FOR DEFINED BENEFIT PURPOSES**).

Any contributions made by an employer for the benefit of an employee-member will be deemed to have been made by the employee, thereby being potentially deductible. These amounts will fall within the percentage and monetary limits as outlined above.

Example 1: Basic employer calculation

Facts: Employee A is a member of a provident fund. Employee A has a total cost to company (remuneration) of R300 000, which includes a basic salary of R180 000. Pursuant to the fund's rules, the employer contribution represents 20 per cent of Employee A’s basic salary, and Employee A’s contribution represents 5 per cent of Employee A's basic salary. In monetary terms, Employer makes a contribution of R36 000 (R3 000 per month) to the fund in the name of Employee A, whilst Employee A makes a contribution of R9 000 (R750 per month) to the fund.

Result: Employee A will be taxed on the R36 000 employer contribution as a fringe benefit. However, for purposes of determining potential contributions deductions, Employee A will be deemed to have contributed the R36 000 to the provident fund, together with Employee A’s own contributions (R9 000), totalling R45 000. Therefore, Employee A will be entitled to a deduction of R45 000 against income earned. Neither the percentage limit (27.5 per cent of R300 000 = R82 500) or the monetary limit of R350 000 will limit the tax deduction.

Example 2: Basic employer calculation with retirement annuity fund

Facts: Employee B is a member of a pension fund. Employee B has a total remuneration of R300 000, which includes a basic salary of R180 000 and a travel allowance of R80 000 (taxable at 80% for remuneration purposes). Employee B has a taxable income of R250 000 (including net rental profit of R30 000). The employer contribution represents 20 per cent of Employee B’s basic salary, and Employee B’s contribution represents 5 per cent of B's basic salary. In monetary terms, Employer makes a contribution of R36 000 to a South African approved pension fund in the name of Employee B, whilst Employee B makes a contribution of R9 000. Employee B also makes a further contribution of R51 000 (R4 250 per month) to a retirement annuity fund (in respect of which Employee B has provided proof to Employer).

Result: Employee B will be taxed on the R36 000 employer contribution as a fringe benefit. However, for purposes of determining potential contributions deductions, Employee B will be deemed to have contributed the R36 000 to the pension fund, together with Employee B's own contributions to the pension fund totalling R45 000. Employee B's total retirement fund contributions are R96 000 (R45 000 + R51 000). The percentage limit (27.5 per cent of R300 000 = R82 500) will limit the tax deduction in respect of the contribution of R96 000 to R82 500. Therefore, B will be unable to deduct R13 500 in the current year of assessment. The R13 500 will be available for deduction in future years subject to the percentage and monetary limits applicable in those years.

Example 3: Basic retirement annuity fund calculation

Facts: Individual C is self-employed and generates R400 000 from providing consulting services. Individual C makes contributions to a retirement annuity fund during the year of assessment of R120 000 (R10 000 per month).

Result: The deductibility of Individual C's deduction will be based on the higher of "remuneration" or "taxable income". In this instance, the deduction is limited to R110 000 (27.5 per cent of R400 000). The R10 000 excess can be rolled over to a future year of assessment (subject to future percentage and monetary limits).

IV. Effective date

The proposed amendments will be effective in respect of contributions made on or after 1 March 2015.

1.5. VALUATION OF FRINGE BENEFIT FOR DEFINED BENEFIT PURPOSES

[Applicable provisions: New definitions of "defined contribution component of a fund", "defined benefit component of a fund", and "retirement-funding income" in paragraph 1 of the Seventh Schedule and new paragraph 12D of the Seventh Schedule]

I. Background

Going forward, any contributions made by an employer to an approved South African retirement fund for the benefit of an employee will be taxable as a fringe benefit in the hands of the employee (excluding a retired employee) - **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS**. The value of the contribution will include amounts allocated in the fund towards risk benefits and administrative costs.

II. Reasons for change

A. Defined contribution and defined benefit funds

In the case of a defined contribution retirement fund, the contribution can be directly linked to the benefits that the member is entitled to upon withdrawal, retirement, or death. As a result, the employer contribution is an accurate measure of the value that the employee becomes entitled to through the fund.

However, defined benefit funds have an inherent element of cross-subsidisation across members where the value of actual contributions does not exactly match up with the benefits that a member receives. More specifically, the benefits of a defined benefit fund member upon retirement are mostly determined by the member's final salary at retirement, the years of service, and an accrual rate (which indicates how the pension benefits increase due to additional years of service). Therefore, the benefits are determined in relation to a formula, whereas the actual employee and employer contributions over years are based on the pensionable income in that year. It follows that there is no direct relationship between the value of the benefits that a member will receive on retirement and the contributions made.

To illustrate, two members receive the same pension benefits upon retirement if they have the same final salary and years of service. However, Member A received a large increase in salary just before retirement, whereas Member B received steady salary increases. It follows that the total actual contributions for previous years would have been lower for Member A than for Member B. Also, members with more years of service will also receive a larger value of pension benefits due to the increase arising from the accrual rate, implying that defined benefit funds are generally biased in favour of older members against younger members (except if the younger members are highly educated and skilled, allowing them to progress rapidly to a high income).

To summarise, the cross-subsidisation within defined benefit funds effectively ensures that the cash value of the employer contribution is not an accurate reflection of the benefit that the member receives. Therefore, a special valuation method is required to determine the value that a defined benefit fund member becomes entitled to through the fund on an employer contribution.

B. Fund-provided risk benefits

Certain retirement funds provide their members with risk benefits, such as death and/or permanent disability cover. These risk benefits (commonly known as 'approved risk benefits') are akin to the structure of a defined benefit fund as a result of the risk sharing that flows from the pooling of the risks of the members. As a matter of policy, it is preferable that there is consistency in the tax treatment of approved and unapproved risk benefits.

III. Proposal

A. Contributions to a defined contribution fund

As from 1 March 2015, employer contributions to a retirement fund for the benefit of an employee will result in a fringe benefit for that employee (see **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS**). If the employer makes the contribution to a defined contribution fund, the value of the fringe benefit will be the cash equivalent of that part of the contribution that pertains to that employee.

B. Contributions to a defined benefit fund

If an employer makes a contribution to a defined benefit fund for the benefit of an employee, the employer must determine the value of the fringe benefit for that employee through the application of a compulsory formula. The formula approximates the increase in value of the annuity and lump sum benefit of the member as a result of one additional year of service, based on the value that the member will be entitled to as a retirement benefit, as funded by the employer.

1. Conceptual methodology of the formula

The formula was created using the following methodology:

a. A capital value is created which approximates the value of the pension benefits (present value of the annuity and the lump sum) of the member that would be received at retirement as if that calculation had been performed at the end of the current year.

b. Another capital value is created, with the same calculation, but assuming the calculation was performed at the beginning of the current year.

c. The difference between the two capital values represents the increase in the value of benefit within the fund (assuming no change in the definition of pensionable income over the year and no change in the benefit design of the fund, the formula simplifies to the formula described).

d. The methodology assumes an average increase in salary.

2. The formula mechanics

a. Overview

The formula will result in a monthly fringe benefit by virtue of the pensionable income pertaining to a specific month (as opposed to being on an annual basis). The formula in the main relies on information that must be provided by the valuator of the retirement fund to the employer. It follows that the valuator will be required to provide the employer with the necessary information in a structured format and in a timeous manner.

The relevant information is:

i. **The value of the "annuity accrual rate" of the fund (A)**: The increase in the annuity benefit that the member will become entitled to upon retirement as a result of one additional year of service, expressed as a proportion of the member's “projected annuity income” at retirement.

ii. **The value of the "lump sum accrual rate" of the fund (L)**: The increase in the lump sum benefit that the member will become entitled to upon retirement as a result of one additional year of service, expressed as a proportion of the member's “projected lump sum income” at retirement. If the fund does not provide a lump sum benefit to members this value will be zero.

iii. **The value of the "annuity fund factor" for that fund (AF)**: Different values will be provided through a Regulation issued by the Minister of Finance by way of notice in the Government Gazette.

iv. **The value of the "lump sum fund factor" for that fund (LF)**: Different values will be provided through a Regulation issued by the Minister of Finance by way of notice in the Government Gazette.

- The promise of increases in pension benefits during retirement (such as whether their annuity income will increase by a percentage of inflation); and

- The age of retirement within the fund.

Also required in the formula is the "**retirement funding income**" per member (Y), commonly referred to as 'pensionable income'. In terms of the rules of a pension or provident fund, the employer determines its contribution towards the fund on the employee's pensionable income (being an itemised part of the employee's “remuneration”). Due to the uneven fluctuations of the items, retirement fund rules generally exclude items such as bonuses, variable fringe benefits, and overtime pay from pensionable income at the choice of the employer. Further, as the formula in the main approximates the total increase in benefits between one year and the next, the actual value contributed by the employee (V) should be deducted in order to determine the value of the benefit actually funded by the employer.

The formula to be applied by the employer to calculate the value of the fringe benefit for an employee in a particular month is:

$$\mathbf{Y \times ((A \times AF) + (L \times LF)) - V}$$

b. Reason for deducting the employee contribution for the month

The calculation of an employee's fringe benefit in respect of the employer contribution in the case of a defined contribution fund is done with reference to the employer's actual contribution. However, in the case of a defined benefit fund, the fringe benefit value is determined with reference to the entire increase in value, which is co-funded by the employer and the employee. Because the formula represents the entire increase in value, whether funded by the employer or the employee contribution, it is necessary to deduct the employee contribution in order to obtain an accurate value for the fringe benefit.

Example: Application of the formula

Facts: The Employer's contribution towards the pension fund is based on Employee B's basic salary only, totalling R12 000 for the month ("retirement-funding income" or 'Y' in the formula). The employer contribution towards the defined benefit fund is R2 000 and the employee's contribution is R500. The valuator provides the employer with the following information:

i. The value of the "annuity accrual rate" of the fund (**A**): **1/55**

ii. The value of the "fund factor" for that fund (**F**): **10**

iii. The value of the "lump sum accrual rate" of the fund (**L**): **1/15**

iv. The value of the “lump sum fund factor” of the fund (LF): **0.95**

v. The defined benefit employee contribution for the month: **R500.**

Result:

Z = Y x ((A x AF) + (AL x L)) - V
Z = R12 000 x ((1/55 x 10) + (1/15 x 0.95)) – R500
Z = R2441.82 (value of employer contribution as a fringe benefit)

Example: Calculation in respect of contribution limits

Facts: Assume the same information as above, where the employee had an annual basic salary of R144 000 (12 x R12 000) and the deemed employer contribution for the year is R29 301.84 (12 x R2 441.81) where this is a taxable fringe benefit. The employee made contributions of R6 000 (12 x R500) for the year and the employer contributed R24 000 (12 x R2 000).

Results: To calculate the allowable deduction the deemed employer contribution is added to the basic salary to arrive at the final remuneration. The final remuneration to determine the percentage limit is then R144 000 + R29 301.84 which equals R173 301.84. The maximum allowable deduction is then the lower of 27.5% of remuneration (R47 658.01) or R350 000. Since the total contribution is R35 301.84 (R6 000 + R29 301.84) the entire contribution is deductible.

C. Hybrid funds

A retirement fund can consist solely of defined benefit components or defined contribution components, or the fund can house a combination of these components. A defined contribution component within a retirement fund means that within that component, the member is entitled to a retirement benefit that is generally based on the contributions made to the fund plus any fund investment return thereon. However, for a defined benefit component, the member is entitled to a retirement benefit that is based on the member’s final salary, years of service, and a fund-determined factor.

An employer that contributes to a retirement fund that contains both defined benefit and defined contribution components will rely on the valuator of the fund to provide the split per member, of employer and employee contributions pertaining to that member. Again the valuator will be required to provide the employer with the necessary information in a structured format and in a timeous manner.

Once the employer has the employer contribution split per employee, the value of the fringe benefit in respect of the defined contribution component will be the cash equivalent of that part of the employer contribution. The formula will apply to the defined benefit component of the fund and will approximate a benefit increase only in respect of that component of the fund. In order to determine the entire fringe benefit resulting from the employer contribution to the hybrid fund, the employer will aggregate the cash value of the defined contribution component and the result of the formula as applied to the defined benefit component.

Example: Hybrid fund
Facts: Employer contributes R25 000 for the benefit of Employee A to a hybrid pension fund. Employee A contributes R5 000. The valuator supplies the employer with the following information split:

Contribution	Defined benefit component	Defined contribution component
Employer	R10 000	R15 000
Employee A	R2 000	R5 000

The valuator also supplies the employer with the necessary information to calculate the fringe benefit in respect of the employer contribution that pertains to the defined benefit component of the fund. Assume for the purposes of the example that the formula results in a fringe benefit value of R9 000 in respect of the employer contribution towards the defined benefit component.

Result:

Value of fringe benefit
= The contribution in respect of the defined contribution component + the result of the application of the formula to the defined benefit component
= R15 000 + R9 000
= R24 000

D. Approved risk benefits

Ordinarily, approved risk benefits would be treated the same as a defined benefit component of a fund, and would have been subject to the formula. However, unapproved employer-provided death and disability benefits (although subject to the same risk sharing effect) are taxed as at the cash value of the premium paid by the employer for the benefit of the employee. Therefore, the tax treatment of unapproved risk benefits is in line with cash value concept applied to a defined contribution component of a fund.

In order to ensure the uniformity of the tax treatment, approved risk benefits will be regarded as a defined contribution component. The result will be that the fringe benefit that results from an employer contribution (approved) or an employer premium (unapproved) will be taxed the same irrespective of whether the risk benefits are employer-, or fund-provided.

Example - Risk benefits
Facts: Employer contributes R25 000 for the benefit of Employee A to a defined benefit fund that provides approved risk benefits to its members. Employee A contributes R5 000. The valuator supplies the employer with the following information split:

Contribution	Defined benefit component	Defined contribution component
Employer	R23 000	R2 000
Employee A	R5 000	-

Note that the approved risk benefits are treated as a defined contribution component. The valuator also supplies the employer with the necessary information to calculate the fringe benefit in respect of employer contribution that pertains to the defined benefit component of the fund. Assume for the purposes of the example that the formula results in a fringe benefit value of R26 000 in respect of the employer contribution towards the defined benefit component.

Result:

Value of fringe benefit
= The contribution is respect of the defined contribution component + the result of the application of the formula to the defined benefit component
= R2 000 + R26 000
= R28 000

IV. Effective date

The proposed amendments will be effective in respect of contributions made on or after 1 March 2015.

1.6. PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT

[Applicable provisions: The definitions of "pension fund", "provident fund", "retirement annuity fund", "pension preservation fund", and "provident preservation fund" in section 1, and paragraph 6(1)(a) of the Second Schedule]

I. Background

A. Overview

There are three basic types of retirement funds in the South African retirement system: Pension funds, provident funds, and retirement annuity funds. Retirement funds accept contributions for the benefit of (and from) members with the purpose of establishing and growing a member's retirement interest (i.e. savings). For individuals that change employers, there are preservation funds that hold retirement savings until retirement (see paragraph F. Preservation funds below).

B. Contributions to retirement funds

Employer contributions to pension funds and provident funds are tax deductible up to certain limits. Further, while member contributions to pension funds or retirement annuity funds are tax deductible (subject to limits), no tax deduction is available for member contributions to provident funds.

C. Payouts from retirement funds

If a contribution to a retirement fund is tax deductible, the payout is taxable. If a contribution is non-deductible, the payout is tax-free. Growth is never taxed in a retirement or preservation fund and is therefore always taxable upon payout.

Payouts from a retirement fund can be in the form of a lump sum or an annuity. A lump sum will be taxable according to the retirement tax tables while an annuity will be taxable according to the recipient's marginal tax rate.

D. Annuitisation

Pension and retirement annuity fund members are bound by a mandatory annuitisation requirement that requires the members to annuitise a part of their fund interests upon retirement. However, provident fund members are not required to annuitise any portion of fund savings. As a result, provident fund members typically receive their retirement interests as a lump sum upon retirement.

As a general matter, mandatory annuitisation for pension and retirement annuity funds requires that at least two-thirds of a member's total retirement interest be paid in the form of an annuity (including a living annuity) upon retirement. These members will always be entitled to receive at least one-third of their total retirement interests in the form of a lump sum upon retirement.

It should be noted that where a member exits any retirement fund prior to retirement, there is no mandatory annuitisation required. Members in this situation may choose to preserve their fund interest or to receive their entire interest in the form of a lump sum.

E. De minimis exception

The *de minimis* exception overrides the mandatory two-thirds annuitisation requirement. If the total value of a fund interest at retirement does not exceed R75 000, the exception permits the member to receive the entire retirement interest in the form of a lump sum. This exception is based on the premise that an annuity of less than R75 000 is not cost effective in terms of commission and administrative fees. This exception applies separately in respect of each membership interest in a retirement fund.

F. Preservation funds

Preservation funds exist to allow individuals to preserve their retirement savings when changing employers. Therefore, pension preservation and provident preservation funds cannot accept contributions from members; these funds can only accept transfers from (employer-provided) pension and provident funds.

Members of a pension preservation fund have the same mandatory annuitisation requirement upon retirement as pension fund members (e.g. the same two-thirds versus one-third calculation). Similarly, members of provident preservation funds (as with provident fund members) are allowed to receive their entire retirement interest in the form of a lump sum upon retirement.

G. Fund-to-fund transfers

In general, no tax is levied on the transfer of retirement savings from one fund to another. However, due to the lack of annuitisation requirements in provident and provident preservation funds, transfers of retirement savings to those funds are taxed if the transfer is from a retirement or preservation fund where annuitisation is mandatory. This measure ensures that retirement savings in funds that require mandatory annuitisation remain segregated from funds without mandatory annuitisation.

II. Reasons for change

A strong link exists between insufficient retirement income for retired members of provident funds and the lump sum payouts made by provident funds at retirement. In short, the absence of mandatory annuitisation in provident funds means that many retirees spend their retirement assets too quickly and face the risk of outliving their retirement savings. In view of these concerns, it is Government's policy to encourage a secure post-retirement income in the form of mandatory annuitisation. Therefore, provident funds and provident preservation funds must be aligned to other retirement and preservation funds.

The proposals made in respect of **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS** will result in provident fund members being able to claim a deduction in respect of contributions (their own and employer contributions). Pension, provident, and retirement annuity fund members will henceforth enjoy the same tax deduction in respect of contribution. Therefore, uniformity in contribution means that members of pension, provident and retirement annuity funds should be treated the same upon retirement payout (i.e. should be subject to the same two-thirds annuitisation requirements).

III. Proposal

A. Basic annuitisation rule

It is proposed that the same mandatory annuitisation requirements currently applicable to pension and retirement annuity funds be applied to provident funds as from 1 March 2015. More specifically, as from 1 March 2015, any person retiring from a provident fund or provident preservation fund cannot receive a lump sum upon retirement of more than one-third of their retirement interests. In other words, a mandatory compulsory annuity will now be required for the remaining two-thirds of their retirement interests (pre-retirement interests remains free from any mandatory compulsory annuitisation).

B. Protection of historic vested rights within a provident fund

1. **General protective measures:** In an effort to protect historic vested rights, measures will be introduced to segregate historic rights from new rights. These measures will require a certain amount of administrative intervention to succeed:

    a. Balances in provident funds as at 1 March 2015 (and any subsequent growth thereon) need not be annuitised.

    b. If a provident fund member is older than 55 years of age as at 1 March 2015, the mandatory annuitisation requirements will not apply to contributions made by that the person is a member of as at the effective date to the fund (and any growth thereon).

2. **Administrative requirements:** Provident funds must maintain separate accounts in respect of a member under the age of 55 as at 1 March 2015 in order to separate pre-1 March 2015 contributions (and any growth thereon) from post-1 March 2015 contributions (and related growth). This segregation is required in order to determine what part of the member's retirement interest is subject to the mandatory annuitisation requirements versus those interests remaining under the prior dispensation. Separate accounts generally need not be maintained by a provident fund in respect of members of age 55 as at 1 March 2015 (no annuitisation required) and those that join a provident fund on or after 1 March 2015 (full annuitisation required).

Example 1: Provident fund member older than age 55 on 1 March 2015

Facts: Member T of the United Provident Fund is 56 years old on 1 March 2015, at which time Member T's fund interest is R400 000. Member T continues to contribute to the provident fund and retires at age 64. On that day, Member T's retirement interest is R750 000.

Result: Member T will be able to take the entire amount as a lump sum at retirement (as under pre-existing law). The provident fund need not keep split accounts for Member T.

Example 2: Provident fund member younger than age 55 on 1 March 2015

Facts: Member W of Open Provident Fund is 54 years old on 1 March 2015, at which time Member W's fund interest is R450 000 with this amount increasing by R150 000 by the year 2020. Member W also continues to pay R200 000 in contributions to the fund after 1 March 2015 until 2020 with related growth amounting to R50 000. The final retirement interest in 2020 is R850 000.

Fund administration: Open Provident Fund must maintain two separate accounts for Member W. One account in respect of the pre-1 March 2015 contributions and any growth thereon (R450 000 + R150 000); and another account in respect of the post-1 March 2015 contributions and related growth (R200 000 + R50 000)

Result: The pre-1 March 2015 contributions plus any growth thereon (R450 000 + R150 000 = R600 000) can be freely withdrawn as a lump sum. The remaining R250 000 is subject to mandatory annuitisation. Member W may only take one-third of the R250 000 as a lump sum, while the remaining two-thirds is subject to annuitisation.

C. Fund-to-fund transfers

1. **General protective measure:** The protection of provident fund vested rights will apply in respect of–

i. contributions made to a provident fund prior to a 1 March 2015 (and any growth thereon); and
ii. any contributions made after 1 March 2015 to a provident fund of which a person was a member on 1 March 2015, if that person was 55 years of age or older on 1 March 2015.

The vested right protection will apply irrespective of whether the retirement interest remains in the provident fund or whether the retirement interest is transferred to another retirement or preservation fund. .

2. **Administrative requirements:** If a provident fund member wants to transfer the member's retirement interest to another retirement or preservation fund, the provident fund must be in a position to inform the transferee fund of the split of the fund interest between the value that remains subject to annuitisation and the value that continues to enjoy vested right protection. Stated differently, the provident fund must provide the split between the pre-1 March 2015 contributions (and related growth) *vis-à-vis* the post-1 March 2015 contributions (and related growth) for this split to recognised by the transferee fund. However, in the case of members that were 55 and older on 1 March 2015, the provident fund need not provide a split as the entire retirement interest (and any future growth thereon) may be taken as a lump sum irrespective of which fund the person retires from. All other funds inheriting split accounts must similarly retain this split for record-keeping purposes.

Example: **Provident fund member transfers to new fund**
Facts:

- Person S, a member of Investment Provident Fund, is 29 years old on 1 March 2015, at which time the fund interest is R1 000 000.
- Person S continues to contribute to the provident fund. Six years later, Person S resigns. At this point, the R1 000 000 has grown to R2 000 000.
- The new contributions that Person S made to the Investment Provident Fund (and the growth on thereon) amounts to R500 000.
- Person S transfers this R2 500 000 balance to a preservation fund. When Person S turns 70, Person S resigns from the preservation fund with a retirement interest of R10 000 000.
- The pre-1 March account of R2 000 000 grew to R8 500 000, and the subsequent amount of R500 000 grew to R1 500 000.

Administration:

Investment Provident Fund

- Investment Provident Fund must maintain an account for Person S in respect of the fund interest of R1 000 000 as at 1 March 2015 and any growth thereon (R1 000 000). Investment Provident Fund must also maintain a separate account for any contributions made after 1 March 2015 and any growth thereon (totaling R500 000).
- When Person S transfers these amounts to the preservation fund, Investment Provident Fund must provide the preservation fund with a split of fund interests with one account falling within annuitisation (R500 000) and the other enjoying vested right protection (R2 000 000).

Preservation fund
The preservation fund must keep separate accounts for Person S. One account must exist in respect of the fund interest of R2 000 000 that continues to enjoy vested right protection and any growth thereon (R6 500 000). A separate account is required for the R500 000 that remains subject to annuitisation and any growth thereon (R1 000 000).

Result: The pre-1 March 2015 contributions plus growth thereon (i.e. R8 500 000) will remain free from annuitisation. The newer amounts (of R1 500 000) will become subject to the new dispensation. Member W may only take one-third of the R1 500 000 as a lump sum while the remainder is subject to annuitisation.

D. De minimis exception

As a further measure to accommodate provident fund members and ensure a comfortable transition, the current threshold for the *de minimis* exception (R75 000) will be doubled to R150 000 for all retirement funds. As a result, every member may receive their entire retirement interest in the form of a lump sum as long as the portion of the member's retirement interest that is possibly subject to mandatory annuitisation (i.e. the two-thirds amount) does not exceed R150 000.

Example 4: *De minimis* exception
Facts: Member T of Consolidated Provident Fund retires at 60 years of age. Member T was 48 years old on 1 March 2015, at which time Member T's fund interest was R450 000, which increases to R600 000 upon Member T's retirement. Prior to retirement, Member T contributed R80 000 to Consolidated Provident Fund after 1 March 2015 with growth of R40 000. The final retirement interest was R720 000.

Result: The pre-1 March 2015 amount plus growth (i.e. R600 000) thereon is free from annuitisation. The remaining (R120 000) amount is potentially subject to mandatory annuitisation but for the de *minimis* threshold (R150 000). Member T can accordingly receive the entire R720 000 in the form of a lump sum.

E. Free portability between retirement funds

Due to the alignment of the mandatory annuitisation requirements between all retirement and preservation funds, a more flexible system of free portability can now be allowed. The transfer of retirement savings to provident and provident preservation funds from other funds (to the extent that a transfer is allowed) will henceforth be free from tax in all instances (e.g. pension funds can now be transferred to provident funds).

IV. Effective date

The proposed amendments will be effective as from 1 March 2015.

1.7. EMPLOYER PROVIDED ACCOMODATION - LOW-COST HOUSING

[Applicable provision: Paragraph 5 of the Seventh Schedule and new definition of "remuneration factor" in section 1]

I. Background

A. Overview

As a general matter, tax is levied on transfers of value from an employer to an employee, whether in cash or in kind. Therefore, when employers provide an employee with benefits (such as cheap or free services) or sell an asset to an employee at less than market value, the employee is subject to tax on the fringe benefit provided. More specifically, if an employee acquires an asset at less than the market value from an employer, the employee is subject to tax on the difference between the market value and any amount paid by the employee in respect of the asset acquired.

B. Employer-provided housing

It is not uncommon in South Africa for employers operating in remote areas to provide housing to their employees. In particular, it is customary for employers to provide housing in industries that predominantly require employees to be away from their ordinary place of residence. This provision of housing can operate as an offering of rental housing or through the outright transfer of housing.

In certain cases, employer-provided housing (i.e. accommodation) is formally required in order for the employer to conduct business. For instance, in the case of mining, employer-provided accommodation is part of the employer's responsibilities in terms of the Broad-Based Socio-Economic Empowerment Charter for the South African Mining and Minerals Industry (the "Mining Charter").

C. The South African context

In industries where employer-provided housing is customary, employers often sell this housing to employees at less than market value (typically at cost or even below). Financing of this employer-provided housing may take the form of an employer-guaranteed bank loan, a direct employer-provided loan or a deferred salary plan directly with the employer. Under current law, below market housing (even at cost) is taxed as a fringe benefit for the employees involved.

II. Reasons for change

Government is supportive of employers that provide low-income employees with affordable accommodation, thereby empowering their employees through home ownership. However, the potential tax levied on the fringe benefit resulting from this below-market value transfer effectively hinders the viability of these schemes. Because Government wants to encourage employer-assisted housing as part of Government's anti-poverty objectives, these tax barriers must be addressed.

III. Proposal

A. Overview

Low-income employees will not be taxed, taking into account certain requirements, when acquiring low-income housing from their employers at a discount (i.e. at a price below market value). The detailed aspects of these requirements will be discussed below.

B. Employee salary limitations

The aim of this requirement is to restrict the incentive to employees within certain socio-economic levels. Employees falling within this incentive must not earn more than R250 000 in salary (i.e. remuneration) during the year of assessment immediately preceding the year of assessment in which the acquisition took place. For this purpose, remuneration includes fringe benefits, bonuses, over-time, etc. A special rule will apply to gross-up the remuneration if the employee was not in the employment of the employer for the entire preceding year of assessment.

C. Property value limitations

The market value of the immovable property that is acquired by the employee, may not exceed R450 000. The R450 000 applies irrespective of whether the employer acquired the property or developed the property. The R450 000 limit is based on information from employers in industries that customarily provide housing to employees (mining and other companies operating in less accessible locations).

Example

Facts: The employer sells immovable property (market value of R450 000) to Employee A for R 250 000. Employee A's remuneration as at the end of previous year of assessment was R180 000.

Result: Employee A will have a zero value fringe benefit in respect of the difference between the market value and the consideration paid (R200 000).

IV. Effective date

The proposed amendments are effective as from 1 March 2014 and will be applicable in respect of the acquisition of property by an employee from an employer on or after that date.

1.8. ANTI-AVOIDANCE SHARE SCHEMES INCOME RECOGNITION

[Applicable provisions: Section 10(1)(k)(dd) and new section 11(t)]

I. Background

A. Disposal or vesting of restricted equity instruments acquired under share incentive schemes

Anti-avoidance rules exist to prevent taxpayers from disguising salary (ordinarily taxed at the marginal rate) through the use of restricted share (or share-based) incentive schemes that would otherwise trigger low-taxed (or even no-taxed) income or capital gains. The anti-avoidance rule triggers ordinary revenue when the instruments are disposed of by employees (or fully vest for their benefit).

B. Dividends derived from restricted equity instruments forming part of share incentive schemes

In addition, rules exist to prevent taxpayers from converting salary (ordinarily taxed at the marginal rate) into low (or no) taxed dividends. Under these rules, dividends from restricted equity instruments forming part of employee share schemes are taxable as ordinary revenue unless the dividend falls into one of three exceptions:

1. The dividend arises from an equity share excluding hybrid equity shares (determined without regard to the three-year rule);

2. The dividend itself constitutes an equity instrument; or

3. The dividend arises from a trust solely containing equity shares excluding hybrid equity shares (determined without regard to the three-year rule).

In effect, the exemption from income tax of dividends from restricted equity instruments forming part of share incentive schemes will be respected if the underlying shares have pure equity features (e.g. stem from ordinary shares as opposed to preference shares). This distinction has its origin in a former tax avoidance technique used by high-paid executives that was based on restricted liquidating preference shares (i.e. preference shares whose sole value stemmed from a fixed interest-like dividend yield).

II. Reasons for change.

Internationally, Revenue Authorities are tightening the net on the use of dividends as disguised salary. In the South African context, it has become apparent that the anti-avoidance rules in respect of the conversion of salary to dividends are too narrow as they only target dividends from non-equity shares.

However, many share schemes hold pure equity shares where the sole intent of the scheme is to generate dividends for employees as compensation for past or future services rendered to the employer, without the employees ever obtaining ownership of the shares. The dividend yield in these instances effectively operates as disguised salary for employees (that is not deductible by employers) even though these dividends arise from equity shares.

According to policy, if an employer pays an employee for services rendered, the amount should be included in gross income and taxed at marginal rates irrespective of how the employer funded the payment. Furthermore, the same tax consequences should flow irrespective of whether the payment was made directly or indirectly by the employer to the employee (e.g. facilitated through an employee share trust).

III. Proposal

A. Targeted disguised salary anti-avoidance

It is proposed that a dividend paid to a person for services rendered in respect of or by virtue of employment or the holding of an office, not be exempt from income tax, and remain taxable in the hands of that person as normal income (i.e. not subject to dividends tax). However, in order to ensure that the measure does not affect bona fide share schemes, the measure will not apply to dividends paid in respect of a restricted equity instrument or in respect of a share held by the employee. Restated, the intention is that the measure should not apply to dividends in respect of shares where ordinary revenue will be triggered when the shares are disposed of by employees (or fully vest for their benefit).

B. Administrative requirement to address potential double-taxation

Where dividends received and distributed in the same tax year by an employee share trust are subject to income tax in the hands of the employee-beneficiary, dividends tax need not be withheld. The trust can make a declaration to the relevant Central Securities Depository Participant (CSDP) in the case of listed shares, or the distributing company in the case of non-listed shares, not to withhold dividends tax. If dividends tax has been withheld on dividends that will be distributed by the trust and included in the employee's income, the trust may make a declaration to the relevant CSDP or company in order to receive a refund and distribute the full dividend to the employee.

Example 1: Trust receives and pays out dividend in year 1

Facts: The Employer forms a discretionary Employee Share Trust (the Trust). The Employer funds the Trust via a loan. The Trust acquires shares in the Employer's listed Holding company (Hold-co). The employees are appointed as beneficiaries of the Trust to receive the benefits flowing from the shares (i.e. the dividends and voting rights) but will not become owners of the shares. A part of the dividends received will be used by the Trust to repay the loan from the Employer. In year 1, Hold-co declares dividends and a dividend of R200 accrues and is paid to the Trust. When the dividend declaration is announced by Hold-co, the trustees decide to make a distribution of R100 of the dividends to the employees in year 1.

Results: The dividends that accrue to the Trust and are distributed to the employees are taxable in the hands of the employees as normal income. In order to avoid the withholding of dividends tax, the Trust must make a declaration to the relevant CSDP that R100 of the dividends will be income of the beneficial owners of the dividends. When the employees receive the dividends, an obligation to make a provisional tax payment is triggered. The employees should be registered as provisional taxpayers and must make the requisite provisional tax payments to SARS.

Example 2: Trust receives dividend in year 1 and pays out in year 2

Facts: As above. However, the Trust only distributes the R85 (R100 less R15 withheld in dividends tax) received in year 1 to the employees in year 2.

Results: The dividends received by the Trust will be subject to dividends tax. When the Trust makes the distribution of R85 in year 2, the distribution will be taxable in the hands of the employees as normal income. The employees should be registered as provisional taxpayers and must make the requisite provisional tax payments to SARS.

IV. Effective date

The proposed amendments are effective from 1 March 2014 and will be applicable in respect of dividends accrued on or after that date.

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2. INCOME TAX: BUSINESS (GENERAL)

2.1. ANTI-HYBRID DEBT INSTRUMENT RE-CHARACTERISATION RULES

[Applicable provisions: Section 8F and new section 8FA]

I. Background

A. Overview

In the area of corporate financing, there are three basic sources of finance – equity, debt and retained profits. For commercial purposes, debt and equity are the key sources of external finance. As a general matter, debt is redeemable with a yield based on the time value-of-money (e.g. interest), and payment obligations exist without regard to the performance of the debtor company (i.e. payments are required without regard to profits or cash available). On the other hand, equity is typically non-redeemable with the yield (i.e. dividends) depending on the performance of the company (i.e. profits), and payment obligations are discretionary or can be deferred without giving rise to legal claims.

For tax purposes, interest on debt is generally deductible in the hands of the payor (e.g. if incurred in the production of income) and included as ordinary revenue in the hands of the recipient. On the other hand, dividends are not deductible by the payor nor are they includible in the hands of the shareholder. However, dividends may be subject to the Dividends Tax.

B Hybrid Instruments

Current law contains anti-avoidance rules that deal with hybrid debt instruments (i.e. debt instruments with equity features) as well as hybrid equity instruments (equity instruments with debt features). In the case of hybrid debt instruments, the anti-avoidance rules deny a deduction in respect of any amount paid or payable in terms of the hybrid debt instrument. However, the instrument otherwise remains a debt instrument for all other purposes of the Income Tax Act (including interest treatment for amounts received by the payee).

This denial potentially occurs when: (i) the debtor is obliged to convert the instrument to shares, (ii) the issuer has an option to convert the debt instrument to shares, (iii) the issuer can force the holder to reinvest in shares, or (iv) the holder has a deep-in-the money right of conversion. However, for this deduction denial to apply, the conversion obligation or right must be exercisable within a three-year period from date of issue.

II. Reasons for change

When determining the debt versus equity character of an instrument, it is widely believed that most of the tax law follows form. This focus on form seemingly provides taxpayers with the freedom to choose a label for an instrument with consequential tax benefits without regard to (economic) substance. This freedom poses a risk to the *fiscus* because certain taxpayers consistently choose a combination of features that bring about unintended tax benefits. The key driver for this form of tax planning is the issuer's desire to obtain an interest deduction for payment to financiers (as opposed to non-deductible payments of dividends).

When making payments to exempt persons, taxpayers have even a greater tendency to classify share-type instruments as debt in order to obtain an interest deduction, knowing that the recipient is exempt. In this instance, the debt label is commercially neutral for the taxpayer, but the result is negative for the *fiscus* because there is no matching of deductions with income inclusions.

While anti-avoidance rules exist as outlined above for debt conversions, artificial classifications go beyond the use of mere conversion features. For instance, an instrument lacking a maturity date for repayment is a strongly questionable form of debt. Moreover, even the conversion focus presently existing within the hybrid debt rules is too narrow – being limited to a three-year period.

III. Proposal

A. Overview

In order to reduce the scope for the creation of equity that is artificially disguised as debt, a two-fold regime is proposed for domestic company issuers. One set of rules focuses on features relating to the nature of the instrument itself (i.e. the corpus); the second set of rules focuses on the nature of the yield. In making these rules, it is understood that the features distinguishing debt from equity are varied and are often contextual. Nonetheless, the proposal takes aim at companies that issue stated debt instruments so as to artificially generate interest deductions if clear-cut equity features exist when viewed in isolation.

In term of the anti-avoidance rules relating to the instrument (i.e. the corpus), the proposal focuses on debt-labeled instruments that (i) have features that enable a conversion into shares whose market value is less than the amount of the outstanding debt; (ii) have a yield based on the solvency of the issuer or (iii) have features indicating that redemption is unlikely within a reasonable period where a debt instrument exists between connected persons. These features will be tested on a continuous basis (i.e. not once off at the date of issue but at any time thereafter).

In terms of the anti-avoidance rules focusing on yield, the debt yield must be based on time value of money (e.g. a rate of interest) – not other factors. In addition, where the yield is based on a rate of interest but that rate of interest is subject to change as a result of a change in the profits of the issuer, the anti-avoidance rules will apply. .

Where any of the abovementioned features relating to either the corpus or the yield of a debt instrument exist, the anti-avoidance rules will apply and will only cease to apply at the time that the features cease to exist. In applying the anti-avoidance rules, any amount of interest in respect of the instrument will be treated as a dividend *in specie* declared and paid by the issuer. The dividend *in specie* will be deemed to be declared and paid on the last day of the year of assessment of the issuer. In addition, a deduction of the interest will be denied. Similarly, the interest will also be treated as a dividend *in specie* accrued to the holder on the last day of assessment of the issuer.

Lastly, the proposed regime will contain some exceptions to simplify administration and ensure that South Africa is not left in an uncompetitive situation. These exceptions include exceptions for certain forms of regulatory capital issued by regulated intermediaries.

B. Instrument focused recharacterisation

1. <u>Features</u>

The recharacterisation rules target certain mechanisms commonly used to avoid required redemption. These anti-avoidance rules take into account not only the instrument itself, but side arrangements as well. Hence, conditions allowing for the issuer to repay the debt in the form of shares whose market value is less than the outstanding amount of debt will also result in a recharacterisation (i.e. the repayment must generally come in the form of cash or shares equal to the value of the outstanding debt). Moreover, the obligation to repay any amount owing in respect of the debt instrument (i.e. the corpus or interest) will be disregarded if that obligation is conditional upon the solvency of the debtor (i.e. the market value of the issuer's assets being less than its liabilities).

A key feature of debt is the holder's ability to redeem the capital amount loaned within a reasonable period. Instruments without this key feature operate more like equity (i.e. shares), and the yield on these instruments will accordingly be treated as equity yields (i.e. dividends *in specie)*. This is particularly an issue between related parties who are indifferent to the redemption of their capitalisations into companies that form part of the same economic unit. In order to avoid the recharacterisation, the debt instrument (i.e. the corpus) must be fully redeemable within 30 years from the date of issue (taking into account the terms of the instrument itself or any side arrangement). However, this treatment will not apply to financial instruments payable on demand. Further, this anti-avoidance rule will be limited to those debt instruments issued to parties that are connected persons in relation to the issuer company. Where the issuer has a right to convert or exchange that instrument to or for another financial instrument (other than a share) the latter instrument will be treated as one and the same as the former instrument for the purposes of determining the cumulative 30 years redemption period.

As stated above, the test for whether a debt is commercially real or artificial must be tested continuously – not merely from the date of issue or modification. If the conditions of the debt change, the debt becomes subject to the avoidance rules at the time of the change (and not before).

2. <u>Impact of recharacterisation</u>

Debt instruments falling under the reclassification rules will remain within the debt paradigm. Only the interest in relation to the instrument will be treated as a dividend *in* *specie* in the hands of the payor as well as the payee for the period during which the debt instrument constitutes a hybrid debt instrument. As a result, the payor will be denied the deduction for the stated interest. The stated interest will be treated as a dividend *in specie* (potentially subject to the Dividends Tax depending on circumstances), and the interest incurral rules (e.g. section 24J) will no longer be relevant to the existence of the instrument.

C. Yield focused recharacterisation

In some circumstances, the debt/equity recharacterisation will focus on the yield of the instrument without looking to the whole. Under these rules, the recharacterisation will similarly deem the particular yield at issue to be a dividend *in specie* in the hands of both the payor and the payee without converting the instrument as a whole (or even without converting other yields that lack equity features). In order to breach this standard, the yield at issue (taking into account all agreements) must have one of the following features:

a. The yield must not be determined with reference to time-value-of-money principles or a specified rate of interest (e.g. instead being based on company profits); or

b. The interest rate is raised with reference to the increment in the profits of the issuer.

As a result, the payor will no longer obtain any deduction for the stated interest. So much of the interest as is dependent on the increase in the profits of the issuer will be treated as a dividend *in specie* (potentially subject to the Dividends Tax depending on circumstances), and the interest incurral rules (e.g. section 24J) will no longer be relevant to the existence of the instrument. The instrument itself will retain its debt characterisation and other payments will have to be tested separately for debt/equity recharacterisation.

D. Exemptions from reclassification

The anti-hybrid rules will be subject to certain exemptions as a matter of policy. In particular, exemptions will exist for small business companies as well as certain regulated debt issued by banks and insurers.

1. <u>Relief for small businesses</u>

Small business companies (see section 12E) will not be subject to the hybrid recharacterisation rules. In most cases, the differences between debt and equity have little overall impact on the fiscus.

2. <u>Relief for regulated bank capital</u>

Banks often issue various forms of capital, including Tier I (straight equity) and Tier II (debt with equity features) capital. Increased pressure is being placed on the banks to increase these forms of capital via the international banking Basel standards. While it is understood that certain forms of Tier II capital will probably be in violation of the hybrid recharacterisation rules, these rules will be waived for Tier I and Tier II capital issued by banks and controlling companies in relation to those banks so as not to place further pressure on the cost of banking capital given the global regulatory uncertainties in this regard. It is also understood that tax systems of other countries similarly exempt these forms of debt from potential recharacterisation on similar policy grounds.

3. <u>Relief for regulated insurer capital</u>

Short-term and long-term insurers are required to maintain a sound financial condition by maintaining adequate levels of assets to cover their regulated liability and capital requirements. As a safeguard mechanism, the redemption of certain classes of debt instruments issued by short-term and long-term insurers are subject to approval by the Registrar of short term and long term insurance (respectively). These forms of debt operate roughly similar to Tier I and Tier II debt and will accordingly be exempt from the hybrid debt reclassification rules.

4. <u>Linked units held by Pension Funds, Provident Funds, REITs, Long-Term Insurers and Long Term Insurers</u>

It is also understood that there are certain companies partly owned by pension funds, provident funds, REITs, Short-term insurers and Long-term insurers ("Insurers") that issue linked units (constituting of a share and a debenture) to these funds. Profits distributed by these subsidiaries often have a dividend element (for example, 1 per cent as a dividend and 99 per cent as interest). Interest payments in respect of these linked units (the debenture part) will therefore be potentially reclassified in these rules. As a consequence, the subsidiary will not be able to claim a deduction in respect of the yield paid to the funds in respect of these instruments.

Interest paid in respect of the linked units held by a pension fund, provident fund, REIT or Insurers will be excluded from the application of the reclassification rules. However, this exclusion will only apply if the fund acquired the shares before 01 January 2013 and the instrument was also issued before that date.

IV. Effective date

The proposed hybrid instrument recharacterisation rules will come into effective in the case of amounts incurred or accrued on or after 1 April 2014.

2.2. ANCILLARY COMPONENTS OF PIPELINES

[Applicable provision: Section 12D(1)("affected asset" definition)]

I. Background

In 2000, special depreciation allowances were added to encourage and support significant capital investments within the energy generation and the electronic communications sectors. This coverage included pipelines used for the transport of natural oil and the refined by-products, water used for generating electricity as well as cables for the transmission of electricity or electronic communications (plus railway lines). The depreciation allowance applies at a rate of 10 per cent for natural and refined by-products. The depreciation allowance for the other assets mentioned is 5 per cent.

II. Reasons for change

Oil pipeline networks are specifically engineered and built to include communication cables made out of optical fibre. These cables are used for the transmission of electronic communications relating to pipeline operations. While the pipelines themselves are eligible for depreciation allowances, ancillary communication and other equipment associated with the pipeline transmission appear to fall outside these allowances. No reason exists for this deviation.

III. Proposal

It is proposed that the allowance in respect of pipelines used in the transportation of natural oil should be extended to include ancillary equipment (e.g. the communication cables) forming part of the pipelines and transmission lines. This change is consistent with the initial proposal – to provide a depreciation allowance for all assets at issue and all related equipment and structures.

IV. Effective dates

The amendment will come into effective for years of assessment commencing on or after 1 January 2014.

2.3. CROSS-ISSUE OF SHARES

[Applicable provision: Sections 24B and 40CA]

I. Background

If a company issues its own shares in exchange for the issue of shares by another company, both companies will be deemed not to have incurred any expenditure in respect of their respective acquisitions (i.e. both companies will have a zero tax cost in the shares received). However, if a company issues shares as consideration for other assets, the company is generally treated as having incurred expenditure equal to the market value of the shares (measured at their post-transaction value). The difference in both scenarios stems from the fact that the first scenario is tax-free for both parties; whereas, the issue of shares as consideration for other assets typically gives rise to tax (being a disposal of assets by the party receiving the shares).

The zero tax cost rule is fairly broad, covering direct and indirect transfers as well as cross-issues involving connected persons. However, an exception is available from the zero tax cost rule for the cross-issue of shares if preference shares are issued for ordinary shares. This exception exists in recognition of many black economic empowerment financing arrangements. In a typical self-financing arrangement, an operating company issues ordinary shares itself in exchange for the issue of preference shares by the black economic empowerment company. The dividends from the ordinary shares serve as a basis for the dividend payments from the preference shares.

II. Reasons for change

A. Unintended reach of the zero tax cost rule

The zero tax cost rule has broader coverage than initially intended, especially because the zero tax cost rule covers both direct or indirect interests as well as exchanges between connected persons. For instance, if a taxpayer transfers assets to a company in exchange for shares, the zero tax cost rule appears to apply if that company subsequently transfers those same assets to a subsidiary in exchange for subsidiary shares. In addition, the zero tax cost rule continues to have an adverse impact on black economic empowerment transactions. While the operating company is free from the zero tax cost rule in respect of preference shares received to fund the transaction, the black economic empowerment company is fully subject to a zero tax cost in respect of the ordinary shares held in the operating company.

B. Recent case law

In the recent decision of the Supreme Court of Appeal in *C: SARS v Labat Africa Ltd (669/10) [2011] ZASCA 157,* the Supreme Court had to determine whether the issuing of shares by a company as consideration for the acquisition of a trademark amounts to "expenditure actually incurred" by the issuing company. Because the term "expenditure" is not defined in the Income Tax Act, the Court observed that the term's ordinary meaning had to be attributed. In this regard, the ordinary meaning of the term "expenditure" encompasses the action of spending funds, disbursement or consumption and hence, requires a diminution of the assets by the person who expends. The Court held that the issue of shares does not give rise to any diminution in the assets of the issuing company and that the shares issued as consideration for the acquisition of the trademark accordingly do not amount to "expenditure",

The Supreme Court decision removes the necessity of having a non-expenditure rule within the Income Tax Act because this rule now exists via judicial precedent. This finality did not exist when the zero tax cost cross-issue rule was initially legislated.

III. Proposal

The rules against cross-issues will be eliminated due to the adverse impact that the zero tax cost rule has in respect of commercially driven transactions involving the issue of shares for assets. Companies that issue shares for assets (for example, shares in another company in the case of a cross-issue transaction) will generally obtain a market value tax cost in those assets (unless rollover treatment applies under the reorganisation rules).

However, it should be note that the Labat Africa Ltd decision will continue to apply in all other contexts. For instance, if shares are issued in exchange for services, the issue of shares will not be deductible by the issuing company.

IV. Effective dates

The repeal of section 24B will come into effect in the case shares acquired, issued or disposed of on or after 1 01 April 2013.

2.4. REMOVAL OF DIVIDEND EXEMPTION FOR DIVIDENDS APPLIED AGAINST DEDUCTIBLE FINANCIAL PAYMENTS

[Applicable provisions: New proviso (hh) to section 10(1)(k)(i)]

I. Background

Dividends paid by resident companies are generally exempt from income tax but subject to the Dividends Tax at a rate of 15 per cent. However, there are certain specific exemptions to the Dividends Tax (e.g. dividends paid to South African company shareholders).

Current law contains several anti-avoidance rules that are intended to deny the exemption for company shareholders if there are artificial shifts of exempt dividend income or to prevent mismatches (i.e. deductible amounts derived from exempt dividend income). One rule designed to prevent mismatches involves otherwise exempt dividends arising from share lending arrangements if the dividends are applied to pay offsetting manufactured dividends in respect of short-sale obligations.

II. Reasons for change

The current rules cover only one form of financial arrangement where dividends are applied against deductible offsetting payments. For instance, a financial intermediary company may hold shares as an offset against the issue of share derivatives (e.g. stock futures, contracts-for-difference and total return swaps. In these instances, the financial intermediary company receives exempt dividends in respect of the shares with the dividend proceeds applied to offset deductible payments in respect of the share derivative. The net result is a tax mismatch for the financial intermediary company – receipt or accrual of an exempt dividend with the dividend amount applied to cover a deductible payment owed in respect of a share derivative.

III. Proposal

In order to counter mismatches from various dividend/derivative mismatches, dividends received or accrued by a company will no longer be exempt if used as an offset against a deductible payment. More specifically, this provision will operate in similar fashion to the current rule preventing dividend mismatches involving share lending schemes. The exemption for dividends received or accrued by a company will be denied if the company incurs obligations to pay dividends where those obligations are determined wholly or partly with reference to dividends received or accrued.

IV. Effective date

The proposed amendments to will come into effect on 1 January 2014 and will apply in respect of amounts received or accrued during any year of assessment commencing on or after that date.

2.5. DEDUCTIBLE DONATIONS OF APPRECIATED IMMOVABLE PROPERTY

[Applicable provisions: Sections 18A and 37C(5)]

I. Background

A. Special dispensation for deductible donations

A special dispensation for donations exists that allows donations to be deductible against the donor's income when made to certain organisations engaged in public benefit activities. This dispensation also applies in respect of donations made to Government and certain quasi-

Governmental institutions. In this regard, a donation may be made in the form of cash or property (both of which are generally subject to the annual 10 per cent ceiling).

If a donation is made in cash, the cash donation will generally be deductible in the hands of the donor to the extent that the donation does not exceed 10 per cent of the donor's taxable income. Property donations follow a similar paradigm, except for the determination of the deductible amount. Donations of trading stock are fully deductible to the extent of the cost price thereof. For property other than trading stock, the amount of the donation is limited to the lower of cost to the donor or the fair market value of that asset on the date on which the donation is made. Donations within the special dispensation are not subject to the capital gains on the difference between market value and cost (despite the fact that the donation is technically a disposal).

The purpose of the deductible "lower of cost or market value" rule is two-fold. Firstly, taxpayers should not obtain a deduction for pre-tax amounts (i.e. untaxed gains). If taxpayers seek to obtain a deduction for the appreciation, taxpayers should sell the property and recognise the capital gain, followed by a cash contribution. Secondly, concerns exist that taxpayers may overvalue property in order to artificially enhance the deduction.

B. Incentive for environmental conservation participants

Government has created various mechanisms to promote biodiversity conservation, including the use of fiscal incentives to promote land donations for protected environments, national parks and nature reserves. More specifically, if land is declared to be a national park or nature reserve with an endorsement on the title deed for at least 99 years, the lower of the cost or the market value of the land is treated as a tax deductible donation.

However, unlike regular deductible donations, the value of the deduction is spread over 10 years at 10 per cent per annum. The purpose of this 10 per cent spreading is to reduce the adverse impact of the overall 10 per cent ceiling relating to deductible donations.

II. Reasons for change

Oftentimes, landowners own and use their land for many years before considering the possibility of making a donation of that land. Many landowners seeking to make a 99-year private endorsement for the promotion of a national park or nature reserve have owned the land for a considerable amount of time or it has been passed on through family generations. In these instances, the fair market value of the land is considerably larger than the cost. Failure to account for the appreciation differential in the deductible determination essentially eliminates most of the potential tax benefit for making a donation or a 99-year private endorsement for land conservation.

III. Proposal

In order to enhance the incentive for deductible donations on 99-year endorsements for land conservation, donations of appreciated immovable property (that qualify as capital assets) will be allowed to exceed cost. Under the revised rule, the deductible amount above cost will equal the lower of market or municipal value. The municipal value limit will prevent the existence of excessive deductions caused by artificial valuations.

In addition, the revised rule will indirectly take into account the capital gain charge and recoupment that should have arisen had a deemed disposal occurred upon donation. This implicit accounting of the implied capital gain charge and recoupmet ensures some level of parity between a "sale of property for cash followed by a deductible donation of that cash" and a "direct deductible donation". With this adjustment, the deductible amount will be reduced by the taxable capital gain inclusion and recoupments that would have been taken into account for taxable income.

Example

Facts: Mr. X owns farmland with a base cost of R250 000. In 2013, Mr X undertakes a 99-year endorsement of the farm land in terms of the Department of Environmental Affairs' biodiversity stewardship programme. At the time of the donation, the farm land has a municipal value of R3 million and a market value of R3.4 million. Mr X has a taxable income of R1 million for the 2013 year of assessment.

Result: Mr X can potentially deduct the R250 000 base cost as well as a portion of the R2 750 000 municipal value exceeding base cost. Because Mr. X is a natural person, this latter amount equals R1 834 250 (R2 750 000 multiplied by 66.7 per cent). The total potential deduction accordingly equals R2 084 250 (R250 000 plus R 1 834 250). This amount is limited to R100 000 during the current year due to the 10 per cent deductible donation ceiling. The excess R1 984 250 can be carried forward to future years (due to the newly proposed carryover).

IV. Effective date

The proposed amendments will be effective as from 1 March 2014 and will be applicable in respect of amounts paid or transferred during years of assessment commencing on or after that date.

2.6. LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX

[Applicable provisions: New provision under section 23M of the Income Tax Act]

I. Background

A. Initial Framework

Interest is generally deductible if arising from trade, incurred in the production of income and not of a capital nature. This deduction applies even if the creditor is wholly exempt in respect of the interest received or accrued. Notable parties eligible to receive exempt interest are pensions and foreign persons. In the case of a foreign person, interest from South African sources is generally exempt unless that foreign person has a South African permanent establishment. This exemption is roughly matched within the South African tax treaty network, which often exempts foreign residents from taxation in respect of South African sourced interest unless that interest is attributable to a South African permanent establishment. The purpose of this cross-border exemption is to attract foreign debt capital to the domestic market.

B. Anti-avoidance

While debt capital is an important tool for investment, debt capital can also create opportunities for base erosion. Deductible interest paid to foreign (and other exempt) persons represents a risk to the fiscus because of the deduction/exemption mismatch. This mismatch leads certain parties to over-leverage because of the overall tax benefits. In view of these concerns, the tax system contains anti-avoidance measures to prevent this deliberate and excessive mismatch. At the end of the day, a balance is required between attracting debt capital and the protection of the tax base against base erosion.

In order to strike this balance, the Income Tax Act seeks to control excessive debt through one of two means. Historically, a 3:1 debt equity limit has applied to cross-border debt. This limit operated as an adjunct to transfer pricing. In addition, a 15 per cent withholding tax has been enacted that will generally apply to cross-border interest.

II. Reasons for change

The current methods to limit excessive interest owed to exempt persons are largely incomplete. The 3:1 debt equity rule had to be changed in favour of a more facts and circumstances approach so as to satisfy international transfer pricing standards. The 3:1 debt limit also allowed for debt levels that are far too great with the prior rule arguably encouraging debt limits to the 3:1 level. As for cross-border interest withholding, the proposed charge is frequently reduced to zero under most South African tax treaties.

Excessive interest deductions pose a recurring risk if the creditor and debtor form part of the same economic unit. The terms of the funding instrument are often irrelevant because both parties can freely change the terms to serve the overall interest of the group. As a result, the debt label for these instruments is often driven by tax and other regulatory factors; whereas, loan capital frequently represents equity capital to be repaid only once the debtor is profitable.

III. Proposal

A. Overview

It is proposed that the aggregate deductions for interest that is not subject to tax in the hands of the person to whom the interest accrues be subject to a limitation if a “controlling relationship” exists between the debtor and the creditor. However, this limitation does not apply if the interest is included in the net income of a controlled foreign company (“CFC”) as contemplated in section 9D in the foreign tax year commencing or ending in the year of assessment in which the interest deduction is claimed by the debtor.

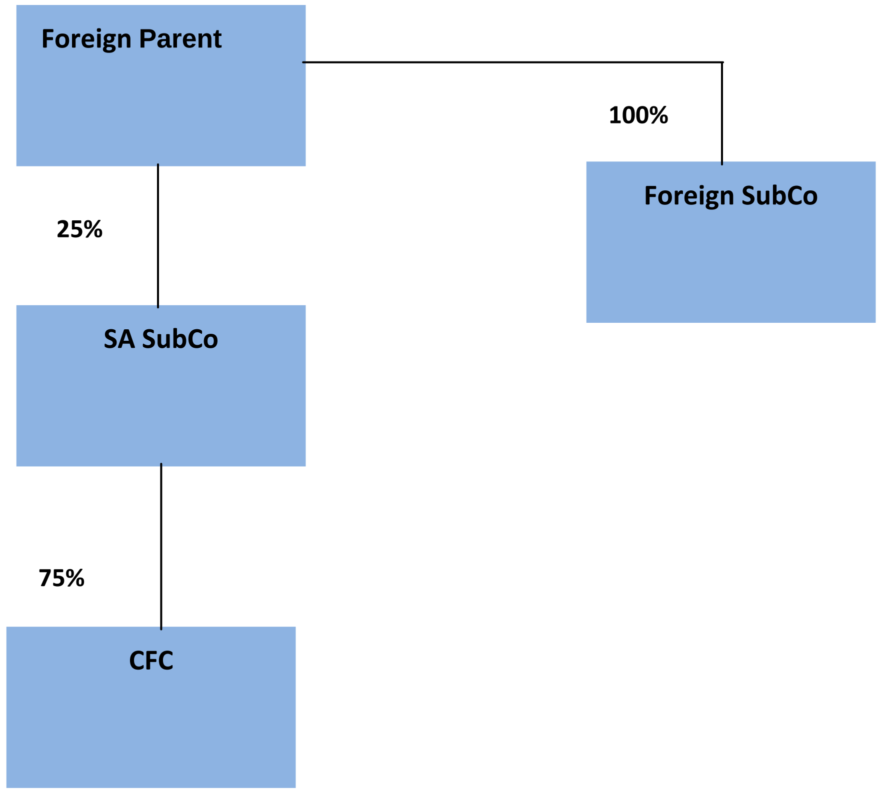
B. Controlling relationships

As stated above, the proposed interest limitation rule will apply only if either the debtor or creditor is in a controlling relationship. More specifically, for purposes of these rules a controlling relationship exists if the creditor and the debtor are connected persons as contemplated in section 1 in relation to each other.

This interest limitation rule will also apply to debt owed to persons who are not in a controlling relationship if:

- that person obtained the funding of the debt from a person with a controlling relationship in relation to the debtor; or
- the debt is guaranteed by a person with a controlling relationship with the debtor.

Example



Facts: Foreign Parent owns 25 percent of the equity shares in SA SubCo (with no other shareholder of SA SubCo holding a majority stake) and all of the equity shares in Foreign SubCo. SA SubCo owns 75 per cent of the equity shares in CFC. What is the impact of this rule on any loans provided to SA SubCo by (i) Foreign Parent, (ii) Foreign SubCo, or (iii) CFC?

Result: The interest limitation rule will apply in respect of any loans from:

(i) Foreign Parent (i.e. Foreign Co is a connected person in relation to SA SubCo because of the ownership of more than 20per cent of the equity shares in SA SubCo without any other shareholder owning a majority stake);

(ii) Foreign SubCo (i.e. a connected person in relation to Foreign Parent); and

(iii) CFC (i.e. SA SubCo directly more than 70 per cent of the equity shares in CFC).

C. Deductible interest limitation

1. <u>Formula calculation</u>

The aggregate deductions for interest paid or incurred (not being subject to tax in the hands of the beneficial owner) in respect of debt owed to persons in a controlling relationship with the debtor will be subject to an annual limitation pursuant to a defined formula. More specifically, the aggregate deductions for these amounts will be limited to:

a) The total interest received or accrued to the debtor; and

b) 40 per cent of adjusted taxable income,

c) Reduced by interest incurred in respect to debts owed (other than debts to creditors described in paragraph (*B*) above.

For this purpose, adjusted taxable income is the taxable income of the debtor less all interest received or accrued, section 9D controlled foreign company net income and recovered or recouped amounts in respect of capital assets with the addition of interest incurred, all capital allowances and an additional 75 per cent of the debtor’s rental income. This formula is increased for rentals because financial institutions are generally more willing to provide funding if immovable property is involved.

Interest expense in excess of the limitation will not be deductible in the current year. The excess will be carried forward into the following year (while retaining its tainted character) and be deemed to be interest incurred in the following year.

Example

Facts: Foreign Parent owns all the shares in Foreign SubCo and 74 per cent of the shares in SA SubCo. In 2013, Foreign SubCo provides a loan of R 7,5 million and charges interest at 10 per cent. SA SubCo has total interest income of R300 000 and has interest expenses of R190 000 on loans provided by unconnected person. The taxable income before interest and capital allowances of SA SubCo in 2013 is R1.5 million.

Result: The interest limitation rule will apply because the loan is provided by a connected person in relation to Foreign Parent (i.e. person who owns more than 50 per cent of the equity shares of SA SubCo. The interest limitation will be as follows:

Interest subject to limitation	= R750 000
Interest limitation	= Interest income + (40% x R1.5 million) – Unconnected persons interest expenses
	=R300 000 + R600 000 – R190 000
	= R710 000

As a result, only R710 000 of the R750 000 interest incurred in the 2013 year of assessment will be deductible. The balance of R40 000 will be carried forward.

D. Special rules

1. Upward adjustments for periods of high interest rates

The 40 per cent deduction limitation is based on the assumption of relatively low national interest rates. Therefore, the limitation will be increased should national interest rates eventually increase beyond a certain level. In particular, the 40 per cent threshold will increase for all taxpayers if the national repo interest rate exceeds 10 per cent. This higher limitation will be calculated as follows:

(40 per cent) "multiplied by" the repo rate/10

Example

Facts*:* The facts in example 1 apply, however a variable rate of interest is charged on the funding from Foreign SubCo. During the 2014 year of assessment, the average repo rate increased to 12% (determined with reference to the monthly average rate during that year of assessment). The interest incurred by SA SubCo in 2014 amounted to R900 000

Result*:* The interest limitation rule will apply because the loan is provided by a connected person in relation to Foreign Parent (i.e. person who owns more than 50 per cent of the equity shares of SA SubCo. The interest limitation will be as follows:

The interest limitation for the 2014 year of assessment will be as follows:

Interest subject to limitation	= R900 000
Interest limitation	= Interest income – interest expenditure (not subject to limitation) + [(40% x (12/10)) x R1.5 million)]
	= R300 000 – R190 000 + (48% xR1.5 million)
	= R830 000

As a result, only R830 000 of the R900 000 interest incurred in the 2014 year of assessment will be deductible. The balance of R70 000 will be carried forward.

2. Back-to-back loans

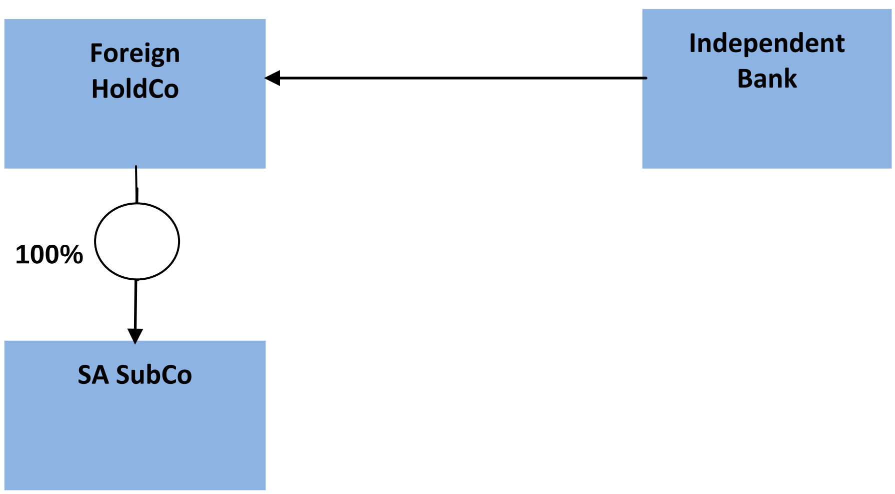
Back-to-back loans require special consideration depending on the location of the initial funding source. A loan from an independent source could originate from a person in a controlling relationship with the debtor. These arrangements typically come in the form of a back-to-back loans or a guarantee. In either case, the focus should be directed toward the original source, not the intermediary making the loan to the debtor company.

a. Relief for back-to-back loans: The debt limitation should not apply to a loan to a company creditor in a controlling relationship with the debtor if: (1) the creditor with a controlling relationship obtained those funds with amounts that are directly derived from an unconnected lending institution, and (2) the interest on such funding is determined with reference to a rate of interest that does not exceed the official rate of interest (as defined in paragraph 1 of the seventh schedule) plus 100 basis points.

b. Tainted backing from persons in a controlling relationship: The debt limitation should apply to loans to a debtor company from any person without a controlling relationship if: (1) that person obtained those funds with amounts that are directly derived from a person with a controlling relationship, or (2) the loan to the debtor company is guaranteed by a person with a controlling relationship.

Example:

Relief for back-to-back loans

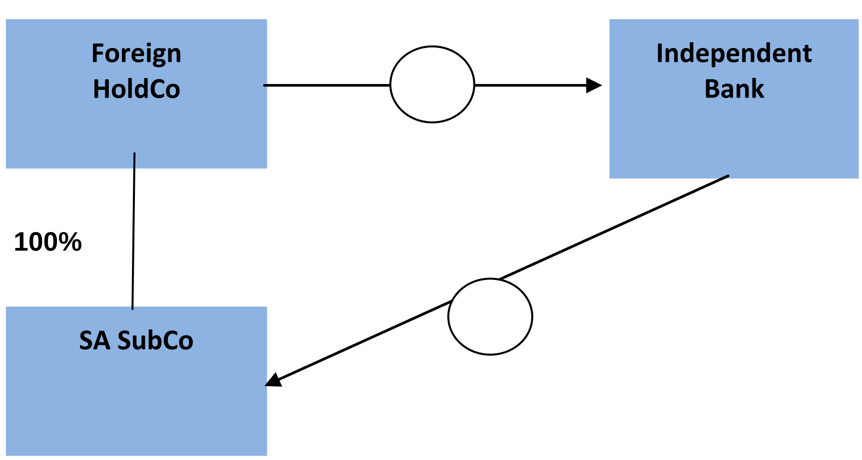


Facts:

1. Foreign HoldCo obtains a loan of R7,5 million at 7 per cent interest from Independent Foreign Bank
2. Foreign HoldCo onlends the R7,5 million at 8,5 per cent interest rate to SA SubCo (assuming that the official rate is 7 per cent)

Result: The interest limitation rule will not apply because the loan was directly funded by an independent lending institution and the interest rate of 8,5% does not exceed the official rate plus 100 basis points.

Example:
Tainted backing from exempt persons



Facts:
1. Foreign HoldCo advances an amount of R7,5 million at 10 per cent interest to Independent Foreign Bank
2. Independent Bank lends the amount of R7,5 million at 12 per cent interest rate to SA SubCo

Result*:*
Although the loan is obtained from a person who does not have a controlling relationship in relation to SA SubCo, the interest limitation rule will apply because the funds were derived directly from a person with a controlling relationship.

3. <u>Exclusion for linked units</u>

It is also understood that there are certain companies partly owned by pension funds, provident funds, REITs, Short-term insurers and Long-term insurers ("Insurers") that issue linked units (constituting of a share and a debenture) to these funds. Interest incurred on linked units will potentially be subject to these interest limitation rules. This would prevent uncontrolled property entities that are partially owned by pensions fund, REITs or insurers from fully deducting their interest expenditure much to their disadvantage as compared to registered REITs. .

As a transitional measure until legislation to regulate unlisted REITs is introduced, interest paid in respect of the above-mentioned instruments held by a pension fund, provident fund, REIT or insurer will be excluded from the application of these limitation rules. However, this exclusion will only apply if the fund acquired the shares before 01 January 2013 and the instrument was also issued before that date

IV. Effective date

The provisions will be effective from 01 January 2015 in respect of interest expenditure incurred on or after that date.

2.7. LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF REORGANISATION AND ACQUISITION TRANSACTIONS

[Applicable provisions: New provisions Section 23N of the Income Tax]

I. Background

A. Deductibility of interest in the case of company acquisitions

Interest expenses incurred in respect of debt used to finance the acquisition of business assets are generally deductible because business assets are intended to produce income. Interest on debt used to acquire shares is generally not deductible because shares produce only exempt dividend income.

Despite the above, interest deductions associated with share acquisitions can be achieved indirectly through the use of the section 45 rollover provisions (or to a much lesser extent, the section 47 rollover provisions). This objective is generally achieved when: (i) an acquiring company purchases all of the shares of a target company using temporary debt-financing, (ii) followed by a tax-deferred sale of assets by the target company to a newly formed subsidiary of the acquiring company that is funded via long-term debt. In these circumstances, the interest on the long-term debt is deductible by the newly formed subsidiary on the assumption that the debt is directly linked to income producing assets of the former target company.

A special deduction (under section 24O) is also available for interest incurred if that interest is associated with debt used to acquire controlling share interests in an operating company. Interest deductions are allowed in this circumstance because this form of acquisition is comparable to indirect share acquisitions.

B. Discretionary limitations

Potentially high levels of debt are often used to fund company acquisitions with excessive debt often anchored on the expectation of inflated future profits. In order to prevent this misuse of acquisition debt, interest deductions associated with this debt are currently subject to discretionary limits as determined by SARS. These limits are designed to target potential base erosion caused by excessive debt (and to prevent the interest deduction from becoming a facilitator of unwarranted risk). The level of debt allowed essentially focuses on the question of acceptable versus unacceptable tax leakage.

II. Reasons for change

As discussed above, the use of excessive debt for funding company acquisitions represents a significant risk to the tax system with taxable profits for the target company often wiped out for many years into the future. While the current discretionary system contains this risk, this discretionary system was never intended to be permanent. Taxpayers seeking debt-financing when attempting to acquire control of companies cannot be expected to obtain pre-approval in respect of every transaction. The purpose of the discretionary system was merely to obtain more information so as to create an informed objective set of permanent rules. The time has now come to set those rules.

III. Proposal

A. Overview

As discussed above, interest deductions associated with acquisition debt will now be contained through an objective set of rules as opposed to the current discretionary system. This interest limitation will apply to all debt used to fund indirect share acquisitions (i.e. facilitated through the use of sections 45 or 47) and direct share acquisitions (facilitated through the use of section 24O). The nature of these rules is roughly akin to the debt limitation rules associated with interest that is not subject to tax and the debtor and creditor are in a controlling relationship (see **LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX**).

B. Deductible interest limitation

1. <u>Ceiling formula</u>

The aggregate deductions for interest paid or incurred in respect of acquisition debt will become subject to an annual limitation pursuant to a defined formula. More specifically, the aggregate deductions for these amounts will be limited to the sum of:

a. the total interest received or accrued to the debtor; and

b. in the case of both reorganisation and acquisition transactions, 40 per cent of adjusted taxable income of the acquiring company,

c. reduced by interest incurred in respect to other debts (excluding debts to which this proposal applies).

For this purpose, adjusted taxable income is the taxable income of the debtor less all interest received or accrued, section 9D controlled foreign company net income and recovered or recouped amounts in respect of capital assets with the addition of interest incurred, all capital allowances and an additional 75 per cent of the debtor's rental income. This formula is increased for rentals because financial institutions are generally more willing to provide funding if immovable property is involved.

2. <u>Dual years</u>

The formula for the ceiling is to be determined against two years with the adjusted taxable income in the year of the acquisition setting the minimum base. The purpose of this minimum base is to provide parties undertaking a company acquisition with the certainty that they can rely on an initial base calculation when negotiating sales terms. More specifically, the limitation will equal 40 per cent of –

The higher of:

a. the adjusted taxable income of the acquirer in the year of the reorganisation or acquisition transaction; or

b. the adjusted taxable income in the year in which the interest expenditure is incurred.

3. <u>Lost excess</u>

Interest in excess of the formula limitation will be permanently lost in the year of assessment of the acquisition and the 5 years of assessment following the year of acquisition. The purpose of the regime is to prevent the use of excessive debt mainly to achieve tax savings so that the tax savings becomes a core element of making the deal viable. In essence, Government does not want the fiscus to be at stake without being present at the negotiating table. In view of the fact that excess interest deductions are permanently lost, the limitation will last for only five years assessment after the year of assessment in which the acquisition occurs.

C. Special rules

1. Upward adjustments for periods of high interest rates

The 40 per cent deduction limitation is based on the assumption of relatively low national interest rates. Therefore, the limitation will be increased should national interest rates eventually increase beyond a certain level. In particular, the 40 per cent threshold will increase for all taxpayers if the national repo interest rate exceeds 10 per cent. This higher limitation will be calculated as follows:

(40 per cent) “multiplied by” the repo rate/10

2. Acquisitions implemented under the section 23K pre-approval regime

Direct and indirect company acquisitions that are currently subject to section 23K will remain subject to conditions upon which approval was granted. However, interest incurred in respect of debt issued or used to redeem, settle or replace debt that was subject to the section 23K regime will be subject to the new acquisition indebtedness ceilings to the extent that such redemption, settlement or replacement occurs on or after 1 April 2014.

3. Exclusion for linked units

It is also understood that there are certain companies partly owned by pension funds, provident funds, REITs, Short-term insurers and Long-term insurers (“Insurers”) that issue linked units (constituting of a share and a debenture) to these funds. Interest incurred on linked units will potentially be subject to these interest limitation rules. This would prevent uncontrolled property entities that are partially owned by pensions fund, REITs or insurers from fully deducting their interest expenditure much to their disadvantage as compared to the registered REITs. .

As a transitional measure until legislation to regulate unlisted REITs is introduced, interest paid in respect of the above-mentioned instruments held by a pension fund, provident fund, REIT or insurer will be excluded from the application of these limitation rules. However, this exclusion will only apply if the fund acquired the shares before 01 January 2013 and the instrument was also issued before that date.

Example 1: Interest rate adjustment

Facts:
During its 2013 year of assessment, company X acquires the assets of company Y by way of a section 45 intra-group transaction. To fund the acquisition, company X issued a R8 million note at an interest rate of 10% per annum.

During the 2014 year of assessment the average repo rate (determined with reference to the monthly average repo rates during that year of assessment) was 11%. The taxable income of company X after taking into account all the adjustments is R1 million.

Results:
Interest subject to limitation = R800 000
Interest allowable per limit = [(40% x (11/10)) x Taxable Income
= 44% x (1 million)
= R440 000

As a result, R440 000 of the R800 000 interest incurred will be deductible in the 2014 year of assessment. The balance of R360 000 will be wholly denied for a deduction.

Example 2: Determination of taxable income and effect of adjustments

Facts:
During its 2013 year of assessment, company X acquires the assets of company Y by way of a section 45 intra-group transaction. To fund the acquisition, company X issued a R8 million note at an interest rate of 10% per annum. During the 2013 year of assessment, company X incurred expenditure and accrued income for the following:

Interest income: R400 000
Rental income: R100 000
Interest expenditure: R80 000

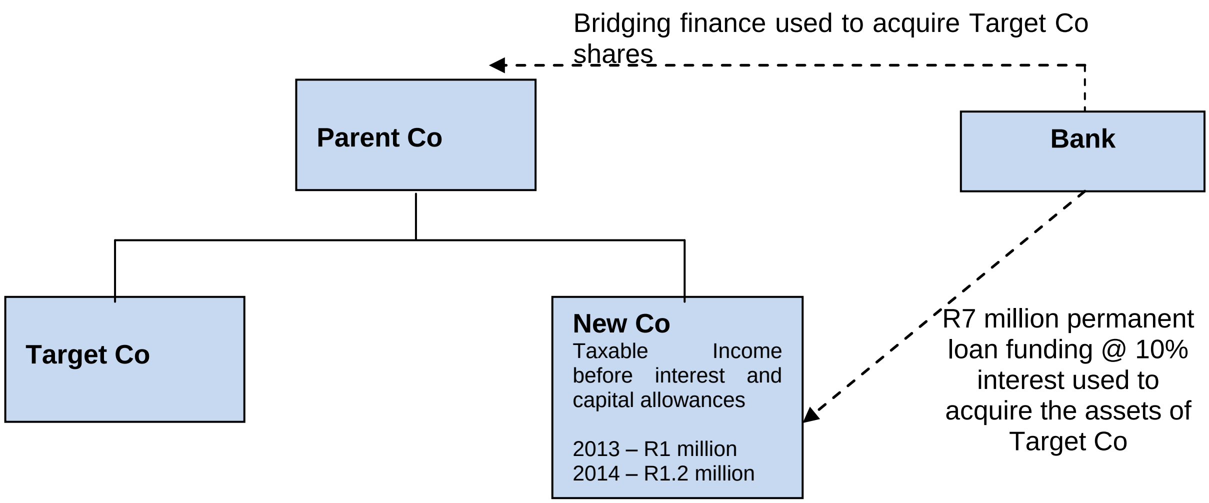
The taxable income of company X (before interest and capital allowances) amounted to R1 million.

Result:
40% taxable EBITDA (for the 2013 year of assessment):
Interest subject to limitation = R800 000
Interest allowable per limit = [40% x (Taxable Income + 0.75(Gross Rental Income)]
= 40% x (1 million + 75 000)
= R430 000
Overall interest limitation:

Overall interest limitation = R430 000 + R400 000 – R80 000
= R750 000

As such, only R750 000 of the R800 000 interest incurred by company X on the acquisition debt will be deductible. The balance of R50 000 will not be deductible.

Example 3: Basic section 45 acquisition with acquisition year EBITDA comparison



Facts:

New Co is established by Parent Co to acquire the assets of Target Co in 2013. The interest deductions allowable for New Co during the 2013 and 2014 years of assessment will be as follows:

Results:

<u>40% taxable EBITDA (for the 2013 year of assessment):</u>

Interest subject to limitation	= R700 000
Interest allowable per limit	= [40% of R1 million taxable income]
	= R400 000

- New Co's interest deduction for the 2013 year of assessment in respect of the acquisition debt will be limited to R400 000.
- As such, the balance of R300 000 will not be deductible.

<u>40% taxable EBITDA (for the 2014 year of assessment):</u>

The limitation for the 2014 year of assessment will be based on the higher of the 2013 overall interest limit and the 2014 overall interest limit.

<u>2013 limit:</u>

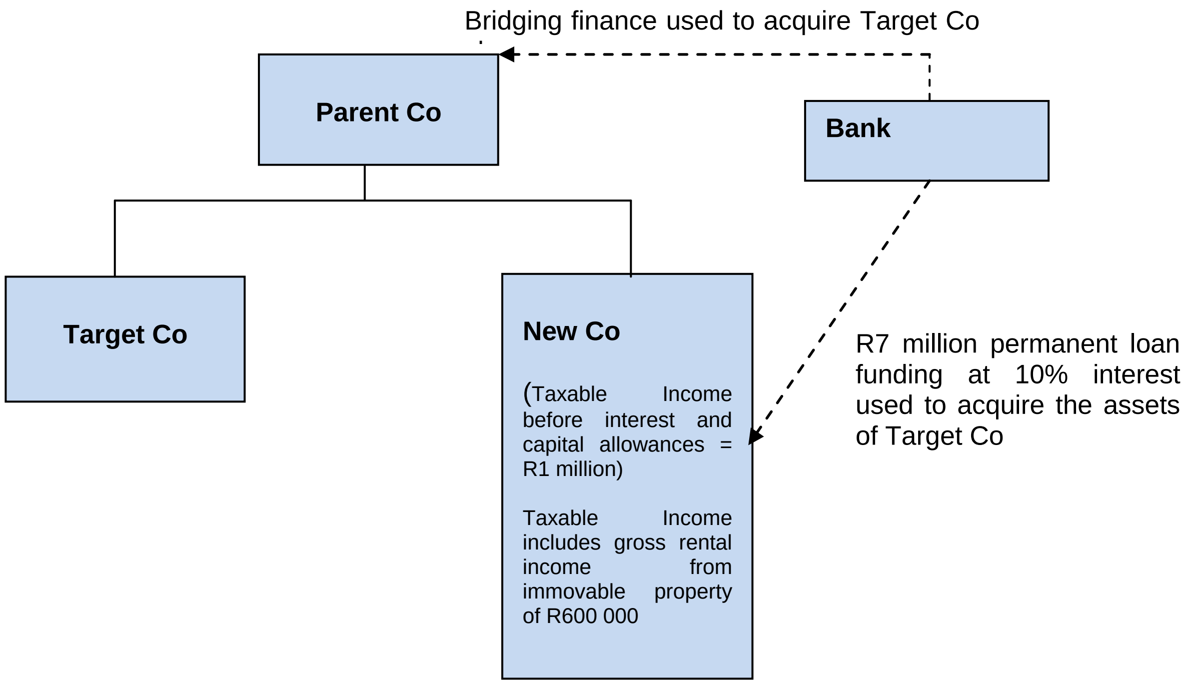
As determined above, the 2013 overall interest limit on acquisition debt was R400 000.

<u>2014 limit:</u>

Interest allowable per limit	= [40% of R1.2 million taxable income]
	= R480 000

- As the 2014 overall interest limit is higher, New Co's interest deduction for the 2014 year of assessment in respect of the acquisition debt will be limited to R480 000.
- As such, the balance of R220 000 of the R700 000 interest incurred in 2014 will not be deductible.

Example 4: Section 45 acquisition of assets generating rental income



Facts:
The facts are the same as those in EXAMPLE 1, except that New Co has gross rental income of R600 000 in the year during which the acquisition took place (i.e. 2013).

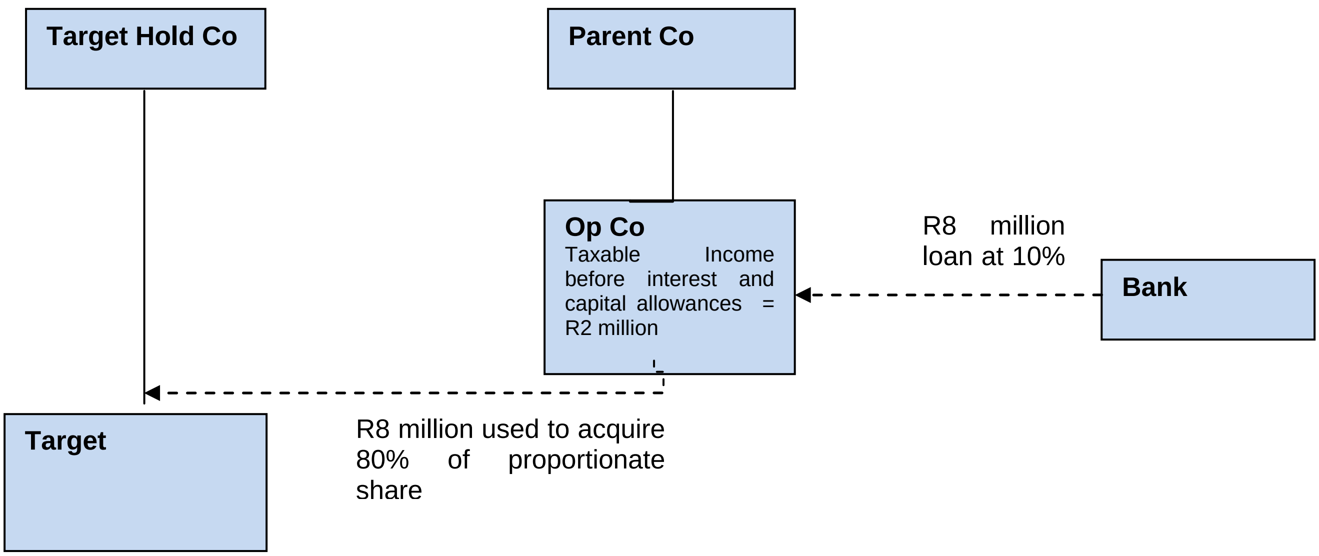
Results:

<u>40% taxable EBITDA (for the 2013 year of assessment):</u>

Interest subject to limitation = R700 000
Interest allowable per limit = [40% x (Taxable Income + 0.75(Gross Rental Income)]
= 40% x (1 million + 450 000)
= R580 000

- New Co's interest deduction in respect of the acquisition debt will be limited to R580 000

Example 5: Section 24O acquisition of partial interest



Result:

Interest subject to limitation = R800 000
Interest allowable per limit = 40% x (R2 million taxable Income of OpCo)
= R800 000

- OpCo's interest deduction in respect of the acquisition debt will be limited to R800 000.

IV. Effective date

The proposed acquisition indebtedness ceilings will come into effect on 1 April 2014 and will apply in respect of acquisition transactions and refinancing arrangements entered into on or after that date. The section 23K approval regime will be limited to acquisition transactions before that date.

2.8. TENANT CONSTRUCTION OR IMPROVEMENTS ON LEASED LAND

[Applicable provision: Section 12N of the Income Tax Act]

I. Background

A. Basic framework for claiming depreciation allowances

The Income Tax provides a variety depreciation allowances for the erection or acquisition of certain movable and immovable assets (e.g. buildings and fixed structures). In order to qualify for these allowances (especially in the case of immovable property), the taxpayer must generally be the owner of the assets.

B. Depreciation allowances for obligatory tenant improvements undertaken on leased property

In addition, if a tenant undertakes improvements in respect of leased land, the tenant can deduct the cost of the improvement over time but only if the improvement was undertaken pursuant to an obligation incurred under an agreement (e.g. typically imposed by the landlord). The cost of these improvements is generally deductible over the rental contract period (subject to a maximum 25 year limitation). If the allowance is not fully exhausted at the end of the lease period, the remaining amount is deductible by the lessee.

This allowance is only available to a lessee if the value (or expenditure) associated with the improvements constitutes income in the hands of the lessor (e.g. the allowance does not apply if the lessor is a tax-exempt entity such as Government). However, this income inclusion is subject to another allowance that effectively ensures that the lessor is only taxed on the present value of the improvements (at the end of the lease term or on termination of the lease).

C. Allowances for obligatory tenant improvements undertaken on leased governmental and certain quasi-governmental property

In 2010, a new provision (i.e. section 12N) was inserted to provide for depreciation allowances in respect of obligatory leasehold improvements undertaken on leased land or buildings owned by the government or certain exempt quasi-governmental entities. Tenants claiming these depreciation allowances can claim the allowances as if the improvement were directly owned. These depreciation allowances in respect of buildings and structures typically have a 10-to-20 year duration.

II. Reasons for change

Oftentimes, tenants may voluntarily embark on improvements on leased land or buildings in order to make their places of business commercially suitable or viable. Improvements by tenants may take the form of erecting a building on leased land or improving or extending existing buildings owned by lessor.

In terms of the Roman-Dutch law principle of *superficies solo cedit* (owner by accession), buildings or other structures affixed or attached to land become the property of the owner of the land. Once the lease expires or is cancelled, the buildings or other structures fall under direct possession and control of the lessor. However, landlords typically receive little value for voluntary improvements of this kind because the tenant is undertaking the improvement solely for the tenant's benefit (with the useful life of the improvement typically matching the lease period).

III. Proposal

It is proposed that the provisions of section 12N be extended to provide for depreciation allowances in respect of costs voluntarily incurred by a tenant to undertake construction or improvements on leased premises. In these certain circumstances, the tenant is deemed to be the owner for purposes of claiming allowances (i.e. the focus of the allowance is on the deemed useful life of the asset at issue as opposed to the duration of the lease).

Given that the proposed allowances will only be applicable in respect of voluntary construction of improvements, no income inclusions will be required for the lessor in respect of the construction or improvements. The rules for obligatory tenant improvements in respect of private and government/quasi-government land will remain as before.

IV. Effective date

The proposed amendments to will come into effect on 04 July 2013 and will apply in respect of improvements completed on or after that date.

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3. INCOME TAX: BUSINESS (FINANCIAL INSTITUTIONS AND PRODUCTS)

3.1. REFINEMENT: INVESTMENT POLICIES DISGUISED AS SHORT-TERM INSURANCE POLICIES

[Applicable provision: Section 23L]

I. Background

A. 2012 income tax anti-avoidance rule

The Taxation Laws Amendment Act 2012 introduced section 23L to curb avoidance in the case of disguised investments in the wrapper of short-term insurance policies. More specifically, section 23L targets short-term insurance policies where the insurer fails to accept significant risk from the policyholder. This type of policy is viewed as an investment policy, meaning that the policyholder may not deduct premium payments in respect of the policy.

B. Investment versus risk contracts under IFRS

The International Accounting Standards Board (IASB) issued phase one of the accounting standards addressing the accounting and reporting of insurance contracts. These standards focus on the accounting and disclosure of insurance contracts by insurers. No official standards exist in regards to the treatment of insurance policies in the hands of policyholders. However, a policyholder must treat the premiums paid in respect of a policy as an asset (as opposed to an expense) if the insurance contract is more properly viewed as an investment.

II. Reasons for change

A. Misplaced focus

The current reliance on IFRS 4 for determining whether a short-term insurance policy should be treated as an investment or a deductible expenditure in the hands of a policyholder is misplaced. As stated above, IFRS 4 focuses on the insurer as opposed to the policyholder. The net result is that the anti-avoidance rule is over-inclusive and under-inclusive. The rule inadvertently covers many insurance contracts merely because the policyholder is a shareholder of the insurer (e.g. captives and cell captives where a genuine risk transfer arises). In addition, the rule may even exclude forms of insurance contracts treated as an investment by policyholders in terms of IFRS and it is often impractical for a policyholder to determine the tax character of a payment based on the IFRS characterisation of the insurer.

III. Proposal

A. Revised focus for non-deductible premiums

The anti-avoidance rules for investment policies disguised as risk insurance will be changed from an insurer focus to a policyholder focus. More specifically, policyholders of short-term insurance policies will not be eligible to deduct short-term insurance premiums in respect of policies unless the premiums are reflected as a current or future expense for financial reporting purposes. As under current law, current expenses are deductible in the current year (under section 11(a)) and future expenses are allocated to future years (under section 23H)).

IV. Effective date

The proposed amendment will apply in respect of premiums incurred by policy holders on or after 1 April 2014.

3.2. ANNUAL FAIR VALUE TAXATION OF FINANCIAL INSTRUMENTS IN RESPECT OF BANKS AND BROKERS

[Applicable provisions: section 24JB]

I. Background

A. Income tax treatment of financial instruments

In general, income tax systems impose tax on a realisation basis when calculating gain or loss in respect of asset values. This method requires a realisation event (e.g. a disposal). This reliance on realisation exists because notional gains and losses cannot generally be determined with accuracy (especially from the perspective of revenue enforcement). In essence, realisation brings certainty to notional profits/losses embedded within assets.

In respect of certain debt instruments (and other arrangements based on time-value-of-money principles) income and expenses are determined on a constant, compounding basis. Legislation allows for mark-to-market taxation in respect of certain financial instruments (e.g. debt, interest-rate swaps and certain options); otherwise, the overall income tax system remains on a realisation basis. This mark-to-market system is allowed in respect of dealings in debt instruments if the taxpayer makes an election and if SARS provides approval.

B. Accounting treatment of financial instruments

Similar to the tax treatment, financial accounting has generally relied on cost as an initial measure. However, over time, a growing trend developed toward notional realisation in respect of liquid financial instruments (e.g. listed and over-the-counter shares, bonds and derivatives). Unlike other assets, the notional value of these instruments bears a strong correlation with their realisation value in terms of accuracy. The widely-traded nature of these instruments also has the benefit of easy verification for enforcement and compliance purposes. This form of annual notional accounting is commonly referred to as a mark-to-market approach (triggering annual gain and loss for IFRS recognition based on notional fair market values).

The International Financial Reporting Standards (IFRS) address the full array of financial instruments (e.g. shares, debt and derivatives) (see IAS 39 and IAS 32, which will soon be replaced by IFRS 9). Many of these financial instruments fall under the new fair market value approach. More specifically:

1. Financial instruments held for trading (as determined under IFRS principles) and derivatives are always reflected at fair market value.

2. Other financial instruments must also be within fair market value treatment but only to the extent it would otherwise result in a measurement inconsistency.

3. Lastly, a financial institution may also manage a group of assets and liabilities through the fair market value system for purposes of risk management and investment strategy. This latter option focuses on how that institution manages and evaluates performance rather than on the nature of use associated with the financial asset or liability. This inclusion within the fair market value system is essentially elective and is often used for certain strategic stakes in a company (e.g. private equity investments and uniquely managed large-scale share interests).

II. Reasons for change

In respect of financial instruments, the rules pertaining to income tax and financial accounting have completely diverged. This divergence has proven to be a challenge for both taxpayers and SARS alike. The sheer volume of financial transactions for large financial institutions requires expensive systems that require constant adjustment. As a result, tax deviations are often accounted for manually, thereby becoming prone to inaccuracies. From a SARS standpoint, the divergence between tax and accounting has become so great that accounting is often no longer a useful benchmark for assessing risk *vis-à-vis* the accuracy of taxable income.

Admittedly, current law contains a specific rule that allows taxpayers to utilise annual mark-to-market fair value methodology. However, this election in favour of annual fair value methodology is limited because this election only caters for specific instruments, thereby leaving equity and other instruments under the realisation principle. Moreover, this election focuses solely on financial assets without regard to financial liabilities (thereby resulting in serious mismatches). Lastly, the elective and pre-approval nature of the current mark-to-market system gives rise to uncertainty and confusion and will be discontinued.

III. Proposal

A. Overview

In order to simplify compliance and enforcement, certain companies and trusts that operate under IFRS will be required to determine their income for tax purposes in respect of certain financial instruments in accordance with financial reporting required by IFRS. The main impact of these rules is to also take into account changes in fair value for certain financial instruments.

B. Covered persons

The new IFRS fair value system will be required for covered persons (as opposed to the present elective system). For this purpose, covered persons consist of:

a. Brokers that are members of the JSE (i.e. authorised users);

b. The Reserve Bank of South Africa;

Entities regulated by the Banks Act, 1990 (Act 94 of 1990) (e.g. local banks, local branches of foreign banks, foreign branches of local banks and controlling companies in respect of banks) as well as any company or trust that forms part of a banking group in terms of the Banks Act. However, this latter category of companies or trusts excludes an entity if:

- the entity is a long-term or short term insurer; or
- the entity is a company which is directly or indirectly more than 50 per cent held by an insurer but is not part of the same section 1 group of companies as the bank (for instance, assume a bank owns 60 per cent of a long-term insurer and that insurer owns all of the shares of a company, both the insurer and the company will not be covered persons);

C. Taxation of covered persons

A covered person must, subject to the exclusions below, include in or deduct from its income the aggregate of all amounts in respect of "qualifying" financial assets and financial liabilities that are recognised in profit or loss in the statement of comprehensive income.
For this purpose "qualifying" financial assets and financial liabilities are:

a. financial assets and financial liabilities defined in and within the scope of IAS 32 of IFRS or any other standard replacing IAS 32 that are recognised at fair value in profit or loss in terms of IAS 39 of IFRS or any other standard replacing IAS 39 (i.e. IFRS 9); and

b. any commodities that are recognised at fair value less cost to sell in profit or loss in terms of IFRS (typically commodities held by broker-dealers as envisioned in the exclusion of inventory accounting in IAS 2).

The application of section 24JB is subject to two notable exclusions. Firstly, the following financial assets that were in terms of IAS 39 of IFRS or any other standard replacing IAS 39 upon initial recognition designated by the covered person at fair value through profit or loss because they are managed and their performance is evaluated on a fair value basis:

a. a share;

b. an endowment policy;

c. an interest held in a portfolio of a collective investment scheme;

d. an interest in a trust,

Secondly, dividends and foreign dividends received by or accrued to covered persons..

To the extent that South Africa does not have the right to tax an amount due to the provisions of a tax treaty for the avoidance of double taxation, the amount will not be included in income under section 24JB(2).

In order to prevent double counting, amounts taken into account in determining the taxable income or assessed loss in respect of a financial instrument within the scope of section 24JB(2) must only be taken into account under that section.. For instance, the interest accrual rules of section 24J will not apply to an income instrument taxed under section 24JB(2).

In essence, if a financial instrument is taxed in terms of section 24JB any amounts in respect of that instrument will not be taken into account as gross income or a deduction under the general deduction provisions.

A. Anti-tax avoidance between covered and other persons

While the new system represents a significant change in terms of taxpayer compliance and SARS enforcement, the new system could potentially be misused to cause tax mismatches. This possibility exists because the majority of taxpayers remain outside the new system.

In order to protect the fiscus, amounts in respect of financial instruments will not be within the scope of section 24JB (2) if an agreement in respect of one or more financial instruments is entered into between a covered person and a counter party which is not a covered person if that agreement was entered into solely or mainly for the purpose of reduction, postponement or avoidance of liability for tax by the covered person

B. Three-Year Transitional gain or loss

Covered persons falling under the new system will be required to change their method of taxing “qualifying” financial assets and financial liabilities from a realisation approach to an IFRS financial reporting based approach. This change should trigger an immediate tax gain or loss, but may potentially have serious cash-flow consequences for new entrants into the system. In order to alleviate the impact on cash-flow, the gain or loss between the two approaches at the end of the year of assessment before the year of assessment the new system applies will be spread over a three-year period. The gain or loss will be measured by calculating the differences between the financial reporting values for purposes of IFRS and the tax base amounts of financial instrumentss. Reliance on IFRS for this purpose simplifies compliance and enforcement for all parties involved.

C. *Ceasing to be a covered person – transitional gain or loss*

If a covered person ceases to be a covered person before the expiry of the three year post-realisation period, all untaxed amounts associated with the spread differential will be triggered in the year of cessation.

D. Ceasing to be a covered person – deemed disposal and re-acquisition

If a covered person ceases to be a covered person, the exit from the system will trigger a deemed disposal and re-acquisition of financial instruments to which that covered person is a party (in addition to the acceleration of the transitional gain or loss, if applicable). The deemed disposal will ensure that all unrealised gains and losses in respect of financial instruments that are within the scope of section 24JB are accounted for before exiting the section 24JB system and that all those instruments enter the standard rules at market value.

IV. Effective date

The proposed amendment applies in respect of years of assessment ending on or after 1 January 2014.

3.3. TAX REGIME FOR COLLECTIVE INVESTMENT SCHEMES IN NON-PROPERTY INVESTMENTS

[Applicable provisions: New Section 10(1)(dA), section 25BA, and paragraph 61 of the Eighth Schedule]

I. Background

Collective investment schemes come in a variety of forms. Schemes exist for securities, participating bonds and property. As a general matter, a semi-flow-through regime exists for collective investment schemes in securities and participating bonds with a separate regime existing for property schemes (the latter now being viewed as REITs with deemed rental distributions if listed). Declared collective investment schemes are not prevalent, however, a new regulatory regime is pending for hedge funds.

In the case of non-property schemes, disposals of capital assets by the scheme are tax exempt. Amounts other than of a capital nature are tax-free to the scheme as long as the scheme itself distributes amounts within a 12 month period. Non-capital amounts retained beyond this 12 month period are treated as ordinary revenue in the hands of the collective investment scheme. Distributions by non-property schemes within the requisite 12-month period generally result in flow-through treatment. In effect, the amounts distributed are deemed to directly accrue to the unit holders at the time of distribution.

A holder of a participatory interest in a collective investment scheme in securities is allowed to treat gains from the disposal of its participatory interest as a capital gain if the participatory interest was hold for a period of at least 3 years.

II. Reasons for change

Interest that accrues to a non-property collective investment scheme in terms of section 24J but which is not received by the schemes within the 12 months period creates a problem. The collective investment scheme cannot distribute this interest that has not been received by it to the holders of participatory interest in the scheme. This results in the collective investment scheme becoming taxable on the interest 12 months after accrual to the scheme.

Hedge funds will be declared as collective investment schemes in terms of the Collective Investment Schemes Control Act (CISCA); possibly in the first quarter of 2014. In terms of CISCA, hedge fund managers will be required to register as collective investment scheme managers and will be required to comply with the same requirements that are currently imposed on managers of the traditional collective investment schemes.

Taking into account the regulatory change for hedge funds as mentioned above, the tax rules should also change by treating all regulated hedge funds on the same basis as collective investment scheme in securities. However, the majority of hedge funds in South Africa are currently conducting their business in the form of partnerships. The tax law treats partnership as transparent meaning that each partner is deemed to be carrying on the business of the partnership and the partnership income and expenditure are taxed in the hands of the partners. To ensure that the partnership rules are aligned with collective investment schemes rules, hedge funds that are structured as a partnership will be subject to the collective investment scheme tax provisions.

III. Proposal

It is proposed that section 25BA be amended to tax the holder of the participatory interest in a portfolio of a collective investment scheme on interest distributed by that portfolio not later than 12 months after the receipt of the interest by the portfolio. The portfolio will be taxed on interest not distributed by it within 12 months of the receipt by the portfolio of the interest.

This section will also be amended to clarify that the collective investment scheme tax provisions (and not partnership taxation provisions) will apply if the partnership is regulated as a hedge fund collective investment scheme. Amounts allocated to partners are to be treated as having been distributed by the hedge fund collective investment scheme to the holders of participatory interests in that scheme.

A holder of a participatory interest in a hedge fund collective investment scheme will also be allowed to treat gains or losses from the disposal of its participatory interest as a capital gain or capital loss if the participatory interest was held for a period of at least 3 years. In other cases the nature of the disposal will be based on judicial precedent.

IV. Effective date

The proposed amendments are effective for years of assessment commencing on or after 1 January 2014.

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4. INCOME TAX: BUSINESS (INCENTIVES)

4.1. REFINEMENTS TO THE RESEARCH AND DEVELOPMENT INCENTIVE

[Applicable provision: Section 11D]

I. Background

Innovation, research and technological development are key factors for improved productivity (leading to new or improved products, processes or services). This enhanced productivity is a necessary condition for increased economic growth and international competitiveness. Research and development can also result in knowledge spillovers and assist in developing skills in the economy. Government recognises the importance of R&D and seeks to encourage higher levels of R&D expenditure and investment. South Africa offers a variety of direct subsidies for R&D through the Department of Science and Technology and in addition the tax regime provides incentives aimed at ensuring that the local R&D environment is sufficiently attractive.

It should be noted that the objective of the R&D tax incentive is to generate additional R&D expenditure, not merely to provide tax relief for R&D expenditure that would have happened in the normal course of business. The success of the R&D tax incentive will be measured against this metric and the extent to which the success of R&D translates into higher levels of domestic productivity, economic growth, skills development, employment and taxable income in future. The tax incentive for R&D is two-fold. Firstly, operating expenses incurred directly and solely for purposes of conducting R&D are 100 per cent deductible. In addition, capital expenses also qualify for an immediate 100 per cent expensing (write-off).

This favourable tax treatment is extended to operating expenses that may be characterised as being capital in nature (oftentimes, such expenses lead to the creation of an intangible asset). Secondly, these qualifying expenses generate a further 50 per cent deduction if the R&D is approved by the Minister of Science and Technology. Thus, some R&D expenses may be eligible for a 150 per cent deduction (i.e. where ministerial approval has been granted).

II. Reasons for change

Information uncovered by the adjudication committee during the approval process for the additional 50 per cent uplift reveals that the incentive can possibly be claimed in respect of some R&D activities that were never intended to fall within the ambit of this regime. An example of such activities is R&D 'related' expenditure incurred to upgrade internal businesses that are subsequently sold to connected parties. The language in the provision also gives rise to uncertainties in interpretation and can be a deterrent to certain legitimate applications. Such anomalies need to be addressed in order to accelerate the adjudication and approval processes.

Taxpayers view the current definition of R&D as automatically qualifying for the 50 per cent uplift. The ministerial approval process was meant to require extra effort by taxpayers to be eligible for the uplift. The intent behind this was to ensure that government subsidises R&D expenditure that was unlikely to have occurred in the absence of the incentive, again the need for some additionality.

III. Proposal

The existing R&D tax incentive regime has been revised to achieve the following main objectives:

1. To align the 100 per cent and 50 per cent deductions. The application by taxpayers to the Minister of Science and Technology will be for the 150 per cent deduction.

2. To ensure a more robust definition of R&D, requiring that R&D for the purpose of this incentive will be innovative in nature (including improvements). Government wishes to encourage R&D expenditure that yields positive externalities for the economy, while recognising that much R&D taking place in South Africa is akin to reverse engineering.

3. To simplify and streamline the legislation for ease of use.

In summary, the amendments are as follows:

1. Adjustments to the R&D definition;

2. Clarification of R&D exclusions;

3. Clarification of section 11D deductible R&D expenditures;

4. Clarity of allowable R&D expenditure to be provided in regulations; and

5. Miscellaneous.

A. Adjustments to the R&D definition

To streamline and simplify the regime, R&D expenses will qualify for 150 per cent deduction if the R&D expenditure (i) meets the definition of R&D, (ii) is approved by the Minister of Science and Technology and (iii) the R&D activities are undertaken in South Africa. It is therefore crucial that the definition for R&D is sufficiently robust and attracts genuine R&D that is innovative.

The first part of the definition focuses on the creation and development aspects whilst the second part of the definition focuses on improvements. Both parts will be subject to the innovative requirement and improvements will also have to result from '*systematic investigative or systematic experimental activities of which the result is uncertain for the purposes of…*' – a requirement that is currently only linked to the creation / discovery of knowledge aspects. In terms of the creation and development aspect of the definition, the creation or development should lead to:

1. An invention capable of registration under the Patents Act; or

2. A design capable of registration under the Design Act, but only functional designs of a scientific and technical nature (as opposed to designs of an aesthetic nature); or

3. Innovative commercial computer programs intended for sale or use to unrelated customers (as opposed to internal upgrades or improved internal use by the entity and related members); or

4. Knowledge essential to the use of such invention, functional design or computer program.

The revised definition ensures that the R&D is intended for wider use than internal business use (e.g. by the taxpayer or those connected to taxpayer). Moreover, the resulting knowledge essential to the use of intellectual property has to be an integral part of the created intellectual property – not just operating manuals or instruction manuals, or documents to be utilised after the R&D is complete. The overall intent of the definition is also shifted more toward a scientific / technological bias with an added emphasis on innovation.

B. Clarification of R&D exclusions

The current R&D regime contains a number of exclusions that should more rightly be viewed as exclusions to the R&D definition instead of a denial of deductible section 11D expenditures. These exclusions are accordingly adjusted as a counterpart to the R&D definition itself.

Certain specific forms of knowledge (for example, management, enhancement of internal business processes, social science and humanities, market research, sales or marketing promotion) fall outside the scope of the incentive.

C. Clarification of section 11D deductible R&D expenditures

1. <u>Excluded expenditures</u>

R&D expenditure is fully deductible even if the expense is of a capital nature. Expenses of a capital nature are included for the purposes of the deduction because taxpayers should not lose the deduction if activities lead to the development of an intangible asset. However, this allowance of expenses of a capital nature also arguably allows for the immediate deduction of capital allowance assets (e.g. buildings and machinery) when these items should be depreciable over time as specified elsewhere in the Act (e.g. section 12C). Capital allowance assets (and registration expenses associated with intangibles), other than prototypes and pilot plants created solely for the purposes of research and development, will accordingly be excluded from the immediate write-off.

2. <u>South African activities must be meaningful</u>

Under current law, the R&D tax incentive regime is available solely in respect of R&D undertaken within South Africa. The proposed legislation clarifies that these activities must have some level of significance, meaning that local persons should have some level of control over research methodology. Stated differently, the activities must enhance local skills development. An exception to this requirement is R&D expenditure incurred for clinical trials. This will be prescribed by the Department of Science and Technology and SARS by way of guidelines and regulations.

D. Clarity for allowable categories of R&D to be provided in regulations

The Minister of Finance, in consultation with the Minister of Science and Technology, may designate certain categories of R&D by way of regulations. The regulations will prescribe the criteria for evaluating eligible and non-eligible R&D in the case of pharmaceutical companies (i.e. clinical trials). More detail will also be provided for other types of eligible R&D expenditure, including the ICT sector.

E. Miscellaneous

1. <u>Government and quasi-governmental funding</u>

Current law prohibits the additional 50 per cent deduction to the extent that the expenditure is funded by a government grant (i.e. an exempt grant) and this limitation was too narrow. The exclusion has been broadened and the denial will be adopted in such a way that if R&D is funded through government or quasi-governmental agencies, there will be no 150 per cent deduction. No reason exists to provide the 150 per cent deduction when government or quasi-governmental agencies fund the expenditure. The purpose of the incentive is to enhance private funding.

2. <u>Withdrawal of approval for additional allowance</u>

Under current law, the Minister of Science and Technology may withdraw approval for an additional allowance (even though the R&D was previously approved) if any material facts change that would have had the effect that the approval would not have been granted. This provision does not comprehensively deal with other factors which that would necessitate withdrawal of approval, such as fraud or non-disclosure and these will be added.

IV. Effective date

The proposed amendments to will come into effect on 1 January 2014 and will apply in respect of amounts incurred on or after that date.

4.2. TAX INCENTIVES FOR SPECIAL ECONOMIC ZONES

[Applicable provision: New section 12Q]

I. Background

A. General

In order to promote investment, growth and job creation in the South African manufacturing sector and the development of selected regions, Industrial Development Zones (IDZs) were introduced. Value-added tax and customs duty relief are applicable within customs controlled areas in the IDZs. These areas consist of entry and exit points controlled by customs personnel and a dedicated customs office provides rapid inspection and clearance.

B. Income tax incentive for industrial investments

Income tax incentives (section 12I) available to certain manufacturing companies include an additional allowance for an industrial policy project differentiated according to the type (greenfield or brownfield) and status (qualifying or preferred). The scoring mechanism allocates an extra point for greenfield investments located into IDZs.

The incentive comes in the form of an additional deductible allowance equal to 35 per cent of the cost of a manufacturing asset used in industrial policy projects with qualifying status (or 75 per cent if these projects are located within an IDZ), and 55 per cent of the cost of a manufacturing asset used in industrial projects with preferred status (or 100 per cent in cases where such projects are located in an IDZ). Another incentive exists for the training of employees.

II. Reasons for change

The Department of Trade and Industry (the DTI) has reviewed the viability of industrial development zones. In an effort to improve governance, streamline procedures and provide more focused support for businesses operating within these zones, the DTI is in the process of introducing special economic zones (SEZs). It is the intention that the existing IDZs will become SEZs. Additional income tax incentives will be introduced to encourage higher levels of investments in the IDZs.

III. Proposal

A. Overview

All special economic zones will qualify for VAT and customs relief (similar to that for the current IDZs), and the employment tax incentive. Businesses operating within approved SEZs (by the Minister of Finance, after consultation with the Minister of Trade and Industry) will be eligible for two additional tax incentives. Firstly, all such businesses can claim accelerated depreciation allowances on capital structures (buildings) and, secondly, certain companies (carrying on qualifying activities within an approved SEZ) will be subject to a reduced corporate tax rate (i.e. 15 per cent instead of 28 per cent).

1. Basic conditions

A lower corporate tax rate will be available for qualifying companies located within approved SEZs (by the Minister of Finance, after consultation with the Minister of Trade and Industry). A qualifying company must be:

Formed or effectively managed within South Africa and generating 90 per cent of its income from services or the sale of goods (i.e. trading stock) from activities attributable to a fixed place of business within one or more SEZ that has been approved by the Minister of Finance (in consultation with the Minister of Trade and Industry).

2. Qualifying criteria

a. The DTI will be responsible for deciding on (and regulating) the qualifying criteria for entry into a special economic zone. All companies that meet such entry requirements will be eligible for the building allowance, employment tax incentive and VAT and customs relief.

b. Once a qualifying company is located within an SEZ, it has to be carrying on certain activities to be eligible for the reduced corporate tax rate of 15 per cent (instead of 28 per cent). The Standard Industrial Classification codes will be used to generate a list of activities (captured by regulation) that will fall outside the scope of the reduced corporate tax rate.

B. Detailed nature of incentives

1. Lower company tax rate

Qualifying companies will be subject to a 15 per cent corporate tax rate if they are carrying on certain activities within an approved SEZ. Transactions between such qualifying companies (in approved SEZs) and other companies may be subject to transfer pricing considerations (i.e. deemed to be an affected transaction for the purposes of section 31).

2. Accelerated capital allowances for fixed structures

Companies that erect or improve buildings and other fixed structures in the approved SEZs will be entitled to capital (depreciation) allowances in lieu of normal allowances. This rate will equal 10 per cent per annum over 10 years.

3. Note on employment incentive

The specific rules associated with the employment incentive are contained within the Employment Incentive Bill, 2013.

4. Value-added Tax and Customs

The current IDZs receive both VAT and customs relief. The SEZs will receive the same relief as the DTI transitions to the new regime. Legislation will be amended accordingly in the 2014 legislative cycle.

IV. Effective date

This provision will come into effect on 1 January 2014 and apply in respect of all years of assessment commencing on or after that date. The effectiveness of these incentives will be reviewed after a period of 10 years, in 2024, with an interim review after 5 years, in 2019.

4.3. EXEMPTION OF CERTIFIED EMISSION REDUCTIONS

[Section 12K of the Income Tax Act]

I. Background

The Clean Development Mechanism (CDM), established as a part of the Kyoto Protocol, provided developed countries (parties included in Annex I) with a mechanism to reduce their own greenhouse gas emission (GHG) reduction obligations by purchasing credits from CDM projects that avoid GHG emissions in developing countries (parties not included in Annex I). CDM projects, which can only be implemented within developing countries, facilitate financing and technology transfer for GHG reduction in developing countries. The CDM includes projects in renewable energy, energy efficiency and other related fields designed to achieve emission reductions.

Specific criteria and procedures must be fulfilled in order for CDM projects to be eligible for registration and approval An important feature of CDM projects is the demonstration of "additionality", whereby it is required that the project participants demonstrate that GHG emissions reduction that the carbon offset project delivers are additional and would not have occurred under a 'business as usual' scenario (i.e. without intended sale of credits in the CDM market) Equally, CDM projects must be developed according to methodologies approved by the CDM Executive Board. If these conditions are satisfied the CDM Executive Board can approve CDM projects to yield reduction credits (commonly known as carbon emission reduction credits). The carbon emission reduction credits from the CDM projects are known as certified emission reductions (CERs). These CERs are saleable to and usable only by developed countries for the purpose of meeting legally binding Kyoto Protocol emission reduction obligations.

After the inception of the first commitment period under the Kyoto Protocol in 2008, there was very limited uptake of CDM projects within South Africa. As a result, an income tax incentive was introduced in 2009 for any person holding a CDM registered project. The incentive exempts amounts received or accrued upon disposal (or anticipated disposal) of these CERs for purposes of normal and capital gains tax.

II. Reasons for change

During the COP18 meetings held in December 2012, it was agreed that parties engaged in CDM projects may continue their activities under those projects and new projects may be registered after December 2012 (i.e. second commitment period). The second commitment period commenced at the beginning of 2013 and ends on 31 December 2020. In line with the second commitment period, the CDM has been extended as a flexibility mechanism under the Kyoto Protocol, enabling developing countries to continue their participation in the global carbon market. However, the current tax incentive is limited to CERs obtained from CDM projects registered before 31 December 2012 (to coincide with the date on which the first commitment period under the Kyoto Protocol would lapse). Therefore, CERs obtained from CDM projects registered after 31 December 2012 could no longer qualify for the incentive.

III. Proposal

It is proposed that the exemption of income resulting from the sale of CERs be extended in line with the renewed Kyoto Protocol commitment. The exemption is accordingly extended to 31 December 2020. Therefore, new CDM projects registered after the former cut-off date of 31 December 2012 and by 31 December 2020 will still be eligible for the tax relief.

IV. Effective date

The amendments to section 12K will come into effect on 1 January 2013 and shall apply in respect of disposals on or after that date.

4.4. OIL AND GAS INCENTIVE

[Applicable provision: Tenth Schedule]

I. Background

A. General Overview

The oil and gas industry was initially (since 1977) regulated via OP26 prospecting lease agreements. These agreements became subject to the Mineral and Petroleum Resources Development Act, 2002 (Act No. 28 of 2002) (“MPRDA”). The MPRDA reordered these rights with all OP26 right holders being forced to convert their rights into new order rights. Oil and gas rights are now issued under the MPRDA by the Department of Mineral Resources. Transfers of oil and gas rights are similarly regulated.

In 2006, a new oil and gas tax regime was enacted within the Income Tax Act (58 of 1962) under the Tenth Schedule (“the Tenth Schedule”). This regime simplified many of the tax incentives offered under the OP26 agreements. Like the original OP26 agreements, the purpose of the Tenth Schedule provides incentives for oil and gas exploration and production. The Tenth Schedule also offers stability against future tax changes in relation to oil and gas exploration and production (via fiscal stability agreements issued by the Minister of Finance).

The current incentives provided by the Tenth Schedule include:

a. The corporate income tax rate for oil and gas companies will not exceed 28 per cent;

b. The Dividends Tax rate may not exceed 5 per cent in respect of dividends paid out of amounts attributable to oil and gas income (or zero per cent if the oil and gas rights were obtained by virtue of previously existing OP26 rights);

c. An additional 100 per cent deduction is available for all capital expenditure incurred in respect of oil and gas exploration, and an additional 50 per cent deduction is available for all capital expenditure incurred in respect of oil and gas production;

d. The provision of a legislative safe harbour exists to prevent the application of thin capitalisation rules to the extent that the amounts borrowed by an oil and gas company do not exceed three times the total fixed capital of that company;

e. An election exists for roll-over or participation treatment on disposal of oil and gas rights in lieu of the application of normal tax treatment for those disposals; and

f. An ability to enter into a fiscal stability agreement with the Minister of Finance so that the oil and gas incentives of the Tenth Schedule are protected against future changes in tax law.

II. Reasons for change

Since the inception of the Tenth schedule six years ago, an increasing number of oil and gas exploration and production rights are now being granted under the MPRDA. Several transfers among oil and gas producers are also taking place. Recent experience indicates that the Tenth Schedule is giving rise to certain anomalies that distort commercial practices. The Tenth Schedule also appears to contain ambiguities and unintended outcomes in terms of technical wording.

III. Proposal

A. Overview

In view of the above, the 2013 tax legislation contains a number of technical changes to the Tenth Schedule to address the above concerns. The changes are:

B. Differential Dividends Tax rates

The Tenth Schedule contains two sets of Dividend tax rates for holders of oil and gas rights; rights holders that hold their rights by virtue of the former OP26 agreements have the benefit of a zero rate whereas newer rights are subject to a 5 per cent rate. The rate differential gives rise to unfair competition and often leads to distortionary behaviour when taxpayers create transactions to achieve the zero rates. The rate differential will be removed and the Dividends Tax rate reduced to zero for all dividend amounts paid out of (and received from) oil and gas income.

C. Ambiguity concerning the Development Phase

An additional 100 per cent deduction is available for all capital expenditure incurred in respect of oil and gas exploration, and an additional 50 per cent deduction is available for all capital expenditure incurred in respect of oil and gas production. At issue is whether the development phase should be viewed as part of the exploration phase or the production phase.

Upon review of the facts, it was never intended that the development phase be viewed as part of exploration. The purpose of the 100 per cent incentive for exploration was to assist companies in their search for oil and gas sites. The 50 per cent incentive was intended to facilitate the capital expenditure needed to extract the discovered value from the site. In terms of oil and gas, the bulk of total extraction costs are associated with development (even exceeding those of the production phase).

The definition of the production phase will accordingly be removed and replaced with a definition that explicitly includes the development phase. The amendments provide a departure from definitions based on activities, to definitions based on phases instead, i.e. exploration, appraisal, development, production. The basis for this decision is to acknowledge that various activities can occur in more than one phase. For example, taxpayers will be able to claim 100 per cent of expenditure of a capital nature associated with wells drilled during the exploration phase and 50 per cent of such expenditure associated with wells drilled for the purposes of development or production.

D. Removal of the thin capitalisation limitations and a zero rate for cross-border interest withholding

The Tenth Schedule provides a legislative 3:1 safe harbour from any thin capitalisation rules imposed under previously existing transfer pricing limitations. This safe harbour is being removed because the concept of thin capitalisation and safe harbours no longer exists in the South African transfer pricing arena. It is also questionable whether the oil and gas tax dispensation should allow taxpayers to obtain a safe harbour given the prevalence of base erosion. Excessive interest allows taxpayers to undermine the 28 per cent headline rate.

In order to ensure that oil and gas companies are not disadvantaged by the change, the Tenth Schedule will now limit cross-border withholding taxation in respect of interest payments to zero. This zero rate will apply if the interest paid by the oil and gas company is paid to another company within the same international group. Hence, a foreign parent will not be subject to withholding tax when receiving interest from a wholly-owned oil and gas South African subsidiary.

The proposed withholding tax on services will not be eligible for the same relief.

E. Deemed trade

It is unclear whether a company engaged solely in exploration can be viewed as being engaged in a trade, thereby being eligible for deductions under the general deduction formula of section 11(a). Other circumstances could arise where trade may not exist (e.g. temporary cessations and post-production rehabilitation). It is accordingly proposed that any holder of an oil and gas right be deemed to be engaged in a "trade" and any expenses in respect of oil and gas right be deemed to be "incurred in the production of income."

F. Clarification of options when disposing of oil and gas rights

Under current law, taxpayers have the option of choosing three different methods of taxation when disposing of oil and gas rights. In addition to the normal rules, taxpayers may choose to receive rollover treatment or participation treatment via an election. While this intention is explicit in the 2006 explanatory memorandum, arguments continue to arise that reliance on the normal rules is no longer possible under the literal terms of the legislation.

In addition, taxpayers will no longer be required “to elect” out of the normal rules should they seek rollover or participation treatment. Both the seller and the purchaser can simply achieve this result via an agreement in writing, thereby obviating the need for an election on a SARS form or return. Lastly, it is unclear whether rollover or participation treatment is available when disposing of rights to a newly formed company because a newly formed purchasing company can only become an oil and gas company after acquiring the right.

IV. Effective date

The amendments will be effective in respect of years of assessment commencing on or after 1 April 2014.

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5. INCOME TAX: INTERNATIONAL

5.1. EXIT CHARGE ON INTERESTS IN IMMOVABLE PROPERTY

[Applicable provision: Section 9H]

I. Background

A. South African exit charge and sourced-based taxing jurisdiction

When a South African taxpayer ceases to be a resident, the taxpayer is subject to an exit tax charge. Upon becoming a non-resident, the taxpayer remains liable to South African tax only on a source basis.

An exit charge is a tax on gains (mostly capital) levied on the taxpayer as if the taxpayer had actually disposed of all of the taxpayer’s assets. More specifically, the taxpayer is treated as having disposed of each asset (other than excluded assets) for an amount received or accrued equal to the market value of the asset on the day before ceasing to be a resident. The taxpayer is then deemed to have immediately reacquired the same asset at a cost equal to the same market value. Excluded assets consist of assets that remain taxable by South Africa even after the taxpayer has ceased to be a resident.

Besides assets that are attributable to a permanent establishment, the main set of excluded assets consists of immovable property situated in South Africa or any interest therein. An interest in immovable property specifically includes a direct or indirect interest of at least 20 per cent in an entity if 80 per cent of the market value of that entity is attributable to South African immovable property. All of these assets are subject to tax on a source basis if held by foreign residents.

B. Tax treaty definitions of “immovable property”

Tax treaties preserve a source country’s primary taxing rights in respect of capital gains arising from immovable property located therein even if owned by a foreign resident. Capital gains arising from property other than immovable property generally fall outside the source country’s taxing jurisdiction (unless attributable to a local permanent establishment). For tax treaty purposes, the term “immovable property” is defined with reference to the definition in the contracting country in which the property is situated (i.e. in terms of the law of the source country). In the case of South African based immovable property, the definition of immovable property is determined with reference to the definition in South African tax law (which covers immovable property but not indirect interests therein). However, many of the newer DTAs expressly extend the definition of immovable property to include interests in immovable property, such as shares in companies mainly holding immovable property.

II. Reasons for change

The Income Tax Act fails to expressly define "immovable property". As a result, it could be argued that the term "immovable property" as expressed in certain older tax treaties is limited solely to the common law definition. This definition would not include any direct or indirect interests in immovable property (such as shares in companies mainly consisting of immovable property).

The exit charge does not apply to exiting residents in respect of South African immovable property or direct or indirect interests therein because these interests are assumed to remain within taxing jurisdiction. However, this assumption fails to take into account the potentially narrow definition of "immovable property" in the context of domestic law that arguably limits South Africa's source jurisdiction solely to "immovable property" itself (as opposed to wider interests therein). As a result, South African residents exiting to certain countries appear to receive the best of both worlds:

1. The exit is free from tax in respect of immovable property interests because these assets are presumed to remain within South African taxing jurisdiction,

2. But no further tax is applied because the tax treaty eliminates future source taxation as a result of the narrow "immovable property" definition.

III. Proposal

The proposed amendment deletes the exclusion of interest in immovable property from the exit charge. As a result, a person that ceases to be a resident will be deemed to have disposed of all assets, including any interest in a property company, for an amount received or accrued equal to the market value of those assets on the day before ceasing to be a resident and to have immediately reacquired the same assets at a cost equal to the same market value.

Under this approach, a direct holding of immovable property will remain subject to South African tax on a source basis once the person is a non-resident. This retention of source jurisdiction would mean that no exit charge would be necessary because these assets would remain within South African taxing jurisdiction despite the cessation of a person's status as a South African tax resident.

IV. Effective date

The proposed amendment will come into operation on the date of promulgation of the Taxation Laws Amendment Bill 2013.

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5.2. CURRENCY RULES FOR DOMESTIC TREASURY MANAGEMENT COMPANIES

[Applicable provisions: Sections 1 (new definition of “Domestic Treasury Management Company”; 24I and 25D of the Income Tax Act and paragraph 43(7) of the Eighth Schedule)

I. Background

A. Newly announced Exchange Control dispensation

On 27 February 2013, the Minister of Finance announced the establishment of a treasury management holding company regime as part of the Budget proposals (see Exchange Control Circular No 7/2013). In the main, companies listed on the Johannesburg Stock Exchange will now be allowed to establish one subsidiary to manage the group treasury functions free from exchange control despite that subsidiary’s domestic incorporation.

B. Base currency for tax purposes

For tax purposes, domestic companies must generally use the Rand as the starting point for their currency translations (measuring foreign currency gains and losses against the Rand). One notable exception is for headquarter companies (i.e. companies subject to tax relief so that funds can be derived from foreign subsidiaries and transferred onward without incurring a layer of South African tax when no value is added within South Africa). Headquarter companies of this nature can use their functional currency as the starting point for their currency tax calculations as opposed to the Rand despite the existence of South African incorporation. For income tax purposes, a functional currency is defined as the currency of the primary economic environment in which business operations are conducted.

II. Reasons for change

There is currently no special currency tax dispensation for South African based treasury management holding companies sanctioned by the South African Reserve Bank. Like any other taxpayer, treasury management holding companies are deemed to operate on a Rand functional currency. This starting point is often problematic because treasury management companies often have a functional currency that differs from their place of operation or incorporation. Required use of the Rand is accordingly impractical, thereby potentially inhibiting the new regime.

III. Proposal

It is proposed that qualifying domestic treasury management companies (as determined by the South African Reserve Bank) become eligible for tax relief in respect of currency in the same fashion as headquarter companies. More specifically, treasury management holding companies will be allowed to utilise their functional currency as a starting point for tax purposes. The new dispensation will apply to taxable income, monetary items and capital gains items.

IV. Effective date

The proposed amendment will apply in respect of any year of assessment commencing on or after 27 February 2013 [i.e. the date that Exchange Control Circular No.7/2013 was initially released].

5.3. REFINEMENT OF PARTICIPATION EXEMPTION IN RESPECT OF FOREIGN DIVIDENDS DERIVED FROM NON-EQUITY SHARES

[Applicable provision: Section 10B(2)]

I. Background

Under current law, foreign dividends are exempt from normal tax if the recipient holds at least 10 per cent of the equity shares and voting rights in the company declaring the foreign dividend. A similar exemption exist for capital gains derived from the disposal of foreign shares if the person holds at least 10 per cent of the equity shares and voting rights in the foreign company. These exemptions are colloquially referred to as the participation exemptions.

An equity share is specifically defined as excluding shares with certain debt-like features. More specifically, an equity share does not include any share that has limited participation rights in a corporate distribution. The foreign dividend participation exemption is also not available to any foreign dividend that is deductible by the payor in terms of law of the payor's country of residence.

A further exemption is provided for foreign dividends declared to a controlled foreign company if the company declaring the dividend and the CFC are resident in the same country (i.e. same country exemption). As with the participation exemption, the same country exemption is also not applicable to interest-like foreign dividends. More specifically, foreign dividends that are deductible for the purposes of the foreign law of the company declaring the dividend do not qualify for the same country exemption.

II. Reasons for change

It was always intended that the foreign dividend participation and same country exemptions should apply only to foreign dividends received from equity shares. However, the current wording of these exemptions seems to suggest otherwise. The wording of the foreign dividend participation exemption seems to suggest that the participation exemption applies to all shares, as long as the taxpayer holds 10 percent of the equity shares and voting rights. This arguably means that once the taxpayer has the required participation of 10 percent in a foreign company, any foreign dividend received from the company is exempt. The foreign dividend same country exemption does not expressly refer to equity shares.

III. Proposal

It is proposed that the Income Tax Act should specifically stipulate that the participation and same country exemptions apply only to dividends derived from equity shares. The participation will therefore not apply to dividends derived from non-equity shares merely because of a qualifying 10 per cent holding elsewhere.

IV. Effective date

The proposed amendment will come into operation on 1 April 2014 and apply in respect of foreign dividends received or accrued on or after that date.

5.4. CONTROLLED FOREIGN COMPANY AND THE WORKING CAPITAL EXEMPTION

[Applicable provision: Section 9D(9A)(a)(iii)(cc)]

I. Background

The controlled foreign company (CFC) rules are mainly designed to create deemed income when a CFC generates passive income and certain forms of diversionary income (i.e. income susceptible to transfer pricing). In recognition of the fact that most companies typically generate small amounts of passive income from available cash-flows, a working capital exemption was introduced many years ago. Under current law, the working capital exemption generally applies to the extent that tainted financial instrument (i.e. passive) receipts and accruals do not exceed 5 percent of total gross CFC receipts and accruals that are attributable to a foreign business establishment. Technically, in the calculation of the 5 percent limit, the total gross receipts and accruals will include amounts attributed to non-resident policyholders who are not CFCs and amounts that would have been subject to withholding taxes on royalties and interest. Previously SA taxed amounts and certain intra-group payments are specifically excluded from the calculation.

II. Reasons for change

Receipts and accruals from CFC treasury operations and CFC captive insurers trigger CFC income (i.e. are viewed as passive) even if these activities otherwise fall within the business establishment exception (i.e. are exempt as active income). However, current application of the five per cent working capital exemption applies to CFC treasury operations and CFC captive insurance operations even though business establishment relief does not otherwise exist. No reason exists to provide working capital relief in the case of CFC treasury operations and CFC captive insurers when these operations are not viewed as active for CFC purposes.

There is also no policy reason, why the calculation of the 5 percent limit should take into account amounts that would not otherwise fall under the indirect CFC taxing jurisdiction. More specifically, amounts attributed to non-resident policyholders and amounts previously subject to withholding taxes on interest and royalties are specifically excluded from the CFC tax net.

III. Proposal

In view of the above, it is proposed that the five per cent working capital exemption should not apply to CFC treasury operations and captive insurers. Passive receipts and accruals will trigger deemed CFC income without regard to the working capital exception despite the fact that these treasury and captive insurer operations may technically constitute a business establishment. The calculation of the working capital 5 percent limit will also specifically exclude amounts attributed to non-resident policyholders and amounts previously subject to withholding taxes on interest and royalties.

IV. Effective Date

The proposed amendment will be effective for foreign tax years of CFCs ending during years of assessment commencing on or after 1 April 2014.

5.5. RING-FENCING OF NET FOREIGN TRADE LOSSES

[Applicable provision: Paragraph (b) of the proviso to section 20(1)]

I. Background

As a general matter, South Africa imposes income tax on residents on a world-wide basis. Theoretically, this world-wide basis of taxation also permits the deduction of expenses incurred in the production against both domestic and foreign income. However, in order to protect the domestic tax base against foreign erosion, the tax system ring-fences foreign losses. More specifically, the Income Tax Act forbids the deduction of foreign assessed losses or the balance of foreign assessed losses (i.e. net foreign trade losses) against income derived from carrying on a South African "trade".

II. Reasons for change

At issue is whether a taxpayer can set off net foreign assessed losses from a foreign trade against South African passive income. It was always intended that these foreign losses should be fully ring-fenced to foreign income without offset against South African income. However, the current wording of the ring-fencing provision suggests otherwise. The current wording merely states that net foreign trade losses cannot be offset against domestic trading income. This language arguably means that net foreign trade losses (such as rental losses) may be set off against South African passive income (such as South African sourced salary).

III. Proposal

In view of the above, it is proposed that the net foreign loss ring-fencing provision be realigned according to the provision's initial intended purpose. The wording will expressly forbid the setting-off of net foreign losses against any South African sourced income.

IV. Effective date

The proposed amendment will apply in respect of any year of assessment commencing on or after 1 January 2014.

5.6. EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES

[Applicable provisions: Sections 9D(1) ("foreign business establishment" definition), 10(1)(o)(i),12C and a new section 12Q]

I. Background

A. Shipping transport owned by South African companies

As a general matter, international shipping transport conducted by South African companies is largely subject to a corporate income tax rate of 28 per cent. The only incentives for international shipping are some depreciation incentives for capital investment in shipping transport.

B. Shipping Transport owned by controlled foreign companies

Income from controlled foreign companies generates deemed income for certain South African shareholders unless the income falls within certain exemptions – the most notable of which is income attributable to a foreign business establishment. The most common form of foreign business establishment involves a foreign fixed place of business but other forms are possible. One of these other forms is international transport, including international shipping transport. More specifically, international shipping transport falls within the ambit of a foreign business establishment if the international shipping transport is conducted solely outside of South Africa.

II. Reasons for change

Government has long been aware that the international trend has been toward greatly reduced taxation of international shipping transport due to the highly mobile nature of this activity. Many leading shipping centres now impose a tonnage tax regime in lieu of income tax. In the case of a tonnage tax, tax is calculated by measuring the tonnage of the ship rather than through reliance on profits with the tax essentially amounting to small license fee. Other countries exempt international transport shipping income altogether. In view of these trends, the 28 per cent South African rate is wholly uncompetitive and is cited as one of the reasons that South Africa can no longer attract ships to its flag despite South Africa’s strategic naval location.

III. Proposal

A. Overview

In view of the above, it is proposed that a new tax regime providing tax relief for shipping companies be introduced. In order to qualify for this relief, the company at issue must be a resident and hold at least one or more vessels that: (i) are flagged in South Africa in terms of the Ship Registration Act, 1998 (Act No. 58 of 1998), and (ii) designed for international transportation of passengers or goods for reward.

B. Relief mechanisms for domestic shipping companies

The new shipping tax regime for qualifying domestic shipping companies includes exemptions from normal tax, the capital gains tax, the dividends tax as well as cross-border withholding tax on interest. These companies also have added flexibility in terms of functional currency.

3. <u>Exemption of shipping income and gains</u>

Receipts and accruals in respect of income derived from South African flagged ships of a qualifying shipping company will be treated as exempt income if that ship is engaged in the international traffic of passengers or cargo for reward by sea. The disposal of the ship is also exempt regardless of whether the gain generates ordinary revenue or capital gains.

4. Exemption of company withdrawals

Dividends paid by a qualifying shipping company will not be subject to the dividend tax if the dividend is derived from South African flagged international transport ship. Interest paid by shipping companies to foreign lenders in respect of debt obtained to finance the acquisition, construction or improvement of a South African flagged international transport ship will be exempt from withholding tax on interest.

5. Permissible use of a non-South African functional currency

Many international transport companies use a currency more suitable to an international environment than the local currency of residence. Given the blanket income tax exemption of receipts and accruals of international shipping income, an international shipping company will not be subject to tax on currency gains and losses. As a collateral measure, a qualifying shipping company may use a currency other than the Rand as the company's functional currency. This new dispensation will apply to the determination of taxable income, monetary items, capital gains items and other tax issues. A functional currency is defined as the currency of the primary economic environment in which business operations are conducted. This overall reliance on a non-Rand currency for tax purposes should eliminate inadvertent currency gains and losses

C. Collateral amendments (depreciation and officers/crew)

Given the proposed exemptions going forward, domestically flagged ships designed for international traffic for reward of passengers or goods will no longer be depreciable. Other ships will remain depreciable over a five-year period at a rate of 20 per cent per annum.

Under current law, the officers and crew of an international transport ship are exempt from tax on their salary (i.e. remuneration) if those persons are outside South Africa more than 183 days. In order to avoid potential issues of pay-as-you-earn withholding for employers of South African officers and crew, officers and crew of domestically flagged ships designed for international traffic will be wholly exempt without regard to the days abroad.

D. Revised foreign business establishment classification for international ships

The special rules for determining foreign business establishment relief for international shipping are too narrow, thereby giving rise to inadvertent controlled foreign company income. International transport ships should not lose the benefit of this relief merely because of occasional visits to South Africa. Therefore, any vessel used for transport that is engaged in international traffic will be treated as a foreign business establishment.

IV. Effective date

The proposed amendments will generally be effective for years of assessment beginning on or after 1 April 2014.

5.7. UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION

[Applicable provisions: Sections 37J through 37O and section 49A through 49G; new sections 49; 50 and 51]

I. Background

A. South African cross-border withholding taxes

South Africa has long history of imposing withholding tax in the case of cross-border royalties (at 12 per cent). From 1 April 2012, South Africa introduced a dividends tax on cross-border dividends (which replaced the Secondary Tax on Companies). From 2011, an announcement was made to enact a unified cross-border withholding regime for interest at 15 per cent (and in 2012, a 15 per cent royalty withholding regime was proposed to replace the pre-existing royalty regime). Both regimes have been enacted for future implementation as of 1 July 2013. All of the above cross-border withholding regimes can be reduced or eliminated by an applicable tax treaty.

B. Local permanent establishments

Withholding taxes are designed to tax passive income. Once a non-resident entity has a permanent establishment in South Africa, the permanent establishment will be taxed on a source basis at a rate of 28% (i.e. at ordinary rates under the normal tax). As a result, the pending withholding regime contains an exemption for South African sourced interest/royalties if a non-resident carries on business in South Africa through a permanent establishment at any time during the year of assessment. South African sourced interest/royalties earned by foreign entities outside of this permanent establishment rule will be subject to a 15 per cent withholding.

II. Reasons for change

A. Lack of cross-border withholding taxes on management/technical fees

Unlike most developing countries, South Africa does not have a withholding tax on management or technical fees. Like interest and royalties, these fees generate local deductions, thereby giving rise to potential base erosion. Internal data suggest that these fees amount to billions per annum, much of which is shifted to low-tax jurisdictions. Hence, some form of protection in the form of withholding is needed to protect the tax base as has already been enacted for cross-border interest and royalties.

B. Taxation of permanent establishments

The current nexus between taxation under normal tax versus 15 per cent withholding is partially inappropriate. While the permanent establishment test is an international standard, OECD principles suggest that normal taxation should be limited solely to amounts that are effectively connected to the permanent establishment. The mere existence of a permanent establishment should not push all locally sourced income away from withholding taxes.

In addition, concerns exist that many foreign entities with permanent establishments are not properly filing their tax returns while acting as the basis for exemption from withholding taxes.

Lack of proper registration means that certain foreign entities are improperly avoiding South African tax altogether.

III. Proposal

A. Proposed withholding taxes on cross-border fees

In view of the above, it is proposed that pending withholding taxes be extended to cross-border consultancy, management and technical fees. This new withholding tax will be a final withholding tax that will be used to identify and collect revenue from non-resident taxpayers who provide certain services within a South African source that fall outside the normal tax. More specifically, all payments for services to a foreign resident from a South African source will be subject to withholding tax if those services are of a technical, managerial or consultative nature. These services should be understood as being comparable to technical fees covered in the context of certain tax treaties. Less technical services (such as hair stylists, real estate commissions and the like) should not be viewed as falling within the withholding paradigm.

In line with other cross-border withholding taxes, the withholding tax on technical, managerial or consultative service fees will be levied at the rate of 15 per cent of the gross amount of fees paid to a foreign-resident (subject to tax treaty relief). The structure of the regime will largely follow the structure for withholding taxes on royalties (more specifically as described below).

1. Liability for tax

As with other withholding taxes, the liability to withhold tax on technical, managerial or consultative service fees will remain with the person making payment (payor) of those service fees to or for the benefit of a foreign person. As stated above, the liability is limited solely to South African sourced amounts. Payment of this withholding charge satisfies any potential liability of the foreign payee.

2. Exemption from withholding tax on service fees

Like withholding taxes on interest and royalties, withholding tax on service fees will be subject to the following exemptions:

a. A foreign payee will be exempt from withholding tax if that foreign payee is a natural person who was physically present in South Africa for a period exceeding 183 days during the twelve month period preceding the date on which the fees are paid;

b. A foreign payee will also be exempt if the service fees are effectively connected to a South African permanent establishment (see the discussion of the permanent establishment exemption below).

In addition, service fees paid in respect of services rendered by any person in his or her capacity as an employee will be exempt (because these amounts fall within Fourth Schedule pay-as-you-earn withholding).

3. Obligation to withhold and declaration for exemption or reduction

Persons potentially subject to withholding can be relieved of their withholding liability only if these payors receive a declaration of exemption/treaty relief from the payee. This declaration must be submitted by the earlier of the date set by the payor or the date of payment.

4. Payment and recovery of tax

Payment to SARS of withholding tax on service fees must be made at the close of the month following the month in which service fees are paid.

5. Refund mechanism

The foreign payee may claim a refund from SARS if a withholding tax on fees is improperly withheld. The foreign payee may claim a refund if the refund claim is made to SARS within three years after payment of the applicable service fees.

6. Currency translation rules

If the payment of service fees is denominated in a foreign currency, the currency must be converted to the South African Rand at the spot rate on the date of withholding.

B. Permanent establishment exemption

Both the pending interest withholding regime and the pending royalty regime exempt payments to foreign persons from withholding tax if those foreign persons have a South African permanent establishment. This exemption will also apply in the case of the proposed withholding tax on cross-border services. This exemption exists because the South African permanent establishment is subject to normal tax (i.e. 28 per cent of taxable income).

However, the permanent establishment exemption will be adjusted in the case of all three withholding taxes. The exemption will apply only if the payment is “effectively connected with” the permanent establishment (because only this income is subject to the normal tax). The mere existence of a permanent establishment will not generate an exemption for wholly unrelated income. An explanation of the term ‘effectively connected’ is provided in the OECD Commentary on paragraphs 4 of Article 10 on dividends, 4 of Article 11 on Interest and 3 of Article 12 on Royalties. The “effectively connected” concept should be understood in the same context.

In addition, for the permanent establishment exemption to apply, the foreign payee must provide proof of SARS registration as a taxpayer. Without this proof, the payor must still withhold and no refund of withholding tax is possible. This proof requirement ensures that foreign persons can no longer escape the ambit of legally required withholding taxes and the normal tax in the case of South African source interest, royalties or services fees.

C. Royalty withholding tax

The royalty withholding tax that is currently contained in the Income Tax Act will continue to apply, however at a reduced rate of 12%. The increased rate of 15% will come into effect with the introduction of the new withholding tax on royalties.

IV. Effective Date

The proposed amendment will be effective for interest that is paid or payable on or after 1 January 2015. The proposed amendment will be effective for service fees paid or payable on or after 1 January 2016. The proposed amendment will be effective for royalties that are paid or payable on or after 1 July 2013. The effective date rules also contain anti-avoidance mechanisms to prevent artificial accelerations of incurrals before the effective date so as to otherwise avoid the new withholding regimes.

5.8. TRANSFER PRICING RELIEF FOR EQUITY LOANS

[Applicable provision: Section 31]

I. Background

Generally, transfer pricing adjustment rules apply to any loan provided by a South African person to a foreign connected party irrespective of the substantive character of the loans involved. For example, transfer pricing equally applies to both short-term and long-term loans as well as interest bearing versus non-interest bearing loans.

However, there are two exceptions to potential transfer pricing treatment. Firstly, loans advanced to a comparably-taxed controlled foreign company are exempt from transfer pricing adjustments. Secondly, transfer pricing relief applies to headquarter company back-to-back loans so loan funds can pass-through the headquarter company without attracting unintended South African tax.

II. Reasons for change

South African companies often capitalise offshore operations through equity-like loans. These loans generally bear little or no yield and are deeply subordinated with long-term or indefinite maturity dates. This form of “capital” financing is normally undertaken for a variety of reasons unrelated to tax. For example, quasi-equity loans are seldom subject to foreign regulatory restrictions, such as divestment and exchange controls.

While the current relief mechanism for loans to comparably taxed controlled foreign companies provide relief in this regard, this relief is fairly limited, especially because quasi-loans are often made to foreign companies that are uncontrolled by the South African shareholder. Oftentimes, the South African shareholder is part of a joint venture arrangement, whereby a consortium of multinational shareholders are capitalising a foreign company with loans with quasi-equity features. Without relief, potential transfer pricing concerns leave the South African shareholder in a compromised tax position vis-à-vis that shareholder’s multinational counterparts.

III. Proposal

In view of the above, it is proposed that transfer pricing relief should be extended to outbound loans that clearly resemble equity. In effect, taxpayers should not be forced to pay tax on notional interest from a share loan that is in substance nothing more than share capital. In particular, this relief will be limited to loans that meet the following qualifying criteria:

- The creditor must be a South African resident;
- The creditor must hold at least 10 per cent of the equity shares and voting rights in the offshore debtor;
- The loan must be perpetual or be non-redeemable within a period of 30 years from the date the loan is granted;
- The redemption of the debt in full is conditional upon the market value of the assets of the foreign company not being less than the market value of the liabilities of the foreign company.

A loan that meets the above criteria is in substance exposed to the same economic risk as equity and thus poses little or no risk to the South African tax base if interest is under-charged (because interest should not be charged at all as an economic matter).

IV. Effective date

The proposed amendment will apply in respect of years of assessment commencing on or after 1 April 2014.

5.9. REMOVAL OF SOURCE FOCUS FOR COPYRIGHT AUTHORS

[Applicable provisions: Sections 10(1)(m) and paragraph 64 of the Eighth Schedule]

I. Background

The current tax framework exempts authors of copyright on revenue amounts received for the foreign assignment or licensing of copyright. More specifically, the exemption applies if the author is a natural person, the first owner of the copyright and the amount received is taxable in another country. There is no similar exemption if the transfer of copyright is subject to capital gains taxation.

II. Reasons for change

The copyright blanket exemption for residents is out of sync with the current world-wide taxation paradigm and does not take into consideration the provisions of DTAs. As a general matter, South Africa has a primary taxing right in respect of the foreign transfer of copyright by a resident unless the transfer is attributable to a foreign permanent establishment. On the other hand, royalties received in respect of the foreign licensing of copyright are subject to a residual secondary taxing right. The exercise of the secondary taxing right means that South Africa will generally grant a credit (i.e. rebate) for the foreign taxes paid.

III. Proposal

In view of the above, it is proposed that the copyright exemption for copyright authors should be deleted.

IV. Effective Date

The proposed amendment will be effective for years of assessment commencing on or after 1 March 2014.

5.10. SHARE ISSUES IN EXCHANGE FOR FOREIGN SHARES AS A MEANS OF CORPORATE MIGRATION

[Applicable provisions: Paragraph 11(2)(b) of the Eighth Schedule to the Income tax Act]

I. Background

The expanded corporate reorganisation rules allow for the tax-free restructuring of both domestic and foreign company assets. In a purely domestic restructuring, assets are moved within a purely domestic company context. Offshore restructuring entails the restructuring of assets between controlled foreign companies and the transfer of foreign assets into the domestic tax framework.

The above restructurings receive rollover relief because the assets concerned remain within the same scope of the South African tax net or move to a more direct form of South African taxing jurisdiction. Outbound restructurings (transfers of domestic assets to foreign entities) are not entitled to rollover relief because an outbound transfer shifts value to a lower level of South African taxing jurisdiction (i.e. to a location wholly outside the South African tax net or from a direct to an indirect position within the South African tax net).

II. Reasons for change

The income tax framework seeks to strike a balance between permissible tax-free restructuring and the shifting of value offshore in order to effect an indirect corporate migration. More specifically, reorganisation rollover relief is not intended to be utilised as a means of shifting untaxed gains offshore. Of concern are various loop structures intended to achieve the same effect.

Many of the transactions of concern involve the dual cross-issue of shares between a resident and a non-resident. The purpose of the cross-issue is to shift control offshore free of tax. Many of these transactions also have the added benefit of the participation exemption, whereby the foreign shares received by the domestic transferor are also free of tax upon the subsequent disposal.

Example

Facts: SA Holdco, a South African company, owns 100 percent of SA *Sub*, a South African trading subsidiary. Foreign HoldCo also owns 100 percent of Foreign Sub, another trading subsidiary. The two groups plan to combine their subsidiary operations with the foreign group obtaining majority control. In order to achieve the combination, SA Sub issues shares representing 60 percent of the value of SA Sub in return for 40 percent of the Foreign Sub shares. The value of the Foreign Sub shares received equals the value of the SA Sub shares exchanged.

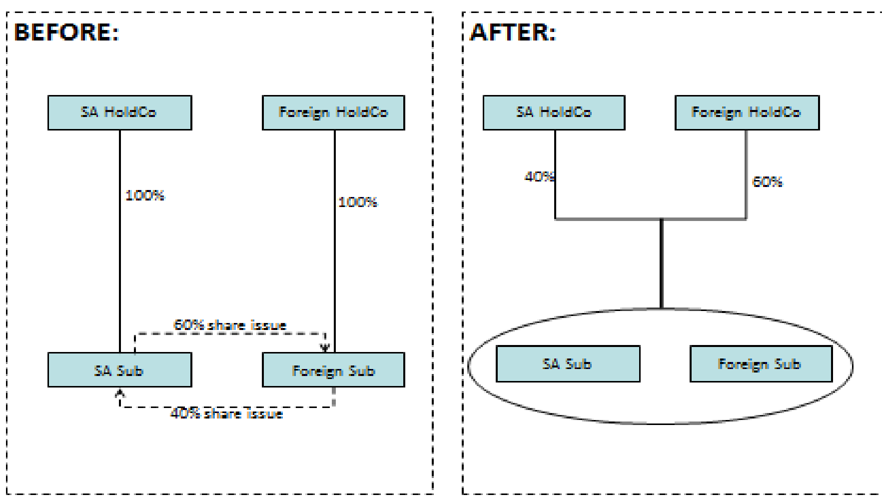
Result: The shares issued by SA Sub are tax-free (i.e. not viewed as a disposal). The transfer by Foreign Sub is outside the South African taxing jurisdiction. In the end, control has been shifted to foreign persons free of tax. SA Sub can probably sell the Foreign Sub shares tax-free due to the existence of the participation exemption.

III. Proposal

In order to prevent the above tax-free shift of control offshore, it is proposed that the tax exemption of the issue of shares should be denied if the issue of shares is in exchange for foreign shares. This anti-avoidance measure includes indirect exchanges involving the domestic company issuer and exchanges where the foreign shares are received by other persons. The issue of domestic shares under these circumstances will now trigger a disposal for capital gains tax purposes.

Example

Facts: SA Holdco, a South African company, owns 100 per cent of SA *Sub*, a South African trading subsidiary. Foreign HoldCo also owns 100 per cent of Foreign Sub, another trading subsidiary. The two groups plan to combine their subsidiary operations with the foreign group obtaining majority control. In order to achieve the combination, SA Sub issues shares representing 60 percent of the value of SA Sub in return for 25 per cent of the Foreign Sub shares issued by Foreign Sub. The value of the Foreign Sub shares received equals the value of the SA Sub shares exchanged.



Result: SA Sub is issuing its own shares for shares of Foreign Sub. SA Sub will be subject to capital gains tax on the disposal (i.e. the issue) of its shares. The SA Sub shares have a zero base cost so the gain equals the market value of the Foreign Sub shares received.

Example 2

Facts: South African Individual owns all the shares of SA Company. Foreign HoldCo owns all the shares of Foreign Sub. In order to combine the operations of the two subsidiaries, South African Individual will contributes all of his or her shares in SA Company to SA Newco for 30 per cent of the SA Newco shares. Foreign Holdco transfers all of its Foreign Sub shares to SA Newco for the remaining 30 per cent of the SA Newco shares.

Result: SA Newco is issuing its own shares for shares of Foreign Sub. SA Newco will be subject to capital gains tax on the disposal (i.e. the issue) of its shares. The SA Newco shares have a zero base cost so the gain equals the market value of the Foreign Sub shares received.

Example 3

Facts: SA HoldCo owns all the shares of SA Sub. Foreign HoldCo also owns all the shares of Foreign Sub. In order to combine the operations of the two subsidiaries, SA Sub issues shares to Foreign Sub. Foreign Holdco issues its shares to SA Holdco. Upon completion of the transaction, SA Holdco owns 10 per cent of the shares of Foreign Holdco, and Foreign Sub owns 80 per cent of the SA Sub shares.

Result: SA Sub is involved in an issue of shares indirectly in exchange for the receipt of Foreign Holdco shares by another person. SA Sub will be subject to capital gains tax on the disposal (i.e. the issue) of its shares. The SA Sub shares issued have a zero base cost so the gain equals the market value of the Foreign Holdco shares received by SA Holdco indirectly in exchange.

Example

Facts: SA HoldCo owns all the shares of SA Sub. Foreign HoldCo also owns all the shares of Foreign Sub. In order to combine the operations of the two subsidiaries, SA Sub issues shares to Foreign Sub in exchange for cash, and SA Sub uses the same cash amount to acquire shares in Foreign Sub. Upon completion of the transaction, SA Sub owns 10 per cent of the shares of Foreign Sub, and Foreign Sub owns 80 per cent of the SA Sub shares.

Result: SA Sub is involved in an indirect issue of shares for foreign shares. The SA Sub shares issued have a zero base cost so the gain equals the market value of the Foreign Sub shares received indirectly in exchange.

IV. Effective date

The proposed amendment will apply in respect of any issue of shares arising on or after 1 January 2014.

6. INDIRECT TAX

6.1. SUPPLY OF SERVICES FOR CONTINGENT CONSIDERATION

[Applicable Value-Added Tax Act provision: new section 9(4)(b)]

I. Background

A special time-of-supply rule exists for goods supplied under an agreement if the consideration for the goods cannot be determined upfront (excluding instalment credit agreements and rental agreements). In these circumstances, the supply is deemed to take place at the earlier of the date when (and to the extent): (i) payment in terms of the agreement is due or received, or (ii) an invoice relating to the supply is issued.

Typically, these deferred supplies relate to goods in the mining, forestry, or agricultural industries where the prices for those goods are dependent on international markets and/or the price is subject to exchange rate fluctuations. For instance, in the forestry industry, the price of logs supplied to a wood mill is dependent on the quality and moisture content of the logs (which is determined by the purchaser only after risk and ownership passes). In the mining industry, the price for ore is often dependent on the quality of the metals extracted from the ore and the average prevailing exchange rate.

II. Reasons for change

As a general matter, no special time-of-supply rule exists for services offered for contingent consideration. There is no cogent reason for this omission. Like goods, the performance of certain services may also be linked to a future contingent event (for instance, the payment for risk services performed for a company may be linked to the share price performance of the company over a certain period). The payment for certain agency services supplied may be inextricably linked to the price of the underlying goods supplied (for instance, an agent's facilitation fee for wool may be dependent on the price a sheep farmer obtains for the wool supplied – a price which itself is dependent on the quality of the wool supplied, the international wool price and/or the prevailing exchange rate).

III. Proposal

It is proposed that a special time-of-supply rule comparable to that of goods be added for services if the consideration for the performance of the services is determined with reference to a future event. The triggering date again occurs on the earlier of the date when (and to the extent): (i) payment is due or received, or (ii) the date of invoice.

IV. Effective date

The proposed amendment applies to services supplied on or after 1 April 2014.

6.2. ENTERTAINMENT SUPPLIED ON BOARD A FLIGHT OR SHIP

[Applicable Value-Added Tax Act provision: Section 17(2)(a)(iii)]

I. Background

Generally speaking, input tax deductions relating to entertainment expenditure are disallowed. However, this prohibition does not apply in several circumstances where business objectives dominate. More specifically, meals and refreshments provided to passengers (or crew members) by a vendor in conjunction with taxable transport services often qualify for input deductions.

II. Reasons for change

Unlike meals and refreshments, entertainment such as movies and electronic games supplied on-board a plane or ship falls under the general VAT definition of "entertainment." This form of entertainment is ancillary to the trip, merely being ancillary especially if this entertainment is provided at no additional cost. There is no sound basis for differentiating between meals and refreshments versus ancillary entertainment if all occur as ancillary to air or sea travel.

III. Proposal

Despite the general VAT prohibition against entertainment, it is proposed that input tax deductions for a vendor's cost to supply entertainment be allowed if:

1. that entertainment is ancillary to air or sea travel; and
2. that entertainment is provided at no additional charge

For practical reasons, all entertainment supplied by a vendor on board a ship or aircraft will be allowed as a deduction for input tax purposes (provided that the entertainment is supplied in conveyance of the underlying taxable transport service).

IV. Effective date

The proposed amendment applies to all supplies made on or after 1 April 2014.

6.3. IMPORTED GOODS ABANDONED, DESTROYED OR DAMAGED

[Applicable Value-Added Tax Act provisions: Section 13(2B) and Schedule 1 Item no. 412.07]

I. Background

Generally speaking, goods imported into South Africa are subject to VAT at the rate of 14 percent when those goods are imported and entered in South Africa for home consumption in terms of the Customs and Excise Act. Goods that are imported into South Africa but which are abandoned, destroyed or damaged are considered to have been entered for home consumption in terms of the Customs and Excise Act. Hence, the VAT applies to these imported goods are abandoned, destroyed or damaged.

II. Reasons for change

Goods imported into South Africa that are abandoned, destroyed or damaged are deemed to be entered for home consumption for Customs purposes, but a rebate applies for Customs purposes (see Schedule 4 Item no. 412.07 of the Customs and Excise Tax Act). This relief exists because the economic value never really enters South Africa with the relief being applied in a controlled way to ensure that goods are actually abandoned, destroyed or damaged as alleged.

While abandoned, destroyed or damaged goods are entered into for home consumption for VAT purposes in similar fashion to the Customs and Excise Act, no corresponding VAT relief is applicable to these goods. As a result, a 'notional' consumption of goods arises, even though the economic value of these goods never really enters the South African tax net.

III. Proposal

It is proposed that the VAT Act (in Schedule 1) be amended to accommodate goods abandoned, destroyed or damaged in terms of the Customs and Excise Act. In effect, goods of this nature will be removed from the VAT net.

IV. Effective date

The proposed amendment applies to goods abandoned, destroyed or damaged on or after 1 April 2014.

6.4. CONVERSION OF A SHARE BLOCK SCHEME TO SECTIONAL TITLE

[Applicable Value-Added Tax Act provision: section 8(19) and section 10(27))]

I. Background

In a share block scheme, shareholders hold a share in a share block company with the share providing a personal right of exclusive use and occupation of a specific unit in the share block scheme. Share block schemes originated when South African property law did not permit persons to hold separate title to an individual flat within a block. With the advent of the Sectional Titles Act in 1986, share block schemes became less attractive to developers (e.g. sale documentation for share block schemes is more onerous and expensive than sectional title, and banks often charge a higher interest rate for share block financing because of the centralized company risk).

Under the Sectional Titles Act, a share block company may convert a share block scheme to a sectional title scheme by special resolution (i.e. Item 8 of Schedule 1 of the Share Blocks Control Act). Under current VAT law, supplies of immovable property made by a share block company to the shareholder pursuant to this form of conversion to sectional title are regarded as out of scope. The shareholder waiver of rights of use in the immovable property (associated with the shares in the share block company) is similarly viewed as out of scope.

II. Reasons for change

Under current law, the shareholder of the share block company can potentially claim a notional input tax deduction in respect of the immovable property acquired as part of the sectional title conversion if the shareholder is a VAT vendor. This claim is based on the argument that the acquisition of the immovable property is like the acquisition of any other second-hand good (especially in view of the wording in the "second-hand goods" definition).

Despite the potential literal language to the contrary, the creation of notional inputs upon a conversion from a share block scheme to a sectional title interest makes no sense. The purpose of the out of scope rules is to ensure that the conversion was a complete non-event. The ultimate owners of the immovable property are merely converting their property rights – the underlying economic interests in the immovable property remain roughly the same. Hence, just as the conversion should be out of scope in the case of outputs, no person should receive input credits for the conversion (more specifically, in the case of claiming a deduction for "second-hand goods"). In practice, there is input tax specifically allocable to the conversion which is trapped as a cost (as section 8(19) views the conversion to be a deemed non-supply); it was never the intention to deny this input tax claim.

III. Proposal

Share block owners acquiring direct ownership of immovable property pursuant to a sectional title conversion (i.e. the circumstances referred to in Item 8 of Schedule 1 to the Share Blocks Control Act) will be prohibited from claiming a notional input tax deduction in respect of that acquisition (insofar as the deduction is viewed as a claim for "second hand goods"). The conversion will be viewed as a deemed supply in the course or furtherance of an enterprise but the supply will be viewed as having a nil value in order to protect the fiscus from erroneous notional input claims; input tax that is allocable to the conversion will be allowed as a deduction under the normal VAT rules.

IV. Effective date

The proposed amendment applies in respect of goods supplied on or after 1 April 2014.

6.5. STREAMLINING OF VAT REGISTRATION

> [Applicable Value-Added Tax Act provision: Section 23(1)(b), section 23(3)(b); section 24(5a) & (b)]

I. Background

A. Compulsory registration

Persons that make taxable supplies in the course of an enterprise are required to register as a VAT vendor in certain circumstances. More specifically, VAT registration is required if the total value of taxable supplies made by a business enterprise at the end of a month exceeds R1 million after taking into account the prior 12-month period. Further, VAT registration is required if reasonable grounds exist for believing that the total value of taxable supplies to be made by that person will exceed R1 million in the next 12 months. In both scenarios, the person must apply to register. Compulsory registration ensures that businesses enter the VAT system in a timely manner.

B. Voluntary registration

Persons may also voluntarily register as a VAT vendor under certain conditions. In the main, businesses may voluntarily register for VAT if the enterprise has already reached a R50 000 turnover taking into account the prior 12-month period or if the business enterprise is acquired from another party as a going concern after having reached that threshold. Persons intending to carry on an enterprise may also voluntarily register for VAT if the R50 000 threshold will be reached in any 12-month period.

Requests for voluntary registration typically arise in the case of start-ups, small businesses and capital-intensive business with long-lead times. Taxpayers typically seek voluntary registration to obtain legitimacy of business operations vis-à-vis retail or commercial customers or to satisfy other regulatory requirements (e.g. as a pre-entry requirement for obtaining Government business). The need for VAT refunds for legitimate input costs is also a factor if input costs are substantial.

II. Reasons for change

VAT registration requires contradictory considerations. On the one hand, VAT registration places businesses squarely within the VAT system so as to trigger the 14 per cent charge on outputs. The fiscus needs these persons to be within the net to ensure that VAT is appropriately collected. On the other hand, businesses seek VAT registration for business legitimacy and potential VAT refunds.

These contradictory considerations place SARS in a difficult position. While VAT registration is a critical component of VAT collections, VAT registration poses a risk of unwarranted VAT refunds. In order to balance these risks, SARS must be certain that persons entering the VAT net represent genuine viable businesses. It is not unknown for certain persons to seek VAT registration to reduce the VAT cost for disguised personal consumption or to operate as an entry point for fraudulent VAT refund claims. One unfortunate by-product of these contradictory forces is the increased level of proof required for VAT registration, thereby hindering many legitimate businesses from timely VAT registration.

III. Proposal

A. Overview

In view of the above concerns, VAT registration will be streamlined. Firstly, compulsory registration will be simplified to reduce the predictive element. Secondly, voluntary registration will be streamlined (more specifically subsection (3)(b) and (3)(d)).

B. Streamlined compulsory registration

In order to reduce the subjectivity around compulsory registration, compulsory registration will be restricted so as to remove the predictive element (i.e. the need to determine the level of business going forward). More specifically, under the revised rules, compulsory registration will be required solely for the following two scenarios:

1. Existing businesses with taxable supplies that have already exceeded the threshold of R1 million within the preceding 12 months (same as current law); and

2. Existing or future businesses that have a written contractual commitment to make taxable supplies exceeding R1 million within the next period of 12 months.

Examples of circumstances falling within the ambit of the second scenario include commercial leasing contracts or a commitment by Government in a contractual tender to provide goods and services. Removal of compulsory registration based solely on a “reasonable grounds” expectation will eliminate most of the disputes involving compulsory registration.

C. Streamlined voluntary registration

It is proposed that the current provisions for voluntary registration remain as is but with minor tweaks to the legislation. The targeted paragraphs that will be tweaked include: paragraph (b) that normally deals with small business and paragraph (d) that deals with specific nature of activities (see below for explanation).

IV. Effective date

The proposed rules relating to compulsory and voluntary registration will be effective from 1 April 2014.

6.6. REGISTRATION OF E-COMMERCE SUPPLIERS

[Applicable Value-Added Tax Act provision: Section 15(2)(a)(viii); section 20(5B); and section 23(1A); Paragraph (b)(vi) of the definition of “enterprise” and “electronics services” in section 1]

I. Background

A. General – Place of supply

Under current law, foreign suppliers of e-commerce (e.g. electronic books, music and programs) are not compelled to register as a VAT vendor. These foreign suppliers of e-commerce wholly transact over the internet with their customers. As a result, these foreign suppliers do not have any physical presence in South Africa despite the existence of multiple South African customers.

On a related note, the VAT Act does not contain any place of supply rules to determine which jurisdiction (South Africa or another country) has taxing rights in respect of e-commerce transactions. This lack of a specific rule for place of supply means that a foreign supplier’s liability to register for VAT requires an interpretative exercise with no clear answers.

The generic rule to determine which jurisdiction has taxing rights is usually based on customer location. This generic rule appears appropriate in the case of foreign suppliers of e-commerce to South African business customers. The foreign supplier should be subject to VAT at a zero rate in the foreign home country (based on the destination principle), and the recipient should be subject to VAT on imported services based on the reverse charge mechanism (see below).

B. Imported services

As stated above, customers that purchase services (e.g. e-books, e-music and e-movies) from a foreign supplier for final consumption must account for VAT on imported services via the reverse charge mechanism. Owing to the self-assessment nature of this mechanism, these customers must declare the VAT on imported services. The foreign supplier does not charge VAT for the services rendered because the foreign supplier is not registered for VAT.

II. Reasons for change

Placing reliance on the reverse charge mechanism for imported services as a means of enforcing VAT is impractical. Customer compliance with the reverse charge mechanism is low, especially in the case of e-commerce. This lack of compliance can be attributable to two causes: (i) some customers do not comply based on sheer ignorance, while (ii) other customers do not comply because they perceive the tax to be wholly voluntary as a practical matter (e.g. enforcement is impossible).

This lack of compliance has left local e-commerce suppliers (especially e-book providers) in an uncompetitive position vis-à-vis foreign suppliers of e-books. Foreign suppliers benefit because these suppliers are not required to charge VAT on their sales to South African customers (due to their wholly foreign location), and customers simply don't pay the VAT. Meanwhile, local e-book suppliers are subject to VAT like any other vendor. The net result is a near 14 per cent competitive advantage for foreign suppliers.

III. Proposal

As previously mentioned, the determination of place of supply for VAT purposes (i.e. the actual or deemed location of the supplier) is important to determine whether a foreign supplier must charge VAT on a supply. In line with OECD principles, it is proposed that place of supply rules be introduced in terms of e-commerce to bolster the current imported services reverse-charge mechanism. Under these new rules, foreign suppliers will be required to register as a VAT vendor because these suppliers provide supplies to South African customers. In view of the fact that customer location is often unknown in the case of e-commerce, a proxy for customer location will be used. It was decided that either of the following will serve as a proxy for customer location: (i) payment from a South African bank, or (ii) customer residency in South Africa. Other proxies were also considered but rejected:

1. **Place of performance:** Unlike physical services, it is impossible to determine the place of performance of an electronic service.

2. **Customer IP address:** Internet Protocol (IP) address depends on where the Internet Service Provider (ISP) is located and does not provide any indication of the exact location of the person with that IP address. Customers can also mask their IP addresses (someone in one country can show that they are located in another country). ISPs may also buy bandwidth from other ISPs based on traffic volumes, which means that the location/country can change.

3. **Customer's billing address:** Customers can easily manipulate their billing address details to avoid the tax.

It should be noted that the reverse-charge mechanism will remain as backstop to the new place of supply rules.

In summary, all foreign suppliers of electronic services to South African customers will fall into the compulsory VAT registration category. Electronic services are defined to include all those services as prescribed by the Minister in regulation. The term 'electronic services' or 'electronically supplied services', is in keeping with international norms. The special compulsory category will have a monetary threshold of R50 000 being applicable before a VAT registration liability is triggered; A lower threshold was mooted to ensure that every effort is made to level the playing field between local and foreign suppliers of electronically supplied services (as the current compliance level associated with the reverse charge provisions is unacceptably low or non-existent). Further, these vendors will be allowed to register for VAT on the payments basis in order to streamline compliance.

IV. Effective date

The proposed amendment applies in respect of supplies of e-commerce services on or after 1 April 2014.

6.7. THE SUPPLY OF SERVICES BY A HOME OWNERS ASSOCIATION

[Applicable Value-Added Tax Act provision: Section 12(f)(iv) and section 8(2G)]

I. Background

The supply of services by a sectional title body corporate to its members in the course of the body corporate management is generally exempt from VAT. Historically, a sectional title body corporate provided (amongst other services) the service of paying the aggregated rates on behalf of the individual owners of the sectional title scheme; the body corporate would then recover these amounts on an individual basis from owners. Hence, imposing VAT on a sectional title body corporate would have effectively triggered an additional layer of VAT for conduit payments that did not contain any meaningful value –addition.

Home owners associations, however, are not exempt from VAT. Unlike a sectional title body corporate, home owners associations had no historical requirement to act as a conduit for municipal rates. Owners of full title properties always paid their municipal rates directly without involvement of the homeowners association.

II. Reasons for change

Since 2006, the requirement that a sectional title body corporate pays over the property rates of the sectional title owners, fell away. Sectional title owners now pay their rates directly. However, these body corporates remained exempt. The exemption remained because the supply of services by the sectional title body corporate to the members is not essentially a business enterprise. The sectional title body corporate is merely a cost sharing device. Homeowners associations essentially operate under the same premise.

III. Proposal

It is proposed that a supply of services by a home owners association to any of its members be exempt from VAT. This exemption will match the current exemption for sectional title body corporates. Further, home owners associations that are currently on register and become liable to deregister for VAT (as of the effective date, in terms of section 8(2) of the VAT Act) will be given a concession to pay over the VAT liability in six monthly equal instalments or in so many instalments as the Commissioner may decide.

IV. Effective date

The proposed amendment applies in respect of the supply of services on or after 1 April 2014.

6.8. SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT

[Applicable Value-Added Tax Act provisions: Section 8(10); section 9(8) and section 10(16); section 22(1) Proviso 2 (i)]

I. Background

A vendor (debtor) that has goods repossessed under an installment credit agreement is deemed to make a supply to the person exercising the right of repossession (creditor). The deemed supply effectively operates as a claw-back of the initially creditable input tax. In effect this claw-back fully or partially reverses the original input claimed by the vendor.

II. Reasons for change

In terms of the National Credit Act, 2005, a vendor can now opt to terminate an installment credit agreement by surrendering the goods that are subject to the agreement back to the credit provider. Under the VAT, however, this form of surrender of the goods by the vendor is not caught by the deeming provision. No reason exists for this omission.

III. Proposal

It is proposed that the current deemed supply pertaining to the repossession of goods be expanded to cater for a surrender of goods by a vendor to a financier (creditor) in terms any instalment credit agreement covered in terms of the National Credit Act, 2005.

IV. Effective date

The proposed amendment applies in respect of goods deemed surrendered on or after 1 April 2014.

6.9. CLARIFICATION OF MINIMUM SPECIFIED CONDITIONS FOR MINERAL RESOURCES

[Applicable Royalty Act section: Section 6A and Schedule 2]

I. Background

The mineral royalty regime was designed recognising that beneficiation is beneficial to the South African economy. The ideal situation would be to impose a royalty on minerals at the mouth of the mine. This is impossible to do as all minerals have to go through some form of beneficiation (e.g. crushing, washing, etc.) before they can be sold. As a result, the principle is to establish 'the value' at the 'first saleable point', which will naturally have an element of beneficiation. A compromise was struck in which unrefined minerals would be subject to a royalty rate that is slightly lower than what would have been used at the mine mouth, and refined minerals are subject to an even lower rate, thus recognising the beneficiation effort.

The royalty for an extractor is triggered on the transfer of mineral resources. Schedule 1 specifies the conditions for refined mineral resources and Schedule 2 specifies the conditions for unrefined mineral resources. If the transfer occurs in a condition below the specified condition, the value is grossed-up to the minimum condition. The minimum condition ensures that taxpayers do not transfer mineral resources without undergoing any meaningful transformation of those minerals to undermine the royalty charge. If the transfer occurs in a condition above the specified condition, the value is based on the higher of the specified condition or the condition upon extraction. The term ‘extraction’ has resulted in confusion as it is impossible to value a mineral at the mine mouth or point of extraction as explained above. The policy intent was to value the mineral upon transfer as the schedules refer the refined and unrefined conditions upon transfer.

II. Reasons for change

The minimum condition rules are causing uncertainty. It appears that some taxpayers have been calculating royalty payments by grossing the value down to the minimum condition if the mineral was transferred in a condition above the specified condition, which was not the intention. The schedules also contain the term ’minimum’ for some minerals and not others.

Moreover, certain minerals contain a range of specified conditions with no explicit rules covering this circumstance. At present, “chrome ore” and “manganese” contain a range as listed in Schedule 2. Coal was previously subject to a range in Schedule 2, but now has a specified condition of 19.0 MJ/kg that has resulted in significant underpayments of mineral royalties.

III. Proposal

A. Minimum condition

The term ‘minimum’ will be removed from section 6A(1) and the schedules as superfluous.

B. Range mineral resources (and coal)

The rules associated with minerals containing a range will be clarified. If the transfer occurs at a condition below the specified range, the value will be determined at the bottom point specified for the range. If the transfer occurs at a condition above the specified range, the value will be determined at the highest point specified for the range. If the transfer occurs between the bottom and top points, the condition upon transfer will apply.

Certain minerals are given a range (as opposed to the standard condition) in recognition of the fact that certain minerals are both extracted and transferred at a variety of grades. If a mineral can be transferred in a variety of high-grade and low-grade conditions falling within the set range, no adjustment is required, i.e. the extractor can simply apply the condition upon transfer of the said mineral. One mineral that previously had such a range was coal. This range will be restored and, under the revised rules, the range for coal will be from 19.0 MJ/kg to 27.0 MJ/kg.

The weighted average calorific value of ‘low’ and ‘very low’ quality coal required by Eskom’s power stations 19.0 MJ/kg. New power plants require coal with calorific values of between 22 MJ/kg and 24 MJ/kg. Coal that is exported is typically at 23 MJ/kg and above. The lower contribution by the coal sector to mineral royalties, compared to its share of total mineral sales and the very low estimated effective royalty rate for the coal sector is an indication that the current point reference of 19.0 MJ/kg is not appropriate and that a range of 19 MJ/kg to 27.0 MJ/kg is justifiable.

The value of coal sales in 2011 was larger than any other mineral (27.5 per cent share), while its contribution to royalties was minimal (5.3 per cent share in 2011/12). The table expands on this point.

R mn	2011 Sales local	export	total	%	2011/12 Royalty Payments total	%	Estimated Royalty Rate
Coal	37 286	50 549	87 834	27.5%	297	5.3%	0.3%
Platinum	10 619	73 234	83 853	26.3%	853	15.2%	1.0%
Gold	3 633	65 258	68 891	21.6%	817	14.6%	1.2%
Iron ore	4 208	58 444	62 652	19.6%	2 501	44.6%	4.0%
Manganese	1 325	8 570	9 895	3.1%	149	2.7%	1.5%
Copper	3 938	1 495	5 433	1.7%	79	1.4%	1.5%
Zinc	169	233	403	0.1%	143	2.5%	
Other					772	13.8%	
Total	61 178	257 783	318 961	100%	5 611	100%	1.8%

IV. Effective date

The proposal will apply to all mineral resources transferred on or after 1 March 2014.

6.10. SMALL BUSINESS EXEMPTION ELIGIBILITY

[Applicable Royalty Act section: Section 7(1)(d)]

I. Background

The Mineral and Petroleum Royalty Resources Act applies to a person (essentially the extractor) that transfers a mineral resource extracted from within the Republic. However, as part of Government's initiative to encourage and support small business development, relief for small mining operations is available in the form of an exemption. This exemption is subject to four requirements: (a) a gross sales limit of R10 million in respect of a year, (b) a royalty liability limit of R100 000 for the year, (c) residency requirement for the year, and (d) a registration requirement (i.e. required registration in terms of the Mineral and Petroleum Royalty Resources Administration Act).

II. Reasons for change

The registration requirement for the royalty exemption is often problematic in the case of small businesses. Many smaller businesses often fail to register due to a lack of knowledge. This lack of registration leaves small business vulnerable to unnecessary royalty charges and related penalties. Small businesses should receive relief regardless of registration.

III. Proposal

It is proposed that the registration requirement be deleted. Small businesses will be eligible for royalty relief regardless of registration.

IV. Effective date

The proposal will come into effect for years of assessment ending on or after 1 March 2014.

6.11. ALIGNING INCOME TAX AND ROYALTY EARNINGS IN THE CASE OF OIL AND GAS COMPANY CAPITAL ALLOWANCES

[Applicable Royalty Act section: section 5(3)(g)]

I. Background

A. Overall royalty formula

The Mineral and Petroleum Royalty Act imposes a royalty charge based on gross sales and an adjustable rate. The adjustable rate takes into account a mineral extractor's profits via earnings before interest and taxes (EBIT) calculation. EBIT is calculated taking into account: (i) gross sales, (ii) recoupments, and (iii) deductions. In terms of deductions, permissible capital expenditure is allowed in order to promote growth and investment in the mining industry. However, the carry-over of excess operating losses is not permitted.

B. Oil & Gas Tenth Schedule capital allowances

The Tenth schedule to the Income Tax Act provides oil and gas companies with a special deduction for capital expenditure in addition to the normal allowance. Capital expenditure for exploration receives 100 per cent uplift, and capital expenditure for production receives a 50 per cent uplift. All excess losses, including excess losses stemming from these uplifts can be carried over to following years in the form of assessed losses.

II. Reasons for change

While Income Tax and the royalty EBIT calculation are largely aligned, the EBIT calculation fails to take the exploration and production capital expenditure uplifts into account. No reason exists for this deviation, especially because other mining capital allowances within the income tax are fully reflected in the EBIT calculation.

III. Proposal

It is proposed that all of the capital allowance uplifts for oil and gas exploration and production be fully reflected within the royalty EBIT calculation. This parity ensures that capital investments for oil and gas are fully incentivized under both the income tax and royalty regimes. Parity of treatment will also greatly simplify compliance and administration of both systems.

IV. Effective date

The proposal will come into effect for years of assessment commencing on or after 1 March 2014.

7. CLAUSE BY CLAUSE

NATIONAL
TREASURY

REPUBLIC OF SOUTH AFRICA

CLAUSE BY CLAUSE EXPLANATION

TO THE

EXPLANATORY MEMORANDUM
(TLAB) 2013

CLAUSE 1

Transfer duty: Amendment to section 1

This amendment will exempt transfers of shares in a REIT from transfer duty.

CLAUSE 2

Transfer duty: Amendment to section 9

These amendments provide exemption for substitutive share-for-share transactions (the exchanging of shares by the shareholders with new shares of the same company). This relief may be necessary if shares are being exchanged with a residential property company.

CLAUSE 3

Estate duty: Amendment to section 4

This amendment deletes an obsolete cross-reference.

CLAUSE 4

Income Tax: Amendment to section 1

Subclause (a): The amendment proposes to standardize references to the Banks Act in the Income Tax Act.

Subclause (b): The amendment proposes to standardise references to the Medical Schemes Act in the Income Tax Act.

Subclause (c): The amendment proposes to standardise references to the Collective Investment Schemes Control Act in the Income Tax Act.

Subclause (d): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (e): The amendment proposes to standardise references to the Collective Investment Schemes Control Act in the Income Tax Act.

Subclause (f): This amendment updates the reference to a collective investment scheme in property to one that qualifies as a real estate investment trust (i.e. a REIT) so as to take account of the introduction of the REIT regime in 2012.

Subclause (g): This amendment updates the reference to partnership to include a foreign partnership (i.e. a definition added in 2010).

Subclauses (h) and (j): These amendments delete a superfluous word.

Subclause (i): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (k): This amendments change the word from “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (l): The amendment proposes to standardise references to a foreign company in the Income Tax Act.

Subclause (m): The amendment proposes to standardise references to the Copyright Act in the Income Tax Act.

Subclause (n): The amendment proposes to standardise references to the Designs Act in the Income Tax Act.

Subclause (o): See notes on **CURRENCY RULES FOR DOMESTIC TREASURY MANAGEMENT COMPANIES.**

Subclause (p): The amendment proposes to standardise references to the Financial Markets Act in the Income Tax Act.

Subclause (q): The special currency tax rules relating to foreign equity instruments (mainly contained in section 9G) are deleted as obsolete (having generally ended in late 2005)).

Subclause (r): The amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks Act and the Copyright Act in the Income Tax Act.

Subclause (s): This amendment updates wording and deletes obsolete provisions.

Subclause (t): This amendment deletes a proviso based on an obsolete provision.

Subclause (u): The amendment proposes to standardise references to the Financial Markets Act in the Income Tax Act.

Subclause (v): The amendment proposes to standardise references to “linked unit” in the Income Tax Act.

Subclause (w): The amendment proposes to standardise references to the Financial Markets Act in the Income Tax Act.

Subclause (x): The amendment proposes to standardise references to the Financial Markets Act in the Income Tax Act.

Subclause (y): The amendment proposes to standardise references to the Long-term Insurance Act in the Income Tax Act.

Subclause (z): The amendment proposes to standardise references to the Medical Schemes Act and the Petroleum Resources Development Act in the Income Tax Act.

Subclause (zA): The amendment proposes to standardise references to “municipal value” in the Income Tax Act.

Subclause (zB): The amendment proposes to standardise references to Patents Act in the Income Tax Act.

Subclause (zC): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zD): The amendment proposes to standardize references to the Pension Funds Act in the Income Tax Act.

Subclause (zE): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zF): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zG): The amendment proposes to standardize references to the Pension Funds Act in the Income Tax Act.

Subclause (zH): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zI): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zJ): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zK): The proposed amendment inserts definitions of "portfolio of hedge fund collective investment scheme". See notes on **TAX REGIME FOR COLLECTIVE INVESTMENT SCHEMES IN NON-PROPERTY INVESTMENTS.**

Subclause (zL): The amendment proposes to standardise references to the Collective Investment Schemes Act in the Income Tax Act.

Subclause (zM): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zN): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zO): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zP): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zQ): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zR): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zS): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zT): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zU): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zV): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zW): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

Subclause (zX): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

Subclause (zY): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

Subclause (zZ): The amendment proposes to standardise references to the Finance Markets Act in the Income Tax Act.

Subclause (zZa): See notes on **EMPLOYER PROVIDED ACCOMODATION – LOW-COST HOUSING and BURSARIES OR SCHOLARSHIPS TO EMPLOYEE RELATIVES.**

Subclause (zZb): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (zZc): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (zZd): The amendment proposes to standardise references to the Long Term Insurance Act in the Income Tax Act.

Subclause (zZe): See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

Subclause (zZf): The amendment proposes to standardise references to the Short-term Insurance Act in the Income Tax Act.

Subclause (zZg): The definition of "South African Reserve Bank" is inserted because this definition is now being used in more than one section.

Subclause (zZh): The amendment updates a cross-reference.

Subclause (zZi): The amendment proposes to standardise references to the Tax Administration Act in the Income Tax Act.

Subclause (zZj): This amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks and the Copyrights Act in the Income Tax Act.

Subclause (zZk): The amendment proposes to standardise references to the Trade Marks Act in the Income Tax Act.

Subclause (zZl): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (zZm): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

CLAUSE 5

Income Tax: Amendment to section 5

The proposed amendment is consequential to the changes effected to the deductions in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

CLAUSE 6

Income Tax: Amendment to section 6A

The amendment proposes to standardise references to the Medical Schemes Act.

CLAUSE 7

Income Tax: Amendment to section 6A

These amendments change the word from “taxpayer” to “person” as a matter of style consistency.

CLAUSE 8

Income Tax: Amendment to section 7

These amendments change the word from “shareholder” to “holder of shares” as a matter of style consistency. The amendment proposes to standardise references to the Patents Act, the Designs Act, the Trade Marks Act, the Copyright Act and the Pension Funds Act in the Income Tax Act.

CLAUSE 9

Income Tax: Amendment to section 8

Subclause (a): The reference is deleted as obsolete in light of the whole-scale changes to the old research and development provisions of section 11D. As a result, the general recoupment rules will apply to the former section 11D research and development provisions.

Subclause (b) and (c): The proposed amendments corrects a grammatical error.

Subclause (d): The proposed amendment prevents a double recoupment because section 19 already gives rise to a recoupment for certain debt cancellations.

Subclause (e): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (f): See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

Subclause (g): These amendments change the word from “shareholder” to “holder of shares” as a matter of style consistency.

Subclauses (h) and (l): These amendments eliminate references to the obsolete Sales Tax, which was replaced by the Value-added Tax in the early 1990s.

Subclause (j): The amendment proposes a deletion of obsolete provisions.

Subclause (k): The proposed amendments correct a grammatical error.

CLAUSE 10

Income Tax: Amendment to section 8C

The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

CLAUSE 11

Income Tax: Amendment to section 8EA

Subclause (a): This amendment involves a grammar change.

Subclause (b): This amendment links the purpose to the use of funds derived from the issue of the preference share as opposed to focusing on the preference share issue itself.

Subclauses (c) and (d): These amendments are intended to clarify the exception to the anti-avoidance rule by making the exception outright as opposed to a “proviso” to a definition.

CLAUSE 12

Income Tax: Amendment to section 8F

See notes on **ANTI-HYBRID DEBT INSTRUMENT RECHARACTERISATION RULES.**

CLAUSE 13

Income Tax: Amendment to section 8F

See notes on **ANTI-HYBRID DEBT INSTRUMENT RECHARACTERISATION RULES.**

CLAUSE 14

Income Tax: Amendment to section 8FA

See notes on **ANTI-HYBRID DEBT INSTRUMENT RECHARACTERISATION RULES.**

CLAUSE15

Income Tax: Amendment to section 8FA

See notes on **ANTI-HYBRID DEBT INSTRUMENT RECHARACTERISATION RULES.**

CLAUSE 16

Income Tax: Amendment to section 9

Subclause (a): The amendment deletes the reference to deemed interest under section 8E because the new section 8E creates deemed income. The source of deemed income arising from dividends (under sections 8E and 8EA) will be determined according to the common law.

Subclause (b): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

Subclause (c): The amendment aligns the source rule in respect of the disposal of immovable property to the wider definition of immovable property in the Eighth Schedule (capital gains tax). As a general matter, non-residents are liable for capital gains tax in respect of disposal of immovable property, including interest in such immovable property. The phrase, 'interest in immovable property' is specifically defined for capital gains tax purposes whilst the source rules merely refers to the phrase without providing a specific definition. There is no reason why the scope of normal tax on the disposal of interests in South African immovable property by non-residents should differ on revenue and capital gains side.

Subclause (d): See notes on **EXIT CHARGE ON INTERESTS IN IMMOVABLE PROPERTY.**

CLAUSE 17

Income Tax: Amendment to section 9B

The amendment deletes an obsolete provision (the anti-avoidance share incentive rules of section 9B have been fully replaced by section 8C).

CLAUSE 18

Income Tax: Amendment to section 9C

Subclause (a): This amendments change the word from “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (b): Amendment to definition of ‘equity share’ includes a participatory interest in a portfolio of a hedge fund collective investment scheme. See notes on **TAX REGIME FOR COLLECTIVE INVESTMENT SCHEMES IN NON-PROPERTY INVESTMENTS.**

CLAUSE 19

Income Tax: Amendment to section 9D

Subclause (a): The proposed amendment corrects a grammatical error.

Subclause (b): See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

Subclause (c): The amendment proposes to standardise references to the Long-term Insurance Act in the Income Tax Act.

Subclauses (d), (e) and (j): Insurance premiums were specifically included in order to avoid any uncertainty of whether they qualify as “items of a similar nature”.

Subclause (f): These amendments simplify the foreign currency rules (i.e. use of non-functional currencies) within a controlled foreign company. More specifically, these amendments eliminate the anti-avoidance rules for capital gains not attributable to the controlled foreign company’s permanent establishment and in respect of foreign equity instruments. Only the hyper-inflationary currency rules remain.

Subclause (g): The amendment proposes to standardise references to the Long-term Insurance Act in the Income Tax Act.

Subclause (h): See notes on **UNIFORM CROSS BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION.**

Subclause (i): See notes on **UNIFORM CROSS BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION.**

Subclause (k): See notes on **CONTROLLED FOREIGN COMPANY AND THE WORDING CAPITAL EXEMPTION.**

CLAUSE 20

Income Tax: Repeal of section 9G

The special currency tax rules relating to foreign equity instruments are deleted as obsolete (having generally ended in late 2005).

CLAUSE 21

Income Tax: Amendment of section 9H

Subclause (a): See notes on **EXIT CHARGE ON INTERESTS IN IMMOVABLE PROPERTY.**

CLAUSE 22

Income Tax: Amendment of section 9I

This amendment changes the word from “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 23

Income Tax: Amendment to section 10

Subclause (a): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (b): This amendment deletes the reference to the Black Authorities Act, 1951.

Subclause (c): This amendment changes the word “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (d): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (e): This amendment changes the word from “its shareholders” to “the holders of shares in that share block company” as a matter of style consistency, and for clarity.

Subclause (f): The proposed amendment deletes obsolete cross-references to other Acts.

Subclause (g): The amendment proposes to standardise references to the Pension Funds Act in the Income Tax Act.

Subclause (h): See notes on **ALIGNMENT OF THE TAX TREATMENT OF INDIVIDUAL – BASED INSURANCE POLICIES.**

Subclause (i): See notes on **ALIGNMENT OF THE TAX TREATMENT OF INDIVIDUAL – BASED INSURANCE POLICIES.**

Subclause (j): The proposed amendment updates wording to match the proposed wording in section 49D(3). See notes on the **UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION.**

Subclause (k): See notes on the **UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION.**

Subclause (l): The amendment provides that a holder of a unit in a collective investment scheme in securities is only exempt from tax on an amount distributed to it if the amount was subject to tax in the portfolio of a collective investment scheme in securities. The amendment will apply in respect of amounts received or accrued to the unit holder on or after 1 March 2015.

Subclause (m): The amendment is inserted for grammatical purposes**.**

Subclause (n): Dividends acquired by way of cession are currently treated as ordinary revenue unless acquired as part of all rights attaching to the underlying share. The goal is to close dividend cession schemes as an exempt income shifting device. However, the exception should be expanded slightly so that the anti-avoidance rule does not apply whenever the cession results in the acquirer holding both the underlying share and all the rights attaching to that share. For instance, if a taxpayer owns a share without corresponding dividend rights, acquisition of those dividend rights by way of cession should not be viewed as an ordinary revenue event.

Subclause (o): See notes on **REMOVAL OF DIVIDEND EXEMPTION FOR DIVIDENDS APPLIED AGAINST DEDUCTIBLE FINANCIAL PAYMENTS.**

Subclause (p): See notes on **ANTI-AVOIDANCE EMPLOYEE SHARE SCHEME DIVIDENDS.**

Subclause (q): See notes on **UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION.**

Subclause (r): See notes on **REMOVAL OF SOURCE FOCUS FOR COPYRIGHT AUTHORS.**

Subclause (s): This amendment corrects a grammatical error.

Subclause (t): See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

Subclause (u): See notes on **BURSARIES OR SCHOLARSHIPS TO EMPLOYEE RELATIVES.**

Subclause (v): The proposed amendment updates a cross-reference.

CLAUSE 24

Income Tax: Amendment to section 10A

The amendment proposes to standardise references to the Long-term Insurance Act in the Income Tax Act, and correct a grammatical error.

CLAUSE 25

Income Tax: Amendment to section 10B

Subclause (a): The amendment corrects a grammatical error.

Subclauses (b) and (c): Under current law, cash dividends received in respect of foreign shares listed on the JSE are exempt from normal tax because these dividends potentially fall within the Dividends Tax. The proposed amendment extends the exemption to include in specie foreign dividends paid in respect of JSE listed shares if those dividends are paid to domestic companies. This exemption matches the current exemption for in specie dividends in respect of domestic company JSE shares paid to domestic companies.

Subclauses (d) and (e): **REFINEMENT OF PARTICIPATION EXEMPTION IN RESPECT OF FOREIGN DIVIDENDS DERIVED FROM NON-EQUITY SHARES.**

CLAUSE 26

Income Tax: Amendment to section 10C

This amendment is consequential to the changes effected to the deduction in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

CLAUSE 27

Income Tax: Amendment to section 11

Subclause (a): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (b): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (c): The amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks Act and the Copyright Act in the Income Tax Act.

Subclause (d): The amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks Act and the Copyright Act in the Income Tax Act.

Subclause (e): This amendment changes the word from “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (f): The amendment proposes to standardise references to the Patents Act, Designs Act and the Trade Marks Act in the Income Tax Act.

Subclause (g): The amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks Act and the Copyright Act in the Income Tax Act.

Subclause (h): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

Subclause (i): This amendment changes the word from “shareholder” to “holder of shares” as a matter of style consistency, and amends the reference to “50” from a textual to a numerical wording.

Subclause (j): The proposed amendment is consequential to the changes effected to the deduction in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

Subclause (k): See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

Subclause (l): See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

Subclause (m): The proposed amendment is consequential to the changes effected to the deduction in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

CLAUSE 28

Income Tax: Repeal of section 11B

The proposed amendment deletes the provision as obsolete.

CLAUSE 29

Income Tax: Amendment of section 11D

See notes on **REFINEMENTS TO THE RESEARCH AND DEVELOPMENT INCENTIVE.**

CLAUSE 30

Income Tax: Amendment to section 11E

The proposed amendment deletes obsolete cross-references.

CLAUSE 31

Income Tax: Amendment to section 12B

Subclause (a) and (c): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (b): See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

CLAUSE 32

Income Tax: Amendment to section 12C

Subclause (a): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (b), (c) and (e): See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

Subclause (d): See notes on **REFINEMENTS TO THE RESEARCH AND DEVELOPMENT INCENTIVE.**

Subclause (f) and (g): The proposed amendments correct a grammatical error.

Subclause (h): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

CLAUSE 33

Income Tax: Amendment to section 12D

See notes on **ANCILLARY COMPONENTS OF PIPELINES.**

CLAUSE 34

Income Tax: Amendment to section 12DA

The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

CLAUSE 35

Income Tax: Amendment to section 12E

Subclause (a): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (b): This amendment changes the word “shareholder” to “holder of shares” as a matter of style consistency, and proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (c): This proposed amendment changes the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 36

Income Tax: Amendment to section 12J

The amendment proposes to standardise references to the Banks Act, Long-term Insurance Act and the Short-term Insurance Act in the Income Tax Act.

CLAUSE 37

Income Tax: Amendment to section 12K

See notes on **EXEMPTION OF CERTIFIED EMISSION REDUCTIONS.**

CLAUSE 38

Income Tax: Amendment to section 12L

The proposed amendment remedies incorrect cross-references.

CLAUSE 39

Income Tax: Amendment to section 12M

The amendment proposes to standardise references to the Medical Schemes Act in the Income Tax Act.

CLAUSE 40

Income Tax: Amendment to section 12N

See notes on **TENANT CONSTRUCTION OR IMPROVEMENTS ON LEASED LAND.**

CLAUSE 41

Income Tax: Insertion of section 12Q

See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

CLAUSE 42

Income Tax: Insertion of section 12Q

See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

CLAUSE 43

Income Tax: Insertion of section 12R

See notes on **TAX INCENTIVES FOR SPECIAL ECONOMIC ZONES.**

CLAUSE 44

Income Tax: Insertion of section 12S

See notes on **TAX INCENTIVES FOR SPECIAL ECONOMIC ZONES.**

CLAUSE 45

Income Tax: Amendment to section 13

The proposed amendment deletes obsolete cross-references to depreciation provisions that no longer have any application.

CLAUSE 46

Income Tax: Amendment of section 13*bis*

The proposed amendment deletes obsolete cross-references to depreciation provisions that no longer have any application.

CLAUSE 47

Income Tax: Amendment to section 13*ter*

These proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 48

Income Tax: Amendment of section 13*quat*

The proposed amendment moves the location of an “and” because the current location reflects the existence of an item no longer within the Income Tax Act.

CLAUSE 49

Income Tax: Repeal of section 14

The proposed amendment deletes shipping allowances as obsolete. See notes on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT**.

CLAUSE 50

Income Tax: Repeal of section 14bis

The section has ceased to apply and has been deleted as obsolete.

CLAUSE 51

Income Tax: Repeal of section 18

The proposed amendment deletes obsolete deductions for medical expenses (with deductions having been replaced with tax credits).

CLAUSE 52

Income Tax: Amendment to section 18A

Subclause (a): The proposed amendment additionally excludes severance benefits because these benefits are taxed on the same basis as retirement and pre-retirement lump sums in terms of the retirement tax tables.

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

Subclause (c): See notes on **ROLLOVER TREATMENT FOR EXCESS DEDUCTIBLE DONATIONS.**

Subclause (d): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

Subclauses (e), (f) and (g): See notes on **DEDUCTIBLE DONATIONS OF APPRECIATED IMMOVABLE PROPERTY**.

Subclause (h) and (i): The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

CLAUSE 53

Income Tax: Amendment to section 19

Subclause (a): The term "cancellation" is removed from the title because the term "reduction" includes a cancellation.

Subclauses (b),(c),(e) and (g): The nexus between the expenditure and the trading stock at issue has been expanded to cover the reduction of debt to fund any expenditure "in respect of" that trading stock (such as improvements o production), not just amounts incurred in the acquisition of trading stock.

Subclause (d): The words are moved for improved readability.

Subclause (f): A link to the recoupment provisions of section 8(4)(a) is added so as to be consistent with the other debt reduction rules within the section.

Subclause (h): The interaction between the debt reduction rules of section 19 and paragraph 12A is being clarified in the case of capital allowance assets. Paragraph 12A applies to reduce base cost in the first instance with excess reductions applied under section 19.

CLAUSE 54

Income Tax: Amendment to section 20

Subclause (a): See **RING-FENCING OF NET FOREIGN TRADE LOSSES**.

Subclause (b): The proposed amendment additionally excludes severance benefits because these benefits are taxed on the same basis as retirement and pre-retirement lump sums in terms of the retirement tax tables.

CLAUSE 55

Income Tax: Amendment to section 22

Subclause (a): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

Subclause (b): The provision is deleted as obsolete.

Subclause (c): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 56

Income Tax: Amendment to section 23

Subclause (a): The amendment is consequential to the changes effected to the deduction in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS**.

Subclause (b)-(e): See notes on **ALIGNMENT OF THE TAX TREATMENT OF INDIVIDUAL – BASED INSURANCE POLICIES**.

CLAUSE 57

Income Tax: Amendment to section 23C

Subclauses (a) and (b): The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

CLAUSE 58

Income Tax: Amendment to section 23I

Subclause (a): The amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks Act and the Copyright Act in the Income Tax Act.

Subclause (b): The amendment proposes wording that improves readability.

CLAUSE 59

Income Tax: Amendment to section 23K

See notes on **DEDUCTIBLE INTEREST LIMITATION IN RESPECT OF ACQUISITION INDEBTEDNESS**.

CLAUSE 60

Income Tax: Amendment to section 23L

See notes on **REFINEMENT: INVESTMENT POLICIES DISGUISED AS SHORT-TERM INSURANCE POLICIES**.

CLAUSE 61

Income Tax: Amendment to section 23M

See notes on **LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX.**

CLAUSE 62

Income Tax: Amendment to section 23M
See notes on **LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX.**

CLAUSE 63

Income Tax: Amendment to section 23N

See notes on **LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX.**

CLAUSE 64

Income Tax: Amendment to section 23N
See notes on **LIMITATION OF INTEREST DEDUCTIONS IN RESPECT OF DEBTS OWED TO PERSONS NOT SUBJECT TO TAX.**

CLAUSE 65

Income Tax: Repeal of section 24B

See notes on **CROSS-ISSUE OF SHARES**.

CLAUSE 66

Income Tax: Amendment to section 24BA

Subclause (a): The proposed amendment is a consequential amendment upon the deletion of section 24B.

Subclause (b): The anti-avoidance rules to prevent fair market value mismatches are clarified and adjusted to accommodate a new exception.

- Firstly, the deemed market rules of paragraph 38 of the Eighth Schedule take precedence over the new anti-avoidance rules. Hence, if a disposal is deemed to occur at fair market value under paragraph 38, the new fair market value mismatch rules do not apply.
- Secondly, the fair market value mismatch rules currently do not apply to companies within the same group. The technical correction clarifies that the group determination is made immediately after the asset acquisition.
- Thirdly, a new exception is made for wholly owned subsidiaries. More specifically, the fair market value mismatch rules do not apply if any person (not just a company) transfers assets to a wholly owned subsidiary (meaning that individuals or trusts making a transfer of this nature are now free from the fair market value mismatch rules).

CLAUSE 67

Income Tax: Repeal of section 24F

Section 24F is now deleted as fully repealed. The sole incentive for films going forward is the exemption under section12O.

CLAUSE 68

Income Tax: Amendment to section 24I

Subclause (a): The proposed amendment corrects a grammatical error.

Subclause (b): See notes on **CURRENCY RULES FOR DOMESTIC TREASURY MANAGEMENT COMPANIES**.

Subclause (c): See note on **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSORT ENTITIES.**

Subclause (d) and (i): The proposed amendment clarifies the relationship between the section 24I(10) deferral rules involving connected persons and the new deferral rules of section 24I(10A). The old section 24I(10) rules are deferred until 1 January 2014 (with a deemed realisation on this closure date). However, the non-current items fall under the deferral rules of section 24I(10A) until the items are realised. The technical correction clarifies that the section 24I(10) deemed disposal event upon the 1 January 2014 termination of section 24I(10) is ignored for purposes of the section 24I(10A) realisation.

Subclause (e): The amendment corrects a cross reference following the deletion of subsection (10).

Subclause (f),(g) and (j): The amendment deletes an otherwise obsolete provision in view of the recent revision (see subsection (10A)) of the rules for recognising connected party exchange items to roughly follow the accounting principles of International Financial Reporting Statement (IFRS). Exchange items falling within the old pre 08 November 2005 will be deemed to be realised at the end of the year of assessment ending before the commencement of a new year of assessment on or after 1 January 2014. In terms of the 2014 cessation, any gain or loss arising may be deferred if the exchange item exists within a group/connected person relationship falling under the new rules. This gain or loss will be deferred until the sooner of realisation or the date when the group/connected person relationship is lost. The effective date of 1 January 2014 mirrors the realization trigger date in the proviso.

Subclause (h): The amendment deletes an obsolete provision in view of the recent revision (see subsection (10A)) of the rules for recognising connected party exchange items to roughly follow the accounting principles of International Financial Reporting Statement (IFRS). The effective date of 1 January 2014 mirrors the existing realization trigger date for section 24I(10) (see further proviso).

Subclause (k): The proposed amendment deletes an obsolete provision. The deleted provision provided an exemption for currency gains and losses stemming from hedging the purchase price of acquiring substantial shareholding in foreign companies. With the alignment of tax and accounting principles, the hedge will be recognised as an exchange item. The exchange item will be recognised on a mark-to-market basis. This eliminates the special rules for monetary items connected to non-monetary items.

CLAUSE 69

Income Tax: Amendment to section 24J

Subclause (a): The proposed amendment adjusts the words for consistency.

Subclause (b): The current "yield to maturity" calculation is adjusted for the variation of terms and conditions but arguably not for other variations in amounts payable (such as a change in estimate due to a change in an external factor as applied to an initial term or condition). The proposed amendment specifically requires an adjustment for variations in amounts payable (even if there is no variation in terms or conditions).

Subclauses (c) and (d): The 2012 legislation recognises that the interest calculation for debts must take into account a change in the date of redemption. The technical correction clarifies that a change in the date of redemption must be taken into account for purposes of the "yield to maturity" calculation.

Clause (e) and (f): Section 24J(9) is being reinstated as we refer to this provision in the new mark-to-market subsection, although it may not be exercised by a company in respect of years of assessment commencing on or after 1 January 2014 or where the company is a covered person, in respect of any year of assessment ending on or after 1 April 2014. This proposal seeks to cater for taxpayers who were forced to exit section 24J(9) and need a transitional arrangement for them to go back to s 24J(2) to (8), s 24K & s 24L. Under this forced exit, a deemed disposal and deemed acquisition at the market value will arise. This deemed event will apply at the close of business in the last year of assessment that section 24J(9) applied to the company.

CLAUSE 70

Income Tax: Amendment to section 24JA

The amendment proposes to standardise references to the Banks Act in the Income Tax Act.

CLAUSE 71

Income Tax: Amendment to section 24JB

See notes on **ANNUAL FAIR VALUE TAXATION OF FINANCIAL INSTRUMENTS IN RESPECT OF BANKS AND BROKERS**.

CLAUSE 72

Income Tax: Amendment to section 24O

Subclause (a): The proposed amendment deletes the definition of "instrument".

Subclause (b), (c) and (d): the proposed amendment substitutes the references to “instrument” to “debt”

CLAUSE 73

Income Tax: Amendment to section 25BA

See notes on **TAX REGIME FOR COLLECTIVE INVESTMENT SCHEMES IN NON-PROPERTY INVESTMENTS**.

CLAUSE 74

Income Tax: Amendment to section 25BB

With a number of property entities seeking listed REIT status upon implementation of the REIT regime, a number of technical issues have been identified. This review will result in the following technical corrections:

- “Associated Property Company” definition is deleted and all references to ‘associated Property Company” is deleted from this section.
- “Controlled Property Company: The term “property” is being dropped from the definition as misleading. The definition itself does not require a property element.
- Declared definition: This definition is now dropped as superfluous.
- A definition of “Property Company” has been inserted.
- Property linked unit definition: The term “property” is being dropped from the definition as misleading. The definition itself does not require a property element. The definition has been moved to section 1.
- Qualifying distribution definition: it has been redrafted to clarify the meaning. The proviso has been amended to exclude section 9D(2) income from gross income.
- Rental income definition: a dividend from a REIT or controlled company will only be taken into account if the company is a REIT or controlled company when it made the distribution. A dividend or foreign dividend from a property company has also been inserted in the definition. Since interest on a linked unit is deemed to be a dividend under section 6(b), it will be included.
- Deduction for qualifying distributions: Three changes are made for determining the deductibility of distributions. Firstly, issues relating to timing are clarified with the definition applying if the company is a REIT or a controlled company on the last day of the year of assessment in which the distribution is made. Secondly, the timing for determining the amount of the qualifying distribution is clarified. This determination is now based on the distribution amount taken into account with reference to the financial results of the company as reflected in the financial statements prepared for that year of assessment. For instance, if a distribution is actually paid in 2016 but is taken into account for financial reporting purposes in

2015, the qualifying distribution is based on rental income for 2015, not 2016. Thirdly, with regard to the limitation on the amount that can be deducted, an assessed loss can now be taken into account when determining the amount of the deduction.

- Amounts received or accrued from a financial instrument (i.e. Income or profits from disposal)are ordinary revenue.. The technical corrections clarify two timing issues. Firstly, the rule applies to any amount received or accrued by a company that is a REIT or a controlled company at the end of that year. Secondly, the exception only applies to the disposal of an interest in a REIT, a controlled company or a property company if that company is a REIT, a controlled company or a property company at the time of the disposal. These amounts will then be of a capital nature.

- No depreciation allowance in respect of immovable property: The technical correction makes it clear that a company that is a REIT or a controlled company at the last day of the year of assessment may not claim any depreciation allowances in respect of immovable property held by it.

- Capital gains tax exemption: The technical correction now allows a capital gain exemption for a company that is a REIT or controlled company at the last day the company’s year of assessment in respect of the disposal of (a) immovable property or (b) a share or a linked unit in a company that is a REIT when the interest was disposed of, or (c) a share or a linked unit in a company that is a property company when the interest was disposed of.

- Payment derived from link units as dividends: Interest in respect of the debenture portion of a linked unit is deemed to be a dividend if the linked unit is in an entity that is a REIT or a controlled company. The technical correction clarifies that the entity making the payment must be a REIT or a controlled company at the time that the interest payment is received by or accrue to the holder of the linked unit before subsection (6) will apply. An amount of interest in respect of a linked unit received by or accrued a REIT or controlled company from a property company must be deemed to be a dividend if the recipient of the interest is a REIT or controlled company at the time of the receipt or accrual.

- Cessation of REIT or controlled company status: No rules currently exist describing how the cessation of REIT status or controlled company status will impact the company. The proposed subsection (7) triggers a closure of the company’s year of assessment when it ceases to be either a REIT or a controlled company. From the day after cessation of its REIT/controlled company status, the company will be taxed under the normal tax regime.

- Subsection(8) will allow a REIT or controlled company to delink linked units, cancel the debenture and capitalise the issue price of the debenture to stated capital without negative tax implications for the holder of the debenture and the REIT or controlled company.

CLAUSE 75

Income Tax: Amendment to section 25D

See notes on **CURRENCY RULES FOR DOMESTIC TREASURY MANAGEMENT COMPANIES** and **EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

CLAUSE 76

Income Tax: Amendment to section 28

Subclause (a): This definition has been moved to section 1 of the Act.

Subclause (b): The definition of "short-term policy" is simplified by removing the reference to the nature of the issuer.

Subclause (c) – Subsection (2) of section 28:

- The wording is changed to clarify whether the short-term policy at issue is a policy issued by the short-term insurer or held by the short-term insurer.
- In addition, the current role of section 23(c) is misplaced. Section 23(c) normally prevents a deduction if that expenditure is to be recovered by insurance. This denial will not apply to expenses paid by a short-term insurer to satisfy insurance claims even if those expenses are covered by reinsurance.
- Lastly, the ordering for deductible expenditure has been changed to prevent overlaps (expenditures for the refund of premiums, expenditures to satisfy claims and other expenditures (such as commission fees)).

Subclause (d) – Subsections (3) and (5) of section 28: The wording connecting the reserve calculation to the short-term insurance act is more explicitly tied together. The key difference is the reduction for claims under policies of insurance (without regard to whether the reinsurance policy is approved or unapproved by the Financial Services Board).

CLAUSE 77

Income Tax: Amendment to section 29A

Subclause (a): This definition has been moved to section 1 of the Act.

Subclause (b): The proposed amendment deletes the references to subsections (11A), (11B) and (11C) as obsolete because these subsections have been deleted.

Subclause (c) and (e): The proposed amendments deletes the word "and" as superfluous.

Subclause (d): The proposed amendment is revising the numerator of the current formula by catering for the losses carried forward from the previous years of assessment and adding 33,3 percent portion of the unrealised gains by an individual policyholder fund or 66,6 percent portion of the unrealised gains by a company policyholder fund in the numerator.

Subclause (f): The proposed amendment is revising the denominator of the current formula to account for unrealised gains.

Subclause (g): Long-term insurers currently may not claim allowances (e.g. depreciation for buildings). This proposed amendment, permits allowances in respect of financial instruments (e.g. bad debt allowances).

Subclause (h): The proposed amendment deletes obsolete provisions.

CLAUSE 78

Income Tax: Amendment to section 29B

Subclause (a): The proposed amendment updates referencing.

Subclause (b): The proposed amendment clarifies the date in which the deemed disposal occurs.

Subclause (c): The proposed amendment clarifies the nature of the losses to be taken into account.

Subclause (d): If an insurer ceases to be engaged as an insurer (via liquidation, reorganisation of otherwise), the spreading of gains is accelerated to the date of cessation.

Subclause (e): The proposed amendment clarifies the nature of the linked policy exemption from mark-to-market taxation. The exemption applies solely to linked policies administered by a Category III provider.

Subclause (f): The amendment proposes to standardise references to the Long Term Insurance Act in the Income Tax Act.

CLAUSE 79

Income Tax: Amendment to section 30

The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

CLAUSE 80

Income Tax: Amendment to section 30A

The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

CLAUSE 81

Income Tax: Amendment to section 30B

Subclause (a): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (b): The proposed amendment changes the word person from the plural to the singular, consistent with overall drafting style.

CLAUSE 82

Income Tax: Amendment to section 31

Subclause (a): The proposed amendment contains more accurate and consistent wording.

Subclause (b): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (c): The proposed amendment includes a company that forms part of the same group of companies as a South African resident in the transfer pricing relief, to further widen the application of this section.

Subclause (d): The deletion of subparagraph (i) is as a result of the addition of the group requirement in the transfer pricing relief. As a result of this, subparagraph (i) was too narrow and has been deleted.

Subclause (e): See notes on **TRANSFER PRICING RELIEF FOR EQUITY LOANS**.

CLAUSE 83

Income Tax: Amendment to section 36

Subclause (a): The amendment updates a Ministerial title.

Subclauses (b) and (c): The amendment proposes to standardise references to the Mineral and Petroleum Resources Development Act in the Income Tax Act.

CLAUSE 84

Income Tax: Amendment to section 37A

Subclauses (a) and (b): The amendment proposes to standardise references to the Mineral and Petroleum Resources Development Act, the Collective Investment Schemes Control Act, the Long-term Insurance Act, and the Banks Act in the Income Tax Act.

Subclauses (c) – (e): The amendment updates a Ministerial title.

CLAUSE 85

Income Tax: Amendment to section 37B

The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

CLAUSE 86

Income Tax: Amendment to section 37C

See notes on **DEDUCTIBLE DONATIONS OF APPRECIATED IMMOVABLE PROPERTY**.

CLAUSE 87

Income Tax: Amendment to section 40C

The proposed amendment provides correct numbering.

CLAUSE 88

Income Tax: Insertion to section 40CA

Subclause (a): The proposed amendment provides correct numbering.

Subclause (b): The proposed amendment deletes a reference to an obsolete subsection. Also see notes on **CROSS-ISSUE OF SHARES**.

CLAUSE 89

Income Tax: Insertion to section 40CA

See notes on **CROSS-ISSUE OF SHARES**.

CLAUSE 90

Income Tax: Amendment to section 41

Subclause (a): The amendment proposes to standardise references to the Banks Act, the Security Services Act, the Long-term Insurance Act, the Short-term Insurance Act and the Collective Investment Schemes Control Act in the Income Tax Act.

Subclause (b): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclauses (c) and (d): The proposed amendment corrects a grammatical error.

Subclause (e): The proposed amendment adjusts the domestic "group of companies" definition of section 41 so as to exclude domestic incorporated companies with a foreign tax residence (by virtue of foreign effective management). The goal of this definition is to treat a tax group as such only if all member companies are mainly within the domestic tax net.

Subclause (f): The proposed amendment proposes to add a holder of a participatory interest in a portfolio of collective investment scheme to the definition of a "shareholder".

Subclause (g): The proposed amendment clarifies that the reorganization rules are subject to the value shifting provisions.

Subclause (h): The proposed amendment deletes a reference to an obsolete subsection.

Subclause (j): The proposed amendment makes provision for the winding-up of a portfolio of a collective investment scheme in property.

Subclauses (i) and (k): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (l): This provision has been deleted as obsolete.

CLAUSE 91

Income Tax: Amendment to section 42

The proposed amendment corrects an incorrect cross reference.

CLAUSE 92

Income Tax: Amendment to section 43

In 2012, a regime was introduced under section 43 to replace the capital gain rules applicable to share-for-share recapitalisations. Under this regime, rollover treatment will apply where a shareholder surrenders an equity share in the form of a linked unit in a company for an equity share other than a linked unit, in that same company. More specifically, where a linked unit (i.e. dual linked share-debenture) is exchanged for a share no capital gains consequences arise due to the roll-over treatment.

However, in the case of an exchange of equity shares by way of a subdivision or consolidation, the bundle of rights attached to such shares before and after the subdivision or consolidation remain the same. In essence, no disposal arises in such instances. Having regard to this consideration, the roll-over relief provided for under section 43 in respect of share exchanges by way of subdivision or consolidation is unnecessary and has therefore been deleted.

Furthermore, Section 43 currently does not recognise that pre-valuation date assets require special treatment. For example, the previously held shares is deemed to have been disposed of for proceeds equal to 'expenditure' incurred on their acquisition. However, a pre-valuation date share is comprised of a valuation date value plus any post-CGT expenditure. The expenditure on a pre-valuation date share cannot be equated with its base cost. The result is that this rule will trigger a capital gain or loss (proceeds equal to historical cost with base cost equal to valuation date value) which was clearly unintended. Furthermore, the new shares are deemed to be acquired on the latest of the dates of the old shares for the expenditure incurred on the old shares. This produces an extremely unfair result. The proposed amendment seeks to convert pre-valuation date shares to post-valuation date shares in order for the rules in section 43 to apply in the normal way.

CLAUSE 93

Income Tax: Amendment to section 44

A REIT, whether it is a company or a property unit trust, is a company. A participatory interest in a property unit trust will constitute an equity share in a company. Section 44 can therefore be used to "convert" a property unit trust to a company without negative tax implications.

Subclause (a): The words are deleted because the resultant company never holds shares in the amalgamated company as part of the transaction.

Subclause (b): The amendment remedies an incorrect cross-reference.

Subclause (c): the purpose of the proposed proviso is to create contributed tax capital in the case where the amalgamated company is a property unit trust.

Subclauses (d) and (e): The current rollover treatment for the resultant company shares acquired by the ultimate shareholder as a consequence of an amalgamation transaction is dependent on liquidation of the amalgamated company (section 44(6)). However, it was always intended that the base cost of the resultant company shares should be rolled over irrespective of the liquidation of the amalgamated company. Given the various administrative processes that often delay liquidation; the focus will shift from the liquidation of the amalgamated company to the acquisition of the resultant company shares by virtue of shareholding in the amalgamated company. As a consequential matter, the tax consequences of any receipt of an amount in addition to the shares in the resultant company by the ultimate shareholder is also provided for in section 44(6) (as opposed to subsections (7) and (10)).

Subclause (f): The deletion is to clarify that a shareholder that acquires an equity share in a resultant company is not receiving a dividend. See subsection 6(c).

Subclause (g): See note on subclause (d) and (e).

Subclause (h): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

CLAUSE 94

Income Tax: Amendment to section 45

Subclause (a): The definition is clarified to ensure that this form of section 45 is limited to domestic transferees. The cross-border rules relating to section 45 are covered under the "(b)" portion of the definition.

Subclauses (b) and (c): The word "company" has been added because section 45 transactions solely involve transferor and transferee companies.

Subclause (d): The proposed amendment is to clarify that the provision applies to both domestic and foreign reorganisations.

Subclause (e): The wording has been changed for readability.

CLAUSE 95

Income Tax: Amendment to section 46

Subclause (a) and (b): The "but only to the extent" language creates the impression that an unbundling may partially fall within and outside section 46. However, section 46 has always been an "all-or-nothing" provision and has been amended accordingly.

Subclause (c) and (d): The proposed amendments corrects a grammatical error.

Subclause (e): The amendment deletes a superfluous provision. The deleted provision required that an unbundling company must be a controlled foreign company in relation to a resident group company. Item (bb) of section 46(1)(b)(i) already requires that the unbundling company must be a CFC and a group company in relation to the shareholder.

Subclause (f): The amendment deletes a superfluous provision. The deleted provision provided that after the unbundling transaction, more than 50 percent of the unbundled company must be owned by a resident who is a member of the same group of companies. This more than 50 percent ownership requirement will be retained in the "before" test (see section 46(1)(b)(ii)(aa)) and note that distributes must be pro rata so there is no difference between before and after.

Subclause (g): One benefit of unbundling treatment is the removal of the Dividends Tax in respect of a distribution of subsidiary shares. The legislation clarifies that domestic and foreign returns of capital are also removed (because these are simply other forms of subsidiary share distributions).

Subclause (h): The proposed amendment contains more accurate and consistent wording.

Subclause (i): As a general rule, significant shareholdings (i.e. 20 percent or more) in an unbundled company cannot be received by non-residents. These rules prevent unbundling rollovers from being used as a means of indirect corporate migration.

Additional rules for disqualified persons were added to address offshore intra-group unbundling distributions to South African residents and controlled foreign companies. However, these rules are superfluous because intra-group offshore unbundling distributions are already limited to South African residents and controlled foreign companies within the unbundling definition. Hence, the 20 per cent limitation to prevent corporate migrations is only needed for listed unbundling and can be limited accordingly.

CLAUSE 96

Income Tax: Amendment to section 47

The amendment eliminates the section 47 exclusion in the case of liquidations outside the scope of the Income Tax Act. The exclusion was creating unintended anomalies in the case of offshore subsidiary liquidations.

CLAUSE 97

Income Tax: Amendment to section 49B

See notes on **UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION.**

CLAUSE 98

Income Tax Act: Insertion of Part IVB

See notes on **UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION**.

CLAUSE 99

Income Tax Act: Insertion of Part IVC

See notes on **UNIFORM CROSS-BORDER WITHHOLDING REGIME TO PREVENT BASE EROSION**.

CLAUSE 100

Income Tax: Amendment to section 64B

The amendment deletes an obsolete provision.

CLAUSE 101

Income Tax: Amendment to section 64C

The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

CLAUSE 102

Income Tax: Amendment to section 64D

Subclause (a): The amendment updates the wording to reflect a fairly recent definition.

Subclause (b): The amendment proposes to standardise references to the Securities Services Act in the Income Tax Act.

CLAUSE 103

Income Tax: Amendment to section 64EB

The proposed amendments clarify a number of technical anomalies associated with the anti-avoidance provision:

- The words beneficial owner are removed from the references to exempt persons because these persons will no longer deemed to be beneficial owners, making the language tautological.

- The relief from the anti-cession rule is clarified. The party acquiring the cession must hold all rights after the cession – all rights associated with that share need not be ceded as part of the transaction. For instance, if a shareholder already holds the corpus and acquires the dividend rights by way cession, the anti-avoidance rule does not apply.

- The language is clarified as to the deemed “dividend flows” and more closely links to the “beneficial owner” language wherever possible.

- The rules relating to “resale agreements” have been clarified. The anti-avoidance rule takes aim solely at scenarios where that acquiring shareholder takes possession on condition of resale of the same share or of comparable shares. In essence, the economic value associated with the underlying share in these circumstances is essentially never acquired (meaning that interim dividends are tantamount to cessions).

CLAUSE 104

Income Tax: Amendment to section 64F

Subclause (a): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (b): The proposed amendment contains more accurate and consistent wording.

CLAUSE 105

Income Tax: Amendment to section 64FA

The proposed amendments update an incorrect cross reference.

CLAUSE 106

Income Tax: Amendment to section 64G

The wording clarifies when withholding is or is not initially required.

CLAUSE 107

Income Tax: Amendment to section 64H

The wording clarifies when withholding is or is not initially required.

CLAUSE 108

Income Tax: Amendment to section 64J

Subclause (a): The words “to the extent that” in relation to a notification receipt are technically flawed.

Subclause (b): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 109

Income Tax: Amendment to paragraph 11 of First Schedule

The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 110

Income Tax: Amendment to paragraph 12 of the First Schedule

The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 111

Income Tax: Amendment to paragraph 2C of the Second Schedule

The amendment proposes to standardise references to the Pension Funds Act and the Long-term Insurance Act in the Income Tax Act.

CLAUSE 112

Income Tax: Amendment to paragraph 5 of the Second Schedule

The amendment is consequential to the changes effected to the deduction in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

CLAUSE 113

Income Tax: Amendment to paragraph 6 of the Second Schedule

Subclause (a): See notes on **PROVIDENT FUND POST-RETIREMENT ANNUITY ALIGNMENT.**

Subclause (b): The amendment is consequential to the changes effected to the deduction in respect of retirement fund contributions. See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

Subclause (c): The proposed amendment changes the word “taxpayer” to “person” as a matter of style consistency.

CLAUSE 114

Income Tax: Amendment to paragraph 3 of the Sixth Schedule

The proposed amendments change the word “shareholder” to “holder of shares in that micro business” as a matter of style consistency.

CLAUSE 115

Income Tax: Amendment to paragraph 7 of the Sixth Schedule

The amendment reflects recent changes to the Government grant rules.

CLAUSE 116

Income Tax: Amendment to paragraph 10 of the Sixth Schedule

The amendment deletes an obsolete cross-reference.

CLAUSE 117

Income Tax: Amendment to paragraph 1 of the Seventh Schedule

Subclause (a): See notes on **VALUATION OF FRINGE BENEFIT FOR DEFINED BENEFIT PURPOSES.**

Subclause (b): The proposed amendments change the word “shareholder” to “holder of shares” and “his” to “the employee’s” as a matter of style consistency.

Subclause (c): See notes on **VALUATION OF FRINGE BENEFIT FOR DEFINED BENEFIT PURPOSES.**

CLAUSE 118

Income Tax: Amendment to paragraph 2 of the Seventh Schedule

Subclause (a): The amendment proposes to standardise references to the Companies Act in the Income Tax Act.

Subclause (b): The proposed amendment contains more accurate and consistent wording.

Subclause (c): The proposed amendment corrects a grammatical error.

Subclause (d): See notes on **REVISED CONTRIBUTION INCENTIVES FOR RETIREMENT SAVINGS.**

CLAUSE 119

Income Tax: Amendment to paragraph 5 of the Seventh Schedule

See notes on **EMPLOYER PROVIDED ACCOMODATION - LOW-COST HOUSING.**

CLAUSE 120

Income Tax: Amendment to paragraph 7 of the Seventh Schedule

The amendment proposes to standardise references to the Value-Added Tax Act in the Income Tax Act.

CLAUSE 121

Income Tax: Amendment to paragraph 9 of the Seventh Schedule

Subclause (a): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (b): See notes on **BURSARIES OR SCHOLARSHIPS TO EMPLOYEE RELATIVES** and **EMPLOYER PROVIDED ACCOMODATION - LOW-COST HOUSING**.

Subclause (c): See notes on **BURSARIES OR SCHOLARSHIPS TO EMPLOYEE RELATIVES** and **EMPLOYER PROVIDED ACCOMODATION - LOW-COST HOUSING.**

CLAUSE 122

Income Tax: Amendment to paragraph 12A of the Seventh Schedule

The amendment proposes to standardise references to the Medical Schemes Act in the Income Tax Act.

CLAUSE 123

Income Tax: Amendment to paragraph 12B of the Seventh Schedule

The amendment proposes to standardise references to the Medical Schemes Act in the Income Tax Act.

CLAUSE 124

Income Tax: Amendment to paragraph 12C of the Seventh Schedule

See notes on **ALIGNMENT OF THE TAX TREATMENT OF INDIVIDUAL – BASED INSURANCE POLICIES.**

CLAUSE 125

Income Tax: Amendment to paragraph 12D of the Seventh Schedule

See notes on **VALUATION OF FRINGE BENEFIT FOR DEFINED BENEFIT PURPOSES.**

CLAUSE 126

Income Tax: Amendment to paragraph 11 of the Eighth Schedule

Subclause (a): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (b): The phrase “member’s interest in” is unnecessary because the new definition of “share” encompasses these interests.

Subclause (c): See notes on **SHARE ISSUES IN EXCHANGE FOR FOREIGN SHARES AS A MEANS OF CORPORATE MIGRATION.**

Subclause (d): The proposed amendment corrects a grammatical error.

Subclause (e): This proposal in a consequential amendment to the proposed amendment to section 43. It seeks to clarify that an exchange of shares by way of a subdivision or consolidation does not constitute a disposal to the extent that the bundle of rights attached to the shares held before and after the subdivision or consolidation remain the same.

CLAUSE 127

Income Tax: Amendment to paragraph 12A of the Eighth Schedule

The nexus between the expenditure and capital assets have been expanded to cover the reduction of debt to fund any expenditure “in respect of” that asset, not just amounts incurred in the acquisition, creation or improvement of that asset.

CLAUSE 128

Income Tax: Amendment to paragraph 13 of the Eighth Schedule

The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 129

Income Tax: Amendment to paragraph 16 of the Eighth Schedule

The amendment proposes to standardise references to the Patents Act, Designs Act, Trade Marks Act and the Copyright Act in the Income Tax Act.

CLAUSE 130

Income Tax: Amendment to paragraph 20 of the Eighth Schedule

Subclause (a): The proposed amendment simplifies rules associated with the addition to base cost for interest incurred in respect of debt-funded shares.

Subclause (b): The amendment deletes an obsolete provision following the deletion of section 24I(11A).

CLAUSE 131

Income Tax: Amendment to paragraph 31 of the Eighth Schedule

Subclause (a): The amendment proposes to standardise references to the Long-term Insurance Act in the Income Tax Act.

Subclause (b): The proposed amendment contains more accurate and consistent wording. In addition, the proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 132

Income Tax: Amendment to paragraph 32 of the Eighth Schedule

The amendment proposes to standardise references to the Collective Investment Schemes Control Act in the Income Tax Act.

CLAUSE 133

Income Tax: Amendment to paragraph 35 of the Eighth Schedule

See notes on **EXIT CHARGE ON INTERESTS IN IMMOVABLE PROPERTY.**

CLAUSE 134

Income Tax: Amendment to paragraph 38 of the Eighth Schedule

Subclause (a) - (c): The proposed amendment corrects a grammatical error.

Subclause (d): The proposed amendment is a consequential amendment based on the deletion of section 24B.

CLAUSE 135

Income Tax: Repeal of paragraph 42A of the Eighth Schedule

The proposed amendment deletes a rollover regime based on company law provisions that no longer exist.

CLAUSE 136

Income Tax: Amendment to paragraph 43 of the Eighth Schedule

Subclause (a): The references to currency are more closely tied to the definitions within the paragraph.

Subclauses (b) and (c): The proposed change clarifies that only two sets of capital gain currency rules are available when disposing of assets. The current simplified method for calculating capital gains and losses for natural persons and non-trading trusts that sell an asset using foreign currency after having acquired that asset in the same currency will be retained (subject to minor alignment in subclause (a)). That is, natural persons and non-trading trust will simply determine the capital gain or loss in the relevant foreign currency followed by a conversion to Rand).

In all other instances, the translation rules use the local currency as the starting point for translating both proceeds and/or the base cost. This translation rule will cover all variations, i.e. where the base cost, proceeds or both are denominated in foreign currency, deemed proceeds or base cost for purposes of paragraph 12 (ceasing to be a resident; non-trading stock that becomes trading stock and assets ceasing to be personal use asset), paragraph 38 (donations, consideration not measurable in money and connected persons non-arms-length price) and paragraph 40 (death), and debt forgiveness for purposes of paragraph 12A. In the main, the currency gain or loss will be determined in local currency and each of the base cost and/or proceeds will be translated to local currency using spot rates.

Subclause (d): This subparagraph is deleted because the debt relief rules have been changed with the cross-references now being obsolete.

Subclause (e): The amendment amends the provision in view of the above deletion of subsection (2), and deletes a cross reference to an obsolete provision.

Subclause (f): The proposed amendment corrects an incorrect cross-reference.

Subclause (g): The currency rules dealing with currency units are deleted as irrelevant because taxation of currency is solely addressed in the mark-to-market rules of section 24I.

Subclause (h): The words are improved for ease of reading.

Subclause (i): The amendment corrects a superfluous cross reference.

Subclause (j): The proposed amendment excludes a permanent establishment outside the Republic as currency for a permanent establishment has been covered in another provision.

Subclause (k): The proposed amendment corrects a grammatical error.

Subclause (l): See notes on **CURRENCY RULES FOR DOMESTIC TREASURY MANAGEMENT COMPANIES and EXEMPTION FOR INTERNATIONAL SHIPPING TRANSPORT ENTITIES.**

CLAUSE 137

Income Tax: Amendment to paragraph 53 of the Eighth Schedule

The amendment proposes to standardise references to the Short-term Insurance Act in the Income Tax Act.

CLAUSE 138

Income Tax: Amendment to paragraph 56 of the Eighth Schedule

Subclause (a): The concepts of the debt relief rules are being changed to co-ordinate with the newly revised basic debt cancellation rules.

Subclause (b): The proposed amendment corrects an incorrect cross-reference.

CLAUSE 139

Income Tax: Amendment to paragraph 57 of the Eighth Schedule

The R5 million asset limit is increased to R10 million in line with other changes relating to the relief for the disposal of small businesses enacted in 2012.

CLAUSE 140

Income Tax: Amendment to paragraph 57A of the Eighth Schedule

The business purpose requirement for the disposal of immovable assets by a micro business will be made consistent with the disposal of other assets.

CLAUSE 141

Income Tax: Amendment to paragraph 61 of the Eighth Schedule

See notes on **TAX REGIME FOR COLLECTIVE INVESTMENT SCHEMES IN NON-PROPERTY INVESTMENTS.**

CLAUSE 142

Income Tax: Amendment to paragraph 62 of the Eighth Schedule

The capital gains exemption for charitable-type donations and bequests to section 10(1)(d) entities is too broad. The entities listed should be limited to non-profit associations and similar entities (section 10(1)(d)(iv)). The relief should not include entities such as pensions.

CLAUSE 143

Income Tax: Amendment to paragraph 64 of the Eighth Schedule

The amendments delete an obsolete cross-reference.

CLAUSE 144

Income Tax: Amendment to paragraph 64B of the Eighth Schedule

The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 145

Income Tax: Amendment to paragraph 67C of the Eighth Schedule

The amendment proposes to standardise references to the Mineral and Petroleum Resources Development Act in the Income Tax Act.

CLAUSE 146

Income Tax: Amendment to paragraph 68 of the Eighth Schedule

The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 147

Income Tax: Amendment to paragraph 75 of the Eighth Schedule

The proposed amendments change the word “shareholder” to “person” as a matter of style consistency.

CLAUSE 148

Income Tax: Amendment to paragraph 76 of the Eighth Schedule

The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

CLAUSE 149

Income Tax: Amendment to paragraph 77 of the Eighth Schedule

Subclause (a) and (c): The proposed amendments change the word “shareholder” to “holder of shares” as a matter of style consistency.

Subclause (b): The return of capital rules associated with liquidations will be extended to include foreign return of capital (return of capital involving the liquidation of a foreign company).

CLAUSE 150

Income Tax: Amendment to paragraph 80 of the Eighth Schedule

Subclause (a) and (b): The exception in subparagraphs (1) and (2) is more directly tied to the donation and bequest relief of paragraph 62.

CLAUSE 151

Income Tax: Amendment to paragraph 4 of Part I of the Ninth Schedule

The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

CLAUSE 152

Income Tax: Amendment to paragraph 10 of Part I of the Ninth Schedule

The amendment deletes an obsolete cross-reference.

CLAUSE 153

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

The amendment proposes to standardise references to the Public Finance Management Act in the Income Tax Act.

CLAUSE 154

Income Tax: Amendment to paragraph 1 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 155

Income Tax: Amendment to paragraph 2 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 156

Income Tax: Amendment to paragraph 3 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 157

Income Tax: Amendment to paragraph 5 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 158

Income Tax: Amendment to paragraph 6 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 159

Income Tax: Amendment to paragraph 7 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 160

Income Tax: Amendment to paragraph 8 of the Tenth Schedule

See notes on **OIL AND GAS INCENTIVE.**

CLAUSE 161

Income Tax: Amendment of the Eleventh Schedule

The amendment changes the title to a grant as a matter of accuracy.

CLAUSE 162

Customs and Excise: Amendment of section 72

Section 72 provides for the value of goods exported, but does not state how that value is to be converted if in a foreign currency. The proposed amendment provides that if the value is expressed in a foreign currency it must be converted into South African Rand in accordance with section 73.

CLAUSE 163

Customs and Excise: Amendment of section 73

Currently, section 73 regulates currency conversion for imported goods. The proposed amendment extends currency conversion to the value of goods exported if that value is expressed in a foreign currency. Because an entry can be prepared and submitted prior to the date the applicable conversion rates are published, it is proposed that conversion rates published by the Commissioner for each Wednesday be applicable from the following Wednesday for an entire week. The Commissioner must publish on the SARS website, in respect of each Wednesday, the selling rates to be used for conversion of the foreign currency of imported goof and buying rates to be used for conversion of the foreign currency of exported goods of each of the major currencies for conversion into Rand, as provided to the Commissioner by the South African Reserve Bank for that Wednesday. This rate will be applicable for the week commencing the following Wednesday. In effect the rates are available a week in advance and fixed for that period. The applicable date for a currency conversion in respect of goods imported (which is currently the date of shipment of the goods) into or exported from the Republic is the date of entry of the goods for any purpose in terms of the Act.

The proposed amendment of the section also includes provisions regarding the rate to be used for a foreign currency not published (subclause (7)) and the circumstances in which a fixed conversion rate may be applied (subclause (8)). Subclause (9) provides that a fixed exchange rate negotiated between buyers and sellers related within the meaning of section 66(2) may not be accepted unless it is proved that the relationship did not affect the rate. Subclause (10) contains transitional provisions.

CLAUSE 164

Customs and Excise: Amendment of Schedules

This clause provides for the continuation, withdrawal or insertion of amendments in the schedules to the Customs and Excise Act made during the period from 1 August 2012 to 31 August 2013.

CLAUSE 165

Value Added Tax: Amendment to section 1

Subclause (a): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

Subclause (b): The definition is revised in line with the definitional changes to section 1 of the Income Tax Act.

Subclause (c): See notes on **TAX INCENTIVES FOR SPECIAL ECONOMIC ZONES.**

Subclauses (d) and (e): See notes on **REGISTRATION OF E-COMMERCE SUPPLIERS.**

Subclause (f): The proposed amendment updates the cross-reference.

Subclause (g): See notes on **TAX INCENTIVES FOR SPECIAL ECONOMIC ZONES.**

Subclause (h): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

Subclause (i): This amendment takes into account changes in the Customs and Excise Act.

Subclause (j): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

CLAUSE 166

Value Added Tax: Amendment to section 8

Subclause (a): See notes on **THE SUPPLY OF SERVICES BY A HOME OWNERS ASSOCIATION.**

Subclause (b): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**
Subclause (c): See notes on CONVERSION OF A SHARE BLOCK SCHEME TO SECTIONAL TITLE

CLAUSE 167

Value Added Tax: Amendment to section 9

Subclause (a): See notes on **SUPPLY OF SERVICES FOR CONTINGENT CONSIDERATION.**

Subclause (b): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

CLAUSE 168

Value Added Tax: Amendment to section 10

Subclause (a): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**
Subclause (b): See notes on CONVERSION OF A SHARE BLOCK SCHEME TO SECTIONAL TITLE

CLAUSE 169

Value Added Tax: Amendment to section 11

The amendment updates a Ministerial title.

CLAUSE 170

Value Added Tax: Amendment to section 12

Subclauses (a- d) See notes on **THE SUPPLY OF SERVICES BY A HOME OWNERS ASSOCIATION.**

CLAUSE 171

Value Added Tax: Amendment to section 13

See note on **IMPORTED GOODS ABANDONED, DESTROYED OR DAMAGED.**

CLAUSE 172

Value Added Tax: Amendment to section 15

See notes on **REGISTRATION OF E-COMMERCE SUPPLIERS.**

CLAUSE 173

Value Added Tax: Amendment to section 16

Subclause (a): The proposed amendment clarifies when VAT input can be claimed in special circumstances.

Subclause (b): The claiming of input VAT on input tax should be linked solely to payments made and not to invoices.

Subclause (c): The amendment updates a Ministerial title.

Subclause (d): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

CLAUSE 174

Value Added Tax: Amendment to section 17

See notes on **ENTERTAINMENT SUPPLIED ON BOARD A FLIGHT OR SHIP.**

CLAUSE 175

Value Added Tax: Amendment to section 18B

With the advent of the Tax Administration Act, this requirement is no longer necessary as SARS already possess the power to request certain information from a vendor.

CLAUSE 176

Value Added Tax: Amendment to section 20

Subclause (a) See notes on **REGISTRATION OF E-COMMERCE SUPPLIERS.**

Subclause (b) See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

CLAUSE 177

Value Added Tax: Amendment to section 22

Subclause (a): See notes on **SURRENDERING GOODS IN TERMS OF A CREDIT AGREEMENT.**

Subclause (b): The proposed amendment corrects a cross reference to the Companies Act.

CLAUSE 178

Value Added Tax: Amendment to section 23

Subclause (a): See notes on **STREAMLINING OF VAT REGISTRATION.**

Subclause (b): See notes on **REGISTRATION OF E-COMMERCE SUPPLIERS.**

Subclause (c) – (d): See notes on **STREAMLINING OF VAT REGISTRATION.**

CLAUSE 179

Value Added Tax: Amendment to section 24

See notes on **STREAMLINING OF VAT REGISTRATION.**

CLAUSE 180

Value Added Tax: Amendment to section 44

Subclause (a-b): The proposed amendments update references to the Companies Act.

Subclause (c-d): See notes on **STREAMLINING OF VAT REGISTRATION.**

CLAUSE 181

Value Added Tax: Amendment to Schedule 1

Subclause (a-b): See notes on **IMPORTED GOODS ABANDONED, DESTROYED OR DAMAGED.**

Subclause (c): See notes on **IMPORTED GOODS ABANDONED, DESTROYED OR DAMAGED.**

CLAUSE 182

The Demutualisation Levy Act: Repeal of Act

The South African Revenue Services are no longer collecting any levies in respect of this Act and there is no further need to administer this Act.

CLAUSE 183

Securities Transfer Act: Amendment of section 8

The reorganisation relief from the Securities Transfer Tax was extended to include the newly added rollover rules of share-for-share substitutive transactions.

CLAUSE 184

Mineral and Petroleum Resources Royalty Act: Amendment to section 5

See notes on **ALIGNING INCOME TAX AND ROYALTY EARNINGS IN THE CASE OF OIL AND GAS COMPANY CAPITAL ALLOWANCES.**

CLAUSE 185

Mineral and Petroleum Resources Royalty Act: Amendment to section 6A

See notes on **CLARIFICATION OF MINIMUM SPECIFIED CONDITIONS FOR MINERAL RESOURCES.**

CLAUSE 186

Mineral and Petroleum Resources Royalty Act: Amendment to section 7

See notes on **SMALL BUSINESS EXEMPTION ELIGIBILITY.**

CLAUSE 187

Mineral and Petroleum Resources Royalty Act: Amendment of Schedule 1

See notes on **CLARIFICATION OF MINIMUM SPECIFIED CONDITIONS FOR MINERAL RESOURCES.**

CLAUSE 188

Mineral and Petroleum Resources Royalty Act: Amendment of Schedule 2

See notes on **CLARIFICATION OF MINIMUM SPECIFIED CONDITIONS FOR MINERAL RESOURCES.**

CLAUSE 189

Taxation Laws Amendment Act, 2011: Amendment to section 13

The proposed amendment clarifies the effective date of section 6quin(3A).

CLAUSE 190

Taxation Laws Amendment Act, 2011: Amendment to section 70

The proposed amendment clarifies the effective date for the zero tax cost rules of intra-group notes.

CLAUSE 191

Taxation Laws Amendment Act, 2012: Amendment to section 2

The proposed amendment deletes obsolete provisions.

CLAUSE 192

Taxation Laws Amendment Act, 2012: Amendment to section 9

This form of recoupment of exempt grants is unnecessary given the tax cost reduction (and other anti-double benefit) rules associated with grants under section 12P.

CLAUSE 193

Taxation Laws Amendment Act, 2012: Amendment of section 17

The use of the phase “in relation to a resident” for a controlled foreign company could be construed as unnecessarily limiting because all controlled foreign companies are in relation to one or more residents.

CLAUSE 194

Taxation Laws Amendment Act, 2012: Amendment of section 19

The proposed amendment deletes obsolete provisions.

CLAUSE 195

Taxation Laws Amendment Act, 2012: Amendment of section 22

The proposed amendment corrects the effective date of the provision.

CLAUSE 196

Taxation Laws Amendment Act, 2012: Amendment of section 50

The proposed amendment corrects the effective date of the provision.

CLAUSE 197

Taxation Laws Amendment Act, 2012: Amendment of section 53

The proposed amendment deletes an obsolete provision.

CLAUSE 198

Taxation Laws Amendment Act, 2012: Amendment of section 54

The proposed amendment deletes obsolete provisions.

CLAUSE 199

Taxation Laws Amendment Act, 2012: Repeal of section 69

The proposed amendment deletes an obsolete version of the withholding tax on interest provisions. This has been replaced with Part IVB of The Taxation Laws Amendment Act, 2013.

CLAUSE 200

Taxation Laws Amendment Act, 2012: Amendment of section 83

The proposed amendment remedies incorrect cross-references and uses the more updated term of “debt” versus a “loan or advance”.

CLAUSE 201

Taxation Laws Amendment Act, 2012: Amendment of section 89

The amendment adjusts the required treaty beneficial relief certificate relief mechanisms in line with other Dividends Tax withholding relief mechanisms.

CLAUSE 202

Taxation Laws Amendment Act, 2012: Amendment of section 98

Subclause (a): The amendment provides a more accurate opening for introducing an amendment.

Subclause (b): The second schedule lump sum rules are adjusted to account for recent exemptions associated with non-deductible contributions made to compulsory annuities.

CLAUSE 203

Taxation Laws Amendment Act, 2012: Amendment of section 99

The second schedule lump sum rules are adjusted to account for recent exemptions associated with non-deductible contributions made to compulsory annuities.

CLAUSE 204

Taxation Laws Amendment Act, 2012: Repeal of section 102

The proposed amendment is to reverse the deletion of the capital gains tax value shifting rules. As a consequence of the repeal of section 24B, these rules are necessary to counter transactions that shift value by the issue of share between connected persons.

CLAUSE 205

Taxation Laws Amendment Act, 2012: Amendment to section 106

The proposed amendment is to reverse the deletion of the capital gains tax value shifting rules. As a consequence of the repeal of section 24B, these rules are necessary to counter transactions that shift value by the issue of share between connected persons.

CLAUSE 206

Taxation Laws Amendment Act, 2012: Amendment to section 109

The proposed amendment is to reverse the deletion of the capital gains tax value shifting rules. As a consequence of the repeal of section 24B, these rules are necessary to counter transactions that shift value by the issue of share between connected persons.

CLAUSE 207

Taxation Laws Amendment Act, 2012: Repeal of section 112

The proposed amendment is to reverse the deletion of the capital gains tax value shifting rules. As a consequence of the repeal of section 24B, these rules are necessary to counter transactions that shift value by the issue of share between connected persons.

CLAUSE 208

Taxation Laws Amendment Act, 2012: Amendment to section 117

The proposed amendment amends the effective date of the provision to January 2013.

CLAUSE 209

Taxation Laws Amendment Act, 2012: Repeal of section 139

See notes on **OIL AND GAS INCENTIVE**.

CLAUSE 210

Taxation Laws Amendment Act, 2012: Amendment to section 170

The proposed amendment amends the effective date of the provision to March 2014

CLAUSE 211

Taxation Laws Amendment Act, 2012: Amendment to section 171

The proposed amendment amends the effective date of the provision to March 2014.

CLAUSE 212

A special zero-rating for the Value-added Tax is added in respect of goods and services supplied by Cricket South Africa for the hosting of the Champions League Twenty20 (2012) event during October 2012.

CLAUSE 213

Short title and commencement.