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THE CHAIRPERSONS OF THE PORTFOLIO COMMITTEE ON FINANCE (PCOF) AND THE SELECT COMMITTEE ON FINANCE (SCOF)

RESPONSES TO WRITTEN REPRESENTATIONS BY ORGANISATIONS TO THE PORTFOLIO COMMITTEE ON FINANCE AND SELECT COMMITTEE ON FINANCE ON THE REVENUE LAWS AMENDMENT BILL NO. 22 OF 2004 (the Bill)

1 Introduction

As indicated to you during the hearings on the above-mentioned Bill on 19 October 2004, National Treasury and SARS wish to respond as follows to the various points raised by commentators in their submissions on the Bill.

Abbreviations used in this document:

BCSA	Banking Council of South Africa
BUSA	Business Unity South Africa
JSE	JSE Securities Exchange South Africa
PWC	PricewaterhouseCoopers
SAICA	The South African Institute of Chartered Accountants

2 Consultation

SARS and the National Treasury placed 15 batches of draft legislation as well as draft explanatory memoranda, dealing with the main categories of amendments, on their websites on 30 September 2004, ten working days before the informal briefing on the draft Bill. An additional batch, dealing with CGT withholding: Non-resident sellers, was released on 8 October 2004.

3 Responses to specific issues raised in representations by commentators to the Parliamentary Finance Committees

Annexure 1: Broad-Based Employee Share Initiative

Section 8B

The definition of 'broad based employee share plan' is limited to plans that grant free shares to employees. This is too restrictive and the legislation should also provide the same benefits to plans that grant shares to employees for a consideration less than market value.
(SAICA)

This comment is partially accepted. Employee share plans providing for consideration of not more than the minimum required in terms of the Companies Act, 1973, will be allowed.

Linked in with the above is the need to exempt the extending of interest-free loans from the employer to its employees to meet their funding contribution required in terms of the Companies Act for the acquisition of the shares.
(SAICA)

This comment is accepted. The main objective of the proposal is to empower rank-and-file employees. Since these employees are unlikely to have cash at their disposal to purchase shares, any fringe benefit in respect of an interest free loan used to finance the minimum amount required in terms of the Companies Act, 1973, will be exempted.

Broad-based participation reduces the generally accepted benefit of acting as a reward as it is nothing less than a general salary restructure. Therefore, there will be little opportunity of rewarding high performers on differential performance.
(BCSA)

The reason for introducing the initiative is to encourage broad-based share ownership and it is not a substitute for an employer's normal employment reward system.

Section 9B currently allows a taxpayer to elect the proceeds on disposal of a listed share held for 5 years or more to be treated as a capital receipt and hence subject to CGT as opposed to income tax. This election is not available to taxpayers who dispose of unlisted shares. We strongly urge you to amend the provisions of section 9B to include a qualifying equity share held for a minimum period of 5 years.
(SAICA)

This comment is not accepted. Section 9B only applies to shares held as trading stock and it is unlikely that broad-based employee share initiative shares will be held as trading stock.

It is recommend that the value of the shares calculated at date of grant be taxed as income as opposed to date of disposal in the event that the shares are disposed of within a 5 year period. This will bring the broad-based employee share initiative in line with that of the executive equity scheme in respect of the taxation treatment of the full gain.
(SAICA)

This comment is not accepted. The sale of the shares within the 5-year period effectively amounts to salary-substitution for tax purposes. The taxation of shares on disposal encourages long-term ownership.

It is not the intention to fully align the broad-based employee share initiative proposals with the executive equity scheme since they have different guiding principles.

As an alternative, the basic exclusion of the first R10 000 of net capital gains derived in any tax year by a natural person should be increased to say R15 000 or R20 000.
(SAICA)

This comment does not relate to any part of the Bill under consideration.

Clarity is required that an exemption under the provisions of section 8B will not be negated by the provisions of section 8C.
(BUSA)

This comment is accepted. A provision will be added to ensure that section 8C does not apply to shares to which section 8B applies.

The limit of R3 000 placed on the value of shares acquired during any 12 month period is too low, especially having regard to the fact that a minimum of 100 shares should be held to avoid the "odd-lot" problems experienced by companies listed on the JSE Securities Exchange. It is strongly recommended that the R3 000 limit be increased to R8 000 or higher. Further, if the above limit is exceeded, only the excess should fall outside these provisions.
(SAICA)
The limitation of R3 000 creates administrative hardship.
(BCSA)

These comments are partially accepted.

The proposal is intended to be of greatest assistance to rank-and-file employees who earn an average of R50 000 to R70 000 per annum and was eventually pitched at 5 per cent of the SITE amount limitation.

Reasons for the low amount include:

- It will limit abuse in the form of deferred compensation arrangements;
- It will limit the temptation to "cash-out" by resigning or entering into further schemes like the disposal of dividend rights;
- A deduction will be allowed to the employer hence the need to limit revenue exposure for the fiscus.

The proposal has been amended to allow for a cumulative share issue of R9 000 over a three year period. This effectively means that an employer can issue shares to an employee to the value of R9 000 during a tax year, followed by two years of no share issuance to the employee. The employer will only be able to claim a deduction of R3 000 per annum over a three year period.

The requirement that 90% of all employees be entitled to participate is onerous and potentially forces employers to go wider than just those that were previously disadvantaged – which is where we assumed this is primarily directed.
(SAICA)
A possible provision should be that the scheme would qualify for favourable treatment if it includes at least 90% of permanent employees with 12 months of service who do not already participate in any other employee share participation scheme.
(SAICA)

These comments are partially accepted.

Since the proposal is aimed at the rank-and-file employees, it will be compromised if employees who participate in executive share schemes are also allowed to be part of the broad based employee share initiative scheme. The 90 per cent rule will, therefore, apply to all employees other than those who participate in any other share schemes of the employer.

Concern exists that the 90% test may prevent relief in situations where one employment company exists within a group of companies. The 90% test would be applying to the single employment company, even though that company will be servicing various companies within that group. In these situations, the 90% test should be divided based on the companies that are being serviced. For instance, if the employment company provides 100 employees to one group company and another 50 to another, the 90 per cent test should be applied separately for both different companies.
(PWC)

This comment is not accepted. The initiative is intended to be broad based and permitting exclusions on an *ad hoc* basis would undermine the intention.

The right of acquisition of empowerment shares at market value appears to be limited to those rights granted by the direct

employer. Other companies within the group should have similar rights to acquire empowerment shares.
(PWC)

This comment is accepted. The right of acquisition will not be restricted to specific employers.

The administration of the scheme would have to be under the control of the employer to enable the employer to meet its reporting requirements in terms of section 69(1)*(g)* of the Income Tax Act. It may therefore be that a trust would be used to administer the scheme. There are potential tax implications pertaining to the trust if the trust grants the shares to the employees for free in that the beneficiaries will be connected persons in relation to the trust, the provisions of paragraph 38 of the Eighth Schedule will deem the disposal to be at market value. This means that the capital gain deemed to have been made by the Trust will be taxable in the hands of the beneficiaries in terms of paragraph 80 of the Eighth Schedule. This negates the relief that these provisions seek to provide. Consideration should be given to either granting exemption from CGT for such capital gain or alternatively providing that the deeming provisions of paragraph 38 of the Eighth Schedule will not apply to a disposal of a qualifying equity share by a trust to its beneficiaries in these circumstances.
(SAICA)
Consideration should be given to circumstances under which the shares are issued to a trust for the benefit of employees. Qualifying conditions can be exactly the same as where shares are issued directly to individuals.
(BUSA)

These comments are not accepted. Shares will be owned directly by employees. The share trust only serves as administrator and does not acquire or dispose of shares.

In order for the share scheme to fall within the ambit of broad-based employee share schemes, the only allowable restriction in respect of the re-acquisition of the relevant shares by the company, is that such acquisition must be at fair market value. However, most schemes provide that, in the case of misconduct by an employee, the employer has a right to re-acquire the shares at cost. The draft legislation does not take this practicality into consideration.
(SAICA)

This comment is not accepted.

It is not the intention of the proposed legislation to replace other punitive measures that are available to an employer in such a situation e.g. labour law. The disposal for employees in this situation will therefore still be economically on par with that of other employees i.e. at market value.

As a consolation for the employer, other vehicles, like labour law and the service contract, may allow for the employer to recover stolen amounts from the proceeds that are due to the employee in respect of the shares.

No distinction is made between someone ceasing employment because of, for example, retirement in the normal course, disability or retrenchment and, on the other hand, for unacceptable reasons, e.g. being fired because of dishonesty. There is no reason why someone whose employment is terminated for anything other than the former reasons should be entitled to have the restriction lifted within five years.
(SAICA)

This comment is accepted. An employer may impose any requirement with regard to the ability of the employee to dispose of shares at market value in the period of 5 years, the nature of which is a matter for collective bargaining between employees and employers.

The scheme can become a deferred remuneration tool that will have the effect of reducing employees' take home pay. It also locks employees in to the current employer.
(BCSA)

This comment is not accepted. This concern was taken into account when setting the limits for the tax free transfer of shares and will also be a matter for negotiation between employees, trade unions and the employers. Should SARS note any trend towards deferred remuneration schemes the provisions will be revisited.

The terms "employee" and "employer" are not defined in either section 1 or section 8B, but is defined in the Fourth Schedule to the Income Tax Act. The definition of employee in the Fourth Schedule includes a labour broker, personal service company, etc. Is the intention to include these classes of persons as participants in the broad-based employee share initiative if they meet the other criteria?
(SAICA)

The intention is to exclude labour brokers, personal service companies and personal service trusts from the benefits of the broad-based employee share scheme. The meaning of "employee" and "employer" has not been defined and the common law meaning will apply. The Fourth Schedule definition is necessarily wide because it is directed at anti-avoidance whereas section 8B is an incentive provision.

The gain from the qualifying equity shares should not be taxable where the shares are disposed of within 5 years in exchange for another share in the employer or another group company. Such a provision is included in section 8C but not in section 8B.
(SAICA)

This comment is accepted. The legislation has been amended accordingly.

With effect from 1 January 2005 International Accounting Standards will require the cost of employee schemes to be reflected through the income statement of the employing company. The costs of those schemes will be borne and actually incurred by the employing company. This will have the effect that incentive schemes will be deductible under general deduction provisions of the Income Tax Act.
(BCSA)

The comment is not accepted. The new accounting standard will have no impact on the tax deductible status of the cost of employee share incentive schemes. According to case law these expenses are not company related, but result in the dilution of shareholder interests. For that reason a specific deduction has been provided for in the context of the broad-based employee share initiative.

If the intention is to encourage broad-based participation, this can be achieved by creating an allowance under section 8B as well as a deduction under section 11*(a).*
(BCSA)

This comment is not accepted. The combination of the tax preferred treatment for both the employer-company and the employee is sufficient to create an incentive for adoption of the initiative.

Certain employees may be unaware of their tax obligations on disposal. Instead of placing the onus on the employee to inform the company of disposal, an obligation should be placed on the employee to provide details to the company upon request by the company. The company will in any event learn of the disposal when its shareholder register requires updating. At that time, the company can then write to the employee, advising the employee of the obligation and request information.
(PWC)

The obligation to withhold Pay-As-You-Earn is on the employer in view of the fact that an employee may not be aware of his or her obligation.

Throughout the section, reference is made to “date of grant” as opposed to date of acquisition – this subsection should therefore also refer to “date of grant” for the purpose of consistency.
(SAICA)

This comment is accepted.

The definition of “date of grant” refers to the approval by the directors. It should be clarified whether this refers to the approval of the directors of the employer or the approval of the directors of the actual company issuing the shares.
(SAICA)

The reference is to the approval by the directors of the employer company.

Consideration should be given to including a definition of “market value” in section 8B.
(SAICA)

This comment is accepted.

Section 10

In section 10(1)*(n*C*)* the share itself is exempt but provision should be made for an exemption for the grant thereof.
(SAICA)

The view is held that the grant of a qualifying equity share would also be exempt according to the words: “any amount received by or accrued in the form of a qualifying equity share contemplated in section 8B”.

Section 11

The proposed section 11*(l*A*)* grants a deduction equal to the market value of the qualifying equity share granted to the employee of that person. It often happens that an employee acquires shares in a listed company whilst he or she is employed by a group company. Often, the listed company is not the operating company with the employees. Although it is not clear who gets the deduction, it would appear that the deduction is to be granted to the employer, notwithstanding that it may be that the employee has been granted shares in a group company. If this is the intention, we welcome this and suggest that the wording be clarified to give effect to this. If the deduction is granted to the company issuing the shares, the employer should be allowed to recompense the company issuing the shares so that the deduction falls in the correct company.
(SAICA)
Uncertainty exists as to which company obtains the deduction in a group situation. Is it the company issuing the shares or the company employing the person receiving the shares?
(PWC)

The employer gets the deduction in all cases.

Section 69

An onerous administrative burden is placed on the employer in that it is required to report on the amounts received by or accrued to employees and former employees from the disposal of qualifying equity shares. The requirement to report on employees is accepted, but it becomes extremely difficult and impractical to monitor the activities of former employees beyond the initial 5 year period, especially in the case of listed shares. The reason being that the transfer secretaries will not have details of the proceeds since this information on dematerialised shares is only available from the stock broker who facilitated the sale. We suggest that the employer merely be required to advise SARS of the date of disposal, number of shares disposed off, the employee's name and last known address in respect of former employees as this information may be available from the Share Transfer Secretaries.
(SAICA)

This comment is accepted. The reporting requirement for the employer will be limited to five years from the date of grant of the qualifying equity share.

Fourth Schedule

Previously, the employer was required to obtain a tax directive for the purposes of determining the tax to be withheld or deducted where the employer is unable to deduct or withhold the full amount of employees' tax during the year of assessment during which the gain arises. Clarity is required as to whether the balance of PAYE owing by the employee will be treated as an interest free loan (taxable fringe benefit) where such amount is deducted in instalments during a year of assessment.
(SAICA)

This will not give rise to a fringe benefit as there is no loan from the employer to the employee. The directive from SARS in effect gives rise to a loan from SARS to the employee.

The proposed amendment refers in paragraph 11A(1)*(b)* to the market value of any qualifying equity share as defined in section 8B. We assume that the intention is to include in the definition of remuneration the market value of shares granted to employees where they do not fall within the definition of qualifying equity share since a qualifying equity share is exempt in terms of section 10(1)*(n*C*)* of the Act and therefore cannot be regarded as remuneration.
(SAICA)

This comment is not correct. The amendment to the definition of "remuneration" includes the market value of a qualifying equity share on date of disposal where an amount must be included in the income of the employee in terms of section 8B. A share which is not a qualifying share for purposes of section 8B would be taxed in terms of section 8C and any gain would form part of remuneration for PAYE purposes.

Effective date

The effective date of the proposed section is not clear, and we suggest that it applies to any equity share granted or issued on or after date of promulgation.
(SAICA; PWC)

The provisions will come into operation on 26 October 2004 and apply to any equity instrument acquired in terms of a broad-based employee share plan approved on or after that date.

Stamp Duty and Uncertificated Securities Tax

In order to provide full tax relief for these broad based employee share plans, it will be necessary to provide relief from Stamp Duty or the Uncertified Securities Tax on both the issue of the shares in a broad-based employee share plan and on the transfer of those shares.
(PWC)

This comment is not accepted. It should be borne in mind that the income tax shield the employer obtains per employee is R900 (R3 000 X 30%), whereas the after-tax transaction cost per employee amounts to only R5.25 (R3 000 x 0.25% X 70%).

Annexure 2: Full Taxation of Executive Equity Schemes

Section 8C (Previously substitution of section 8A)

The accounting and taxation of structuring schemes as cost-to-company schemes will result in equitable tax treatment of receipts of these benefits and payments of these benefits. Benefits should be allowed as a deduction from taxable income in the hands of the employer.
(BCSA)
While the need for SARS to impose provisions of this nature is understood, this position has been predicated on an assumption that these schemes are a form of conventional remuneration that should be taxed. If this assumption is to prevail, then a corresponding deduction should be granted to the employer company. This is the approach adopted by the new accounting provisions that require share-based payments to be expensed from 2005.

We are of the view that this is one further aspect where the tax regime should be symmetrical.
(SAICA)

These comments are not accepted. No deduction is to be allowed as these expenses are not company related, but result in the dilution of shareholder interests for tax purposes.

Consideration should be given to allow a taxpayer to defer payment of the tax to the year in which he or she actually disposes of the shares. Alternatively, in order to provide for equity in the share scenario, the tax should be levied on the basis of "payment and delivery". The gain only materialises when delivery of the shares is taken. Before that any gain is of an unrealised theoretical nature. This is the case in most overseas jurisdictions, for example, United Kingdom, USA and Germany, where tax accrues on payment and delivery of the shares.
(SAICA)

These comments are not accepted. Once the restrictions have been lifted the employee has full control over the shares and it is appropriate to tax at that point in time. The employee can sell the shares in order to pay the tax. If any further deferral were to be allowed a deemed interest charge should be imposed.

The situation should be addressed where an employee resigns or is dismissed and in terms of the rules of a share incentive scheme is required to sell the shares back to the employer at cost price.
(BUSA)

This comment is accepted. The gain or loss is to be determined with reference to the amount for which the share is disposed of in situations where the shares are sold "at cost" to the employer, associated association or other person in terms of a restriction imposed on the employee.

We are concerned that the proposal will trigger possible double taxation if an option is viewed as distinct from the underlying share. An interpretation exists that both the grant of the option and the conversion to a share will each trigger taxation without offset.
(PWC)

This interpretation is not supported as section 8C(1)*(b)* specifically prevents the double taxation of options and the acquisition of another equity instrument.

Definition of “restricted equity instrument”

Paragraph (a) of the definition of ‘restricted equity instrument’ refers to “any restriction.” Should this restriction not be limited to only those restrictions that will prevent the taxpayer from freely disposing of the equity instrument at market value by virtue of their employment?
(PWC)
All shares in private companies would *ipso facto* be restricted because of the restrictions on the free transfer of shares.
(BUSA)

This comment is partially accepted and the definition of “restricted equity instrument” will be clarified by excluding restrictions imposed by legislation.

It is a requirement of the JSE Securities Exchange that executive directors obtain the approval of the Chairman or designated Officer before being allowed to dispose of their shares in the employer company or group company. It is not clear if this will also be construed as a restriction with the result that the vesting date will then not be the earlier date when the individual may be “entitled” to dispose of the shares save for such further JSE Securities Exchange restrictions.
(SAICA)
In terms of the JSE Securities Exchange, there are closed periods during which a company’s shares may not be disposed of. Will the vesting date, for purposes of section 8C, be the date immediately after the closed period, or will the so-called closed period be disregarded in determining the vesting date?
(SAICA)

These will be construed as restrictions in terms of the proposed amendment if they can be considered to be imposed otherwise than by way of legislation.

The definition is too broad and would include normal pre-emptive provisions in any shareholders’ agreement, or even in the company’s articles. One wants to avoid the debate of whether the shares were acquired *quo* shareholder or *quo* employee or director where the individual is both a shareholder and employee or director.
(SAICA)

There would always be a debate whether the shares were acquired in the capacity as shareholder or employee. It would be in the capacity of employee or director if the shares were acquired by virtue of employment or office of director.

Why should shares which are pledged to the employer or share trusts as security for a loan raised to acquire the shares be treated as restricted shares?
(BUSA)

Shares granted in these situations are almost always granted by virtue of employment or the holding of the office of director, as envisaged by the proposed amendment and would constitute restricted shares.

Section 10(1)(nE) exemption

The old section 8A will continue to apply in respect of all equity instruments granted prior to date of promulgation. The so called "old schemes" could still result in the equity instruments previously acquired by participants being re-acquired by the employer company or share trust at the original acquisition price which may be higher than the then market value. In order not to be retrospective it is recommend that the exemption provision be amended to state that it would only apply to equity instruments granted prior to date of promulgation of the current amending legislation.
(SAICA)

The exemption in section 10(1)*(n*E*)* will still apply to affected executive share schemes that are covered by section 8A.

Annexure 3: Hybrid Financial Instruments

There appears to be a general paranoia about debt which could be converted into equity which appears to be unfounded. Interest payable on debt will only qualify for deduction for income tax purposes if such interest satisfies the requirements of the Income Tax Act. However, interest received by or accrued to the recipient will be included in gross income and be subject to income tax. The end result is that there is generally symmetry in that the payer obtains a deduction, provided certain requirements for deduction are met, whilst the recipient is subject to income tax on the interest received or receivable.
(SAICA)

The reason for the significant avoidance of income tax is that capital is raised by a group of companies in terms of schemes whereby the interest and principal amount of the real loan are deducted for income tax purposes without an offsetting income inclusion for tax purposes. The remedy is to tax the groups of companies according to the economic substance of the financing arrangement and to, therefore, limit the deduction of interest to interest on the actual financing requirements of the borrowing company. The circular flow of funds that members of a group of companies are party to have been taken into account.

Members of the Banking Council would prefer the question of hybrids and derivatives to be dealt with comprehensively under a separate section.
(BCSA)

This comment is not accepted as the subject matter is complex and requires the commitment of substantial resources. This aspect will receive attention in the medium term.

The amendments to section 8E and the introduction of section 8F are designed to have the effect of re-categorising equity into debt or debt into equity so as to result in the tax treatment corresponding to the economic substance. If that is the case there is no reason to go only halfway. It is punitive to disallow the interest under section 8F *and* impose STC, but then tax the recipient of the interest in full. That recipient should be treated as receiving a dividend with an STC credit. Likewise, under section 8E, the issuer should be deemed to have paid interest as well. This is the way it is dealt with elsewhere, e.g. the United States of America. If the concern is that interest is being paid on what in essence is equity, then the payment and receipt should be treated as being of a similar nature.
(SAICA; PWC)
The three-year period would exclude transactions entered into for periods exceeding three years. This could be subject to manipulation to avoid falling into the ambit of the section.
(SAICA)
The 3 year cut-off also is of little relevance as most convertibles are for long-term capital formation. This will limit the effect of equitable tax treatment of hybrids. If scope is provided for empowerment transactions, this will also be used to structure commercial transactions.
(BCSA)
The mere result that the debt may convert to equity within the three year period for purposes of section 8F should not re-classify the interest to a dividend only for the payer but still be treated as interest for the recipient.
(SAICA)
We urge a reconsideration of section 8F or alternatively for the recipient not to be taxed on the receipt of the interest where such interest is deemed not to be deductible by the payer in terms of section and is subject to STC.
(SAICA)

It is accepted that it is easy to create financial instruments which will fall outside the scope of the provisions of sections 8E and 8F. The reason for introducing a fixed three year term is to create a clear no-go zone for convertible instruments where the substance of the instruments clearly deviates from their legal form.

The three year period has not been extended as more information will have to be gathered to evaluate the impact a possible extension of the

period will have on BEE transactions. The intention is to utilize the reportable arrangement regime to gather information in this regard. If the three year period for purposes of sections 8E and 8F were to be extended, consideration would be given to the introduction of a symmetrical treatment for the issuer and recipient.

Section 8E

It may happen that in the course of an ordinary commercial transaction a company which has, say, issued redeemable preference shares, assumes the obligation to redeem the shares as part of the restructuring of the company, e.g. prior to its sale. Thus the agreement might simply state that the issuer undertakes to redeem its redeemable preference shares, say, within seven days of the date of signature of the agreement. This means that the preference share is now deemed to have a date of issue on the date of signature, and because the redemption period is less than three years, it becomes an affected instrument.
(SAICA)
The section states that the dividend will be deemed to be interest in the recipient's hands in respect of any dividend declared on or after the effective date, and "effective date" is defined as 23 March 1989. This, taken literally, means that all dividends declared in prior years have suddenly been re-categorised as interest.
(SAICA)

These comments are accepted. The intention is not to apply the provisions of section 8E retroactively, but only from the date that an instrument becomes a hybrid equity instrument. The provisions have been changed to only apply from a prospective date.

Section 8F

Limiting the deductibility of expenses while taxing the gain in the hands of the holder seems inequitable.
(BCSA)

This comment is not accepted. The reason for taxing the holder of a hybrid debt instrument is to mirror the provisions of section 8E.

The "date of issue" includes the date on which the instrument becomes convertible. This makes no sense as no deduction will be allowed if the instrument is at the option of the issuer convertible within three years from the date on which it becomes convertible. The words "if these rights are created subsequent to the actual date of issue" should be added.
(SAICA)
The section appears to disallow the interest payments totally where the instrument is convertible within three years. It is suggested that the interest be disallowed only to the extent that the instrument is convertible within 3 years so that equity may prevail. An instrument may be partially convertible within 3 years

but the interest on the entire instrument, including that portion that is not convertible within 3 years will be disallowed, in terms of the proposed legislation.
(SAICA)

These comments are accepted. These provisions have been changed to only apply prospectively.

Section 24J

Differential tax treatment arises where conversion rights are not taxable because of the acquisition of a capital instrument at some future date. By disallowing interest on the debentures equilibrium is restored. Resolution can be obtained by classifying the instrument under section 24J, thereby causing the increase in capital value to be taxed as income, without disallowing interest.
(BCSA)
Include hybrid financial instruments in the definition of an "instrument" by adding the following:

> **"any instrument which is, at the option of the issuer or the holder, convertible or exchangeable into a share or repayable, either in shares or through any other means".**

This has the result that it becomes unnecessary to amend sections 8E and 8F.
(BCSA)

These comments are not accepted. A convertible interest-bearing debt is already covered by the provisions of section 24J until the date of conversion or exchange into a share. The amendment proposed by the Banking Council also does not cater for arrangements which are debt in form but in substance equity.

We are concerned that the net has been cast too wide in terms of the proposed deduction from the initial amount and that no deduction is appropriate in terms of amounts paid for services in connection with the transaction.
(PWC)

The comment is accepted. The condition has been introduced that the payment must the deducted only if the purpose or probable effect is to directly or indirectly make a payment to a holder of an instrument pursuant to a transaction, operation or scheme.

This section is currently unwieldy and difficult to comprehend, even by tax specialists. It is very difficult to continually patch up a section in order for it to make sense. We recommend a complete rewrite of this provision.
(SAICA; PWC)

The level of complexity is inevitable due to the extremely complex structures and transactions it was designed to regulate. The section will be revisited when a comprehensive review of the taxation of financial instruments is undertaken.

The amendments to section 24J are based on the concept of a "transaction, operation or scheme". This expression is used in a negative context simply because that is the expression used in section 103 of the Act. The fact is that the words themselves are perfectly ordinary and innocuous, describing ordinary, everyday and innocuous business events. The provision must, therefore, be narrowed down by adding that that has the effect of avoiding, postponing or reducing a tax liability and that has as its sole or main purpose the avoidance, postponement or reduction of a taxation liability.
(SAICA)

This comment is not accepted in view of case law in this area which indicates that it is likely that transactions that have a financing component, which is the case here, would arguably be removed from the scope of the concept "transaction, operation or scheme".

The proposed amendments in respect of the forward purchase of shares could be more easily achieved by splitting convertible instruments into their equity and debt components for tax purposes. Such treatment is already required for accounting purposes.
(SAICA)

This amendment has been withdrawn.

The term 'lease and leaseback' should be defined.
(SAICA; PWC)

This amendment has been withdrawn.

With reference to the 'yield to maturity' definition, the draft mentions an amount that is likely to be payable. This will give rise to disputes with regard to quantification. It is suggested that it be deleted.
(SAICA)

This amendment has been withdrawn. It has initially been designed to deal with rights created in respect of transactions under sections 24M and 24N.

The current proposed legislation seeks to disallow the excess interest in the borrower's hands and to also tax the difference between the cost of the share conversion rights and the issue value thereof. It is believed that the amendments should only disallow the so called "excess" interest incurred by the borrower.

Essentially a group of companies should only be allowed a deduction on the "net" amount of the loan.
(SAICA)
The legislation proposes two remedies for the excessive interest deductions, each of which would suffice. The application of both would appear to place the taxpayer in double jeopardy.
(BUSA)

These comments are accepted. It has been decided to retain only the provisions disallowing the excess interest in the borrower's hands.

Section 64C

In terms of section 64C a deemed dividend arises when amounts are incurred in respect of instruments falling within section 8F. Interest is incurred on a day-to-day basis. Is STC triggered on a day-to-day basis or on distribution or at the end of the year of assessment of the payer? This aspect needs to be clarified.
(SAICA)

The general rules contained in section 64C(2) and (6) will apply to determine the point in time when the deemed dividend arises.

Effective date

The effective date of amendments to section 8E, 8F and 24J require further clarification. What will be regarded as the effective date when shares are forward purchased prior to promulgation but only issued after date of promulgation? Does "issued" refer to the actual date of issue or the defined "date of issue"?
(SAICA)

The amendments to section 8E and the new section 8F will come into operation on 26 October 2004 and will apply to instruments issued, acquired or transferred during any year of assessment commencing on or after that date. The amendments to section 24J will come into operation on 1 January 2005 and apply in respect of any instrument issued, acquired or transferred on or after that date.

Annexure 4: Deferred Instalment Sales

Section 24M

If the future purchase price is undeterminable, there is in substance no sale. The circumstances are very similar to those of operating leases where an economic sale has not taken place. The seller should retain the asset until all economic benefit passes. Transactions could be structured that would have the result of deferring income for the transferor and increase the opportunities for tax arbitrage between a taxpayer with an assessed loss and another in a tax paying position. The

methodology will create a greater divergence between accounting treatment and the tax treatment of transactions.
(BCSA)

These comments are not accepted. Tax law generally is independent from the accounting treatment of the transaction.

Members of the Banking Council would prefer if this section is to be deferred until such time as all the implications have been considered.
(BCSA)

This proposal is not accepted. The introduction of the proposal should not be delayed. The Banking Council's concerns are overstated.

The proposed section deals with the specific allowances that are to be impacted. However, allowances claimable in respect of intellectual property, mining operations and farming operations are not dealt with.
(SAICA)

This proposal is accepted. A reference to depreciable asset as defined in section 1 of the Income Tax Act has been used.

We are concerned that the wholesale exclusion of connected persons from these provisions is arbitrary. In order to overcome this exclusion, we suggest that the exclusion apply only in those instances envisaged in the Eighth Schedule (i.e. where the transaction is not at arm's length).
(PWC)

This proposal is accepted. The connected person test will be withdrawn.

Section 24N

The current deferral applies only to the sale of equity shares. The rule should also apply to the sale of direct interests in a business. The exclusion of connected persons is also arbitrary.
(PWC)

These comments are not accepted. The application of the rules with respect to direct interests would be complex and the relief provided in section 24M would already be of assistance in many cases. The reason for excluding transactions between connected persons is to limit potential tax avoidance opportunities.

Transaction taxes

Stamp Duties and Uncertificated Securities Taxes should similarly be deferred in these situations.
(PWC)

Further consideration will be given to this aspect in future.

Annexure 5: Relief for Interest-Bearing Investments Held by Namibian, Swaziland and Lesotho Investors

Previously the 183 days or carrying on business tests were only applied to emigrants by referring to people who were at any time resident. Now it applies simply to any non-resident. If the decision has been taken to no longer treat emigrants differently, there appears to be no reason to retain those tests at all. If a natural person is not a resident there is no basis on which to tax that person merely because he or she is here in any one year for more than 183 days.
(SAICA)

This comment is not accepted. In accordance with international practice South Africa has full taxing rights on interest paid to non-residents, limited only by percentage ceilings negotiated for purposes of Double Taxation Agreements (DTAs). The granting of the exemption in respect of non-resident individuals who are physically present in South Africa for 183 days or less during a tax year is already a concession. A non-resident who is present in South Africa for more than 183 days during a tax year has established a link with the country and also benefited from services in the country. The non-resident should, therefore, be subject to tax on interest income.

If non-residents are to be taxed on interest because they carry on business through a permanent establishment, it should only be interest effectively connected with that permanent establishment and not any and all interest – this is consistent with our treaties.
(SAICA)

This comment is not accepted. In accordance with international practice South Africa has full taxing rights on interest paid to non-residents, limited only by percentage ceilings negotiated for purposes of DTAs. It is only when such a ceiling applies that the DTA provisions dealing with interest connected to a permanent establishment become relevant. The granting of the exemption in respect of businesses that do business in South Africa but do not have a permanent establishment in South Africa is thus a concession. The use of a permanent establishment threshold ensures that a solid nexus exists for taxing income in South Africa.

The retroactive exemption for pension funds should also be extended to Namibian long-term insurers and to Namibian unit trusts, thereby eliminating any uncollected tax liability dating back to 1 January 2000 (i.e. when South Africa switched to a worldwide system of taxation).
(PWC)

This proposal is not accepted. The reason a retroactive date is proposed only in the case of non-resident retirement funds is that they

enjoyed an exemption in terms of a specific provision until the tax year before the tax year commencing on or after 1 January 2001.

Annexure 6: Public Private Partnerships

Would it not be appropriate to amend section 11*(f)* to cater for public private partnerships by lifting the restriction that the recipient need not be tax exempt?
(SAICA)

This comment is not accepted. During discussions with stakeholders the need for an amendment to section 11*(f)* was not raised. A distinction can be drawn between a cash contribution in the case of a lease premium and a major stake in immovable property in the case of leasehold improvements.

Annexure 7: Eliminating Tax Preferences for JSE Securities and Bond Exchanges

The JSE, like other exchanges, has historically had a tax exempt status. Bearing in mind that the JSE is not supported in any way by government funding, this tax exempt status has enabled the JSE to accumulate reserves, which it has used to fund strategic projects. These strategic projects have resulted in the JSE being able to offer a world class exchange in South Africa. The removal of the tax exempt status therefore does hold significant consequences for the JSE. Resolving the resultant regulatory and tax consequences will take time. That said, however, we do understand National Treasury's in principle desire to remove tax exemptions.

For this reason we have been working with National Treasury to clarify the conditions applicable to the removal of the JSE's tax exempt status. Following our discussions with National Treasury, they have undertaken to amend the draft Bill as it was published for comment, clarifying that the removal of the tax exempt status will occur on a date to be promulgated in future. This will allow the conclusion of the thorough investigation into the regulatory and tax consequences.
(JSE)

Discussions are ongoing with the JSE and Bond Exchange in order to ensure a smooth transition. The withdrawal of the exemption will come into operation on a date to be fixed by the President by proclamation in the *Gazette*.

Annexure 8: Stamp Duties

It is submitted that it cannot be administratively efficient, either for the taxpayer or for SARS, to collect insignificant amounts by way of adhesive stamps.

We therefore suggest that the proposed R100 limit be increased to cover cases where the duty does not exceed R250 or a higher amount.
(SAICA)

This comment is partially accepted. The R100 limit was based on the assumption that leases are for only one year. However, if the period of the lease is open-ended, the lease must be stamped for two years. On this basis the R100 duty exemption has been adjusted upwards to R200.

The removal of the limit in respect of rentals (previously, the rental for stamp duty purposes was limited to the market price of the immoveable property in question) is prejudicial in cases of long-term leases, for example 99 year leases. There is no basis for stamp duty to exceed the previous limit. Alternatively, the stamp duty should be subject to the maximum amount of transfer duty that would have been payable had the lessee acquired the immoveable property at that date of commencement of the lease at the market price.
(SAICA)

This comment is not accepted. Under current law no linkage exists between Stamp Duty and Transfer Duty. Furthermore, leases already enjoy the advantage of the proposed stamp duty of 0.5% as opposed to the average rate of 5% in the case of transfer duty.

Various amendments to the Stamp Duties Act provide for interest at the rate of 10% per annum to be paid for late payment of duty. We suggest that the rate be linked to a rate in the Public Finance Management Act to prevent the Stamp Duties Act having to be amended regularly merely as a result of changes to interest rates in the market.
(SAICA)

This comment is not accepted. Unlike the other taxes where the interest calculation is computerised, stamp duty and related interest calculations are still a manual process. The complex interest calculations that arise from the constantly changing interest rates as determined by the Public Finance Management Act can only efficiently be calculated electronically. Until such a time as stamp duty goes electronic the 10% flat annual rate is a compromise between administrative simplicity and an annual revision of the interest rate.

The discretion of the Commissioner to remit penalties and the maximum limits of penalties/interest do not apply to debit entries, leaving banks potentially worse off than before. Unlike other dutiable items the period for payment has not been increased from 21 to 30 days.
(BCSA)

These comments are accepted. Only the general interest, penalty and additional duty provisions will apply in respect of debit entries. The

period for payment of debit entries has been increased to 30 days after the end of the month during which entry is made.

Annexure 9: Transfer Duty

Various amendments to the Transfer Duty Act provide for interest at the rate of 10% per annum to be paid for late payment of duty. We suggest that the rate be linked to a rate in the Public Finance Management Act to prevent the Transfer Duty Act having to be amended regularly merely as a result of changes to interest rates in the market.
(SAICA)

This comment is not accepted. Unlike the other taxes where the interest calculation is computerised, transfer duty and related interest calculations are still a manual process. The complex interest calculations that arise from the constantly changing interest rates as determined by the Public Finance Management Act can only efficiently be calculated electronically. Until such a time as transfer duty goes electronic the 10% flat annual rate is a compromise between administrative simplicity and an annual revision of the interest rate.

The proposed legislation is silent as to whether the Commissioner is obliged to supply reasons to the client or the other person as to why he did not sustain the objection to the lodging of the complaint with a professional body and whether the Commissioner's decision is subject to objection and appeal.
(SAICA)

The proposed amendment aligns the Transfer Duty Act to the Value-Added Tax and Income Tax Acts. Section 20C of the Transfer Duty Act sets out the procedures to be followed and after these have been exhausted and the Commissioner nevertheless lodges a complaint to the professional body, the aggrieved party can state his or her case at the hearing.

It is not clear as to whether the controlling body is to supply any information to the Commissioner to evidence that it has considered the complaint. Should the controlling body consider the complaint, but decide not to take any disciplinary measures, it is not clear whether it will be obliged to give reasons for this to the Commissioner and whether the Commissioner can object to this.
(SAICA)

The rules of the relevant controlling body should apply.

Annexure 11: Measures to Enhance Tax Administration

Registration of tax practitioners

The section to register tax practitioners applies only to tax consultants who practice for their own account or in partnership

but excludes all employees and directors of incorporated practices, private companies and close corporations since these persons will be advising clients of their employer. Persons who practice in partnership or individually are prejudiced. This deficiency should be rectified.
(SAICA)

This comment is accepted. Although the proposed legislation already covers "Every natural person who for reward provides advice...", without specifying the source of the reward, the proposed legislation has been reworded to make it clear that natural persons will be required to register whether they or their employers are compensated for the provision of their services.

Clarity should be provided as to how one determines if a person provides tax advice as an "incidental or subordinate part of providing goods or other services". Will this be determined in relation to fees earned or time spent?
(SAICA)

The application of this principle will be clarified by way of explanatory notes to the registration form and, if feedback from tax practitioners demonstrates this is necessary, by the issue of an Interpretation Note on this matter.

It could be argued that all Chartered Accountants in public practice provide tax advice as incidental or subordinate to their accounting and audit mandate. Insurance brokers could argue that they complete some hundreds of tax returns and provide tax advice as incidental or subordinate part of their main business as insurance brokers. Further, there is no reason why insurance brokers/consultants or other persons who provide tax advice should be specifically excluded.
(SAICA)
The proposed exemptions include those persons who provide advice that is incidental to the provision of other goods and services. The extent of "incidental" should be more clearly defined.
(BCSA)

The legislation has been clarified to reflect that the provision of tax advice must be incidental to the provision of another good or service on a client by client basis.

While it is appropriate to exclude lawyers who provide advice in anticipation of litigation, the fact is that most tax counsel at the Bar provides general tax advice and not only in anticipation of litigation.
(SAICA)
By implication, advice from advocates and lawyers on the legal implications of entering into transactions by clients that have tax implications but not expected to result in litigation will require such advocates and lawyers to register as tax practitioners.

This is a discriminatory requirement which will restrict this profession in undertaking their normal business.
(BCSA)

To the extent that attorneys and advocates provide general tax advice that is not in anticipation of litigation, such advice is analogous to that given by any other professional.

The provision excluding advocates and lawyers who provide advice or assistance during or in anticipation of litigation is unfair. Accountants also assist clients in preparing for litigation, for example with regard to objections to tax assessments. The legislation should not be discriminatory so as to grant one sector an unfair advantage by not requiring them to register.
(SAICA)

Attorneys and advocates are granted a unique privilege with regard to their representation of their clients before the Courts, which is not extended to any other profession. The legislation seeks to strike a balance between this privilege and the competitive concerns raised by SAICA by treating attorneys and advocates similarly to other professionals when they "provide general tax advice", as mentioned above.

The following questions need to be addressed:

a) What information SARS requires and for what purpose?
b) Whether SARS will be allowed to refuse registration and if so on what grounds?
c) Whether SARS may use the information in assessing tax returns (i.e. risk profiling of taxpayers)?
d) How long will it take SARS to register the practitioner?
e) Is it only SARS that will have access to this register?

(SAICA)

The discussion paper on the regulation of tax practitioners that was released in 2002 prompted comments from certain sectors that the educational and experience requirements proposed were too onerous. The concept of setting tax type, or sub-tax type, requirements (e.g. Income Tax and Employees Tax) was also raised by certain commentators. The registration of tax practitioners by SARS has therefore been proposed to obtain information to properly evaluate these comments and draft future legislation. This information will cover areas such as the nature of the advice or assistance provided, and the tax practitioner's current qualifications and experience. The legislation does not make provision for the refusal of a registration and it is not clear how the registration of the tax practitioner could be used to assess or risk profile his or her clients' returns. The time it will take to register a practitioner will depend on the quality of the data provided in the registration form but should be similar to that for an income tax assessment for an individual taxpayer. Finally, the proposed registration provisions are contained in the Income Tax Act, 1962, and will therefore be subject to the secrecy provisions contained in section 4 of that Act. It is, however, anticipated that legislative authority will be

sought to transfer information regarding a tax practitioner's identity, contact details, qualifications, and experience to any regulatory authority for tax practitioners to be established by legislation.

We are concerned at the level of legislation which seems to be enacted by way of regulations as opposed to statutory legislation passed by Parliament and trust that this very important aspect of regulating tax practitioners is not left to governance by regulations outside of Parliament.
(SAICA)

No such regulatory authority is proposed in the draft Bill.

BUSA submits that it is unwise to provide prison sentences for procedural misdemeanours.
(BUSA)

The penalty on default in this case is a fine or imprisonment not exceeding 24 months. This is the penalty that applies for "lesser offences" such as failure to submit a return or register as a taxpayer. In practice the Courts do not impose imprisonment for a failure to file a return but rather impose a fine. More serious offences are subject to a fine or imprisonment of up to five years.

Advance rulings

Although the advance ruling system has generally been welcomed, the general trend of the comments seems to suggest that the system is too restrictive and should be widened in many respects such as a wider range of rulings, less restrictions, no retroactive withdrawals, limitation on publication and specified turnaround times.

Before any comments are offered on the specific issues raised, it is important to put this initiative into perspective. One of the main reasons for an advance ruling system is to create certainty for taxpayers on the tax implications of proposed transactions. What is of importance here is that these rulings will be given on transactions still to be entered into and it is in this respect that some risk is attached to the proposed measure.

Risks could include for example the issuing of incorrect rulings based on incomplete or misleading information. The issue of incorrect rulings in a binding rulings regime can of course pose a major risk for the fiscus as incorrect rulings could lead to substantial revenue losses. Although the counter argument will be that rulings are fact based, in practice it remains an arguable point whether all information was in fact made available. This is something we have experienced in practice as SARS has given rulings over the years. These rulings are however nonbinding rulings outside a comprehensive legislative rulings framework now proposed.

Although SARS has some experience on the issue of rulings as mentioned above, a formal rulings regime is something that will take time to develop, thus the reason for a more modest approach at this

stage. Our past experience will certainly help to lay a foundation but we will still need to "walk" before we can say we can "run" in this regard. As an example, advance pricing agreements and product rulings have been excluded from the system.

The rulings regime proposed is therefore a first step in the direction of providing clarity in the case of genuinely anticipated transactions such as a foreign taxpayer wanting to invest in SA who requires certainty on the tax treatment of such a transaction. It is certainly not put in place to serve as a tax advisory service to rule on proposed transactions put together to avoid tax. For such advice taxpayers must consult their own advisors.

We are concerned that most of the points raised in our submission of 27 February 2004 addressed to the Commissioner of SARS on the draft discussion paper that was released for comment previously have been ignored.
(SAICA)

These points have not been ignored. They were fully considered but were not accepted as they were not aligned with international practice, would require disproportionate commitment of resources, or were otherwise inappropriate.

Points that were accepted included the:
- Deletion of the requirement that a tax advisor acting on behalf of a taxpayer disclose the details of that advisor's involvement with any similar transactions;
- Inclusion of a requirement that the Commissioner provide an estimate of the cost recovery fee (and that the taxpayer be notified before that estimate is exceeded); and
- Inclusion of provisions for the editing of rulings prior to publication to protect confidentiality.

We cannot see why the applicant should furnish reasons as to why the applicant believes that the proposed ruling should be issued since a ruling is merely a written statement issued by the Commissioner regarding the interpretation or application of the Act. The Commissioner has the right to issue the ruling in the negative or positive based on his interpretation of the Act.
(SAICA)

This comment is not accepted. This requirement is consistent with the practice of the other jurisdictions reviewed. Thus, for example, the Australian Tax Office (ATO) requires an applicant to state the reasons why a ruling is necessary. The Canadian Rulings Directorate requires, *inter alia*, a description of the income tax concern that is the cause of the request for the ruling, together with submissions as to why the authorities in favour of the taxpayer's position should prevail. In the United States, if the taxpayer advocates a particular conclusion, an explanation of the grounds for that conclusion and the relevant authorities to support it must be included. (Even if not advocating a particular tax treatment of a proposed transaction, the taxpayer must

still furnish views on the tax results of the proposed transaction and a statement of relevant authorities to support those views.)

SARS is at a loss to see why it should be required to issue a binding ruling in a situation in which the applicants themselves are unwilling or unable to articulate the reasons why they believe the proposed ruling should be granted. Providing this information can only help to facilitate the rulings process, even in those situations in which the Commissioner ultimately disagrees with the taxpayer.

The application and cost recovery fees should be capped. (BUSA)

This comment is not accepted. Complex applications that require the commitment of substantial resources should not be provided at a discount compared to simpler applications requiring the commitment of fewer resources.

We are surprised no rulings will be granted on Transfer Pricing transactions. This is an area, which is open to uncertainty, and any moves to reduce the uncertainty would be welcomed especially given that SARS will have to make a determination at some point in time in assessing the taxpayer.
(SAICA)

This comment is not accepted. Like the determination of the market value of an asset, transfer pricing is an inherently and intensely factual area that is particularly ill-suited to resolution through the advance ruling system. Thus, other jurisdictions that have sought to provide greater certainty in this area have developed alternative mechanisms such as an Advance Pricing Agreement (APA) system. An APA system, which is also voluntary, typically involves a five-phase process, consisting of: (1) an application; (2) due diligence; (3) analysis; (4) discussion and agreement; and, (5) drafting, review and execution. Each application is assigned to a multi-disciplinary team that usually includes an economist, legal, accounting, and industry expert personnel. In short, the basis of such a system is "generally different from that of other private rulings, the procedure varies from that of private rulings and there are distinct issues which arise in the context of APAs." (The International Guide to Advance Rulings, published by the International Bureau of Fiscal Documentation (© 1997 – 2002))

Scope of Advance Ruling system should be extended to Uncertificated Securities Tax, Stamp Duty, and Transfer Duty.
(PWC)

This comment is accepted.

Mechanisms for the creation of an independent body to hear advance ruling applications and dispense such rulings should be facilitated.
(BCSA)

This comment is not accepted. It is part of the Commissioner's core function to interpret and administer the tax laws. This function cannot be "outsourced." In addition, while SARS is sensitive to the concerns raised, the Commissioner does not believe that an independent rulings body (for example, one based on the so-called "Indian" model) would better suit the needs of the taxpaying community and SARS. In particular, the negative characteristics inherent in such a system, including, *inter alia,* the likelihood of increased cost, complexity and delay, the use of compulsory process and discovery, and the binding force of any decision on both parties, more than outweigh the suggested benefits of such a system.

The powers and discretion of the Commissioner in the process of hearing the applications are biased towards the process of revenue collection and should be counterbalanced by representation from taxpayer bodies that are seeking clarity and equity in the interpretation processes.
(BCSA)

This comment is not accepted. The powers and discretion of the Commissioner under the proposed legislation are consistent with the powers and discretion granted to revenue authorities under advance rulings systems in the vast majority of other countries that have been studied. Representation by taxpayer bodies is not only inconsistent with the practice in those countries, it would create significant legal and practical problems in respect of matters such as confidentiality, privilege and conflict of interest.

It is proposed that transactions that are not seriously contemplated be excluded. How will SARS determine whether a transaction is seriously contemplated?
(PWC)

This comment is not accepted. The proposed legislation is consistent with the standards adopted by many other countries, including Australia, Canada, New Zealand and the United States. It is necessary in order to ensure that limited administrative resources are allocated, *inter alia*, to the most pressing and important matters. It is unreasonable to expect the system to respond timeously to transactions that are not only seriously contemplated, but fast moving as well, while at the same time having to devote staff to requests involving transactions that are at best speculative and hypothetical. From a practical standpoint, the ATO addresses this problem, *inter alia*, by requiring the taxpayer to make an affirmative declaration regarding the status of the subject matter of the ruling request. In addition, the contents of the application itself, and, where necessary, further communication with the taxpayer, would also be used in making this determination.

Why should issues that are vexatious be excluded?
(PWC)

This comment is not accepted. From the context of “frivolous or vexatious” it is clear that what is intended is the refusal of applications dealing with issues “lacking a sufficient ground and serving only to annoy or harass when viewed objectively”.

How long will the exclusion in respect of draft legislation run?
(PWC)

The exclusion will generally run from the date that draft legislation is released for comment either by the public or specific industry groups.

The proposal that the Commissioner may reject an application to give a ruling on section 103 severely dilutes the benefit of an advance ruling. That section is a discretionary section so if the transaction has already taken place he would, even under the current law, be bound to issue the ruling because he has to exercise his discretion and indicate how that discretion has been exercised.
(SAICA)
Ruling on application of anti-avoidance is a key function of the system (i.e. SARS acceptance of *bona fide* business reasons and not SA tax driven)
(PWC)

These comments are not accepted. Limitations in respect of anti-avoidance provisions are a basic feature of the rulings system in all of the major jurisdictions that have been reviewed, including Australia, Canada, Germany, the Netherlands and the United States. Thus, for example, in Australia, the ATO is not prepared to rule on products with significant tax avoidance potential, including products that use non-recourse or limited recourse financing. In addition, in deciding whether anti-avoidance provisions may apply to prevent it from making a ruling, the ATO will also pay particular attention to: (1) any mechanism that would eliminate a borrower’s liability; (2) any arrangement where the repayment of principal or interest is linked to there being income from the product; (3) “round robin” type transactions in which there is a circular flow of cash among the parties to the transaction; and (4) any arrangement that includes the use of significant security deposits or other back to back arrangements. In Canada, where the ruling requested concerns the application of the general anti-avoidance rule to a transaction, the taxpayer must provide submissions to establish that the transaction would not result directly or indirectly in a misuse of the provisions of the Canadian Income Tax Act or an abuse having regard to the provisions of the Act as a whole. In Germany, a taxpayer’s request will be rejected outright if the taxpayer’s main objective is to achieve tax savings. Requests will also be rejected if they involve a review of tax savings models, a determination of the limits of the substance-over-form rules, or a determination of the behaviour of a sound and conscientious business person. Similarly, in the Netherlands, a request will be rejected if it is perceived to be testing the boundaries of what is legally acceptable, is aimed primarily at eroding the tax base, or could harm the interests of a treaty partner. In the United States, the Internal Revenue Service

(IRS) will not issue a ruling in connection with or in respect of transactions that lack a *bona fide* business purpose or have as their principal purpose the reduction of federal taxes.

It is also common cause that issues arising under anti-avoidance provisions are often inherently and intensely fact intensive and that the advance ruling mechanism is not an appropriate vehicle for their resolution. Thus, as the Full Federal Court in Australia has warned:

> "both the Commissioner and the taxpayer must be aware of the difficulty which a private ruling on Part IVA [the Australian general anti-avoidance provisions] will create. Where an arrangement in respect of which a private ruling is sought has not yet been carried out, it is difficult to see how there could be adequate facts upon which to base a private ruling. Even where the scheme has been carried out, there may in many cases be difficulty in obtaining all relevant facts, particularly those relating to the manner in which the scheme was entered into and carried out."

Bellinz Pty Ltd v. Federal Commissioner of Taxation, 98 ATC 4634; (1998) 39 ATR 198, 212.

In sum, proposed section 76G(2)*(a)* merely provides the Commissioner with the discretion to refuse requests regarding the application or interpretation of the South African anti-avoidance provisions and doctrines. As such, it is fully within the mainstream of policies and practices in this area that have been developed by other countries with advance tax ruling systems. Indeed, section 76G(2)*(a)* is considerably less severe than the mandatory prohibitions in this area that have been adopted by several countries.

SARS may reject an application that covers an issue that is similar to a ruling that has been issued. This may be necessary as a result of a change in law.
(PWC)

It must be borne in mind that the exercise of this right of rejection is discretionary. Factors such as new legislation or legal precedent would be taken into account when that discretion is exercised.

A further exclusion is that a ruling will not be issued if "a matter the resolution of which would be unduly time-consuming or resource intensive". We cannot understand why this exclusion is necessary given that the taxpayer will be paying for such a ruling. It must be accepted that the majority of ruling requests will be for complex issues.
(SAICA, PWC)

This comment is not accepted. Exclusions of this type are common in other countries such as Australia, New Zealand and the United States and have proven necessary to ensure the proper functioning of the

system and to prevent inefficient use or allocation of limited administrative resources, notwithstanding the presence of other checks and balances. The existence of these exclusions, moreover, has not noticeably affected the application or benefits of the ruling systems in those other jurisdictions.

It is problematic that the Commissioner may extend the range of issues in respect of which applications will not be accepted.
(PWC)

This comment is not accepted. The provision in question was added in response to comments received from The Banking Council on the discussion paper on this issue. In particular, The Banking Council proposed that "[t]o avoid the waste or resources (financial or otherwise) from both the taxpayer and SARS' perspective the new ruling system should clearly stipulate the circumstances under which the SARS would not consider issuing a ruling." The authority in question is similar to the ATO's authority to "embargo" certain issues and for the IRS to issue "no ruling" lists. For example, taxpayers generally may not be aware of various issues pending before the courts. The list issued under proposed section 76G(3) would serve to identify such issues for taxpayers from time to time. Similarly, based upon experience, the Commissioner may be able to identify and delimit particular areas in which he has, or would be likely to, exercise his discretion to refuse an application under proposed section 76G(2).

Our main concerns relate to the ability of SARS to retrospectively withdraw the binding private or class ruling. This undermines the very canons of certainty, which the Advance Tax Ruling system is meant to introduce. This provision should be withdrawn.
(SAICA)
Retrospective revocation creates uncertainty and casts doubt on the value of the system.
(PWC)

These comments are not accepted. A binding private or binding class ruling may only be revoked or modified retrospectively in certain very narrowly defined circumstances. In particular, such a ruling may only be revoked if it is erroneous **and** at least one of three conditions, discussed in more detail below, are also satisfied.

The provisions of this section attempt to strike an appropriate balance between competing interests and concerns, including the need to protect a taxpayer's reasonable reliance upon binding rulings that have been issued and the need to ensure that the tax laws are enforced in a fair and impartial manner that results in a level playing field for all members of the taxpaying community. It is well established both in South Africa and other jurisdictions that a taxpayer is not entitled to a windfall simply as a result of an erroneous interpretation of law by the tax authority and that the government is generally entitled to correct such errors and assess the amount of tax properly due at any time within the applicable statute of limitations. See generally *Carlson's Investment Share Block (Pty) Ltd. v. CSARS*, 2001 (3) SA

210 (W); *COT v. Astra Holdings (Private) Ltd t/a Puzey & Payne*, 66 SATC 79; *Commissioner of Inland Revenue v. McNab*, (1984) 6 NZTC 61; *Automobile Club of Michigan v. Commissioner of Internal Revenue*, 383 U.S. 180 (1957).

In the case of binding private or binding class rulings, which are initiated only in response to applications from taxpayers, SARS – and ultimately the general body of taxpayers – bear the risk of erroneous rulings in all but the three very narrowly defined situations. The first is one in which the applicant has not yet commenced the proposed transaction that is the subject of the ruling. In such a situation, a taxpayer has not yet changed its position to its detriment in reliance upon the erroneous ruling and would, in essence, simply receive a windfall if the Commissioner were precluded from correcting the error. The second involves a situation in which a person other than the applicant (or class member) would suffer a significant disadvantage if the ruling is not withdrawn or modified and the applicant (or class member) would suffer comparatively less if the ruling is withdrawn. In essence, an applicant's reasonable reliance is again given greater weight unless there is a third party that would suffer a greater harm if the withdrawal or modification is not given retrospective effect. The third involves a situation in which the effect of the ruling would materially erode the South African tax base and it is in the public interest to withdraw or modify the ruling retrospectively. Again, under the proposed amendment, an applicant's reasonable reliance is protected unless it is outweighed by the harm to the country and the public interest.

Where a ruling is withdrawn and given that the taxpayer has paid for such a ruling, will the fee be refundable and will SARS be liable to re-imburse the taxpayer for costs incurred in transacting or planning to transact based on the advance ruling?
(SAICA)

It should be borne in mind that fees will be charged on a cost recovery basis alone. With respect to the question of refunding fees and reimbursing costs, it would be helpful if SAICA could provide guidance regarding the circumstances under, and the extent to which, member firms provide such refunds and reimbursements to clients in connection with tax advice they have given which is subsequently determined to have been erroneous.

It is not clear whether the taxpayer can influence the format and content of the publication. It is also not clear what happens in cases where the taxpayer disagrees with SARS on the content of the publication, which disagreement cannot be resolved. In our view the taxpayer's view should prevail.
(SAICA)

These comments are not accepted. Section 76O(4) provides that the Commissioner may consider, prior to publication, any comments and proposed edits and deletions to the draft of the ruling, edited for publication, that the Commissioner must send to the taxpayer. While the taxpayer's reasonable and legitimate concerns about

confidentiality will be given consideration, the taxpayer cannot be given an effective veto over the content of the published ruling without potentially compromising the intelligibility of the published rulings and the underlying rationale for publication.

There is an absence of either requirement on Commissioner to take cognisance of taxpayer comments or sanction if Commissioner fails to meet own obligations.
(PWC)

This comment is partially accepted. Section 76O(4) has been amended to require that the Commissioner "must consider" the taxpayer's comments.

We would question whether an additional category of private rulings could not be introduced which would not be made public. Such non-published rulings would protect the intellectual property of the applicant for the ruling.
(SAICA)
The publication of rulings may expose the applicant's intellectual property in the transactions or structures they have designed.
(PWC)

These comments are not accepted. Without the publication of these rulings, edited to protect the identity of the taxpayer, the advance tax ruling system would quickly lead to the development of a private body of law which could give some taxpayers an unfair advantage and exclusive knowledge about the interpretation of certain areas of tax law. This risk and the pernicious effects this would have upon the tax system and taxpaying community at large outweigh the possible unfairness posed by the possibility that other taxpayers may benefit indirectly from an applicant's ruling request.

The advance tax ruling system is completely voluntary. If a taxpayer objects to publication, it can forego requesting a ruling. But once a ruling has been requested, the Commissioner cannot permit the ruling process to be co-opted into a secret but official seal of approval to be used by a firm to market its latest tax products.

Internationally, the publication of rulings, edited to protect the identity of the taxpayer, is a well established practice that is followed in countries as diverse as Australia, Canada, India, and the United States.

We believe that SARS should be required by law to process rulings within a specified time period. We would suggest a maximum of 90 days, allowing for complex matters and having regard to the fact that taxpayers will be paying for such rulings.
(SAICA)

Time frames are required either administratively or in legislation. Certain transactions are likely to require at least "in principle" agreement on tight deadlines.
(PWC)

These comments are not accepted. The rulings system will be an entirely new function within SARS. While SARS is fully cognisant of the need to issue rulings timeously, it is firmly believed that the imposition of rigid statutory deadlines at this stage would not only be inconsistent with the practice and approach of the overwhelming majority of other countries, but impractical as well.

Experience in other countries has shown that ruling requests can cover a wide spectrum of issues and topics and can range from the relatively simple and straight-forward to the extremely novel and complex. In addition, turn-around time often depends upon the quality of the ruling request itself and the taxpayer's cooperation with the revenue authority. Under the circumstances, other countries have refrained from imposing statutory deadlines in this area. Indeed, India is the only country surveyed in which such a deadline has been imposed and in that case it is six months, twice the "maximum" time frame proposed by SAICA.

Statistics from Canada for 1999 show that 18% of rulings requests were processed within four weeks, 34% were processed within eight weeks, and 56% within 12 weeks. Statistics from New Zealand for 2001 show a similar pattern: 18% of rulings were processed within four weeks, 31% within eight weeks, and 65% within twelve weeks. (By way of comparison, the Canadian ruling system has been in place for more than a quarter century and is staffed by approximately 90 full-time lawyers and accountants.)

As indicated in the discussion paper on this issue, SARS will endeavour to process rulings consistent with international norms, taking into account factors such as the complexity of the ruling request, the completeness and quality of the application, and the taxpayer's cooperation in the process

We cannot see why SARS is not willing to grant rulings on whether a person is an independent contractor, labour broker, personal service company or personal service trust. SARS has the right to obtain whatever information it requires from any person and is best placed to determine whether a person is one of the above.
(SAICA)

This comment is not accepted. Certain issues, such as the classification of individuals as employees or independent contractors, are inherently and intensely factual. Experience in other jurisdictions has shown that the ruling function is not well suited to addressing such issues. These concerns have even been expressed in jurisdictions like India that have taken the rare step of establishing an independent ruling authority with the powers of a civil court, including discovery and inspection, examinations under oath, and the issuance of summonses

and subpoenas. See, for example, *Hyder Consulting Ltd. v. CIT* 236 ITR 640, which held that whether reimbursement of actual expenses to sub-consultants should be subject to withholding or not constituted “a factual issue that will have to be examined at the time of assessment of the income of the applicant”.

It is not understood why, in the case of “binding private rulings” SARS states “These rulings may not be relied upon or cited as precedent by any other taxpayer.” Particularly if the circumstances are the same then why not let these rulings be used as precedent.
(SAICA)

This comment is not accepted. Experience in other countries has shown that requests for binding private rulings may often raise complex, novel issues, while still requiring a timeous response. Limiting the binding effect of these rulings to the taxpayer named and the transaction described therein permits the Commissioner to provide guidance and certainty to the applicant, while ring-fencing the potential negative consequences if the ruling should be discovered to be erroneous in whole or in part.

Multiple requests for private rulings on a particular issue would be considered when identifying issues for general binding rulings.

Annexure 12: Share for Property Transfers

Section 24B

The wording “transaction, operation or scheme” in section 24B should be extended to include only transactions, operations or schemes that have the effect of avoiding, postponing or reducing a tax liability and that have as their sole or main purpose the avoidance, postponement or reduction of tax liabilities.
(SAICA; PWC)
The general anti-avoidance provisions of section 103 of the Act are sufficient to apply to section 24B and we, therefore, do not see the need to bring in the words “transaction, operation or scheme” into section 24B.
(SAICA)
The anti-avoidance rules for section 24B (cross-issues) should be limited to a specific time-frame (say 18 months) and only if no bona fide commercial reasons exist for the transaction. Under current law, these anti-avoidance rules could theoretically be separated by 10 years.
(PWC)

These comments are not accepted. The anti-avoidance proposals are targeted at the direct and indirect cross issue of shares (and debt instruments). At issue is the scope of indirect cross issues within the ambit of these anti-avoidance provisions. Purpose driven anti-avoidance intent tests are difficult to enforce, especially since the

parties often have the power to cloud their real tax avoidance intent behind artificial commercial labels.

Shares issued in exchange for shares or debt are excluded from the proposed section 24B as it is considered that this provides an easy opportunity to artificially inflate the value of both sets of shares. As it would be practically impossible to inflate the price of listed shares or debt instruments the exclusion of shares should exempt listed shares.
(SAICA)
We struggle to understand the cross issue concerns as we are not aware of this occurring in practice. In any event, would an issue of shares in exchange for debt not be void in terms of section 38 of the Companies Act? Our only concern here is whether this can be applied far more widely than intended.
(SAICA)

These comments are not accepted. The problem of cross issues is more than just the artificial inflation of values through the false pricing of shares. The cross issue itself is problematic in terms of valuing the shares because nothing of substance is created in the transaction. The values added are simply circular. A company issuing shares is simply receiving additional value in itself through the dual cross issue. No value can be added to a company through the additional indirect ownership in its own shares. Therefore, the fact that the shares at issue are listed is irrelevant.

The general rule providing base cost for property acquired with shares is welcomed. However, this rule should be made retroactive for all share-for-property transactions dating back to 1 October 2001 (i.e., when CGT was enacted).
(PWC)

This comment is partially accepted. The general rule will be effective for assets acquired on or after the date of promulgation of the Amendment Act. The suggestion to make the proposal retroactive to 1 October 2001 for CGT purposes (excluding trading stock) is accepted.

Shares can also be issued in terms of section 45, yet mention is only made of sections 42 and 43.
(SAICA)
The interrelationship between the anti-avoidance rules of section 24B (cross-issues) and the company reorganisation relief rules is unclear. The relationship should also be clarified to ensure that the intra-group rules override the anti-avoidance rules of section 24B.
(PWC)

These comments are accepted. Specific provisions regarding the relationship between the corporate restructuring rules and the anti-avoidance rules of section 24B have been inserted in the corporate restructuring rules.

The new proposed section 24B grants a company a "deemed expenditure actually incurred" on the acquisition of any asset from a non-connected person. With respect, we cannot see why this provision is not extended to the acquisition of goods and services where the acquiring company issues shares as consideration for such acquisition.
(SAICA)
The acquirer is currently subject to income tax on the value of the shares in terms of the definition of "gross income", and there appears to be no symmetry where the company acquiring the goods or services is not entitled to any deduction for the issue of such shares.
(SAICA)

These comments are partially accepted. The proposed provisions apply to assets which would include goods. With respect to services the question of valuation is problematic. In addition international comparatives are not as supportive with respect to this treatment of services as is the case with assets.

Annexure 13: Technical and Textual Amendments

Section 7(8)

The reason for the amendment is that income of an offshore trust will not be attributed to a donor if it is not "income" as defined, which, in the case of a non-resident trust, requires the gross income to be from a South African source. But this is not the correct interpretation of "income". In *CIR v Simpson*, 16 SATC 268, the Appellate Division (as it then was) held that, in relation to (what is now) section 7(2), the word "income" must not be given its defined meaning but rather it means profits or gains.
(SAICA)
The stated aim of this section is to prevent tax avoidance by the shifting by South African residents of assets offshore via foreign trusts. Following the latest circulars by the Exchange Control Department of the Reserve Bank dealing with so-called looping structures, it is effectively impossible for a foreign trust funded by a South African resident to derive South African sourced income without contravening the Exchange Control Regulations. Accordingly it is very unlikely that a South African court will favour an interpretation of this section that will result in the section only applying to attribute income earned in contravention of South African law.
(SAICA)

These comments are noted.

Section 10(1)(d)(iii)

The Bill should amend the date by which organisations and similar bodies established to promote the common interests of

persons carrying on any particular kind of business profession are required to reapply for tax exemption. It is untenable that taxpayers should be required to reapply for tax exemption by 31 December 2004 without knowing the conditions which must be met in order to secure exemption from income tax It is therefore submitted that the date by which the affected organisation should reapply for tax exemption should be extended until 31 December 2005 or at least a period of 6 months after the date upon which the conditions required under the section have been promulgated in the regulations to be issued under the Income Tax Act.
(SAICA)
In relation to section 30 of the Act, the necessary regulations relating to clubs have still not been issued by the Minister, and yet the deadline for application remains 31 December 2004. We suggest that consideration be given to extending this deadline.
(SAICA)

These comments are not accepted. Regulations are not required for approval of an exemption for these organizations and there are still 2 months to apply. It should also be noted that where the organization enjoyed an exemption in terms of a repealed section, that exemption will still be applicable until the Commissioner has informed the organization of his decision in terms of section 10(1)*(d)*(iii) or (iv).

Section 11C

Consideration should be given to allowing the deduction of interest against local dividends in situations where the borrowings were effected in order to fund a BEE deal, in terms of an approved BEE charter.
(SAICA)

This comment does not relate to any part of the Bill under consideration.

Section 25B

We have grave concerns regarding the proposed changes to this subsection as they will result in the conversion of both exempt amounts (e.g., foreign inheritances) or capital amounts (proceeds from the disposal of a capital asset) received by the trust into income of the beneficiary.
(PWC)
The rationale given for the proposed amendments to this section is the same as that given for the amendments to section 7(8). Accordingly, the same risk arises, namely that capital receipts in the hands of the trust will be converted to revenue receipts in the hands of the beneficiary. Furthermore, the same solution, involving the alteration of references to "income" to references to "an amount", is proposed.
(SAICA)

These comments are accepted. The provision has been reworded to retain the concept of “receipts and accruals of the trust which would have constituted income if the trust had been a resident”.

Section 45(4)(a)

The anti-avoidance provision should only apply if the parties to the transaction cease to form part of the same group within a period of 18 months.
(SAICA)

This comment has been raised in prior years and not accepted. The avoidance potential is higher in this area, thereby rendering an 18 month rule ineffective.

Section 45(4)(b)

The proposed amendment refers to “… that transferee company must be deemed to have disposed of that asset to a connected person on the day immediately before the date on which that transferee company ceased to form part of that group of companies and as having immediately reacquired that asset from that person for expenditure equal to the base cost of that asset immediately prior to that disposal”. It is suggested that it be stated that the assets are deemed to have been disposed of at market value. In addition, the transferee company should be deemed to have acquired the asset at the market value.
(SAICA)
The anti-avoidance rules for escaping the grouping charge through multiple company transfers within a group are supported. However, the gain should be limited to the deferred gain on the tax-free transfer(s) unlike the proposal which taxes all the gain accrued upon the degrouping event. This limitation would match the other reorganisation provisions.
(PWC)

These comments are accepted. The transferor company is deemed to have disposed of the asset at market value and the transferee company is deemed to have reacquired the asset at market value and, for the purposes of allowances, the lower of the market value or cost of the asset to the transferee.

The provisions match the tax treatment of sales to controlled companies.

Eighth Schedule: par 56(2)(b)

Whilst this new proviso dealing with capital gains and losses is welcomed to ensure symmetry, the problem is not entirely addressed in that if the acquiring person has the gain included in income as opposed to aggregate capital gain or aggregate capital loss, the creditor will still be denied the deduction of the capital loss.
(SAICA)

This comment is not accepted. This aspect is already catered for in current legislation under paragraph 56(2)*(c).*

Section 64B

Section 64B(3A) further limits the South African resident taxpayer from claiming an STC credit in respect of foreign dividends, which profits were originally taxed in South Africa. This is untenable and subjects SA taxed income to double STC. There is a concern that this will be seen as a real deterrent to multinationals remitting these dividends back to South Africa.
(SAICA; PWC)
Current STC relief for foreign dividends stemming from South African dividends subject to STC should be retained if taxpayers can directly trace the source of the dividends. The equity thresholds (i.e., the more than 25% and 10% tests) should apply only if no tracing is possible.
(PWC)

This comment is accepted. The current provisions in the Income Tax Act dealing with the direct tracing of profits will be retained.

STC relief should be extended to include dividends from a foreign company to the extent that dividend relates to South African branch profits of the foreign company (normally subject to a 35% percent rate in lieu of the standard 30% rate plus the STC).
(PWC)

This comment is accepted. An STC credit is provided for foreign dividends arising from a South African branch or agency.

It is correctly pointed out that secondary tax on companies (STC) is a corporate tax. On this basis it is inconceivable that a foreign dividend that is exempt where more than 25% of the equity is held should not also qualify for an STC credit. This means that, in effect, any dividend so-received when on-declared will be subject to corporate tax in South Africa, i.e. STC, which is contrary to the stated intention.
(SAICA; PWC)

This comment is not accepted as it does not relate to any part of the Bill under consideration.

The amendments to section 64B(5)(*f*) are very poorly worded. It is not clear in terms of the wording whether it is in order for the subsidiary company to qualify for the exemption under (f) the holding company must undertake not to apply the exemption itself in on-declaring the dividend. That is, the provision is seen as more than a test in determining whether the subsidiary company qualifies for the STC exemption in respect of its dividend. It is thus hereby assumed that the reference to the exemption merely serves to clarify the fact that, should the shareholder declare a dividend, that dividend would, unless the shareholder elects section 64B(5)(f), be subject to STC.
(SAICA)

This comment is accepted. The provision has been reworded to clarify that it should apply as a hypothetical test.

Section 64C

The deletion in section 64C(4) of paragraphs *(g)* and *(j)* compounds a problem that arose out of the 2003 amendments, and this problem is not solved by the rewording of paragraph *(k)*(ii). The law allows interest-free loans within members of the same group without triggering STC, but the requirement that the exemption is limited to profits and reserves "that arose" while the shareholder and relevant company were members of the same group is going to cause significant practical problems in relation to a group's treasury operations. The fact is that when a new company joins the group it is inevitable that it will be integrated into the group and it is impractical and, indeed, impossible, to dissect intra-group loans between those representing reserves which arose prior to acquisition and those which arose thereafter.

In our view, once a company has joined a group, from a purely practical point of view all intra-group loans should be exempt, irrespective of the source of those loans.
(SAICA)

This comment is not accepted. The exemption should only apply up to the profits that arose while the shareholder and relevant company were members of the same group of companies. If this were not the case, the circumvention of the requirements of section 64B(5)(*f*) would be permitted.

It is also noted that in subsection (4)*(d)* a loan is only exempt if the interest rate is not less than the official rate of interest. It used to be that if the loan was not denominated in SA Rand, the interest rate had to be market-related in relation to the currency in which the loan has been granted, but this appears to have been dropped.
(SAICA)

The definition of "official rate of interest" in paragraph 1 of the Seventh Schedule still makes provision for a market related rate of interest in the case of a loan which is denominated in a foreign currency.

Section 66

The proposed amendment creates uncertainty. Section 67 requires the person to register when he or she becomes liable for taxation, whereas section 66 requires any person in receipt of gross income to submit a return. Where that person, for example, then earns gross income that will be exempt or the final taxable income is less than the threshold, he or she must submit a return, but has no duty to register.

Section 66(1B) should contain the following exemptions:
- **if the gross income consists solely of dividends exempt under section 10(1)(k); and**
- **if that person is not required to register under the provisions of section 67.**

(SAICA)
The income tax return registration reporting requirements for foreign parties should be eased or eliminated if those persons solely receive tax-exempt interest. Current requirements for non-residents to register and file returns, even where earning only exempt income is at odds with encouraging portfolio investment.
(PWC)

These comments are accepted. The annual notice published by the Commissioner in terms of section 66 of the Income Tax Act will deal with this issue.

Annexure 14: Value-Added Tax

The legislation amendment refers to the organisations carrying on activities that fall under certain headings, which headings are then listed but not the activities. No reference is made as to under what legislation, schedule or Act the headings or activities are listed. We recommend the following amendment:

"… relating to those activities that fall under the headings-
(a) welfare and humanitarian;
(b) health care;
(c) land and housing;
(d) education and development; or
(e) conservation, environment and animal welfare,
as listed under the Ninth Schedule to the Income Tax Act."
(SAICA)

This comment is not accepted. The proposed amendments are all textual in nature. In the text: "welfare organisation" is replaced with the more modern "public benefit organisation" aligning the VAT Act to the Income Tax Act. The reference to the Ninth Schedule to the Income Tax Act is not appropriate because certain activities listed are either

exempt or do not constitute an enterprise. In May this year a list was published on the SARS website for public comment until September 2004. Some comments have been received and will be considered in the process of further refining this list. The final list will be published as a Regulation to the VAT Act.

The amendment seems to provide relief for meals or refreshments supplied to crew members that are away on journeys for extended periods while they are carrying out their duties. It appears that the amendment could be open to abuse. For example, the operator of any ship or vessel could provide large quantities of meals or refreshments to the crew members in the course of making a taxable supply, but which may be consumed afterwards or elsewhere by the crew member. The operator would then still qualify for an input tax deduction. (SAICA)

This comment is not accepted. A closer reading of the subsection requires that the supply of the meal be made in "such" ship to a crew-member. The wider interpretation that the consumption can take place off the ship is highly improbable.

Section 20(8) now requires a vendor to obtain and maintain a declaration in respect of second-hand goods, in the form that the Commissioner may prescribe. While this is perfectly acceptable in the case of second-hand goods in general (e.g. a trade-in of a motor car) it is entirely impractical in the case of a repossession of goods subject to an instalment credit agreement (hire purchase).
(SAICA)

The target of the proposed amendment is the buying and selling of second hand goods of a relatively low value. Typically these goods do not require registration (as e.g. motor cars would) nor are they subject to other laws (i.e., credit agreements). Typically, this industry is unregulated and lends itself to abuse. That said SARS intends to fully engage with various industry players as to what the Commissioner may prescribe. At this stage it is not envisaged that repossessed goods will be subject to a harsher scrutiny that is currently the case.

Annexure 15: Value-Added Tax- Public Entities

We agree with the amendments in principle. However, with regard to certain entities the amendments have the effect that they would fall outside the scope of VAT, i.e. that their activities (and subsidies) are not subject to VAT and that they are not entitled to input tax deductions on their expenses. It is further stated that if it is determined that these entities are supplying goods or services which are the same or similar to taxable supplies made by other vendors, the Commissioner, in pursuance of a decision by the Minister, will notify such entities that these activities fall within the ambit of "enterprise" and "designated entity". It is important that the Commissioner also

publishes the names of the entities, and/or their activities, which would be regarded to be taxable.
(SAICA)

This comment is not accepted. Public entities that can no longer claim VAT input tax deductions will be compensated for that loss by receiving higher transfer payments from National Government.

Currently the Public Finance Management Act ("PFMA") is undergoing a process of re-classifying all Public Entities. Broadly speaking a regulatory entity will be classified as such under the PFMA and any business activity within that regulatory entity will be ring-fenced and moved out as a business entity under the proposed PFMA re-classification. The VAT provisions follow that PFMA classification. Therefore regulatory public entities, for example, will not be allowed to register for VAT. However, a business activity (meeting the VAT enterprise rules) within such a regulatory entity should be VAT registered. Because only the PFMA can ring-fence a business activity within such a regulatory public entity and move it out, there may be a significant time delay between the date that business activity is liable to VAT registration and the actual date of reclassification. It is for this reason that the Commissioner/Minister of Finance can notify such an entity to register that business activity for VAT. Within this context it is impossible at this stage to publish a list of affected entities as the full consequences of the PFMA re-classification are not yet known.

We would like to point out that the proposed stamp duty deletions of Item 15 schedule 1 in the Exemptions from duty under paragraph (1) and (2) and paragraph (3) (p) were effected last year.
(PWC)

This comment is accepted and the proposed amendment is withdrawn. The proposed amendment was in fact re-enacting the provision and is not deleting it. Last year these provisions were mistakenly deleted in the belief that they were obsolete. However because this was a charging provision the deletion means that anyone that should have stamped under that provision (and subject to the rates prevailing at the time), now no longer can stamp at the "old" rates. These persons will now be subject to the new provision and the "new" rates.

For the sake of consistency section 6*(a)* of the UST Act should receive the same exemption as that contained under Item 15 of schedule 1 of the Stamp Duties Act, that exempts the issue of share in an intra-group context.
(PWC)

This comment is not accepted. This is beyond these proposed amendments and is an issue for next year's budget. SARS and National Treasury are currently reviewing the intra-group provisions and this issue will be considered.

Annexure 16: CGT Withholding: Non-Resident Sellers

SARS should undertake a widespread taxpayer education campaign to ensure that purchasers of property are adequately informed of their new obligations.
(SAICA)

This comment is noted for further attention.

A one-page return is needed for any non-resident (and, indeed, any person) who has no other source of income or assets in South Africa, whereby the tax is still calculated using the normal rules, but would obviate the need for the non-resident actually to be registered as a taxpayer in the normal way.
(SAICA)

This comment is noted and will be considered from an administrative point of view.

It should be required from the buyer or SARS to forward some proof of payment to the seller of payment of the tax. It appears that SARS is carrying the risk of misappropriation of the withholding tax by the purchaser.
(SAICA)

Any amount withheld by the buyer is recoverable from the buyer in the event of default.

The payment terms of the withholding tax of 10 and 20 business days respectively is very restrictive and out of step with general tax compliance legislation. Payment by the end of the month following the month of payment should be sufficient and will allow the parties sufficient time to meet their obligations.
(SAICA)

The period of time within which the withholding tax should be paid should be compared and aligned with the royalty withholding tax which is payable within 14 days as well as PAYE which is payable within 7days. The periods of time within which payment must be made have been changed to 14 and 28 days respectively.

A major concern we have is the transfer of the onus from the Commissioner to the purchaser who now has to determine whether the seller is a non-resident for taxation purposes. This is not an easy provision to determine and the penalty for the purchaser not complying is severe.
(SAICA)
SARS has the right to obtain such information as it may require which right the purchaser does not enjoy. Failure by SARS to provide this assistance may impact negatively on the purchaser and it will seem to be unfair to penalise the purchaser for non compliance. The seller will have right of legal recourse where the seller believes that the purchaser has incorrectly withheld the

amount but the purchaser will rather err on the "right side" to avoid personal liability. This needs to be addressed in the legislation.
(SAICA)

The liability on the purchaser is alleviated by the obligation that has been placed on the estate agent and conveyancer to inform the purchaser that the seller is a non-resident. The value threshold attached to properties which would be affected by the section will limit the number of transactions subject to withholding. In view of the comments by the Portfolio Committee on Finance the value threshold has been increased to R2 million.

If the buyer has not withheld the tax, for example due to ignorance, the entire withholding tax plus interest is effectively a penalty, as the buyer will in any event have paid the seller. Thus it does not appear necessary to have penalty provisions at all and SARS should have the discretion to waive the interest as well. The rationale is that, unlike other tax obligations, the buyer will already have been penalized on any additional amount that he is required to pay.
(SAICA)

This is required to prevent misappropriation of funds by the buyer as pointed out by SAICA in their presentation.

The Commissioner's discretion to remit the whole or part of the penalty imposed on the purchaser for failure to pay the required amount within the period allowed for payment should be subject to objection and appeal.
(SAICA)

This comment has been noted for future amendment.

In South Africa the estate agent is generally the agent of the seller, not the buyer. Should the estate agent or the seller, or both, have deliberately misled, or not informed, the buyer of the nationality of the seller then the buyer is left exposed to the unpaid withholding tax plus interest and penalties. The buyer should be specifically exempted from liability in these circumstances. The statement that "the purchaser knows or should reasonably have known" is too vague to penalise the purchaser. What would be regarded factually to determine whether the purchaser should reasonably have known that the seller was not a resident of the Republic is not clear.
(SAICA)

This comment is partially accepted. If the estate agent has not informed the buyer, the agent will be held liable. A buyer will not be personally liable for the withholding tax if the estate agent or conveyancer fails to notify the buyer of the non-resident status of the seller.

The obligation of the estate agent to inform the purchaser that the seller is a non-resident has no time restriction. The agent could for example inform the buyer only after payment has been made to the seller and the purchaser would still be required to pay the withholding tax. The estate agent's obligation to inform the purchaser of the non-resident status of the buyer should thus be at the time of signature of the agreement of sale so that the purchaser is timeously aware of his obligations.
(SAICA)

This comment is accepted. The estate agent or conveyancer must notify the purchaser in writing before any payment is made to the seller of the fact that the seller is not a resident.

It is unreasonable to place the onus of informing the purchaser that the seller is a non-resident, with punitive consequences, on conveyancers especially having regard to the fact that a conveyancer has virtually no contact with or prior knowledge of the seller.
(SAICA)

A conveyancer is only liable if he/she knows or reasonably should have known that the seller is a non-resident and fails to inform the purchaser. The conveyancer should make reasonable enquiries as to the residence status of the seller.

The withholding requirements should be on the conveyancer and/or the agent and not the purchaser.
(BCSA)

This comment is partially accepted. See the next comment and the final comment in this section in this regard.

Penalties on a purchaser who relies on an agent and conveyancer is inequitable and unprofessional.
(BCSA)

The comment is accepted. A purchaser will not be personally liable for the withholding tax if the estate agent or conveyancer fails to notify the purchaser of the non-resident status of the seller.

How will payment be allocated to non-residents that have not registered?
(PWC)

This aspect will be handled administratively.

Withholding funds from properties which are fully bonded becomes a financial burden. Sales in execution and under conditions of insolvency should be excluded from the withholding requirements.
(BCSA)

This comment is not accepted. Withholding tax can be withheld from any payments made by or on behalf of the purchaser. Provision has been made for the seller to obtain a directive for the withholding of a reduced or no amount.

Difficulties are created for parties where settlement is effected in shares.
(BCSA)

This comment is not accepted. This is an existing issue since capital gains tax would in any event be leviable with respect to the seller.

How do these rules apply if the parties are wholly foreign (i.e., the seller, buyer, estate agents and conveyancers)?
(PWC)

The withholding obligation will apply fully, as the property is located in South Africa and the remedies can be exercised against the purchaser.

4 General

After studying the Urban Development Zone legislation and having discussions with numerous parties we have grave concerns about the limited usefulness due to current, probably unintentional restrictions.
(Frank Gormley)

This matter does not form part of the Bill under consideration. The urban development zone tax incentive is already wide ranging. The incentive covers all construction costs related to the erection, extension, addition or improvement of commercial, residential or industrial buildings. These costs include the following:

- costs incurred by a taxpayer on demolishing or destroying any existing building (or any part of a building)
- costs incurred with respect to permanent fixtures lying near the site. These costs include provision for the following amenities:
  - water;
  - power;
  - sewage;
  - access or parking for the building;
  - drainage;
  - security for the building (including fences, cameras and surveillance equipment);
  - means of waste disposal;
  - sidewalks; and
  - landscaping (including earthworks, greenery and irrigation).

The urban development zone tax incentive is available to any taxpayer (including individuals, companies, close corporations and trusts as well as partners in a partnership), who erects or constructs a new building or carries out improvements on an old building. The taxpayer must use the new building or improvement solely for purposes of that taxpayer's

trade. Thus the buildings must either be used for business purposes or contribute to the increase of rental stock. Stated differently, the National Treasury does not want to incentivise private consumption through the tax system.

Inner city regeneration started before the incentive was introduced, which is a strong indicator that there is already a significant dead-weight loss to this incentive. There also are preliminary indications that there is substantial interest in the incentive as it is currently designed. The incentive is a catalyst, operating as a means to attract private sector businesses and to support other efforts aimed at regenerating urban areas in need.

Any suggestion for a legislative change along the lines suggested would represent a major policy shift from the current system, with the potential for substantial revenue costs. The Minister of Finance has indicated his intention to review the progress of the incentive within the following two years. This review will enable the Minister to measure the costs of the incentive against its effectiveness, and thus determine the affordability thereof and the need for any further refinements.

Propose the introduction of discretion in the imposition of penalties and sanction by the Commissioner in the unintentional failure to report a reportable arrangement.
(BCSA)

This matter does not form part of the Bill under consideration. The sanction for failure to report a reportable arrangement is a graduated one. All failures to report result in one of criteria for applying the provisions of the general anti-avoidance provisions in section 103(1) being deemed to have been met. Where the failure is not willful or reckless and the taxpayer is able to show that the arrangement was entered into otherwise than "solely or mainly for the purposes of obtaining a tax benefit", this deeming provision has no tax effect.

On the other hand, where the failure to report is willful or reckless, additional tax equal to the tax benefit actually derived by way of the unreported arrangement is also levied, unless extenuating circumstances exist. The net effect of this provision is that, barring extenuating circumstances, the willful or reckless failure to report negates any tax advantage derived by way of the unreported arrangement even if the arrangement was entered into otherwise than "solely or mainly for the purposes of obtaining a tax benefit."

It must be appreciated that whilst an enormous effort has been made by us in identifying areas of concern both for the taxpayer and the Fiscus, the severe time constraints within which we have had to comment on the draft legislation has prevented us from considering all practical situations and transactions which may be affected by the proposed legislation.
(SAICA)
It may well be necessary to enact further amendments to this legislation as further problems or limitations are identified by

taxpayers. We have seen this trend over the past few years in amending legislation given the volume and complexity of tax legislation that has and is being passed annually.
(SAICA)
The Banking Council would have appreciated a longer time frame within which to consult with its members and respond more comprehensively than we have done in the paragraphs below. The seven business days allowed for comment on a draft bill of 166 pages is prohibitive and we repeat our request for a longer commentary period.
(BCSA)

These comments are noted.

Prepared by SARS and the National Treasury