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

**RESPONSES TO REPRESENTATIONS BY ORGANISATIONS AND  
INDIVIDUALS TO THE MEETINGS OF THE PCOF AND SCOF ON THE  
REVENUE LAWS AMENDMENT BILL, 2003 (the Bill)**

**1 Introduction**

As indicated to you during the hearings on the above-mentioned Bill on 23 and 24 October 2003, 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:

ABASA	Association for the Advancement of Black Accountants of Southern Africa
AHI	Afrikaanse Handelsinstituut
CAFSA	Charities Aid Foundation of South Africa
LRC	The Legal Resources Centre
NPP	The Non Profit Partnership
PWC	PricewaterhouseCoopers
SACC	South African Council of Churches
SACOB	South African Chamber of Business
SAGA	Southern African Grantmakers' Association
SAICA	The South African Institute of Chartered Accountants

## 2 Consultation

SARS and the National Treasury placed 19 batches of draft legislation, dealing with the main categories of amendments on their websites from 3 September 2003 until 26 September for public information. It was pointed out that the amendments contained in the drafts were merely proposals which were subject to change and final approval by the Minister of Finance and that early comment on the drafts would be considered for possible inclusion in a revised draft Bill. The following persons submitted comments to SARS and/or National Treasury:

- ABSA
- Accounting and Income Tax Services
- AHI
- Chamber of Mines
- CAFSA
- City of Cape Town
- City of Johannesburg
- Deloitte & Touche
- Edward Nathan & Friedland
- Ernst and Young
- Eskom
- Fullinput Tax Services
- IPO: SA Film Industry
- Life Offices Association
- Maitland Trust
- Momentum Group
- National Film and Video Foundation
- Payroll Association
- PWC
- SAGA
- SAICA
- SACC
- SACOB
- Sanlam
- Sonnenberg Hoffman Galombik
- Standard Bank Group
- Telkom
- Vorster Pereira Attorneys
- WB Cronje
- AD Friedman
- R G Glass
- Karl Muller
- P J Nel

The Bill made available to your Committees on 8 October 2003 took into account some of the comments received before that date. The draft Explanatory Memorandum on the Bill was made available on 10 October 2003. The documents were placed on the websites of SARS and National Treasury shortly after being made available to you.

**Insufficient time is allowed for proper consideration of voluminous and often complex amendments which invariably results in unintended consequences emerging in due course which would require further amendment.**

(AHI)

Batches of the draft legislation have been made available to the public for comment from 3 September 2003 and the draft Bill since 8 October 2003. The whole taxpaying community and all tax practitioners had the opportunity to comment on the provisions of the draft Bill.

**The cost of complying with the administrative requirements of taxation legislation is becoming increasingly prohibitive, not only for small businesses, but for business in general.**

(AHI)

This comment is noted. Both SARS and National Treasury bear this in mind when drafting amendments to tax legislation. However, it must be accepted that a complex business environment gives rise to a relatively complex legislative framework.

### **3 Responses to specific issues raised in representations by commentators**

#### **3.1 Administrative Provisions**

**We are concerned that the power conferred upon the Commissioner in terms of the proposed section 13A of the Transfer Duty Act which treats mere filings by the Commissioner with a clerk of the Court as though that were a civil judgement lawfully given by that court, effectively bypasses the due legal process.**

(PWC)

This comment is not accepted. Similar provisions where a taxpayer fails to pay tax or interest are currently contained in section 91(1)(b) of the Income Tax Act and section 40(2)(a) of the VAT Act. This amendment, therefore, merely extends the similar measures contained in our main tax laws to the Transfer Duty Act.

**We are uncomfortable that the Commissioner is enabled for purposes of the collection of transfer duty, stamp duty, MST and UST to appoint any debtor of a taxpayer to be an agent of that taxpayer and to collect any tax due from that person. This enables SARS to appoint unpaid collection agents and foist additional administrative requirements upon the taxpaying community as a whole. If it is to be retained some linkage should**

**be introduced between the monies due from a person to the relevant taxpayer and the tax for which collection is sought.**  
(PWC)

This comment is not accepted. Similar provisions to appoint an agent where the Commissioner deems it necessary are contained in section 99 of the Income Tax Act and section 47 of the VAT Act. This amendment, therefore, merely extends the similar measures contained in our main tax laws to the Transfer Duty Act. The duties, tax or amounts which the agent is liable to pay is limited to amounts held by the agent or which is due by the agent to the taxpayer.

**We are concerned that the remedies against agents for purposes of the Transfer Duty, Stamp Duty, MST and UST Acts are far too broad and that the scope be limited to agents or trustees of the taxpayer against which the Commissioner may have a claim.**  
(PWC)

This comment is not accepted. Similar remedies of the Commissioner against agents and trustees are contained in section 100 of the Income Tax Act and section 49 of the VAT Act.

**Third parties appointed by the Commissioner who neglect to take the prescribed oath of secrecy in terms of the Income Tax Act are subject to the trivial penalty on conviction of R50.**  
(Banking Council; AHI)

The failure to take the prescribed oath or solemn declaration is currently subject to the R50 penalty. However, failure to take the oath or declaration does not absolve the person employed or engaged by the Commissioner from more significant remedies. These persons are also subject to imprisonment for a maximum period of 2 years on conviction for contravention of the preservation of secrecy requirements. Nevertheless it is proposed that the amount of R50 be increased to R500 as it has not been adjusted for some years.

**It is not clear whether the proposed limitation in respect of the extension of time in which to object in relation to the 30-day limit is subject to the “exceptional circumstances” requirement.**  
(Deloitte & Touche)

The normal rule will still be that an objection must be lodged within 30 days of the date of assessment. The period may then be extended for a further 30 days on reasonable grounds being submitted. If any extension beyond the period of 60 days is required, exceptional circumstances need to be advanced. The reason for bringing in a stricter test in this regard is that the new court rules prescribe strict time lines for both the taxpayer and the Commissioner. Previously no time lines were prescribed within which the Commissioner had to deal with an objection by a taxpayer. This has now changed to ensure a more speedily resolution of tax disputes.

**We are alarmed that the period of objection may not be extended, notwithstanding the existence of exceptional grounds, where the assessment was issued in accordance with the practice generally prevailing at the time.**

(PWC)

This comment is accepted. The limitation to appeal has been reworded to provide that the period for objection may not be extended where the grounds for objection are based wholly or mainly on any change in practice generally prevailing which applied on the date of the assessment.

**The settlement of disputes should not be limited to either accepting the Commissioner's or the other party's interpretation. There may be a "middle of the road" interpretation, which is acceptable to both parties.**

(AHI)

The purpose of the settlement of disputes procedure is to cater for situations where there is a disagreement on the interpretation of facts and/or law. The definition of "settle", therefore, specifically provides that the disputed liability is compromised otherwise than by accepting the other party's interpretation.

**The Commissioner is given unilateral powers to determine whether a matter constitutes intentional tax evasion whereupon the settlement provisions do not apply.**

(ABASA)

A let out is incorporated into the provisions dealing with intentional tax evasion which provide that, where there is a dispute and the circumstances contemplated in section 88D exist, settlement may still be explored.

**Where the Commissioner or delegated official in the settlement of dispute provisions is perceived to have a personal, family, social, business, professional, employment or financial relationship with the taxpayer concerned such relationship should be declared and recorded in the interest of full disclosure.**

(Banking Council)

This comment is accepted in the sense that the Commissioner or delegated official who has a personal, family, social, business, professional, employment or financial relationship with the person concerned may not be involved in the settlement procedure and another delegated official will have to settle the dispute.

**The suspension of section 89*quat* interest during the period a taxpayer is in default or fails to comply will give rise to disputes as it is unclear when a taxpayer will be in default or fails to comply. What if an extension is requested for submission of the requested information but there is no response from SARS?**  
(Deloitte & Touche)

**The suspension of interest provisions are too widely drafted as this could result, for instance, in the suspension of interest on a repayment in respect of the 1999 tax-year where the taxpayer has failed to comply with a deadline in respect of the submission of their 2003 tax return.**

(SAICA)

**There must be a link between the refund in question and any delay by the taxpayer related thereto.**

(PWC; SAICA)

This provision has been withdrawn from the Bill.

**The additional tax imposed for failure to submit an estimate of taxable income for provisional tax purposes on time has been extended to instances where the Commissioner has exercised his powers under paragraph 19(3) to increase the amount of an estimate supplied by the taxpayer.**

(PWC)

This statement is incorrect as the amendment specifically precludes the imposition of additional tax where the Commissioner has increased the taxpayer's estimate in terms of paragraph 19(3).

### **3.2 Business and Reinvestment Provisions**

**The reinvestment of replacement asset relief measures require that the replacement asset be brought into use within 18 months of the disposal of the existing asset. Some very large assets require a substantial amount of time to erect and to bring them into use. A period of three years should be allowed.**

(SACOB; SAICA)

This comment is accepted. A period of 12 months within which a contract must be concluded for the acquisition of a replacement asset has been introduced and the replacement asset must be brought into use within 3 years of the disposal of the replaced asset. The Commissioner has the discretion to extend these periods for a further 6 months if reasonable steps were taken to ensure that they were met.

**The deduction of start-up expenses incurred by small business corporations is limited to about R20 000, whereas for other entities this is dependent on taxable income.**

(ABASA)

The proposal appears to have been misunderstood. The draft legislation provides for the deduction of start-up expenditure as well as an additional maximum amount of R20 000 for small business corporations, i.e. a 200 per cent deduction for the first R20 000 of expenditure and losses actually incurred in the year of assessment during which the small business corporation commences trading.

### 3.3 Capital Gains Tax

**Paragraph 12(5): The restrictions with regard to the loan having been acquired from a non-group company or where the debt arose prior to the date that the companies formed part of the same group of companies should be deleted. Whilst we understand that there must be some concern with regard to tax avoidance where loans are acquired and subsequently waived, we cannot see how commercially someone would be willing to obtain a tax benefit of 15 cents for every Rand that they outlay if the sole or main reason is to obtain a tax benefit.**  
(SAICA)

This comment is not accepted. Amongst other things it exists to exclude disguised donations.

**A further important point on this deemed disposal paragraph is that the exclusion from the deemed disposal for CGT does not apply where the shareholder is a natural person or trust. With respect we cannot see any reason why these classes of taxpayers are excluded resulting in the taxpayer being prejudiced where it has natural persons or trusts as shareholders.**  
(SAICA)

This comment is not accepted. The proposed amendments are limited to situations which impact on the corporate restructuring rules for which Budget authority to effect changes exists. The extension to natural persons and trusts may be addressed in future as part of the review of all the insolvency provisions in the Act.

**Unless a consequential amendment is made to paragraphs 39 and 56, a creditor shareholder will be faced with the denial of a capital loss in all situations where relief has been afforded to the debtor company from the operation of paragraph 12(5). This will operate as a deterrent for companies to liquidate or deregister.**  
(SAICA)

This comment is not accepted. From a tax policy point of view a loss should not be allowed where a corresponding gain has been exempted.

**In the amendment of the part disposal rule in paragraph 33 of the Eighth Schedule SARS/Treasury is mixing up the technical term “base cost” and paragraph 20 expenditure.**

(KPMG)

This comment is accepted and the paragraph will be clarified.

**A lack of clarity has been created by the proposed amendment to paragraph 63 as the result of a circular argument in that relief cannot apply unless section 10 is applicable, which in turn does not apply to capital gains.**

(SAICA)

This comment is accepted and the amendment will be clarified by referring to any amount constituting gross income of whatever nature which would be exempt from tax.

**It is not clear whether the proposed definition of date of distribution in paragraph 74 will cover the situation of a section 311 compromise which must be approved by 75% of shareholders as well as by the courts or where a distribution is made subject to a suspensive condition.**

(SAICA)

The first situation is covered by the provisions of the draft legislation. As far as the second situation is concerned, where a distribution is subject to a suspensive condition, no accrual takes place.

**Currently the Eighth Schedule does not make provision for the calculation of the base cost of a pre-valuation date asset in circumstances where no amount accrues to the taxpayer during the tax year in which the disposal takes place or where amounts accrue over more than one year. In those situations the taxpayer cannot calculate a capital gain or loss.**

(SAICA)

This aspect will be considered and appropriate amendments may be proposed at a future date.

**A CGT event arises where a resident ceases to be a resident. Consideration should be given to insert a sort of *de minimis* rule for expatriates.**

(KPMG)

This aspect does not form part of the Bill under consideration. It should be borne in mind that the definition of “resident” already caters for an extended physical presence in the Republic without being considered resident.



### 3.4 Corporate Rules

**Losses incurred by a transferor cannot be transferred to the transferee under the rollover relief provided for in the corporate rules. The transfer of losses should be allowed even if it entails some sort of ring-fencing.**

(Deloitte & Touche)

This aspect does not form part of the Bill under consideration and could be considered in the medium to longer term as an element of group taxation should it be introduced. This comment contradicts the plea for a moratorium on introducing further major tax policy changes.

**The issue of acquisitions from non-residents in terms of the corporate rules requires to be specifically provided for, if not the resident takes on a base cost of zero. The provisions need to match the treatment of assets when a person becomes resident. This would facilitate further investment in South Africa from overseas.**

(PWC)

This comment is accepted and a new section 31A is to be introduced which provides that assets are to be transferred at the consideration in respect of the disposal by the non-resident which is not a controlled foreign company. However, where the non-resident and resident are connected persons the market value of the asset must be used.

**More targeted relief is required to deal with scenarios where SA groups are driving or otherwise managing a company, but due to local law or regulation or simply sound commercial practice, a local participator is required and the 75 per cent threshold cannot be met. Black economic empowerment initiatives are good examples of such a dynamic in South Africa. The proposed changes to the definition of domestic financial instrument holding company and foreign financial instrument holding company in section 9D represent backward steps and cannot be supported. Taking into account the concern raised of the risk of loss trafficking, the view is held that the corporate group relief should not be restricted where a company meets the requirements of a domestic financial instrument holding company.**

(PWC; SAICA)

The comment is not accepted. Where a shareholding of less than 75 per cent exists the subsidiary cannot be considered part of the economic unit that comprises a group. A permissible minority shareholding of 25 per cent is already a generous concession.

**The proposed amendment to the definition of “domestic financial instrument holding company” makes it more restrictive in application than a “foreign financial instrument holding**

**company” as far as the exclusion of shares and debt of a controlled group company instead of any company in the same group of companies is concerned.**

(Deloitte & Touche; PWC)

This comment is not accepted. Shares and debt held by holding companies and their controlled companies in other group companies that are not controlled (75% interest) by the holding company or its controlled companies should count against the holding company. From a tax policy point of view group relief in respect of unrealised gains and losses in respect of financial instruments which are not excluded should be limited to 75% holdings.

**In order to determine whether certain debts are to be excluded in determining whether a company constitutes a “foreign financial instrument holding company” the debt should be an integral part of a business conducted as a going concern. This test should be removed or simplified.**

(ABASA)

This comment is not accepted. Passive debt that does not form part of a business conducted as a going concern should be taken into account for purposes of this test as its exclusion would undermine the rationale for its existence.

**Any requirement to perform the 50% test on a company’s assets by reference to actual cost to determine whether it constitutes a domestic financial instrument holding company (which cannot benefit from the corporate restructuring rules) is fundamentally flawed and should be removed. It seems that companies which are converting trade debt to cash as quickly as possible, developed their own intangible assets (at no allocated historical cost) or are financing their business assets through finance leases which are not capitalised for tax purposes are precluded from the reorganisation relief notwithstanding that on a market valuation basis they could not be considered as financial instrument holding companies.**

(PWC)

These comments are partly accepted. It is proposed that the cost test be relaxed by allowing up to two third of assets consisting of unacceptable financial instruments (instead of the current 50% of assets). In the case of intra-group transactions and liquidation distributions no regard will be had to financial instruments the market value of which is equal to their base cost.

Cost is one of the foundations of the tax system. Market value is used in certain areas but even there it is sometimes subject to a cost override. A clear example is to be found in the so-called kink tests in the CGT system that apply to virtually all pre-valuation date assets. The cost test is required as a safety net for situations where

the market value of certain assets, especially intangible assets, is overstated in order to overcome the limitation in respect of domestic financial instrument holding companies.

The problem with a market value test as the sole test for a financial instrument holding company is that it is particularly vulnerable to manipulation in the area of intellectual property. SARS has come across instances where well known advisors have provided intellectual property valuations that were more than halved when challenged. (Similar experiences in prior years led to the special loss limitation rules in the CGT system for pre-valuation date intellectual property.)

In as far as leased assets are concerned leasing assets has very different tax consequences from owning them. These differences are simply maintained.

**A group of companies would not be able to effect an intra-group transaction, lend the remaining funds to the holding company and then liquidate into the holding company. The proposed definition of domestic financial instrument holding company does not allow for loans from lower tier companies to be disregarded.**

(SAICA)

This comment is partly accepted in that any loan, advance or debt entered into between a company and its controlled group companies will be disregarded.

**For the purposes of clarity specific provision should be made that where a company has ceded its assets by way of security that those assets still be included within the total assets in respect of which the 50% test is performed.**

(PWC)

This comment is not accepted. The view is held that the company continues to be the owner of the relevant assets.

**Provision needs to be made in the corporate rules for the spreading of the gains and recoupments in terms of paragraphs 65 and 66 of the Eighth Schedule, where a clawback of gains or recoupments is triggered on disposal of an asset by a transferee within a period of 18 months.**

(PWC)

This comment is not accepted. If the company disposes of the asset in order to reinvest the funds in a replacement asset the spreading rules in paragraph 66 are available.

**It is not clear why a reference to the valuation of the asset as at 1 October 2001 is inserted in the company formation rules.**

(KPMG)

Where a taxpayer valued an asset for Capital Gains Tax purposes on 1 October 2001 and transfers the asset to a company in terms of the company formation rules the legislation currently does not provide for the utilisation of the market value for the calculation of a capital gain or loss on subsequent disposal of the shares acquired in the formation company. The proposed amendment allows for the use of the market value in this situation.

**The definition of “unbundling transaction” is unclear. To qualify, an unlisted shareholder must own at least 75% of the shares in the unbundling company. Does this mean that to the extent to which the shares are not disposed of to a group shareholder it is not an unbundling transaction?**

(KPMG)

Correct, in the case of an unbundling of an unlisted company. The unbundling relief applies if the unbundling company disposes of all the equity shares it holds in the unbundled company.

**The exclusion of companies regulated in terms of the Stock Exchange Control Act, 1985, from the limitation relating to foreign financial instrument holding companies is uncertain and should be clarified. Listed companies could be regulated in terms of that Act.**

(ABASA)

**Why do adverse consequences arise if companies who made use of the intra-group relief measures cease to form part of the same group of companies ever? An 18-month rule is proposed.**

(KPMG)

These are not aspects which form part of the Bill under consideration.

### **3.5 Foreign Provisions**

**It appears that whilst a normal CFC may carry forward any excess foreign tax credits an elective CFC may not. What is the reason for this variance in treatment?**

(PWC)

The reason for allowing a taxpayer to elect to treat a foreign company which is not a CFC to be treated as a CFC is to allow the resident to claim foreign tax credits in order to remove the effect of double taxation. However, this elective provision should not be used to bring foreign tax credits in excess of the South African tax liability into the tax system which would shield other sources of low taxed foreign income. Therefore, the elective provision should not be used as a tax avoidance opportunity.

**We do not see why the excess foreign tax paid which relate to any includable diversionary and passive income of a CFC will not be allowed to be carried forward to be offset against South**

**African taxes that may be payable in future years of income. It does not seem logical to deny the carry forward of excess taxes paid but yet tax the income where the full effective rate of tax in any one year does not equal to or exceed 30%. The reason for the full effective rate of tax in a year not being at least 30% could be for a variety of reasons beyond the control of the taxpayer. We are of the view that it is inaccurate to assume that all South African companies that have offshore companies do so for the sole or main reason of avoiding or minimising their South African tax liability on a group basis. There are a number of commercial reasons, including freedom from exchange controls, proximity to markets, etc. We cannot see any reason for imputing the income of a sales or service company into a South African taxpayer where that company is located in a country which has a tax rate equal to or higher than the corporate rate of tax in South Africa.**  
(SAICA)

These comments are not accepted. The limitation of foreign tax credits to the South African tax payable on the foreign diversionary and foreign passive income during a specific tax year has the same effect as an exemption system. However, where those sources of income are subject to foreign tax which is less than the South African tax on that income the difference in tax will be payable in South Africa after set off of excess foreign tax credits from other sources of taxable foreign income.

**Offshore financing subsidiaries of South African banks with business establishments earning income from wholesale banking activities by financing the activities of independent third parties are inadvertently subject to imputation under section 9D.**  
(Banking Council)

More information was provided on National Treasury and SARS's request. However, it appears that the clients of the foreign wholesale banking operations are all located outside the jurisdictions where the foreign companies are located. Those clients all have South African connections, i.e. they are residents or are members of South African group companies. One of the main reasons for operating in those jurisdictions *vis-à-vis* from South Africa is the low tax payable in those jurisdictions. From a tax policy point of view the activities of these "foreign" wholesale banking operations should be subject to tax in terms of the Controlled Foreign Company regime.

**The long delay in introducing the exemption in respect of foreign dividends is unacceptable. SACOB and KPMG propose an effective date of tax years commencing from 1 January 2004.**  
(Deloitte & Touche; SACOB; KPMG)

This comment must be balanced against previous requests made before the Committees that an extended period for adjustment of offshore structures be granted, should the designated country list be modified. Most of the changes relating to the taxation of foreign

income will only come into effect from the commencement of tax years on or after 1 June 2004. This would provide resident taxpayers sufficient time to study and implement the changes to the provisions relating to the withdrawal of the designated country exemption and indirect foreign tax credits, and the new system of exemption relating to previously taxed CFC income.

**The removal of the designated country exemption could leave the taxpayer in a worse-off situation. A Group Treasury company in a high tax jurisdiction might not have paid tax in that jurisdiction because of a tax loss or group tax relief and the companies income will now be taxed under section 9D .**

(SACOB; SAICA)

This statement is not correct. As far as the group tax relief is concerned, the current designated country exemption consists of a dual test, i.e. the income must have been subject to tax in a designated country and the income should have been taxed at a statutory rate of tax of at least 27 per cent in that country.

**It is unclear why the election for a foreign company to be treated as a CFC takes into account the participation rights of a resident and connected persons whereas the foreign dividend participation exemption only takes into account equity shares held by a person other than a company, or in the case of a company equity shares held together with companies in the same group of companies.**

(Deloitte & Touche)

This comment is not accepted. CFC relief rules are more expansive, whereas the participation exemption for foreign dividends should only be available to members of a group of companies that in aggregate hold a more than 25 per cent interest in the company declaring the foreign dividend.

**There does not seem to be an obvious reason why a resident holding between 10% and 25% of a foreign company would elect that the foreign company be deemed to be a CFC.**

(KPMG)

A resident may make the election to be taxed on the net income of that foreign company under section 9D in order to utilise the foreign tax paid by that company as credits and not to be taxed on the distribution of the profits of the foreign company. This enables the resident to avoid the economic double taxation of profits distributed and taxed as a foreign dividend where no underlying foreign tax credits may be claimed.

**It seems inequitable that residents holding more than 50% of a foreign company are taxed on the company's passive income, no amount is taxed for holdings between 25% and 50% and foreign dividends are taxed for holdings of not more than 25%.**

(KPMG)

The reason for taxing foreign dividends from 25 per cent and smaller holdings is that such holdings are considered to be portfolio investments. Although the percentages differ, it is an internationally accepted principle to tax income from portfolio investments. The taxation of the passive income of CFCs is an extension of this principle whereby the indirect holding of a passive investment is taxed. From a tax policy point of view a participation exemption has been introduced which means that foreign dividends from these shareholdings are not subject to tax where an interest of more than 25 per cent is held in a foreign company.

**Include references to the exemptions under section 10(1)(k)(ii)(bb) and (cc) in respect of dual listed company dividends and previously taxed section 9D income in the list of sections for which a CFC is deemed to be a resident.**

(SACOB; SAICA)

This comment is not accepted as the dual listed exemption is not limited to residents and the previously taxed section 9D income relief measure is already provided for in section 9D(9)(f).

**The exemptions provided in section 9D for net income which was taxed at an effective rate of tax of 30 per cent in another country will be impractical to implement as it will be impossible to extract each item of affected income where thousands of transactions have been entered into.**

(SACOB)

**It is not clear whether “rate of tax in terms of this Act” in section 9D(9)(b) refers to the effective or nominal South African tax rate. Must the income attributable to the relevant portion be singled out or would one look at the total taxable income in which that portion is included?**

(SAICA)

**The exclusion from the ambit of the “connected sale/service” exclusions that apply in relation to the business establishment provisions should refer to income which has been or will be subject to tax at a rate of tax at least equal to the “qualifying statutory rate” as defined in section 9E.**

(Deloitte & Touche)

These comments are accepted and the exemption relating to acceptably taxed income will be removed. An amount equal to the net income of the CFC will be imputed and foreign tax credits will be allowed against the South African tax liability.

**The anti-avoidance provisions relating to the passive income inclusion in section 9D are too broadly stated and the existing formulation is recommended.**

(Deloitte & Touche)

This comment is not accepted. The reformulated anti-avoidance provision is more focussed on round-tripping schemes.

**The replacement of a foreign financial instrument holding company with a domestic financial instrument holding company had it been a resident is inexplicable.**

(Deloitte & Touche)

This comment is accepted and the definition of a foreign financial instrument holding company in section 41 is used with adjustments for intra-group shares and debts.

**When performing either of the tests for foreign or domestic financial instrument holding companies no account has been taken of situations where the company in respect of whom the test is carried out has subsidiaries of the opposite kind, i.e. where a domestic company has foreign subsidiaries or a foreign company has domestic subsidiaries. The definitions should be amended to provide for these situations.**

(PWC)

This comment is accepted and provision will be made for situations where a domestic company has foreign subsidiaries or a foreign company has domestic subsidiaries.

**The proposed amendment to the definition of Foreign Financial Instrument Holding Company (FFIHC) seeks to restrict the exclusion only to situations where the share is in a controlled group company in relation to the taxpayer and to a loan, advance or debt entered into between either the taxpayer and any controlled group company in relation to the taxpayer or controlled group companies in relation to that company. This means that where a company holds 73% of the shares of a company whilst the remaining 27% of the shares are held directly by the ultimate South African parent company, the value of the 73% shares must be included in determining whether the taxpayer is a FFIHC or not. This seems totally illogical as the shares are held 100% within the same group of companies. Similarly, we do not see why the restriction should apply to loan transactions with controlled group companies in relation to the taxpayer being tested under the FFIHC definition. It must be noted that one is not able to conduct significant treasury operations in a multinational group from within South Africa having regard to our Exchange Control Regulations.**

(SAICA).

**The participation exemption should apply to the disposal of shares in a group company and not merely a controlled group company.**

(Deloitte & Touche)



These comments are accepted and shares and loans held in any company in the same group of companies will be excluded.

**The exclusion of foreign dividends in respect of preferent shares from the participation exemption is considered to be penal where a taxpayer holds more than 25 per cent of a foreign company.**  
(SACOB; SAICA)

This comment is not accepted. The dividends in respect of preferent shares are in essence interest and should not get the benefit of the participation exemption for foreign dividends.

**In the tax avoidance provision limiting the participation exemption in respect of foreign dividends it is not clear whether deductible expenditure corresponding to the amounts not taxed must be incurred within or outside South Africa.**  
(SAICA)

This provision has been clarified and provides that in order for the limitation to apply the expenditure must be deductible for purposes of determining the liability for tax in terms of the Income Tax Act, 1962.

**The proposed provision allowing deductions of interest against foreign dividend income refers solely to companies and thus excludes other persons such as natural persons, trusts, deceased and insolvent estates. There seems to be no logical reason for this especially given that the inclusion of foreign dividends in the definition of gross income is not limited to companies.**  
(SAICA)

The comment is accepted and the deduction will be allowed to all taxpayers.

**The promised amendment to section 24I(11) has not been included in these amendments. The unintended denial of an exchange gain or loss where assets acquired in a foreign currency are used by the taxpayer or are disposed of locally should be withdrawn.**  
(Deloitte & Touche)

**Section 24I(11) requires an amendment to remove the fact that it covers trading stock as well as capital assets.**  
(KPMG)

**Section 24I(11) should be amended to bring it in line with the explanation given in the Explanatory Memorandum to Act 60 of 2001 and with SARS's practice.**  
(SAICA)

This requested amendment has already been effected and is contained in paragraph 43(4) of the Eighth Schedule to the Income Tax Act. In essence, exchange gains and losses attributable to any

asset which is deemed to be a South African sourced asset (capital assets as well as trading stock) will not be disallowed in terms of section 24I(11). This amendment will be clarified by specifically stating in section 24I(11) that the limitation will not apply where the provisions of section 9G or paragraph 43(4) of the Eighth Schedule would apply had the asset been disposed of regardless of whether or not that asset constitutes trading stock.

**The provisions relating to the remedy where a resident fails to comply with the reporting requirements in respect of CFCs are penal and onerous. They do not recognise the practicalities of doing business in foreign jurisdictions where the requirements in respect of financial statements and accounting practices differ from those in South Africa.**

(SACOB; KPMG; SAICA)

**SARS is provided with discretionary powers to impose a penalty. It is unreasonable to allow SARS to levy double tax on a taxpayer as a result of administrative difficulties.**

(KPMG)

**We believe the focus should rather be on making this an offence, with consequential implications.**

(SAICA)

These statements are not accepted. The reason for the reporting requirements is to determine whether a resident has an interest in a CFC which could result in an inclusion in the resident's income and to determine the type and scope of the activities conducted by the CFC. The requirement relating to the submission of the financial statements of a CFC requires financial statements prepared in accordance with generally accepted accounting practice. This would include the generally accepted accounting practice of the foreign jurisdiction in which business is conducted.

**It appears that where a CFC is held underneath a chain of South African companies, each of those South African companies must file all the information required in the return relating to controlled foreign companies.**

(PWC)

This comment is accepted and the reporting requirements will be changed to impose the compliance requirements on South African companies which directly own foreign companies, as is the case for the imputation of section 9D amounts.

**The application of the section 8E anti-avoidance provisions is currently too wide as it also covers listed companies. No credit for foreign tax paid is granted in respect of the foreign dividend which is deemed to be interest received for tax purposes.**

(PWC)

**Controlled foreign companies generating passive income are subject to the imputation rules in full although they may also generate losses from active businesses which qualify as**

**business establishments.**

(PWC)

These aspects do not form part of the Bill under consideration.

**3.6 Individuals and Employees**

**Directors of private companies, like all other taxpayers, should be subject to tax on the income that accrues to them.**

(Deloitte & Touche; KPMG)

This comment is not accepted as many directors of private companies are in a unique position where their director fees and bonuses are only fixed after the end of the financial year of the company when the financial statements are finalised. In the absence of anti-avoidance measures this permits the deferral of employees' tax through the use of loan accounts.

The possibility was raised that all cash received by directors should be taxed, but then no distinction would be drawn between disguised remuneration and genuine loans. The relief measure proposed in the Bill of excluding directors of private companies from applying the formula calculated remuneration will apply to directors earning at least 75 per cent of their remuneration in the form of fixed monthly payments. This means that a director of a private company can earn an annual bonus equal to a maximum of four months salary and not be subject to the formula based determination of PAYE to be deducted on a monthly basis.

**Public officers, directors and shareholders should only be personally liable for the employees' tax due to the State by the employer to the extent they benefited from the transgression or it can be shown that they are aware of it and colluded therein. The person affected should be empowered to recover the tax from the employer.**

(Deloitte & Touche)

**In the provisions dealing with the personal liability of directors, shareholders and directors of a company for employees' tax not paid over to the Commissioner it should be stated that the primary liability remains with the employer.**

**Also it appears that each and every director, shareholder and public officer may be pursued for payment of the same amount with no reference to their actual interest in the company. No cognisance has been taken of the fact that different views may be taken as regards the tax which requires to be deducted. For example, an employer may take the position that no PAYE requires to be withheld in respect of an individual he considers to be an independent contractor. If this subsequently transpires to be incorrect, or if SARS takes a different view, the directors, shareholders and public officer will automatically be personally**

**liable, while any mistake could have been as a result of incorrect information provided to them.**

**In a scenario where SARS does in fact collect the tax from the responsible individual concerned, any reimbursement of that amount of tax by the employer to the individual must be catered for in that such amount will not be considered taxable income or a fringe benefit.**

**(PWC)**

**In situations where a representative employer or a director becomes personally liable for the payment of employees' tax, the employer should remain liable for payment to SARS.**

**(AHI)**

**We object to the public officer and shareholders of the company being held personally liable for employees' tax and unemployment insurance contributions as they may have no knowledge of whether employees' tax, UIF and penalties have been paid timeously by the company. We believe that if any provisions are to be introduced, it should be effective only where the directors and or shareholders have benefited after the date that the employees' tax or UIF became payable to SARS. Further, their personal liability should be limited to the extent of such benefit received after the date of the company's liability for employees' tax or UIF.**

**(SAICA)**

The comments are partly accepted and the provisions will be redrafted to limit liability to the representative employer as well as directors or shareholders who controls or are regularly involved in the management of the company's overall financial affairs. The personal liability of the representative employer, directors or shareholders only arises where the employer has withheld PAYE but has not paid it to SARS within the required period. The representative employer, director or shareholder who is personally liable and then pays employees' tax, additional; tax, penalty or interest may recover the amounts from the employer or from funds held on behalf of the employer.

International experience has shown that the imposition of personal liability on officers and shareholders of a company is an effective procedure to prevent the misuse or misappropriation of funds collected on behalf of the State.

### **3.7 Lending Arrangements**

**As there may be a delay between the trade date and settlement date the definition of "lending arrangement" in section 1 of the Uncertificated Securities Tax Act, 1998, should be amended to provide that the ten day and 12 month periods should be measured from the date the securities are delivered to the borrower. This would not open any loopholes.**

**(Rand Merchant Bank)**

This comment is accepted and the periods will be determined with reference to the date of transfer of the securities from the lender to the borrower.

**Lending of securities should be allowed by a borrower for purposes of delivery to the Lender.**

(Rand Merchant Bank)

This comment is accepted on condition that the borrower can demonstrate that the lending arrangement was not entered into for purposes of the avoidance of any tax or to keep any position open for more than 12 months.

### **3.8 Mining Rehabilitation**

**Previously the trusts could invest their funds in institutions approved by SARS. This is now changing and requires the Financial Services Board to approve the investment by the trust of its funds in any assets other than those made in financial institutions. The other issue is whether the FSB would have capacity to deal with these. (SAICA)**

The proposed amendment only refers to investments in financial institutions as defined in section 1 of the Financial Services Board Act, 1990 and does not require specific approval by the FSB of investments by the company, society, association or trust.

**Should the fund fail to comply with the provisions of this Act or its regulations under which it is established, the SARS can potentially tax all accumulated reserves of the fund at the company tax rate. This is extremely penal. In our view the net income of the year in which the fund transgressed should be taxed, not the prior years.**

(SAICA)

The comment is not accepted. The fund's approval will only be withdrawn after due notice after it has in a material respect or continuously failed to comply with the provisions of section 10(1)(cH). Thereafter the fund has at least 3 months within which it must transfer its assets to another approved fund. Only if the fund has not taken reasonable steps to so transfer its assets will the accumulated reserves be taxed. These measures are similar to those applicable to PBOs approved under section 30.

### **3.9 Public Benefit Organisations**

**Consideration should be given to allowing tax deductibility of donations at source through payroll-giving schemes.**

(CAFSA; SAGA)

This aspect does not form part of the Bill under consideration. It would require a tax calculation to be done by employers taking into account donations within the deductible limit by the employee to PBOs as well as administrative changes by employers and SARS.

**The limit on tax-deductible donations should be removed completely.**

(CAFSA; SAGA)

This aspect is not part of the Bill under consideration and was not announced by the Minister in the 2003 Budget. Such a step would require consideration of the affordability from a budgetary point of view.

**There are a great number of organisations doing valuable work which have not previously had to submit an application for tax exempt status although they were entitled to. These organisations would not be entitled to an exemption from transfer duty, deductible contributions for estate duty purposes or stamp duty exemption. The application deadline in terms of section 30 should be extended.**

(CAFSA; SAGA; LRC; NPP; SACC)

**The deadline for lodging exemption applications should be reviewed in the light of the extension of the list of qualifying PBOs.**

(ABASA)

This comment is partially accepted. Organisations which were exempt under those provisions of section 10 which were repealed in 2000 will be granted a further period of one year within which to apply for approval in terms of section 30 of the Income Tax Act. If these organisations do not apply before 31 December 2004 their tax exempt status will be forfeited. However, in view of the revenue risk associated with section 18A status a similar extension has not been granted to organisations which have not applied for approval by the Commissioner in terms of section 18A. These organisations only have until 31 December 2003 to apply for approval in terms of section 18A.

**The donation for section 18A purposes should include limited interests (fiduciary, usufructuary and annuity rights), intangible assets (copyright, goodwill, patents and intellectual property) and financial instruments (promissory notes, NCDs, mortgage bonds and acknowledgements of debt).**

(CAFSA; SAGA)

This comment is partly accepted. The donation of financial instruments with a financial institution as defined in the Financial Services Board Act, 1990 and such other prudent investments in financial instruments as the Commissioner may determine after consultation with the Executive Officer of the Financial Services Board will be allowed. However, the donation of limited interests and intangible assets will not be allowed. The donation of cash, full

interests and tangible assets is to be encouraged in contrast to the donation of intangible assets which are currently rarely donated in any event. The reasons for excluding limited interests and intangible assets are the risk of tax avoidance and problems with the valuation thereof.

**The special fiscal dispensation granted with respect to transfrontier parks represents a curious anachronism when contrasted with the exclusion of section 18A benefits in relation to numerous other important and valuable public benefit activities listed in Part I of the Ninth Schedule.**

(CAFSA; SAGA)

The Bill provides for a significant expansion of the public benefit activities which qualify for section 18A benefits. The decision to add activities is made taking into account a number of factors such as prioritisation of government policy initiatives, affordability and administrative issues. It should also be noted that the dispensation granted to transfrontier conservation areas exists only for a limited period of time under special conditions.

**It needs to be made clear that the tax deductibility of a donation given in good faith to an eligible organisation in respect of an eligible activity should be deductible by a taxpayer irrespective of whether the recipient organisation is dishonest or not. Punish the perpetrator not the victim.**

(CAFSA; SAGA)

This aspect does not form part of the Bill under consideration.

**The audit certificate to be submitted by an organisation carrying on both Part I and II activities should confirm that donations were not misappropriated.**

(CAFSA; SAGA)

This comment is not accepted. To serve as a control measure the audit certificate should confirm that all donations in respect of which receipts were issued were utilised solely in carrying on activities contemplated in Part II of the Ninth Schedule.

**Insofar as other African countries are concerned it is urged that South Africa adopt a liberal attitude to its treatment of public benefit activity and that the present restriction that 85 % of benefit accrues to South Africa be eliminated and not be made conditional upon Ministerial approval.**

(CAFSA; SAGA)

This comment is not accepted. This aspect is not part of the Bill under consideration and has not been dealt with in the 2003 Budget.

**It is proposed that section 18A funding associations be permitted to advance funds to non-section 18A approved organisations which are engaged in public benefit activities that have applied for section 18A status.**

(LRC; NPP)

This comment is not accepted. By allowing such a step would undermine the whole section 18A system.

**The proposed provision dealing with donations from persons who are not residents does not include other Governments or UN Agencies.**

(CAFSA; SAGA)

This interpretation of the word “person” is not accepted. Person as defined in section 1 of the Income Tax Act would include any foreign government, organisation, body and agency.

**The measurement of “cost” and “time” to determine the percentage of benefit persons in the Republic receive from the activities of the PBO is highly problematic and unreliable and creates an unrealistic expectation that it may be possible to measure cost and time.**

(CAFSA; SAGA)

This method of measuring was introduced in 2002 and does not form part of the Bill under consideration.

**The public benefit activity relating to Land and Housing: Provision of residential care for retired persons should cover situations where there is a partial recovery of cost from persons who are poor and needy.**

(SACC; CAFSA; SAGA)

This comment is accepted. The provision has been reworded to require the active provision of residential care to poor and needy retired persons without full recovery of cost.

**Does “clinics” as used in the public benefit activity under Land and Housing have a clearly defined meaning?**

(CAFSA; SAGA)

The term “clinics” is not defined and it should be interpreted as the ordinary meaning of the word, i.e. private or specialised hospital, place or occasion for giving medical treatment or advice.

**The exclusion of certain items in Part I of the Ninth Schedule from the list in Part II cannot be justified and all activities under Part I should be included.**

(CAFSA; SAGA; LRC; NPP)



This comment is not accepted due to quantification and affordability concerns. However, most of the activities under the heading “Land and Housing” have been listed. The remaining activities under the headings “Welfare and Humanitarian” and “Education and Development” in Part I are also added to the list of activities qualifying under section 18A.

**Part II of the list of activities qualifying for section 18A benefits should be expanded to include all public benefit activities listed in Part I under Welfare and Humanitarian, Health Care, Land and Housing and Education and Development.**

(SACC)

This comment is accepted except for the following activities which have not been listed:

- The provision of residential care for retired persons.
- Building and equipping of community centres, sport facilities or other facilities of a similar nature for the benefit of the poor and needy.

The first activity has been excluded because there is no requirement for facilities to be dedicated to the poor and needy. Thus the wealthy would be able to benefit from the deduction of contributions to their own retirement homes. The activity under the second bullet does not fall within the themes for the expansion of Part II this year.

**The following general public benefit activity should be added to the list under Part I:**

**“Any activity intended to promote the extension or protection of the rights, freedoms and values enumerated in Chapter 2 (the Bill of Rights) of the Constitution.”**

(LRC; NPP)

This aspect is not part of the Bill under consideration. However, this matter is to a large extent already covered under the activities listed in Part I.

**The current legislation severely restricts the potential for organisations to raise funds through trading and severely punishes breaches of the legislation. It is proposed that the acceptable trading threshold be increased to the greater of R100 000 or 50% of gross receipts and that trading income in excess of these limits be subject to normal principles of taxation.**

(LRC; NPP)

**Ultimately the limit on income a PBO is allowed to earn from trading should be substantially raised or abolished altogether. In the interim earning trading income in excess of the limits should cease to be grounds for withdrawal of PBO status and the excess should be subject to normal principles of taxation.**

(SACC)

These aspects are not part of the Bill and require much further investigation and research. National Treasury and SARS reiterate that unrestricted trading by PBOs raises concerns with respect to unfair competition with taxpayers and abuse of exempt status. Should a PBO wish to trade in order to raise funds, it is permitted to do so by way of a taxable subsidiary.

**It is proposed that small PBOs, defined as associations of persons with gross annual receipts of less than a specified threshold, be required to meet a less rigorous set of registration requirements. Small PBOs could also be excused from filing annual tax returns.**

(SACC; LRC; NPP)

This comment is not accepted. A dual system would currently be difficult to administer, but could be considered in future.

**It is proposed that PBOs that continue to qualify for exemption under section 21(2)(a) of the Taxation Laws Amendment Act, 2000 obtain exemption under the Skills Development Levies Act.**

(LRC; NPP)

This comment is accepted and an exemption will be introduced by referring in the exemption provisions in section 21 of the Taxation Laws Amendment Act, 2000, to any Act administered by the Commissioner for SARS.

### **3.10 Reportable Arrangements**

**The banks have regularly offered to disclose the information with a view to facilitate an advanced ruling system which would enable the correctness of any assumptions on the tax treatment of a transaction to be established at the outset. The proposed disclosure requirement is likely to result in the proliferation of *ad hoc* tax amendments.**

(Banking Council)

**The reporting requirements should be delayed until SARS is in a position to issue advance rulings to taxpayers on proposed transactions.**

(SAICA)

**To impose such legislation in a developing country such as ours is wholly inappropriate. Instances where advance reporting of the nature proposed exist are only where a system of advance rulings also exist, for example in the UK. This legislation should be combined with or preferably preceded by the awaited legislation on an advanced ruling process.**

(PWC)

**The information can be obtained without having to resort to legislation. By refining existing questions on the income tax returns and providing proper and clear guidance on the completion thereof, SARS should be able to gather the additional**

**information needed.**

(PWC)

These comments are not supported. A distinction should be drawn between an advance ruling system which is a voluntary system which gives certainty to taxpayers on the treatment by SARS of a transaction to be entered into and reportable transactions where taxpayers are obliged to disclose transactions which may pose a risk to tax collections. The intention is not to only introduce either of the two systems but to have both to complement each other. Although there may be an overlap between the two systems, disclosure of transactions entered into is required to act as an early warning system to SARS. The information provided in the tax returns reflects transactions entered into many months and sometimes years before the tax returns are submitted. The transactions being targeted are devised in the financial sector which is on a par with that of many first world countries. SARS has practical experience of billions of Rand of transactions entered into by taxpayers that resulted in the deferral and avoidance of taxation.

**The provision that arrangements may be identified by the Minister which are similar to any other listed arrangement is vague.**

(AHI)

This comment is accepted and the legislation will be reworded to provide that the Minister has the power to identify any arrangement which has certain characteristics, which are likely to lead to an undue tax benefit.

**Opposed to the power granted to notify additional transactions without Parliamentary scrutiny.**

(Banking Council)

This comment is addressed by providing that any arrangement identified by the Minister by notice in the *Gazette* must be tabled in Parliament within 12 months from the date of publication for incorporation in the Income Tax Act.

**The failure to report a transaction will frustrate the taxpayer's ability to rely on the tax treatment in accordance with prevailing law. The economic consequence of this measure bears no relation to the seriousness of the "offence" committed. The right to claim general deductions or input credits for VAT purposes may also be affected. No provision is made for the Commissioner to waive the penalty and the measure is not subject to objection and appeal.**

(Banking Council)

This comment is partly accepted and the penalty provision will provide for two levels of sanction.

Firstly, a company or trust which fails to report will automatically be deemed for purposes of the application of the general anti-avoidance provisions in section 103(1) of the Income Tax Act to have—

- entered into the arrangement in a manner which would not normally be employed for *bona fide* business purposes, other than the obtaining of a tax benefit;
- entered into the arrangement by means or in a manner which would normally be employed in the entering into or carrying out of an arrangement of that nature; and
- created rights or obligations which would not normally be created between persons dealing at arm's length under an arrangement of that nature.

Secondly, willful or reckless failure to report will result in the obligation to pay, in addition to the normal income tax liability, an amount equal to the tax benefits to which the company or trust is entitled. Provision is made for the Commissioner to consider mitigating circumstances to reduce the additional amount.

**It is unreasonable to expect delivery of the information required on the date of conclusion of the transaction. A period of at least 30 days to comply should be granted. In order to lessen the compliance burden on the taxpayer it is proposed that the obligation to deliver certified copies of all the signed documents be omitted.**

(Banking Council)

These comments are accepted. An arrangement should be reported within 60 days after the date that any amount is first received by or accrues to or is paid or actually incurred by any person in terms of the arrangement. Provision has been made for the Commissioner to extend this period by no more than 60 days where reasonable grounds exist for the delay in reporting that arrangement. In the case of documents to be supplied it will be acceptable for copies of the signed documents relating to the arrangement to be provided.

**There has been no prior consultation with the industry on these proposals.**

(Banking Council; PWC)

The draft legislation was brought to the attention of the Banking Council on 8 October 2003.

**The definition of “reportable transaction” would in all probability include many unintended transactions in its ambit, e.g. employment contracts, finance leases, insurance policies and endowment policies. The compliance burden imposed upon taxpayers and SARS is severe and impractical.**

(Deloitte & Touche; SACOB; KPMG; PWC)

**The definition of “reportable transaction” is extremely wide and could possibly include any contract of insurance. It is proposed that a threshold of R1million tax benefit be incorporated which**

**would trigger the reporting requirement.**

(AHI)

**Merely advising a client of an allowance that might be claimed on new plant or advice that a client might qualify as a PBO could be seen to fall within the definition of tax benefit.**

(KPMG)

**A de minimus tax benefit reporting level of R10 million for any transaction or series of similar transactions could be set.**

(PWC)

These comments are partly accepted and provision will be made for reporting where an arrangement provides for a variation of interest, finance cost, fees or other charges of more than R5 million should the actual tax treatment differ from the anticipated tax treatment or should the anticipated tax treatment be challenged by the Commissioner.

**It is in our view unconstitutional to deny a taxpayer any tax benefits in terms of the unreported transaction on failure to report. There is already a criminal sanction provided for in section 104(1A)(a).**

(AHI)

**The constitutionality of denying a taxpayer any benefits to which it is entitled in terms of the law should be questioned. It is not in the public interest to subject administrative oversights to such severe sanctions.**

(KPMG)

The comments are not accepted. Nevertheless the sanctions for non-compliance have been restructured. Failure to report will result in a stricter application of the general anti-avoidance provisions of section 103(1) and an additional amount equal to the tax benefits is payable for willful or reckless failure to report. The criminal sanction has been withdrawn.

**To include “confidentiality” as a trigger for a reportable transaction, denies companies their proprietary rights in respect of new products and protecting their intellectual property in a very competitive environment. SARS has an unprecedented objective to inhibit innovation and competition in the financial services sector in the belief that it comes at a substantial cost to the fisc.**

(AHI)

**The protection of intellectual property by a taxpayer would be penalised by way of the onerous reporting requirements. This requirement could result in millions of reportable transactions.**

(KPMG)

**To require the banking community and tax advisors to disclose information where a confidentiality arrangement is in place is overly cumbersome and onerous.**

(PWC)

The confidentiality criterion has been withdrawn. However, the statements are not accepted. The information provided to the Commissioner would have been subject to the secrecy provisions contained in section 4 of the Income Tax Act.

**The criminal sanctions for claiming any tax benefit where no identification number has been issued and for failure to disclose the identification number in the tax return should be deleted as they are too extreme.**

(AHI)

These provisions are withdrawn as the requirement for an identification number to be issued is no longer required.

**Guidelines should be provided of what should be reported.**

(ABASA)

**A further concern raised is whether the taxpayer reporting the transaction will be required to provide the Commissioner with any opinion obtained on the tax treatment or consequences of the transaction. We are strongly of the belief that any opinion obtained with regard to the tax treatment or consequences should not be required to be made available to the Commissioner as this could be crucial to the taxpayer in the event of litigation against the Commissioner.**

(SAICA)

The specific items of information are set out in the proposed section 76A(3) and do not specifically include an opinion obtained by the taxpayer.

**The definition of tax benefit needs to be narrowed in order to only penalise transactions entered into other than for commercial benefit.**

(ABASA)

This comment is not supported as it could be argued that the benefit of a tax reduction or deferral constitutes a commercial benefit.

**The proposals will place a significant burden on SARS's already stretched resources as they will receive a large volume of information from numerous taxpayers which will need to be reviewed and processed. Identification numbers will also need to be issued timeously. Significant additional infrastructure will be needed to administer the provisions. These provisions cannot be effectively enforced and should not be enacted. Concern is expressed that South Africa is putting in place an overly cumbersome administrative regime.**

(PWC)

**The provisions will furthermore have a significant detrimental impact on key sectors of the economy, including banking and professional services. Over regulation limits economic growth. Caution against introducing legislation that makes South Africa a less competitive environment (due to heavier regulation) than both its peers and the more developed nations.**  
(PWC)

The provisions have been focused on the areas currently of greatest concern by eliminating the confidentiality criteria, by introducing a R5 million threshold for reporting where there is a variation of interest or other charges and withdrawing the obligation on SARS to allocate an identification number.

**The focus should be on using SARS's available resources to create certainty as a priority over using those existing limited resources to police additional regulations.**  
(PWC)

This comment is not accepted. Such a focus would be to the benefit of those taxpayers who are not willing to come forward but who would prefer to delay or obstruct SARS's knowledge of their structures.

**If the legislation is to be introduced it should only apply in respect of reportable transactions entered into on or after some future date and preferably one year after the legislation becomes law.**  
(PWC)

This comment is partly accepted and the reportable arrangement provisions will come into operation on a date to be determined by the President by proclamation in the *Gazette*.

### **3.11 Research and Development**

**The fact that deductions are only allowed where research and development is conducted in South Africa is very restrictive in respect of pharmaceutical companies conducting clinical trials outside South Africa.**  
(KPMG)

This comment is not supported. From a tax policy point of view South African activities should benefit and be encouraged by the tax deduction granted for research and development.

### **3.12 Ring-fencing of Assessed Losses**

**All trades are within the ambit of the ring-fencing of losses as far as the three out of five year test is concerned. This could not have been intended.**  
(Deloitte & Touche)

This is indeed the intention. However, the provisions must be evaluated in their broader context—

- Firstly, persons with incomes below the amount at which the maximum marginal rate is applicable will not be affected.
- Secondly, should the three out of five year rule apply it is only an indication that the trade may be a suspect trade. If the taxpayer can prove that there is a reasonable prospect that the trade will be profitable within a reasonable period, the ring-fencing provisions will not apply.

**Although higher income individuals are targeted by this legislation anyone could have the means to embark on a loss-generating secondary trade, irrespective of their income. Higher income groups are therefore discriminated against.**

(KPMG)

The biggest risk to the fiscus from the utilisation of assessed losses from secondary trades arises in respect of persons subject to the top marginal rate of tax. These provisions are therefore targeted at this group of taxpayers.

**The term “trade” should be defined for purposes of the ring-fencing provisions.**

(KPMG)

This comment is not accepted. Trade is very widely defined in section 1 of the Income Tax Act. However, SARS’s practice in determining what constitutes a separate trade for purposes of the ring-fencing provisions would be clarified by way of an interpretation note if necessary.

**It is unclear why reference is made to relatives. Where a relative carries on a trade he/she would be taxed in their own hands.**

(Deloitte & Touche; KPMG)

This reference is intended to cater for situations where the taxpayer is in partnership with the relative and ensures that the provisions are not sidestepped in this manner.

**It is not clear what farming or breeding animals on a full time basis means. Could more than one activity be carried on simultaneously on a full time basis? Is it a requirement that the taxpayer not carry on any other trade or employment in order to satisfy the requirement of full time. Surely this cannot be the intention of the legislature as the trade could still be carried on full time by employees of the taxpayer without the taxpayer having to be personally involved on a full time basis.**

(KPMG’ SAICA)

This provision will be clarified by way of an interpretation note, if necessary.



**In a typical year owners of racehorses spend about R400m on horses which make possible the success of the horse racing industry. The benefits derived are the substantial provincial betting taxes and net VAT (R245m) and tens of millions in income tax, VAT and other levies from thousands of direct and indirect participants. More than 200 000 people depend on the industry for a living. Casinos and the National Lottery compete with gambling on horse racing. Were the annual losses of R190m of owners to be ring fenced from their other income there is no doubt that horse ownership would decline to a level insufficient to keep the industry viable. The total tax value of the industry as a whole to the fiscus is considerable and its preservation should be the guiding force in tax policy. It is recommended that owners and part time breeders of race horses be exempted from the operation of the proposed section 20A of the Income Tax Act because horse racing is distinguishable from other commercial activities.**

(Horse Racing Industry)

This comment is not accepted. Ownership of racehorses has not specifically been listed as a suspect trade. However, owners of racehorses will be subject to the three out five year rule just like any other trade. Where the owner of a race horse with an assessed loss from horse racing can demonstrate that there is a reasonable prospect of deriving taxable income within a reasonable period, the assessed loss will not be ring-fenced and can be set-off against other taxable income of the owner of the horse.

**These provisions will have a dramatic effect on economic growth on this country and the economic consequences for small businesses should not be underestimated.**

(AHI; ABASA)

**The proposed legislation would seem to discourage taxpayers from creating alternative sources of wealth for themselves. There are many anecdotes about how an individual's hobby or pastime ultimately developed into a successful and profitable business. A genuine small business may be prevented from setting off losses they incur against other income.**

(KPMG)

These statements are highly questionable as the draft legislation specifically provides that the targeted losses of individuals will not be forfeited but merely ring-fenced. Furthermore, losses will not be ring-fenced where the taxpayer proves that the trade has economic substance and is not a hobby-like activity by demonstrating that there is a reasonable prospect of deriving taxable income within a reasonable time from the suspect trade.

**The ring-fencing provisions are not required if SARS applies the trade test and disallows all expenses which are not incurred in**

**carrying on a trade. The provisions will not apply to a taxpayer who can evidence that a genuine business is conducted in a business-like manner. Surely an assessor cannot instruct taxpayers how they should run their businesses?**  
(KPMG)

This comment is not accepted. In a recent court case the court had regard to the intention of the taxpayer which is a subjective test. Unfortunately, as was noted in an earlier judgement, this places SARS in a very difficult position. In the words of Smalberger J in ITC 1319 (42 SATC 263); “Insofar as the test propounded by Silke purports to be an entirely subjective one, I do not agree with it. It seems to me that before a person can be said to be carrying on farming operations there must be a genuine intention to farm, coupled with a reasonable prospect that an ultimate profit will be derived, thereby incorporating an objective element into the test. To hold otherwise would make it well-nigh impossible for the Commissioner to determine whether or not to allow farming losses as a deduction from other income, for he must needs adopt an objective approach when doing so.”

The legislation provides for objective tests to be applied in determining whether the trade is carried on in a commercial manner, taking into account facts and circumstances such as the number of full time employees, the commercial setting of the trading premises, the extent of equipment used and the time the taxpayer spends at the business premises.

**The phrases “reasonable prospect” and “reasonable period” as well as the factors to which specific consideration will be given are too subjective and place a very heavy onus on taxpayers to prove that their activities fall outside the ambit of suspect trades.**  
(KPMG)

**It is suggested that a fixed period of say 3 or 5 years be used rather than the term “reasonable period.**  
(SAICA)

The comments are not accepted. The application of these tests will depend on the specific circumstances of the relevant taxpayer and other factors could be taken into account other than those specifically mentioned in the legislation.

**The requirement of six year losses out of ten years is unreasonable because businesses may experience a bumper year every so often, in which case it may be reasonable to continue despite the occurrence of many years of losses.**  
(KPMG)

This comment is not accepted. The six out of ten year automatic loss ring-fencing rule only applies to suspect trades listed in section 20A(2)(b).

**The reporting requirements are objectionable and place a heavy onus on taxpayers who are conducting suspect trades who will be unaware of the provisions of section 20A of the Income Tax Act.**

(KPMG)

The reporting requirements have been withdrawn. Specific questions will be incorporated in the annual tax return for individuals which will assist taxpayers in identifying trades generating losses which may possibly be ring-fenced.

### **3.13 Secondary Tax on Companies**

**All foreign dividends exempted under the participation exemption should be permitted an STC credit on being repatriated to South Africa. Otherwise it will serve as a deterrent for repatriating foreign reserves from previously exempted designated countries and to bring any foreign reserves onshore in order to be distributed further within South Africa.**

(SACOB; SAICA)

This comment is not accepted. The disallowance of an STC credit achieves parity between the distribution of domestic and foreign profits by way of dividends by resident companies.

**Borrowers of securities which receive dividends on the borrowed securities during the maximum ten day holding period may not utilise the dividends received to offset future STC liability.**

**Credits disappear into the ether and no one has access to them.**

(PWC)

**The exclusion of any dividend received by a borrower under a lending arrangement, from the calculation of the net amount of any dividend for the purpose of determining STC liability has the effect that on declaration of such amount as a dividend by the borrower company the dividend will attract STC for a second time after STC was paid by the company that declares the dividend to the borrower shareholder. Where a taxpayer borrows shares solely to obtain the dividend, such arrangement will not fall within a lending arrangement and will attract stamp duty on the transfer of the shares from lender to borrower and *vice versa*.**

(SAICA).

These comments are not accepted. The STC credits are disallowed in the hands of the borrower in order to preclude lending arrangements being entered into for the purpose of STC credit shopping. In the absence of the credit exclusion a borrower would be able to borrow shares solely to obtain the STC credit.

**It seems that the period within which the valuation is required to be done for capital gains tax purposes also applies equally for the STC exclusion of capital profits on liquidation of a company.**

(SAICA)

The statement is correct. The deadline of 30 September 2004 for the valuation of assets also applies to valuations for the purposes of the exemption in respect of the distribution of capital profits from STC.

**We believe that the amendment granting an STC exemption for the distribution of profits, derived by a company prior to it becoming a resident, on liquidation/winding up or deregistration, should be made retrospective because any profits derived by a company prior to it becoming a resident and distributed prior to 26 February 2003 remain liable for STC.**

(SAICA)

The comment is not accepted as the imposition of STC where a company becomes a non-resident was only announced on 26 February 2003. This amendment is consequential upon that imposition.

**We suggest that the additional words “or is deemed to accrue” be added to the provision dealing with the exemption of dividends within a group of companies in section 64B(5)(f) to cater for amounts that do not accrue but are deemed to have been distributed by a company in terms of section 64C(3).**

(SAICA)

The comment is not accepted. A similar exemption has been provided for in section 64C(4)(k).

**The proposed amendment to section 64B(5)(f) requires the shareholder to hold directly 75% or more of the equity shares of the company declaring the dividend before the dividend may be exempt from STC. This leaves the anomalous position that where a company’s shares are held 60% and 40% by two companies within a group, the dividend declared will now be subject to STC, notwithstanding that the entire equity shares are held within a group. We cannot see any reason for this change given that STC will be paid where the dividends are declared ultimately to shareholders who do not form part of the group.**

**We request that this provision be revisited, with the intention of leaving the current legislation unchanged.**

(SAICA)

The comment is accepted. The current wording of paragraph (f) which allows for an exemption where the shareholder forms part of the same group of companies as the company declaring the dividend is retained.

**The exemption for dividends deemed to have been declared to a controlling group company should be clarified to provide which of the companies referred to must be residents.**

(KPMG; SAICA)

The legislation will be clarified to state that both the shareholder and the connected person in relation to the shareholder, if applicable, must be residents in order for the exemption to apply.

### **3.14 Value-Added Tax**

**The proposed amendment in clause 170 (1)(c) to section 11(2)(o) would result in main businesses or branches outside South Africa being in a disadvantageous VAT position in that the services rendered to these entities would be standard rated to the extent that the services are consumed in South Africa.**

(Deloitte & Touche, SAICA, KPMG and PWC)

Section 11(2)(o) has subsequently been amended to incorporate the principle that services provided to branches or main businesses outside the Republic by a branch in the Republic, provided certain conditions are met, will be zero rated. This amendment is in line with the current provision in the VAT Act (section 11(2)(l)) that zero rates services to non residents in certain circumstances.

**The proposed amendment to section 20 and 21 by requiring the VAT registration number of the recipient to be reflected on a tax invoice, debit or credit note will result in an increased administrative burden for all vendors.**

(KPMG, Deloitte & Touche, PWC)

The proposed amendment has subsequently been amended to require only the name and not the legal or trading name of the recipient to be reflected on the tax invoice. This amendment will reduce the administrative burden on vendors. The reason for requiring the VAT registration number to be reflected on the tax invoice is to ensure that only the vendor to whom the supply has been made and the tax invoice issued, is entitled to claim the input tax. Errors pertaining to the VAT number of the recipient can be alleviated by accessing the VAT vendor search function on the SARS website. In addition, it must be borne in mind that there is a long lead time until 1 March 2005 before the amendment comes into operation to allow vendors adequate time in which to effect the necessary system changes.

**In paragraph (b) of the definition of “consideration” and paragraph (c) of “designated public body or public private partnerships” read with S17(2)(e), the effect of the proposed amendment of the “consideration” is that no output tax needs to be accounted for in respect of grants received by any vendor. When read with S17(2)(e), it appears that grants received by any**

**person are effectively consideration for exempt supplies, as the deduction of input tax in respect of VAT incurred is expressly denied to the extent that the goods or services are acquired as a result of, or in anticipation of the grants. Therefore, any VAT funded by the grants cannot be deducted as input tax. This will result in additional costs for non-designated entity recipients of the grants, as well as apportionment difficulties.**

(PWC)

The proposed amendment runs parallel with National Treasury's proposal to increase the grants by the value of the VAT that will be denied in terms of section 17(2)(e). The proposed legislation is only intended to come into effect on 1 April 2005 which would allow the affected vendors the opportunity to address any apportionment challenges they may experience.

**The same meritorious grounds which justified the exclusion of "designated entities" from the ambit of the exemption also apply to local authorities. Grants received by local authorities in terms of the Division of Revenue Act should be treated as consideration for a taxable supply, otherwise local authorities will be denied an input tax deduction in respect of goods or services acquired to make taxable supplies.**

(PWC)

"Designated entities" are not excluded from the ambit of section 17(2) on meritorious ground but because the grants that they will receive will be subject to VAT. Local Authorities are not included in the definition of "designated entities" and the grants they receive will not be subject to VAT. It therefore follows that the Local Authority should also not be entitled to an input tax deduction in respect of the grant received.

**The use of the word "any grant" in paragraph (b) of the definition of "consideration" raises concerns. Grant is only defined in relation to a public or local authority. A number of associations not for gain receive grants from other institutions, not being public and local authorities. It is not clear whether such grants received from other institutions would still constitute consideration for taxable supplies.**

(PWC)

As the definition of "grant" is restricted to payments from public and local authorities other grants are not excluded from the definition of "consideration". All concerns about welfare organisations have been addressed as they have been included in the definition of a "designated entity".

**In paragraph (b)(i) of the definition of "enterprise", if the intention is to limit the activities of national and provincial public entities which can constitute a VAT enterprise, such entities should first**

**be excluded from the ambit of paragraph (a) as in the case of local authorities. The exclusion of these entities will effectively result in the exemption of their activities.**

(PWC)

It is the intention to limit the activities of national and provincial entities which will be subject to VAT to those entities which conduct activities that are in competition with the private sector. As the definition of “enterprise” operates any activity of a public authority or an entity which the Minister decides competes with private sector vendors falls into paragraph (a) of the definition, as can be seen from the opening words of paragraph (b). If these authorities and entities were excluded from paragraph (a) they could then never be enterprises in terms of the definition. The position with regard to local authorities is different as they are excluded from paragraph (a) and their activities which are regarded as an enterprise are identified in paragraph (c) of the definition.

**Section 8(2): It appears that the amendment only applies where a person stops being a vendor. However, in cases where a person receives non-taxable grants and makes taxable supplies, it is suggested that the same effect be created by not requiring the person to make “change in use” adjustments in respect of, for example, capital assets.**

(SAICA)

The amendment to section 8(2) is proposed to prevent a circular flow of funds within the Government sphere as any tax that a Government entity would have to pay as a result of the application of the section would have to be financed by the Government. It is necessary to examine the effect of the changes on the VAT position of all the Government entities so that their funding can be adjusted. Where it is found that Government entities are required to make an adjustment because of change of use, consideration will be given to whether it is easier to fund the additional tax payable rather than to introduce further tax relief provisions.

**As regards the proposed insertion of the definition of “grant”, we are of the opinion that the proposed amendments should not be implemented, the section 11(2)(p) zero-rating be maintained and the definition of “transfer payment” be amended to expressly provide that only a payment made by a public or local authority in respect of goods or services supplied for the direct benefit of or consumption by the public authority itself should be regarded as consideration for taxable supplies. If no such direct benefit or consumption can be identified, the payment should qualify as “transfer payment”.**

(PWC)

Section 11(2)(p) was introduced as a temporary measure when VAT was introduced to allow government departments sufficient time to make the necessary adjustments to budgets for VAT. It was never

intended to be a permanent feature. There is no clear definition of what a “transfer payment” is and over the years payments have enjoyed zero-ratings which should not have qualified and there has been abuse of the provisions. It was for this reason that the Minister announced in his Budget that an investigation into grants would be undertaken. From the investigation it became clear that the question of government transfer payments and grants is a problem that other countries also experience and have addressed in different ways. In order to ensure an equitable distribution of Government funding which is not skewed by tax considerations, it has been decided that the problem must be addressed from both the tax and expenditure side. It is for this reason that the amendments will only be introduced in the future when it is possible to make the necessary adjustments to the quantum of such grants (the grants may either be increased or decreased depending on the current VAT treatment of such grants). The zero-rating for housing subsidies has, however, been retained.

**The introduction of section 17(2)(e), which will effectively result in an exemption of grants received by any person other than a designated entity is not supported. For example, if a grant is paid to a “non-designated entity”, such as a municipality or farmer, the grant income of the municipality or farmer will effectively be exempt and no input tax deductions will be claimable for VAT incurred on advertising costs. The value of the grant to the municipality or farmer will thus decrease by the amount of VAT incurred on expenses. To be able to meet its budget, the municipality or farmer will call upon government to increase the amount of the grant. If their pleas are ignored, their budgets will be insufficient to perform their duties.**

(PWC)

Grants / subsidies to a “non-designated entity”, such as a private business, are not payments in return for goods and / or services and should be viewed as outside the scope for VAT purposes. The practical implications are that such grants are exempted for VAT purposes. It should be noted that private businesses that are receiving such grants zero-rated are receiving an additional unintended benefit equal to the input VAT that may be claimed. However, the administrative and financial implications of this particular provision will be reviewed before the provision comes into effect on 1 April 2005.

**Section 20(4): We suggest that the threshold in respect of the proposed amendment be set at R5 000 to lessen the administrative burden placed on, for example, retailers.**

(SAICA)

Increasing the threshold will limit the efficacy of the proposed amendment and increase the risk to SARS of fraudulent input tax claims.



### 3.15 General

**Absent from the draft Bill, though much anticipated and hoped for, is legislation pertaining to the introduction of a formal advance rulings process.**

(PWC)

A discussion paper on a proposed system for advance tax rulings has been published on SARS's website on 19 November 2003, for public comment.

**Businesses are increasingly falling foul of the law through an inability to comprehend the complexity of the tax laws. Our plea is for a moratorium on any further significant changes for the foreseeable future in order to consolidate the tax changes since 1998 to enable taxpayers and SARS to absorb the very significant changes that have taken place over the last few years.**

(ABASA; Deloitte & Touche)

This comment is noted.

**Prepared by SARS and the National Treasury**