



**NATIONAL  
TREASURY**

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**REPUBLIC OF SOUTH AFRICA**

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**EXPLANATORY MEMORANDUM**

**ON THE**

**REVENUE LAWS AMENDMENT BILL, 2008**



[W.P.2 – '08]

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**EXPLANATORY MEMORANDUM**  
**ON THE**  
**REVENUE LAWS AMENDMENT BILL, 2008**

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**INTRODUCTION**

The Revenue Laws Amendment Bill, 2008, introduces amendments to the Transfer Duty Act, 1949, the Estate Duty Act, 1955, the Pension Funds Act, 1956, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Value-Added Tax Act, 1991, the Income Tax Act, 1993, the Income Tax Act, 1994, the Restitution of Land Rights Act, 1994, the Tax Amnesty Act, 1995, the Final Relief on Tax, Penalty and Additional Tax Act, 1996, the Revenue Laws Amendment Act, 2006, the Taxation Laws Amendment Act, 2007, the Securities Transfer Tax Act, 2007, the Revenue Laws Amendment Act, 2007, and the Taxation Laws Amendment Act, 2008.

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**EXPLANATION OF MAIN AMENDMENTS: INCOME TAX ACT**

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**RETIREMENT ISSUES**

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**(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

**Current law**

Withdrawal benefits fall into three categories: (i) benefits payable to retirement fund members when they exit a fund prior to retirement, (ii) payments subsequent to their pre-retirement exit from the fund, or (iii) certain payments from the fund before termination of membership. These benefits are partly tax-free and partly taxable. The tax-free part is generally calculated as follows:

- the first R1,800 of any withdrawal lump sum from a retirement fund (i.e. an annual R1,800 tax exemption); and
- an amount equal to contributions to the fund that did not qualify for a tax deduction when the contribution to the fund was made (i.e. previously taxed amounts).

The remaining taxable portion of the lump sum is taxed based on an averaging formula. This averaging formula is based on the highest average annual tax rate for the tax year in which the retirement lump sum is payable or the previous tax year. All taxable amounts are subject to PAYE withholding before payout.

## **Reasons for change**

The problem with the rules outlined above is two-fold. Firstly, the tax-free amount is very low and has not been adjusted for many years. Secondly, the averaging formula is complex and is dependant upon information which the retirement fund or retirement fund member cannot easily access or determine at the time of the withdrawal. The combination of these issues has prompted the need for change.

Further complexity is created when recurring payments (e.g. ongoing maintenance payments payable in terms of a court order) need to be made. These benefits are taxed as lump sums when payment is made. However, on assessment, additional tax may be payable and the fund member may not have the money available to pay the tax.

## **Proposal**

### *1. New Tax Table and exemption for pre-retirement lump sums*

#### Applicable clauses and Income Tax Act provisions:

Clause 4(1)(y); section 1 (paragraph (a)(i) of the “retirement-funding employment” definition)

Clause 6(1); section 5(10)

Clause 7(1); section 6(1)

Clause 18(1)(f); section 11(n)(aa)(A)

Clause 34(1)(b); section 18A(1)(c)

Clause 35(1); section 20(1)(c)

Clause 37(1)(a); section 23(i)

Clause 58(1)(a); paragraph (b) of Formula B of paragraph 1 of the Second Schedule

Clause 64(1)(c); paragraph 6(b) of the Second Schedule

Clause 65(1); repeal of paragraph 7 of the Second Schedule

Clause 70(1); paragraph 11B of the Fourth Schedule

The proposal seeks to alleviate the level of pre-retirement taxation of longer-term savings without encouraging withdrawals immediately before formal retirement age. This result is achieved by linking the rules relating to pre-retirement lump sum withdrawals to the retirement lump sum tax table. More specifically, under the proposal, pre-retirement withdrawals will be treated the same as post-retirement withdrawals, except that only 7.5 per cent of the R300 000 exemption (i.e. R22 500) will apply to pre-retirement withdrawals. The change means that pre-retirement withdrawals would be taxed at a rate of 18 per cent up to R600 000 with the top rate reaching 36 per cent at R900 000, subject to the R22 500 exemption. Pre-retirement withdrawals will

be taxed on a cumulative basis (i.e. subsequent withdrawals pre-retirement will be added and taxed at higher marginal rates). It should be noted that in calculating the tax liability upon retirement the accumulated withdrawals pre-retirement will also be added to the lump sum upon retirement. The tax tables to be applied to pre-retirement and retirement lump sum benefits will be included in the 2009 legislative amendments.

2. *Exclusion of pre-retirement withdrawals pursuant to recurring maintenance orders*

Applicable clauses and Income Tax Act provisions:

Clause 8(1)(b); section 7(11)

Clause 16(1)(d); section 10(1)(u)(i) and (ii)

Clause 58(1)(e); paragraph 1 (“lump sum benefit” definition) of the Second Schedule

Section 7(11) was amended during 2007 to recognise payments by retirement funds for the maintenance of a child in terms of maintenance orders. This section is substituted to recognise recurring payments made by retirement funds in terms of all maintenance orders. The wording in the Second Schedule is also amended to specifically exclude these recurring payments from being taxed in terms of that Schedule. These recurring payments are instead taxed in the hands of the member (and are subject to PAYE) as “remuneration” within the normal tax system.

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## **ALLOCATIONS TO SPOUSES UPON DIVORCE**

### **Current law**

Under pre-existing rules relating to the Divorce Act and Pension Funds Act, the amount awarded to a non-member upon divorce could not be paid prior to that member’s exit from the fund. The fund administrator was only required to make an endorsement in the records of the fund so that a part of the pension benefit should eventually be paid to the non-member upon the member’s subsequent exit (or retirement) from that fund.

Due to recent legislative changes, a retirement fund interest is now deemed to be part of a fund member’s estate for purposes of divorce (this is to give effect to the “clean-break” principle). This interest can now be immediately divided and the divided portion may be awarded to the member’s former spouse (i.e. the fund administrator can now make an immediate payment to the member’s former spouse prior to the member exiting or retiring from the fund). The non-member can receive this award in cash or have this award transferred to his or her own retirement fund.

## Reasons for change

The Income Tax rules relating to the division of retirement fund savings need to be realigned in light of changes to the Divorce Act and Pension Funds Act. The Income Tax rules need to incorporate the “clean-break” principle. The Income Tax also needs to be amended so as not to trigger tax if a former spouse’s funds are momentarily withdrawn and immediately reinvested in a new retirement savings vehicle (under current law, any withdrawal triggers a tax accrual).

## Proposal

### Applicable clauses and Income Tax Act provisions:

Clause 4(1)(o); section 1 (paragraph (b) of the proviso to the “pension preservation fund” definition)

Clause 4(1)(u); section 1 (paragraph (b) of the proviso to the “provident preservation fund” definition)

Clause 16(1)(d); section 10(1)(u)(i) and (ii)

Clause 58(1)(c) and (d); paragraph (d)(iA) of Formula B of paragraph 1 of the Second Schedule

Clause 59(1)(a); deletion of paragraph 2(b)(i) of the Second Schedule

Clause 59(1)(b) and (c); paragraph 2(b)(iA) and (ii) of the Second Schedule

Clause 60; paragraph 2B of the Second Schedule

Clause 63(1)(b); paragraph 4(4) of the Second Schedule

Clause 64(1)(a) and (b); paragraph 6(a) & (aA) of the Second Schedule

### 1. *General overview*

The essence of the proposed changes to the taxation of retirement savings in the context of divorce is to effectuate the “clean-break” principle already incorporated in the Divorce Act and Pension Funds Act. The current complexity stems mainly from the co-ordination of the effective dates of the changes to the Income Tax Act, the Divorce Act and the Pension Funds Act. The way in which the changes to the Income Tax Act will affect a particular divorce order will depend on the date of the divorce order.

As a general matter, amounts awarded in terms of a divorce order will be taxed in the hands of the non-member former spouse if the amount accrues to the non-member former spouse on or after 1 March 2009. The date of 1 March 2009 is tied to the new stand-alone rate table applicable to withdrawal benefits (discussed above), which also comes into effect on 1 March 2009. The date of accrual is linked to the timing of the divorce order as described below (with one set of accrual rules for divorce orders granted on or after 13 September 2007 and another set of accrual rules for divorce orders granted before 13 September 2007).

## 2. *Divorce orders granted on or after 13 September 2007*

For divorce orders granted on or after 13 September 2007, the date of accrual is determined by the date that the amount stated in the divorce order needs to be deducted from the member's minimum individual reserve in terms of the Pension Funds Act. If the deduction from the member's minimum individual reserve is required to be made on or after 1 March 2009, the new "clean-break" principles apply as described below. If the deduction from the member's minimum individual reserve is required to be made before 1 March 2009, the old rules apply (i.e. the member remains subject to tax on amounts eventually received by the non-member former spouse).

To the extent that the new "clean break" principles apply, the non-member's former spouse has a choice. The former spouse may completely withdraw retirement fund amounts from retirement savings, in which case a liability for tax will be triggered. Alternatively, the non-member may transfer the amounts from the former spouse's retirement fund to a separate retirement fund, in which case no liability for tax will be triggered. In the case of the latter, no further tax will apply to amounts subsequently withdrawn from the separate retirement fund to the extent those amounts were previously taxed under the pre-existing "accrual" principles.

## 3. *Divorce orders granted before 13 September 2007*

For divorce orders granted before 13 September 2007, the date of accrual is determined by the date that the former spouse chooses to completely withdraw the retirement fund amounts or to have these amounts transferred to the former spouse's retirement fund. If the former spouse fails to make an explicit choice, the date of accrual is the date that the fund has to pay the non-member in terms of the Pension Funds Act.

In respect of all divorce orders granted before 13 September 2007, the tax liability for all of these payments remains that of the member (not of the former spouse). However, depending on the date of accrual, the tax liability will be determined either under—

- (i) the pre-existing formula (highest average rate of tax of the current or previous tax year) if the accrual date occurs prior to 1 March 2009; or
- (ii) the stand-alone withdrawal tax table if the accrual date occurs on or after 1 March 2009.



## **DEFAULT PRESERVATION OF WITHDRAWAL BENEFITS**

### **Current law**

In terms of the definitions of “pension fund” and “provident fund”, membership of a fund is dependent upon the employer/employee relationship. If a member ceases to be employed by the employer, an exit event is normally triggered (in terms of the fund rules), and a benefit becomes payable (accrues) to the member, normally within six months after the termination of the employer/employee relationship. Tax is automatically levied upon this accrual irrespective of whether the amount is paid to the member (or subsequently transferred directly to another retirement fund vehicle).

### **Reasons for change**

Automatic accrual (triggering tax) effectively provides an incentive for the member to take the cash rather than preserve the money within a subsequent retirement fund vehicle. In essence, the automatic tax trigger effectively eliminates the choice that the member has of preserving these savings in a retirement fund vehicle without tax or of withdrawing the savings after being reduced by tax on the withdrawal.

### **Proposal**

Applicable clause and Income Tax Act provision:

Clause 63(1)(a); paragraph 4(1) of the Second Schedule

It is proposed that the accrual event for retirement fund savings be postponed until the member actually chooses to receive the payment in cash. In essence, the switch is from an accrual system to a cash system. In the case of pre-existing amounts that were subject to tax even though directly transferred to a retirement fund vehicle (due to the pre-existing “accrual” principle), no tax will apply to these amounts subsequently withdrawn from unclaimed benefit funds.

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## **ANNUITISATION OF DEATH BENEFITS**

### **Current law**

Lump sum benefits that become payable by a retirement fund upon the death of a member are deemed to accrue to the member immediately prior to death. This benefit is accordingly taxed in the hands of the deceased member as a retirement lump sum. If annuities are payable by the retirement fund upon death (*in lieu* of or in addition to a lump sum), the annuity is instead taxed in the hands of the beneficiaries.

## **Reasons for change**

In some instances, the beneficiaries prefer to receive annuities rather than a lump sum so that funds are available over the longer-term. However, if the retirement fund rules only provide for a lump sum, tax will be imposed on the lump sum irrespective of the decision by the beneficiaries to reinvest the funds in an annuity.

## **Proposal**

### Applicable clause and Income Tax Act provision

Clause 62(1); paragraph 3 of the Second Schedule

It is proposed that no retirement benefit be deemed to accrue to the member immediately prior to his death to the extent beneficiaries choose to receive the funds in the form of an annuity. This tax relief will apply irrespective of the fund rules. On the other hand, annuities payable to beneficiaries will result in a tax liability for beneficiaries to the extent that these beneficiaries receive annuity payments. Similarly, death benefits payable to beneficiary funds and unclaimed benefit funds will not be taxable because all the funds remain in long-term fund savings.

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## **PRESERVATION FUNDS AND EFFECTIVE DATES**

### **Current law**

Preservation funds were previously registered with SARS as either pension funds or provident funds, both of which were governed by RF1/98 (i.e. “old generation funds”). The definitions of “pension preservation fund” and “provident preservation fund” were introduced in the Income Tax Act earlier this year to allow for preservation funds to be formally recognised as preservation funds (i.e. “new generation funds”).

### **Reasons for change**

Transitional issues have arisen in respect of the conversion from old generation funds to new generation funds. In the meantime, fund administrators are uncertain as to whether they should comply with the old or new generation fund rules whilst in the process of conversion.

### **Proposal**

#### Applicable clauses and Income Tax Act provisions

Clause 4(1)(n); section 1 (further proviso to paragraph (c) of the “pension fund” definition)

Clause 4(1)(q); section 1 (further proviso to the “pension preservation fund” definition)

Clause 4(1)(t); section 1 (further proviso to the “provident fund” definition)

Clause 4(1)(v); section 1 (further proviso to the “provident preservation fund” definition)

Certain deeming rules are proposed to clarify the transitional issues referred to above. In terms of the deeming rules, an old generation fund will lose its status as a pension fund or provident fund on the date that the fund submits the rules to SARS in order to request approval as a new generation fund (i.e. as a pension preservation fund or provident preservation fund). At the same time, these funds will be deemed to be new generation funds from the same date. In essence, actual approval will not be immediately required for conversion – only the submission of an application.

It is important to note that this “deeming” provision only applies to old generation funds that convert to new generation funds. Wholly new funds (not previously registered with SARS) must wait for SARS approval before operating as a pension preservation fund or as a provident preservation fund. This “deeming” provision will apply only once the Revenue Laws Amendment Act, 2008, is enacted.

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## **UNCLAIMED BENEFIT FUNDS**

### **Current law**

Unclaimed benefits will be specifically defined in the Pension Funds Act by way of the Financial Services Laws General Amendment Act (which is currently still in Bill form). Benefits payable by a retirement fund will effectively become “unclaimed” after 24 months from the date of the exit event. This 24-month rule is one of the reasons why the “accrual” date of withdrawal benefits is postponed until a full withdrawal occurs (i.e. so that a deemed accrual does not arise merely because members cannot be found, see the notes on **DEFAULT PRESERVATION OF WITHDRAWAL BENEFITS**). The accrual date of death benefits has similarly been postponed if the death benefits are annuitised (see the notes on **ANNUITISATION OF DEATH BENEFITS**).

After the 24-month waiting period, the Financial Services Board requires that unclaimed benefits be transferred to a separate fund called an Unclaimed Benefit Fund (“UBF”). These funds are registered with the FSB as pension funds and will register with SARS either as pension preservation funds or as provident preservation funds.

### **Reasons for change**

The UBF will receive both unclaimed benefits that have already been taxed (benefits that accrued to members when the exit event occurred prior to 1 March 2009) as well as unclaimed benefits that will not be taxed (i.e.

benefits when the accrual event occurs on or after 1 March 2009). No provision exists in the Income Tax Act for relief on benefits that are paid by an UBF even if those benefits have already been taxed prior to transfer to the UBF.

## **Proposal**

### Applicable clauses and income tax paragraphs

Clause 62(1); proviso (v) to paragraph 3 of the Second Schedule  
Clause 64(1)(d) and (e); paragraph (i)(bb)(D) of the proviso to paragraph 6 of the Second Schedule

It is proposed that amounts paid by an UBF as a retirement or (pre-retirement) withdrawal lump sum will be tax-free to the extent that these amounts represent amounts that were previously taxed (i.e. either when transferred to the UBF or when generating taxable income prior to payment to the UBF).

Example. Facts. Individual X was a member of the ABC pension fund. Individual X's employment is terminated on 30 September 2004, but the fund is never informed of this termination. Individual X's retirement fund was R100 000 at the time. This R100 000 amount is reinvested in 2007 so as to generate taxable income of R20 000. In 2009, an amount of R120 000 is transferred into the UBF. In 2010, Individual X is located by the UBF with Individual X requesting full payment of the benefit held by the UBF. Individual; X's fund value at this stage is R130 000.

Result. The UBF will have to apply for a tax directive on the R130,000. However, R120,000 will be tax-free.(i.e. the R100 000 amount taxed on shortly after termination and the other R20 000 of taxed growth).

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## **MINOR BENEFICIARY FUNDS**

### **Current law**

Death benefits payable by a retirement fund with minor beneficiaries have often been paid to beneficiary trusts (vesting trusts). These benefits were taxed in the hands of the deceased upon transfer to the trust and any subsequent growth was taxed in the hands of the minor beneficiaries.

### **Reasons for change**

With effect from 1 January 2009, vesting trusts for minor beneficiaries will be formalised as "beneficiary funds". These "beneficiary funds" will be regarded as pension funds for purposes of the Pension Funds Act and regulated as such. The Income Tax Act will automatically recognise these funds as tax-exempt because of their new regulatory status.

Beneficiary funds are faced with the same problem as UBFs in the sense that these funds will receive both pre- and post-tax amounts. As with UBFs, the Income Tax Act does not provide any tax relief for benefits subsequently paid by these beneficiary funds even though some of these amounts were previously taxed.

### **Proposal**

Applicable clauses and Income Tax Act provisions  
Clause 4(1)(f); section 1 (paragraph (eC) of the “gross  
Income” definition)  
Clause 62(1); proviso (iv) to paragraph 3 of the Second Schedule

It is proposed that tax-relief be provided to prevent double taxation of previously taxed amounts. Hence, regulated minor beneficiary funds for minors containing amounts that were previously subject to tax (as unregulated trusts) will not be taxed again when these funds make subsequent payouts.

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## **TRANSFERS FROM PENSION TO PROVIDENT FUNDS**

### **Current law**

Employer contributions to either a pension or provident fund are tax deductible by the employer. Only member contributions to pension funds are tax deductible for employees because employee access to the fund portion upon retirement is limited to one third of the full fund value.

Pension and provident funds are approved by SARS on condition that a lump sum benefit may become available to a member upon one of three exit events, namely: (i) resignation, (ii) retirement, or (iii) death. All three events trigger an accrual under the Second Schedule to the Income Tax Act. Whether the accrual is taxable is a function of the deductions that are determined under that Schedule. No deduction is available if members elect to have their fund interest in a pension fund transferred to a provident fund. This lack of a deduction essentially means that pension-to-provident transfers should be fully taxable.

### **Reasons for change**

According to a recent judicial decision, no accrual takes place when a member's fund interest is transferred from a pension to a provident fund in terms of Section 14 of the Pension Funds Act. Because no accrual takes place, the Second Schedule allegedly does not apply (so that no tax is payable). This view is contrary to the policy rationale for the difference in tax treatment of employee contributions to pension funds *versus* provident funds.

If this view were allowed to prevail, fund members could effectively obtain a tax deduction for indirect employee contributions to provident funds.

## **Proposal**

### Applicable clauses and Income Tax Act provisions:

Clause 58(1)(c) and (d); paragraph (d) of “formula B” in paragraph 1 of the Second Schedule

Clause 59(1)(b) and (c); paragraph (2)(b) of the Second Schedule

Clause 64(1)(d) and (e); paragraph (i)(bb)(C) of the proviso to paragraph (6) of the Second Schedule

It is proposed that transfers from a pension to a provident fund be deemed to accrue to the member and create a lump sum withdrawal benefit in the hands of the member. The amount transferred should be regarded as an after-tax contribution to the provident fund (with no subsequent tax being required when withdrawn from the provident fund).

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## **EMPLOYERS AND EMPLOYEES**

### **REPAYABLE EMPLOYEE BENEFITS**

#### **Current law**

Many employers make payments to employees that are subject to resolutive conditions, all of which are fully taxable (and subject to pay-as-you-earn withholding). Examples of these payments include retention bonuses and maternity leave payments. Employees on occasion are forced to return the amounts initially received (e.g. as a result of failure to remain with the employer as required or return to work after maternity leave).

#### **Reasons for change**

While the initial payment to the employee is fully taxable as discussed above, employees do not obtain any tax deductions for sums repaid. This denial of deductions exists because section 23(m) of the Income Tax Act limits the types of expenses that an employee may deduct. This overall result violates basic tax principles because the employee is being taxed even though no net enrichment arises.

#### **Proposal**

### Applicable clauses and Income Tax Act provisions:

Clause 18(1)(g); section 11(nA) and (nB)

Clause 37(1)(b) and (c); section 23(k) and 23(m)(iiA)

It is proposed that refunded employment-related benefits be allowed as a deduction against taxable income (including repaid payments stemming from a restraint of trade). These amounts will also be deductible expenses even if refunded by a personal services provider. To the extent that the employee does not have sufficient taxable income to deduct the full amount of the refunded benefit, an assessed loss will be created and carried forward to the following tax year.

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## **PERSONAL USE OF BUSINESS CELL-PHONES AND COMPUTERS**

### **Current law**

Private use of employer provided cellular telephones and notebook computers by employees is generally a taxable fringe benefit in terms of the Seventh Schedule to the Income Tax Act. Similarly, the private use portion of telephone line rentals and call charges paid for by an employer is taxable in the hands of the employee.

### **Reasons for change**

Employers are increasingly providing employees with cellular telephones and notebook computers to encourage productivity outside the workplace. However, given the fact that employees are able to use these items outside the office, personal use of these items is ultimately inevitable. From a technical perspective, the incidental private use of cellular phones and notebook computers should be taxable. However, the enforcement and compliance costs associated with taxing these benefits are potentially prohibitive.

### **Proposal**

Applicable clauses and Income Tax Act provisions:

Clause 72; paragraph 6 of the Seventh Schedule

Clause 73; paragraph 10 of the Seventh Schedule

It is proposed that where certain assets are provided by an employer to an employee mainly for business use, no taxable value be placed on the private use of those assets. These assets consist of all telephone or computer equipment, which would include:

- Modems on fixed lines of all kinds (dialup, ADSL, data lines)
- Removable storage of all kinds - memory sticks, disks
- Printers
- Office-related software (MSOffice, operating systems, development tools, management tools, etc.)

The same principles will apply to the “private use” of employer provided or employer subsidised communication services (such as telephone line rentals and subscriptions for internet access).

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## **CONSOLIDATION OF DEEMED EMPLOYEE ANTI-AVOIDANCE RULES**

### **Current law**

Employee remuneration (e.g. salaries) is subject to a special set of tax rules, including regular pay-as-you-earn withholding as well as limitation on deductions (pursuant to section 23(*m*)). A number of years ago, a variety of schemes emerged that were aimed at artificially disguising the employee-employer relationship so as to avoid the tax rules associated with this form of income.

In addition to common law principles, the Income Tax Act accordingly contains provisions specifically aimed at preventing practices that seek to artificially disguise the employee-employer relationship. For example, payments made to “labour brokers”, “personal service companies” and “personal service trusts” are regarded as employee “remuneration.” The latter two of these anti-avoidance rules are aimed at employees seeking to disguise their relationship by utilising an entity format (e.g. companies and trusts).

### **Reasons for change**

The current set of anti-avoidance rules causes unnecessary overlap in the case of entities. While the impact of this overlap can effectively be reduced by requesting exemption certificates from the South African Revenue Service, these requests are burdensome from both an enforcement and compliance point of view.

### **Proposal**

#### Applicable clauses and Income Tax Act provisions:

Clause 18(1)(*b*); section 11(*cA*)(iii) and (iv)

Clause 23(1)(*f*); section 12E(4)(*a*)(iv)

Clause 37(1)(*b*); section 23(*k*)

Clause 66(1); paragraph 1 of the Fourth Schedule

Clause 67(1)(*a*); paragraph 2(1A) of the Fourth Schedule

Clause 69(1); paragraph 11 of the Fourth Schedule

In order to promote ease of enforcement and compliance, streamlined rules are proposed for entities that eliminate the anti-avoidance overlap. It is therefore proposed that the rules for trusts and companies be replaced by a single definition of “personal service provider” (“PSP”). The “labour broker” rules will be retained but limited to natural persons.



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## **ADDITIONAL DEDUCTIONS FOR LEARNERSHIPS/APPRENTICESHIPS**

### **Current law**

In order to encourage job creation and skills development, the Income Tax Act provides employers with an additional tax deduction (over and above the normal tax deduction for salary) in respect of certain learnerships. This additional deduction applies in respect of–

- learnership agreements that are registered with a SETA; and
- contracts of apprenticeship registered with the Department of Labour.

The additional deduction for the employer exists when an employee enters into a learnership and again when the employee completes the learnership. The additional deductions associated with learnerships with new employees are slightly higher than those with pre-existing employees. New and pre-existing employees with disabilities generate a higher level of additional deductions.

### **Reasons for change**

A tax problem arises with certain apprenticeships where a single apprenticeship extends over a number of years as opposed to multiple annual contracts over the same period. In some cases, the Manpower Training Act, 1981 (Act No. 56 of 1981) specifically requires the minimum period for these apprenticeships to extend beyond a year (i.e. a period of 12 months).

At issue is the fact that the additional deduction is premised on a starting date and an ending date. In the case of short-term contracts over a multi-year period, these start and end dates give rise to additional deductions per annum. On the other hand, if a learnership or an apprenticeship has a multi-year span, an additional deduction exists only in the initial entry year and later again in the completion year.

### **Proposal**

Applicable clause and Income Tax Act section:

Clause 25; section 12H

The proposal seeks to provide relief for apprenticeships registered in terms of the Manpower Training Act if the minimum period exceeds 12 months. The proposal essentially seeks to treat these multi-year learnerships/apprenticeships as if they were roughly equivalent to a series of annual learnerships. The proposal applies in respect of learnerships involving all persons (pre-existing employees, new employees and employees with disabilities).

More specifically, the first year of the learnership/apprenticeship provides the same additional deduction of entry as any other learnership. However, the year of completion generates an additional deduction equivalent to a series of learnerships, taking into account mid-year start dates and mid-year end dates (to the extent applicable). This ending additional deduction equals the applicable amounts described below.

In principle an employer will be entitled to two deductions per year for each year of the duration of the apprenticeship. As a practical matter, at least one deduction will always be claimed in the year the agreement is entered into. Where no formal examination is completed before the completion of the apprenticeship, the additional deductions will only be claimed upon completion of the apprenticeship.

*Example. Facts.* Employee X entered into a four year apprenticeship agreement with employer Y. Employer Y agrees to pay new employee X R25 000 per year. Assume this amount is fixed for the four years.

*Result.* In year 1 employer Y can claim an additional allowance of R25 000. No additional allowance may be claimed in years 2 and 3. In year 4, assuming that employee X has successfully completed the apprenticeship, employer Y can claim an additional allowance of  $R25\ 000 \times 2 \times 4 = R200\ 000$  less R25 000 (the amount claimed in year 1) = R175 000. In essence, the ending additional deduction equals the starting and ending additional deductions for all years of the learnership less the starting deduction for the first year (which has already been taken into account).

The proposal also adds certain reporting requirements are aimed at enabling the monitoring of the overall progress of the additional deduction for learnerships. Under these reporting requirements, the companies must report to the various SETAs (sector education training authorities under the Skills Development Act, 1998), and the SETAs must aggregate this information for the National Treasury. This aggregated information will be used to determine the viability of this initiative over the long-term.

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## **PAYROLL GIVING**

### **Current law**

Some employers operate payroll giving programs that allow their employees to make regular donations to public benefit organisations (PBOs) by way of the payroll system (i.e. by directly subtracting donations from salaries). At present, employees may claim deductions for donations made to PBOs (and other entities) qualifying under section 18A. Employees make these claims when submitting their annual tax returns.

## Reasons for change

While the current section 18A deduction for donations operates as an incentive for voluntary private contributions for the public benefit, “pure” salary employees are only entitled to a deduction thereof on assessment of the annual tax return (which could be many months after the date the donation was made).

## Proposal

### Applicable clauses and Income Tax Act provisions:

Clause 34(1)(c); section 18A(2)(b)

Clause 67(1)(c); paragraph 2(4)(f) of the Fourth Schedule

In order to expand the potential pool of donors, accelerate the tax benefit to employees and reduce the number of refunds on assessment, employers may account for section 18A donations by employees. Under the proposed change, employers who administer donations by employees through their payroll systems must also make corresponding tax deductions for pay-as-you-earn withholding to account for those donations.

For purposes of pay-as-you-earn withholding, the deductible section 18A amount is subject to a ceiling of 5 per cent of the employee’s remuneration. This 5 per cent ceiling is proposed because an employer will not be aware of other aspects of the employee’s overall tax situation. This ceiling decreases the likelihood that the section 18A deduction could lead to a tax shortfall on assessment of the annual tax return.

Employers will be required to obtain section 18A receipts from the applicable section 18A entity for the donations made to the entity. Employees will be able to rely on employee tax certificates to substantiate these deductible donations for purposes of their annual tax return.

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## INDIVIDUALS

### DEDUCTIONS IN RESPECT OF DISABILITY EXPENSES

#### Current law

Natural persons may deduct certain medical-related expenses from their income. The extent to which qualifying medical-related expenses are deductible is determined both by the age of the taxpayer and whether the taxpayer or a member of the taxpayer’s immediate family is “handicapped”. In the case of the latter, all qualifying expenses are tax deductible.

## **Reasons for change**

The use of the term “handicapped” and the definitions “handicapped person” and “handicapped child” are outdated. In addition, there is uncertainty regarding the tax deductibility of some of the expenses incurred by a taxpayer with a “handicap” or with a “handicapped” dependent.

## **Proposal**

It is proposed that the term “handicapped person” be replaced with the more widely accepted and understood term “person with a disability”. In line with Government’s overall policy, this term means any person with a “moderate to severe limitation of that person’s ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment”. In addition, to add objective criteria, the limitation must:

- (i) last for more than a year; and
- (ii) be diagnosed by a duly registered medical practitioner in accordance with criteria as prescribed by SARS.

In order to provide more certainty regarding the tax treatment of expenses incurred relating to the disability, the type of tax deductible expenses will be clarified by way of a list prescribed by SARS. This list will be drafted (and reviewed regularly) in consultation with organisations representing persons with disabilities.

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## **BROAD-BASED EMPLOYEE SHARE SCHEMES**

### **Current law**

A tax-free broad-based employee share scheme was introduced into the Income Tax Act with effect from 26 October 2004. In terms of this scheme, an employer may, in certain circumstances, grant or issue shares to employees without a taxable fringe benefit being created in the hands of the employee. This grant is effectively tax-free in the hands of the employee if the scheme meets a number of stringent criteria. This tax-free treatment is limited to a R9 000 ceiling over three years (with a corresponding deduction for the employer).

### **Reasons for change**

Due to the apparent lack of usage of this incentive, a review was conducted to determine its shortcomings. Industry viewed the terms of the incentive as overly restrictive, thereby preventing any practical use thereof. The main concern was that the R9 000 ceiling is too low given market conditions (e.g. the administrative burden of the implementation of a scheme that would qualify for the incentive outweighs the benefits that could be derived from it).

Other concerns also existed, such as the required participation of 90 per cent of employees.

## **Proposal**

### Applicable clauses and Income Tax Act provisions:

Clause 10(1); section 8B(2) and (3)

Clause 18(1)(e); section 11(A)

#### 1. *Monetary Cap*

It is proposed that the R9 000 tax-free ceiling be raised. The incentive will now have a R50 000 ceiling over five years (section 8B(3) – “qualifying share” definition). The matching employer deduction will also be raised to the same level by allowing R10 000 per annum over a five year period (section 11(A)). This five-year time horizon matches existing broad-based employee share schemes, especially those aligned with the charter codes.

#### 2. *Participation percentage threshold*

It is proposed that the 90 per cent employee share participation requirement be lowered to 80 per cent (section 8B(3) – paragraph (b) of the “broad-based employee share plan” definition). A lower percentage is proposed for a variety of reasons, including the desire on the part of employers to exclude certain non-performing employees. Other concerns existed about difficulties created by margins of error, especially if there is a prolonged time lapse between the classification exercise and the actual granting of shares.

#### 3. *Expansion of permissible employee share restrictions*

Under current law, employers are permitted to impose only limited restrictions on the tax-preferential shares granted. For instance, while employers can retain a right to reacquire the granted shares from the employee, the reacquisition must be at market value as of the date of the employer’s reacquisition. It is now proposed that this restriction be relaxed in relation to employee misconduct or poor performance. Under these conditions, the employer can reacquire the shares from these employees at the lower of–

- (i) market value as of the date of the initial grant; or
- (ii) market value as of date of reacquisition by the employer (section 8B(3) – paragraph (d) of the “broad-based employee share plan” definition). In other words, the employer can deny employees engaged in misconduct or poor performance from obtaining any benefit of share appreciation arising after the date of grant.

*Example. Facts.* On 5 January 2009, Y is granted 2 500 Holdco shares by way of section 8B at a cost of R0.5 per share (the minimum required payment in terms of Companies Act). The shares are trading at R2 on the date of grant, and Y is restricted from selling these shares for a

period of 5 years from date of grant. Assume the Holdco shares have a value of R3 per share as of 10 August 2009.

*Result.* As a general matter, section 8B only allows the employer to reacquire the shares at their value on date of reacquisition (i.e. at R3 if reacquired on 10 August 2009). However, if the employer is reacquiring shares from a non-performer, the employer can reacquire the shares at the lower of the market value as of the date of the initial grant (i.e. of R2) or the market reacquisition value (i.e. R3). In this case, reacquisition from a non-performer on 10 August 2009 can occur at R2 per share.

#### 4. *Group of companies*

Under current law, the equity shares granted must consist of shares in the employer or any company forming part of the same “group of companies” as the employer. It is proposed that the term “group of companies” be replaced with the term “associated institution” as defined in the Seventh Schedule (section 8B(2) and (3) – “broad-based employee share plan” definition). This change realigns the share scheme with other fringe benefit schemes (which are mainly addressed in the Seventh Schedule).

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## **FURTHER LIMITATION OF BENEFITS OF EXECUTIVE SHARE SCHEMES**

### **Current law**

The tax system has long sought to address executive share schemes that seek to undermine the tax base by converting executive bonuses into a variety of employer share arrangements. The most recent legislation targeting this form of avoidance is section 8C, which seeks to ensure that restricted share arrangements result in ordinary revenue for employees when applicable restrictions are lifted.

### **Reasons for change**

A new generation of executive share schemes that seek to avoid section 8C on artificial technical grounds has emerged. Some of these schemes involve trusts in which the executive obtains a right to the value of the shares held in trust without any right to acquire the underlying shares. Other schemes do not contain any restrictions on the employer shares themselves but impose other financial penalties on the employee for violating employer restrictions on the employer shares.

## **Proposal**

Applicable clause and Income Tax Act provisions:  
Clause 11; section 8C(1A) and (7)

### *1. Targeting of new generation of share schemes*

The ambit of section 8C is extended by widening the scope of the term “equity instrument” (section 8C(7) – “equity instrument” definition). This new definition includes “any contractual right or obligation the value of which is determined directly or indirectly with reference” to the underlying share. Hence, section 8C now applies to an interest in a trust even if the employee has a right solely to the value of the shares in the trust (without any direct right in the shares themselves).

The definition of “restricted equity instrument” has also been expanded. Restrictions no longer just cover rights of forfeiture or acquisition at a price other than market value. The revised definition now also includes any other financial penalty for not complying with the employer’s terms for issuing the shares (section 8C(7) – paragraph (b) of the “restricted equity instrument” definition).

### *2. Capital distributions*

Questions have been raised about the treatment of “capital distributions” arising in respect of restricted equity instruments held by employees. These capital distributions normally give rise to accruals of a capital nature, but the better theoretical answer is to tax these distributions as ordinary revenue as if these amounts arose from any other disposal of restricted equity instruments (section 8C(1A). See also paragraph 35(3) of the Eighth Schedule which ensures that the same amount is not taxed again as a capital gain). The argument in favour of this result is even more pronounced now that capital distributions are essentially treated as part-disposals (see paragraph 76A of the Eighth Schedule).

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## **CORPORATE AND COMMERCIAL ISSUES**

### **SECONDARY TAX ON COMPANIES (“STC”) REFORMS**

#### **Current Law**

The STC is a tax that is levied with reference to the amount of dividends “declared” by a company less dividends accrued to that company. Consequently, the liability for STC falls on the company distributing the dividend (as opposed to the shareholder receiving the dividend).

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

- The first phase entailed the reduction of the STC tax rate to 10 per cent, as well as a revision of the tax base (i.e. the definition of “dividend”) on which the STC relies. The initial elements of this phase were effected by the Revenue Laws Amendment Act, 2007.
- The second phase entails the replacement of the STC with a new tax on company dividends to be levied at a shareholder level.

### **Reasons for change**

#### *1. Need for the shift from a company-level tax to a shareholder-level tax*

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

- because the STC reduces the accounting profits of South African resident companies, those companies are at a disadvantage compared to their international counterparts which do not bear any adverse accounting profit reduction when paying dividends.
- since the STC is levied at company-level, tax treaty limits on the rate of tax which may be imposed in respect of dividends generally have no effect (unless the relevant treaty makes specific provision for STC).
- foreign investors are generally unfamiliar with STC and its mechanics, thereby creating uncertainty.

It is argued that the combined effect of all of these problems is that the cost of equity financing is increased.

#### *2. Need for a change to the tax base*

Problems exist with the tax base upon which the STC relies. More specifically, the section 1 dividend definition draws its meaning from the term “profits” (i.e. a dividend expressly or implicitly requires a reduction in profits), but the term “profits” itself is never expressly defined in the Income Tax Act. It is understood that the term “profits” draws its meaning from company law and accounting principles. This mixture of (often complex) concepts of accounting, company law and tax has complicated the tax system and has created opportunities for avoidance.

### **Proposal: Conversion of STC to Dividends Tax**

Applicable clauses and Income Tax Act provisions:

Clause 56; sections 64D, 64E, 64F, 64I and 64J



## 1. *Basics of the Dividends Tax*

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

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

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

- i. a South African resident company;
- ii. a pension, provident or other similar benefit fund;
- iii. a sphere of the South African government (i.e. national, provincial or local);
- iv. an exempt South African public entity;
- v. an approved public benefit organisation; or
- vi. an environmental rehabilitation trust (as contemplated in section 37A).
- vii. a shareholder in a registered “micro business” as defined in the Sixth Schedule (in this regard, see the notes on **Presumptive Tax for Micro Businesses** below).

The above list of exemptions is much broader than the exemptions currently existing for the STC. For instance, dividends paid to pension and provident funds are now exempt, thereby providing a further stimulus for retirement savings. More notably, all dividends paid from one resident company to another are now exempt without regard to whether those companies are within the same group of companies. This company-to-company exemption represents an element of a classical model of taxation of dividends (in which the underlying profits of companies are taxed in the companies and dividends are taxed in the hands of shareholders when dividends leave South African companies).

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

*Result.* The Dividends Tax only applies once the R20 000 of dividends are paid to Individual. The previous dividends are exempt.

*Example 2. Facts.* Company X is a listed company on the Johannesburg Securities Exchange. Company X has issued 1 million ordinary shares. Of these ordinary shares, 600 000 are held by natural persons who are residents; 300 000 are held by South African retirement funds and 100 000 are held by resident companies. Company X pays a dividend of R5 per share.

*Result.* The dividends paid to resident natural persons are subject to the Dividends Tax. The dividends paid to pension funds and resident companies are exempt.

Finally, although not expressly stated in section 108 of the Income Tax Act, it should be noted that tax treaty relief potentially applies now that dividends are taxed at a shareholder-level. The treaty relief generally has the greatest practical significance in the case where a foreign resident has a minimum 10 to 25 per cent interest (depending on the relevant treaty) in the capital of the domestic company paying the dividend. In these cases, the rate of Dividends Tax may be reduced to 5 per cent.

## 2. *Transitional arrangements*

### a. *STC credits*

In addition to the above relief for certain beneficial owners of dividends, an exemption is proposed for dividends paid by companies that have unutilised STC credits. The STC credit of a company is the cumulative amount of dividends which accrued (or are deemed to have accrued) to the company during the last dividend cycle under the STC system and which exceeds the dividends declared on the last day of that dividend cycle, if any. The last dividend cycle ends on the day before the Dividends Tax becomes effective. This exemption ensures that profits previously subject to the STC are not subject to another tax (i.e. the Dividends Tax) when subsequently passing through resident companies.

Dividends paid on or after the effective date of the Dividends Tax by companies with STC credits will reduce the balance of their STC credits. For purposes of administrative convenience, STC credits will be exhausted first (i.e. a company will not be entitled to pay a dividend which does not reduce STC credits). Moreover, STC credits of a resident company may be increased if a dividend from another resident company with STC credits accrues to the first-mentioned company. The transfer of STC credits will only be possible if the company paying the dividend has provided the recipient shareholder of the dividend prior written notice of the amount by which its STC credit has been allocated to the dividend which accrued to that shareholder. STC credits must be allocated on a *pro rata* basis amongst all shareholders within the same class entitled to the dividends, irrespective of whether those shareholders are exempt from the Dividends Tax. However, notification of the STC credit transferred will only be required if the recipient of the dividend is a South African resident company.

*Example 1. Facts.* Company X has two shareholders (SA Pension Fund and Individual). SA Pension Fund and Individual each hold 50 per cent of the shares of Company X. Company X has R400 of STC credits (i.e. Company X has received R400 of dividends previously subject to STC). Company X distributes R600 to its shareholders by way of a dividend.

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

STC credits will work themselves up through a chain of South African resident companies. These credits will also be pro-rated amongst each class of shareholder (as they move through the chain).

*Example 2. Facts.* Company X has two resident shareholders (Company Y and Individual). Company Y and Individual each hold 50 per cent of the shares of Company X. Company X has R400 of STC credits (i.e. has received R400 of dividends previously subject to STC). Company X distributes a total of R600 to both of its shareholders by way of a dividend.

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

STC credits under the new Dividends Tax will be dependent on the company payor providing reporting information to the payee. The company payor will be required to determine the percentage of the dividend that will be exempt by virtue of STC credits, and this percentage will need to be reported and relied upon through the chain. Failure to transmit this report in time to the payee will result in the denial of STC credits for the shareholder with the STC credits still being reduced in the hands of the payor. This notification will need to be transmitted by the date of payment of the dividend.

All remaining STC credits will terminate on the fifth anniversary from the date that the Dividends Tax becomes effective.

*b. Other Transitional Arrangements*

In addition to the above STC credit transition rules, another transitional rule will apply to dividends declared before the date that the new Dividends Tax

becomes effective and paid after that effective date. These dividends will be subject to STC and will not be subject to the Dividends Tax (despite the fact that they are paid after the effective date). This transitional rule will only have practical application on transition from the STC system to the Dividends Tax system.

### **Proposal: Revised dividend definition**

#### Applicable clauses and Income Tax Act provisions:

Clause 4(1)(b) through (d); section 1 (“contributed tax capital”, “dividend” and “foreign dividend” definitions)

Clause 49(1)(g); section 42(3A)

Clause 50(1)(a); section 44(4A)

Clause 52(1)(b); section 46(3A)

#### 1. *New definition of “dividend”*

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

The definition contains two exclusions. Firstly, dividends do not include amounts resulting in a reduction of contributed tax capital (see below). Secondly, dividends do not include situations where a company transfers its own shares. The transfer of a company’s own shares is not within the dividend definition on the basis that such a transfer does not result in an outflow of overall value from the company (all underlying assets remain with the company).

#### 2. *Definition of “foreign dividend”*

The new rules above apply only to domestic dividends. The concept of foreign dividends remains under review. The new definition of “foreign dividend” is therefore an interim measure. In essence, this definition merely preserves the pre-existing dividend definition for foreign dividends. The rules for foreign dividends will be reviewed before the new Dividends Tax comes into effect.

#### 3. *New definition of “contributed tax capital” (“CTC”)*

##### *a. Basic rules: additions, starting amounts and reductions*

The CTC of a company is a notional amount derived from the value of any contribution made to a company as consideration for the issue of shares by

the company. CTC will be reduced by any part thereof that is allocated by the company in a subsequent transfer to one or more shareholders.

As a general rule, the CTC of a company is based on amounts received by or accrued to a company as consideration for the issue of shares by the company. For instance, if an individual contributes an asset worth R100 to a public company in an offer of shares to the public, R100 is added to CTC. Applying basic principles, an amount received by or accrued to a company as consideration for the issue of shares would not only include cash or the value of an asset received by or accrued to the company. CTC would also include the value of services provided by a person to the company as consideration for a share issue or the cancellation of a loan account owed by the company as consideration for the issue of shares.

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

In order for a transfer from a company to a shareholder to constitute a reduction of CTC (and accordingly fall outside the “dividend” definition), the definition of CTC requires that the company determine in writing that the transfer constitutes a transfer of CTC. Without this written determination (which could, for example, take the form of a company resolution), no reduction of CTC can occur (and the amount transferred would constitute a dividend subject to the Dividends Tax). In effect, the rules amount to a unilateral company election. In order for this written determination to be valid, the determination must be made by the date of the transfer by the company to the shareholders.

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

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

*Example. Facts.* Company X has two ordinary shareholders (A and B) and one preferred shareholder (C). A owns 25 ordinary shares, and B owns the other 75 ordinary shares. Company X has CTC of R150 in respect of its preference shares and R380 in respect of its ordinary shares. As part of a written company resolution when making a

distribution to its ordinary shareholders of R200, Company X decides to allocate R60 of the ordinary share CTC to shareholders A and B.

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

$$\text{CTC transferred to A} = \frac{25}{100} \times 60 = \text{R15}$$

$$\text{CTC transferred to B} = \frac{75}{100} \times 60 = \text{R45}$$

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

*c. CTC and company reorganisation rollovers*

The company reorganisations rules of section 41 through 47 potentially require special adjustments for the CTC calculation (similar to other rules such as base cost, cost price and allowances). More specifically, special CTC rules apply in the case of asset-for-share transactions under section 42, amalgamation transactions under section 44 and unbundling transactions under section 46.

*(i) CTC and Section 42 asset-for-share rollovers*

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

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

*Result.* The amount of CTC that is contributed to Company Y is equal to the base cost of the asset to Individual X (i.e. R10) and not its market value (i.e. R100).

The CTC rules essentially mimic the other section 42 base cost, cost and cost price rules. Hence, in the case of a section 42 rollover to a listed company where the transferor fails to hold the 20 per cent threshold, the resulting CTC from a capital asset contribution is equal to the market value (not rollover base cost) of the asset.

#### (ii) CTC and section 44 amalgamations

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

*Example 1 (simple amalgamation). Facts.* Target Company and Acquiring Company are completely independent from one another with neither company holding any shares in the other. Target Company disposes of all of its assets to Acquiring Company in terms of a section 44 amalgamation transaction. The CTC in Target Company is R200, and the CTC in Acquiring Company is R300. As a result of the transaction, the existence of Target Company is terminated.

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

*Example 2 (amalgamation preceded by a CTC transfer). Facts.* The same as *Example 1*, except that Target Company makes a cash distribution of R80 to its shareholders as part of the amalgamation. This transfer includes a R50 CTC allocation.

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

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

$$\begin{array}{l} \text{Amount of CTC} \\ \text{of target} \\ \text{company that is} \\ \text{transferred to} \\ \text{acquiring} \\ \text{company} \end{array} = \begin{array}{l} \text{Value of shares in} \\ \text{target company held by} \\ \text{shareholders other than} \\ \text{acquiring company} \\ \text{Value of all shares in} \\ \text{target company} \end{array} \times \begin{array}{l} \text{CTC of target} \\ \text{company at time} \\ \text{of its termination} \end{array}$$

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

*Result.* The amount of CTC of Target Company that is transferred to Company R is calculated as follows:

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

$$= \text{R360}$$

### (iii) CTC and section 46 unbundling transactions

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

*Example 1. Facts.* Parent Company owns all the shares in Subsidiary. The CTC in Parent Company is R750, and the CTC in Subsidiary is R500. Parent Company has a value of R1 000 (excluding the value of



Subsidiary) and Subsidiary has a value of R500 (together they have a value of R1 500). All the shares of Subsidiary are unbundled to the Parent Company shareholders.

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

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

*Example 2. Facts.* Parent Company owns 900 shares of Subsidiary with the remaining 100 shares held by Individual X. The CTC in Parent Company is R4 000, and the CTC in Subsidiary is R800. Parent Company has a value of R15 000 (excluding the value of Subsidiary) and Subsidiary has a value of R5 000. All 900 shares of Subsidiary held by Parent Company are unbundled to the Parent Company shareholders. Individual X retains the 100 shares previously held.

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

## **Proposal: Dividends Tax Withholding**

Applicable clauses and Income Tax Act provisions:

Clause 56(1); sections 64D, 64G, 64H, 64K and 64L

### *1. General overview*

The new Dividends Tax seeks to retain the tax collection mechanism that exists within the current STC system. This tax collection mechanism, however, is more complicated in the context of the Dividends Tax. Under the STC, the company payor can make the tax calculation mainly by reference to its own tax situation. Under the Dividends Tax, however, the company payor is required to be far more aware of the shareholders' tax situation (e.g. whether the shareholder qualifies for an exemption or for treaty relief) in order to determine the appropriate tax obligation.

The new withholding Dividend Tax envisions two general sets of withholding obligations. As an initial matter, the company paying the dividend is the

primary party required to undertake the withholding. However, this obligation may be shifted to an intermediary (on the basis that the intermediary may be in a far better position to determine the shareholders' tax situation, especially in the case of uncertificated shares in a listed company).

2. *Withholding by company payors (section 64G)*

a. *Standard obligation*

Under the Dividends Tax any resident company that declares and pays a dividend will be required to withhold (i.e. hold back 10 per cent of the amount of the dividend and pay that amount to SARS). As discussed earlier, payment of the dividend arises when the dividend accrues to a shareholder. However, this standard obligation to withhold is subject to exemptions and tax treaty adjustments.

b. *Exemptions and tax treaty relief*

Generally, the existence of a withholding exemption for a company payor depends on whether the share giving rise to the dividend is a certificated share (i.e. where ownership of the share is evidenced in paper form) or an uncertificated share (i.e. where ownership of the share is evidenced in electronic form). In the case of uncertificated shares, the rules relating to withholding are easier to comply with for company payors than those applicable in the certificated environment. This difference exists because most of the beneficial shareholder information in an uncertificated environment is known by regulated intermediaries (as opposed to being known by the company payor).

(i) *Dividends in respect of certificated shares*

A company payor making a dividend payment in respect of certificated shares must not withhold Dividends Tax in two sets of circumstances:

- if payment is made to a beneficial shareholder that has submitted a written declaration that the beneficial owner is exempt from the Dividends Tax ; or
- if payment is made to a company within the same group of companies (as defined in section 41 (i.e. a dividend within a domestic group)).

A company payor must also reduce the amount of Dividends Tax owed upon receipt of a declaration that the beneficial shareholder is entitled to a reduction of tax by virtue of a tax treaty.

Declarations must be received in a timely manner so that the payor company has the administrative capability of exempting or reducing the otherwise existing withholding obligation. This date is set by the company. The declaration must also include an undertaking by the beneficial shareholder that it will promptly notify the company of any cessation of beneficial ownership.

Once submitted, declarations apply to all future dividends until one of the earliest of the following three events occur: (1) the beneficial owner notifies the company that beneficial ownership has ceased, (2) the share register changes in respect of the registered shareholder in relation to the underlying share, or (3) a period of three years from the date of submission of the declaration elapses (this three year limit is aimed at ensuring that companies regularly review their records).

It should be reiterated that the obligation to reduce the amount of withholding tax as a result of a proper declaration is not optional for the company payor. The company payor must reduce the level of withholding in accordance with any declaration that is received timeously. .Appropriate reliance on a declaration form also fully relieves the company payor from liability to the SARS for any Dividends Tax in respect of that declaration.

(ii) *Dividends in respect of uncertificated shares*

It is proposed that if a company payor pays dividends in respect of uncertificated shares, the company payor be exempt from withholding obligations *per se*. As discussed above, this exemption exists because dividend payments in respect of uncertificated shares are always made *via* regulated intermediaries (such as a central securities depository participant). These regulated intermediaries almost universally have better access to shareholder information in the case of uncertificated shares.

3. *Withholding by intermediaries (section 64H)*

After determining the withholding obligation of the company payor, a second question exists as to whether an alternate obligation exists for an intermediary (i.e. parties that pay dividends that were declared by other persons). To the extent an intermediary exists, the general rule is that the intermediary is required to withhold the full 10 per cent amount unless a specific exemption exists (or tax treaty relief applies). These exemptions and relief mechanisms again depend on whether the dividend is paid in respect of a certificated or an uncertificated share. In addition, an intermediary does not have any withholding obligation if another party has already paid the tax (e.g. the company payor or the beneficial shareholder).

It should further be noted that two types of intermediaries exist: regulated and unregulated intermediaries. A regulated intermediary is subject to one or more regulatory controls associated with uncertificated shares (e.g. the Securities Services Act). Any registered shareholder lacking a beneficial interest in the underlying share can qualify as an unregulated intermediary (e.g. a nominee).

(i) *Dividends in respect of certificated shares*

The exemptions and treaty relief mechanisms for the payment by an intermediary of a dividend in respect of certificated shares roughly follow the same paradigm as a payment of a dividend by a company payor. An

intermediary (regulated or unregulated) making payment in respect of certificated shares must not withhold if payment is made to a beneficial shareholder that has submitted a written declaration of exemption. An intermediary payor must also reduce the amount of Dividends Tax owed upon receipt of a declaration by a beneficial shareholder claiming tax treaty benefits.

Declarations must be received in a timely manner so that the payor intermediary has the opportunity to exempt or reduce the otherwise existing withholding obligation. This date is set by the intermediary. The declaration must also be accompanied by an undertaking by the beneficial shareholder promptly notifying the intermediary of any cessation of beneficial ownership.

Once submitted, declarations apply to all future dividends until the earliest of three events occur: (1) the beneficial owner notifies the intermediary that beneficial ownership has ceased, (2) the share register changes in respect of the registered shareholder in relation to the underlying share, or (3) a period of three years from the submission of the declaration elapses (this three year limit is aimed at ensuring that intermediaries regularly review their records).

As with company payors, the obligation to reduce withholding based on a proper declaration is not optional. The intermediary must reduce the level of withholding in accordance with any declaration that is received timeously. Appropriate reliance on a declaration form also fully relieves the company payor from liability to the SARS for any Dividends Tax in respect of that declaration.

*(ii) Dividends in respect of uncertificated shares*

The rules for intermediaries pertaining to uncertificated shares are roughly the same as those for certificated shares. Exemptions and treaty relief again exist by way of declaration.

*4. Payment and recovery of the Dividends Tax (section 64K)*

As discussed above, the Dividends Tax (or withholding) payment obligation is imposed on the beneficial owner, the company payor and an intermediary (if applicable), all of whom will be liable until the tax has been paid to SARS. This discharge will take place if any one of these parties makes payment of the Dividends Tax (i.e. the party making payment relieves the other parties of the residual liability owed to the SARS).

If liability for payment of the Dividends Tax arises (either on the part of the beneficial owner, a company payor or an intermediary), the tax must be paid over to SARS on or before the last day of the month following the month during which the dividend is paid by the company declaring the dividend (i.e. a dividend payment on 20 July means that the tax must be paid by 31 August). As a practical matter, the company payor or intermediary will operate as the first point of call for the tax as a result of their withholding obligations.

5. *Refund of tax (sections 64L and 64K(2))*

Special rules are required to ensure that beneficial owners can obtain a tax refund if the amount of tax withheld exceeds the tax liability. As a general matter (as discussed above), a company payor or intermediary must not withhold (or must reduce the tax charge in accordance with a tax treaty) upon receipt of a timely declaration from the beneficial owner. However, special refund procedures are required if this declaration is not timely, not properly submitted, or is incorrectly processed.

In these circumstances, the refund rules (depending on timing) are as follows:

1. *Company refund process:* If a declaration by the beneficial owner is submitted within one year after payment of the dividend otherwise eligible for exemption or relief, the company payor (or intermediary) must refund the Dividends Tax to the beneficial owner. However, this refund is required only if the company payor (or intermediary) makes further dividend payments from which dividends tax was withheld within one year from payment of the initial dividend at issue. In these cases, the company payor (or regulated intermediary) refunds the over-withheld amount to the beneficial owner and thereby reduces its payments of dividends tax on the subsequent dividend payments to SARS.
2. *SARS refund process:* If a refund is not made within one year from date of payment of the dividend (e.g. because no further dividend payments were made in that year), the beneficial owner may obtain a refund from SARS.
3. *Three-year time limit:* No amount may be refunded after three years from the date on when the Dividends Tax is withheld.

*Example 1. Facts.* Company X is a listed company which issued 1 million uncertificated shares. Company Y holds shares of Company X through Regulated Intermediary. Company X pays a dividend of R5 per share and Company Y is entitled to R500 of dividends by virtue of its beneficial interest in 100 shares of Company X. Assume all parties are residents (and therefore Company Y is exempt from the Dividends Tax).

*Result.* Company X is exempt *per se* from withholding tax by virtue of the fact that the shares involved are uncertificated shares. Regulated Intermediary is not obligated to withhold dividends tax if Company Y submits its declaration to Regulated Intermediary in a timely manner. If not, Regulated Intermediary must withhold and pay R50 (10 per cent of R500) to the South African Revenue Service. If the declaration is late but within one year from payment, Regulated Intermediary must pay the R50 back out of Dividends tax withheld in relation to the next dividend payment to be made by Regulated Intermediary (as long as the Regulated Intermediary makes a dividend payment within the

required one-year period). If no refund occurs within the one year period, Company Y can make a claim for refund directly to the South African Revenue Service.

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## **PASSIVE HOLDING COMPANIES**

### **Current law**

In terms of the current law, the maximum rate of income tax for individuals is 40 per cent and the rate for companies is 28 per cent. Companies are also subject to STC, which is levied on the net amount of dividends declared by South African resident companies. The STC falls on the company and not the shareholder.

### **Reasons for change**

The STC will be discontinued and be replaced by a Dividends Tax. The new Dividends Tax will shift the tax from companies declaring dividends to shareholders receiving dividends. Dividends accruing to companies will offer an arbitrage opportunity because company-to-company dividends will be exempt. As a practical matter, this deferral of dividends tax is one of the largest revenue collection aspects of concern.

The 28 per cent company rate also offers another ongoing arbitrage advantage for companies *vis-à-vis* individuals, the latter of whom face a top 40 per cent marginal tax rate. Of concern is passive income, such as interest, that can just as easily be earned in an individual's hands, but for tax considerations.

The main objective of the passive holding company anti-avoidance rules is to counter the trapping of dividends and passive ordinary revenue in a company. Active income is not a concern because strong non-tax business reasons exist for keeping businesses in limited liability form. Real estate (even though potentially passive) is also not of concern for the same reasons. The higher rate of capital gains tax for companies (the effective 14 per cent rate versus the effective marginal 10 per cent rate for individuals) also more than offsets any ordinary rate rental arbitrage advantage from real estate.

### **Proposal**

Applicable clause and Income Tax Act provision  
Clause 14(1); section 9E

#### *1. General overview*

The passive holding company anti-avoidance rules are designed to prevent (i) a close group of individuals (or families) from maintaining passive financial

instruments in a company structure in order to build-up passive amounts at reduced tax rates, or (ii) the deferral of the dividend withholding tax. As discussed above, these rules will not apply to the real estate industry because of the business need for limited liability.

The passive holding company tax is triggered by a three-part requirement: (i) a company requirement, (ii) an ownership requirement, and (iii) an income requirement (section 9E(1) – “passive holding company” definition). The main tax avoidance concern relates to the new Dividends Tax on shareholders, therefore, the introduction of the passive holding company tax will have the same effective date as the Dividends Tax.

2. *Company requirement (section 9E(1) – “excluded company” definition)*

These rules apply to any company but exclude a number of companies referred to as “excluded companies”. Excluded companies fall into several groups. One group of exclusions is for regulated companies (e.g. banks and insurers): the regulatory environment governing these companies makes it highly unlikely that their formation was motivated primarily for tax reasons. Listed companies and their 70 per cent controlled group companies (as well as collective investment schemes and venture capital companies) are excluded because the widely-held intended nature of these entities excludes the possibility of a closely-held tax avoidance scheme. Public benefit organisations and clubs are excluded because these entities do not allow for the accumulation of profits for the benefit of private shareholders. The excluded companies mentioned above are most probably also excluded due to the ownership requirement discussed below. Foreign companies are excluded because the CFC anti-avoidance rules are designed to prevent offshore avoidance of this kind.

3. *Ownership requirement (section 9E(1)(paragraph (b) of the “passive holding company” definition)*

A company will qualify as a passive holding company only if more than 50 per cent of the participation rights (as contemplated in section 9D) in that company are held by five or fewer resident natural persons (i.e. individuals). These rights include any right to profits or capital (e.g. ordinary shares and preference shares). The participation rights can be held directly or indirectly (i.e. through one or more entities). For instance, if an individual owns all the shares of a company and that company owns all the shares of a subsidiary, both companies satisfy the ownership requirement.

4. *Gross income requirement (section 9E(1) – “gross income” definition, paragraph (a) of the “passive holding company” definition and “passive income” definition)*

For a company to qualify as a passive holding company in a particular year of assessment, more than 80 per cent of the gross income must constitute passive income. Passive income is income derived from financial instruments. Certain dividends are excluded from the “gross income” definition for

purposes of section 9E, meaning that this dividend income neither “counts for nor against” the taxpayer (i.e. this income is excluded from the numerator and the denominator). To be excluded, the dividends must be derived from companies in which equity shares and voting rights of at least 20 per cent are held. The purpose of this exclusion is to prevent potential double counting from lower-tier companies that may also be treated as a passive holding company. Royalties are expressly excluded and capital gains are implicitly excluded (not being part of the section 1 “gross income” definition).

*Example 1. Facts:* Company X is owned equally by three unconnected individuals. Company X receives R500 of dividends from Company Y (in which it owns 10 per cent of the shares), R200 of interest and R300 from payment for goods sold and delivered. Company X also realises R1 000 of capital gains from the sale of land.

*Result:* Dividends and interest constitute passive income. Due to Company X’s less than 20 per cent holding in Company Y, the dividend received by Company X is included in the calculation. The capital gains are excluded from the denominator and numerator *per se*. The sum of all passive income, (i.e. dividends and interest) is 70 per cent of Company X’s gross income. Therefore, Company X does not satisfy the gross income requirement for passive holding company classification.

In determining the more than 80 per cent passive income threshold, the test also takes into account group company active income (i.e. non-passive income). This group reliance is designed to ensure that the passive holding company anti-avoidance rules do not undermine legitimate treasury operations that are used to reinvest funds in group businesses.

*Example: Facts:* Company X is wholly owned by an individual. Company X has income of R200 of which R190 constitutes passive income. Company X owns all the shares of a subsidiary. The Subsidiary for the same year of assessment has R1 000 of income of which R300 is passive income.

*Result:* The total gross income of the group (i.e. Company X and Subsidiary) amounts to R1 200. The passive income of Company X amounts to only R190 of the R900 group total (R1 200 less the R300 passive subsidiary income). Therefore Company X is not a passive holding company.

## 5. *Impact of passive holding company treatment*

### a. *Special tax rates (sections 9E(2) and (3))*

Passive holding company dividends and taxable income (excluding taxable capital gains) will be subject to special rates of tax. These rates will be fixed annually by the Minister of Finance with the first rates to be released with the introduction of the new Dividends Tax. At the outset, it is intended that the tax



rate on dividends will be set at 10 per cent (i.e. equal to the current STC rate). It is also intended that the tax rate will be set at 40 per cent for all taxable income earned by the passive holding company (other than capital gains which will fall outside the passive holding company anti-avoidance rules).

*b. Rules addressing the potential for double tax (section 9E(4))*

Dividends paid by a company are not subject to the new Dividends Tax if previously taxed by virtue of the passive holding company anti-avoidance rules. This relief applies regardless of whether the passive holding company tax applied to dividends taxable at 10 per cent or taxable income taxable at 40 per cent. The special tax is a “first-in-first-out” system in terms of which the tax applies only once the dividends paid by the company exceed the dividends or taxable income to which the passive income holding company anti-avoidance rules applied.

*Example 1. Facts:* Company X is owned by one individual. In 2015, Company X receives R600 of interest and R1100 of dividends, and earns other income of R300 from active trading activities. Company X is subject to tax as a passive holding company because 85 per cent of the gross income is from passive financial instruments. In 2015, the dividends are subject to a 10 per cent tax and the other income is subject to a 40 per cent charge. Company X declares a dividend of R600 to Individual at the end of the year.

*Result:* All of the R600 of dividends paid will be exempt from the Dividends Tax. These amounts do not exceed the total amount already subject to tax pursuant to the application of the rules for passive holding companies.

*Example 2. Facts:* The facts are the same as *Example 1*. In 2016, Company X solely earns R200 gross income from active trading activities. Company X pays another R500 of dividends in the same year.

*Result:* Company X is still entitled to the relief even though Company X is no longer a passive holding company (i.e. the relief applies to “any” company).

**6. General administration**

As with other separate taxes within the Income Tax Act, provisions are included in order to administer any taxes imposed on passive holding companies.

## COMPANY REORGANISATIONS: DE-GROUPING CHARGE

### Current Legislation

Under current law, a de-grouping will trigger a gain or loss based on the market value of the asset at the time of the de-grouping, with the asset obtaining a market value tax cost once the de-grouping has occurred. The depreciation is generally capped at the pre-de-grouping cost. Losses are intended to be clogged (i.e. deductible only against other section 45 gains of the transferee).

### Reasons for change

Various flaws exist in the current de-grouping rules. These flaws may result in double taxation, with gain not always reflected in the tax cost. The anti-loss rules may be prohibitive. Concerns also exist that the de-grouping charge does not work properly when multiple section 45 transfers (and other rollover reorganisation transactions) precede a de-grouping.

### Proposal

Applicable clause and Income Tax Act provision:

Clause 51(1)(a) through (d); section 45(4)(b)

#### 1. *General overview*

The proposed amendments revise the de-grouping charge so that the charge is more appropriate to the underlying theory. As an initial matter, it is proposed that the de-grouping charge only give rise to gains – losses will henceforth be ignored (i.e. a de-grouping will no longer result in a clogged or otherwise disallowed loss). Secondly, the gain and tax cost concepts will be altered to move away from the current “linear” formulation (i.e. a deemed sale/repurchase followed by various adjustments up to the de-grouping). The revised de-grouping charge simply triggers a gain that is added to tax cost. Lastly, the revised de-grouping charge seeks enhanced coverage when successive rollovers precede the de-grouping charge.

#### 2. *Capital gains plus recoupments*

##### a. *Basic capital gain (section 45(4)(b)(i))*

Under the proposal, a de-grouping will trigger built-in capital gain for capital assets (i.e. the capital gain not recognised by virtue of the prior intra-group transfer). This capital gain will essentially be capped at the “lesser of” the gain at the time of the section 45 transfer or the gain existing on the date of de-grouping.

*Example 1. Facts.* Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Vacant land to Sub 2 in 2007. Vacant land has a value of R100 and a base cost of R20 at the time of the transfer. Section 45

intra-group rollover treatment applies to the transfer. In 2010, Parent sells all the shares of Sub 2, thereby triggering the de-grouping charge. Vacant land has a value of R115 at the time of the de-grouping (and a base cost of R25 (i.e. the 2007 base cost of R20 plus improvements of R5)).

*Result.* Sub 2 had R80 of built-in capital gain (R100 minus R20) at the time of the section 45 transfer and R90 of capital gain at the time of the de-grouping (R115 minus R25). The capital gain is therefore limited to R80.

*Example 2. Facts.* The facts are the same as for Example 1, except that Vacant land has a value of only R95 at the time of the de-grouping.

*Result.* Sub 2 has R80 of built-in capital gain (R100 minus R20) at the time of the section 45 transfer and R70 of capital gain at the time of the de-grouping (R95 minus R25). The capital gain is therefore limited to R70.

*b. Recoupments (section 45(4)(b)(ii))*

Under the proposal, section 8(4) recoupment will apply and is aligned with the recoupment procedure of a normal disposal. However, it is recognised that situations may arise where recoupment and capital gain changes over time. For instance, the initial intra-group transaction could have high capital gain with low recoupment, followed by a subsequent lower capital gain and higher recoupment. In these situations, it is proposed that the section 8(4) recoupment will be the “higher of” the initial section 45 transfer recoupment or the de-grouping date recoupment.

*Example. Facts.* Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Vacant land to Sub 2 in 2007. Vacant land has a value of R95 and a base cost of R55 at the time of the transfer. Vacant land was initially purchased for R70 with the R55 base cost resulting from R15 of prior depreciation deductions. Section 45 intra-group rollover treatment applies to the transfer. In 2010, Parent sells all the shares of Sub 2, thereby triggering the de-grouping charge. Vacant land has a value of R70 at the time of the de-grouping (as well as a base cost of R40; i.e. R30 of potential depreciation recoupment).

*Result.* The initial potential capital gain is R25 (R80 value minus R55 base cost), and the de-grouping date capital gain is R0. However, the initial potential recoupment is R15 (R70 minus R55) while the de-grouping date recoupment is R30 (R70 minus R40). Under these circumstances only R30 is treated as a recoupment.

*c. Cost adjustments (capital gains base cost and depreciable cost)*

In the case of a de-grouping involving a capital asset, the taxpayer should retain the base cost as existed prior to the de-grouping plus an increase for

any gross income/capital gain arising from the de-grouping. Hence, if any gross income or capital gain results from the de-grouping (e.g. due to a depreciation recoupment or value exceeding cost), the full amount is added to the capital gains tax base cost.

*Example. Facts.* Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Vacant land to Sub 2 in 2007. Vacant land has a cost and value of R100 and a base cost of R90 in 2007. For the next few years, base cost is adjusted downward by R30 for depreciation, followed by a R10 increase for improvements. The net result is a base cost of R70. In 2010, a de-grouping occurs when the value of Vacant land is R125.

*Result.* The de-grouping capital gain is R0 (the lesser of the initial potential capital gain of R0 and the de-grouping date potential capital gain of R15). The de-grouping recoupment is R40 (the greater of the initial potential recoupment of R10 and the de-grouping potential recoupment of R40). The R40 is added to the de-grouping date base cost of R70 for a total of R110.

Under the proposal, the de-grouping charge will effectively trigger the same depreciation cost result as a “connected person” sale because the deemed sale is between the same de-grouping transferee company. The section 23J(2) paradigm will roughly apply for purposes of depreciation cost. Hence, depreciable cost will equal initial cost of the transferor plus ordinary revenue triggered on the de-grouping, plus only 50 per cent of the capital gains triggered on the de-grouping. In the example above, depreciable cost will increase by the full R40 because the R40 amount represents gross income.

### 3. *Special rules for section 36 mining assets (section 45(4)(b)(ii))*

Mining assets trigger ordinary revenue for the full gain even if the gain exceeds the initial depreciation (paragraph (j) of the “gross income” definition). While this form of ordinary revenue increases the depreciable cost or value of the asset, this increase only occurs immediately before subsequent disposal of the asset (proviso to section 45(4)(b)(ii)). This deferred increase ensures that the paragraph (j) gross income is not immediately offset by a section 36 capital deduction while ensuring that no double tax occurs upon subsequent disposal.

*Example. Facts.* Parent owns all the shares of Sub 1 and Sub 2. Sub 1 transfers Mining Vacant land to Sub 2 in 2009. Vacant land has a value of R100 and a base cost of R0 in 2009. In 2010, a de-grouping occurs when the value of Mining Vacant land is R125. Assume that neither Sub 1 nor Sub 2 has any unredeemed capital expenditure. Sub 2 sells Mining Vacant land for R142 in 2011.

*Result.* The de-grouping recoupment is R125 (the greater of the initial potential “recoupment” of R100 and the de-grouping date potential “recoupment” of R125). Sub 2 may not treat this R125 amount as section 36 capital expenditure on the de-grouping date. However, the

R125 amount can be used to offset the R142 of ordinary revenue (under paragraph (j) of the “gross income” definition) in the case of the 2011 sale.

4. *Trading stock (section 45(4)(b)(iii))*

Under the proposal, the trading stock section 22 “cost price” is uplifted in a similar way to the capital gains tax base cost. Any taxable income (other than capital gains or recoupments) triggered from the de-grouping will be added to the section 22 “cost price”.

5. *Successive transfers (section 45(4)(b)(i) through (iii))*

a. *Application of the six-year rule*

If an asset is transferred via a series of section 45 transfers, each section 45 transfer is to be tested separately for purposes of the 6 year rule. As a practical matter, the test for de-grouping will be determined by starting with the de-grouping date and going back six years.

*Example. Facts.* Parent owns all the shares of Sub 1, Sub 2, Sub 3 and Sub 4. In 2007, Sub 1 transfers Vacant land to Sub 2 under section 45. In 2008, Sub 2 transfers Vacant land to Sub 3 under section 45. In 2010, Sub 3 forms Sub 5 with Vacant land transferred to Sub 5 under section 42. In 2012, Sub 5 transfers Vacant land to Sub 4 under section 45. In 2014, Sub 5 de-groups from the Parent group.

*Result.* In 2014, the de-grouping rules apply to section 45 transfers within the prior 6 years. The Sub 2 transfer to Sub 3 in 2008 is covered as well as the Sub 5 transfer to Sub 4 in 2012. The Sub 1 transfer to Sub 2 in 2007 is outside the scope of the de-grouping charge.

b. *Successive Gain Considerations*

Special adjustments are required if successive section 45 transfers are involved. Setting as recoupments, the key is to trigger the highest level of the section 45 deferred capital gain/taxable income and compare that amount with the capital gain/taxable income at the date of de-grouping. In other words, the capital gain/taxable amount will essentially be capped at the “lesser of” (i) the capital gain/taxable amount potentially existing on the date of de-grouping and (ii) the highest capital gain taxable amount at the time of each prior section 45 transfer during the six year period.

*Example. Facts.* Parent owns all the shares of Sub 1, Sub 2 and Sub 3. Sub 1 transfers vacant land to Sub 2 in 2007. Sub 2 then transfers vacant land to Sub 3 in 2008. Section 45 intra-group rollover treatment applies to both transfers. In 2010, Parent sells all the shares of Sub 3, thereby triggering the de-grouping charge for both transfers. In 2007, vacant land has a value of R100 and a base cost of R85. In 2008,

vacant land has a value of R130 and a base cost of R85. In 2010, vacant land has a value of R200 and a base cost of R95.

*Result.* The first step is to compare the gain for each deferred section 45 transfer and then use the highest gain. Hence, the 2008 deferred gain of R45 (R130 less R85 base cost) is the starting point because the deferred 2008 gain is higher than the deferred 2007 gain (of R15). This gain is then compared with the de-grouping gain of R105 (R200 less R95). The net result is a de-grouping charge amounting to R45 of capital gain.

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## **COMPANY REORGANISATIONS: ELECTIONS**

### **Current law**

Rollover treatment for reorganisations contemplated in Part III of Chapter II of the Act (sections 41 through 47) is generally elective. In the majority of cases, however, the parties to a reorganisation prefer rollover treatment. Consequently, in practice, an election for the rollover treatment to apply is the rule rather than the exception.

### **Reasons for change**

Given that the parties to a reorganisation almost invariably elect for rollover treatment, concern has been expressed that the need to actively make an election is an unnecessary administrative and compliance burden. The rules around the election procedure have also caused some uncertainty.

### **Proposals**

#### Applicable clauses and Income Tax Act provisions:

Clause 49(1)(d) and (i); section 42(8A) and deletion of section 42(1)(c)  
Clause 51(1)(c) and (k); section 45(6)(g) and deletion of section 45(1)(c)  
Clause 53(1)(b) and (d); section 47(6)(b) and (bA) and deletion of section 47(1)(b)

#### *1. General overview*

In order to address the administrative and compliance concerns mentioned above, the proposed legislation amends the Part III of Chapter II reorganisation rules so that:

- Rollover treatment applies as the automatic default for all reorganisations; and
- Where appropriate, parties are allowed to elect out of rollover treatment if desired.

## 2. *Asset-for-share and intra-group transactions (sections 42 and 45)*

Asset-for-share and intra-group transactions will no longer require an election for rollover treatment to apply. However, taxpayers may elect out of rollover treatment if desired (because some taxpayers may prefer to avoid the corresponding price of rollover treatment).

In addition, the asset-for-share rules will not apply if the disposal pertaining to the asset-for-share transaction does not give rise to taxable income. This circumstance will most likely arise if the transferor is not subject to tax. In this case, no election exists (or would be desired by the parties) because the transferor is not subject to tax *per se* and the transferee would not benefit from rollover capital gain treatment.

## 3. *Amalgamation and unbundling transactions (sections 44 and 46)*

No amendments are required in terms of section 44 amalgamation and section 46 unbundling transactions. These situations already apply automatically unless an “election out” is made.

## 4. *Liquidation distributions (section 47)*

Liquidation distribution transactions will no longer require an election for rollover treatment to apply. However, taxpayers may elect out of rollover treatment if desired (because some taxpayers may prefer to avoid the corresponding price of rollover treatment).

In addition, the liquidation distribution rules will not apply if the disposal pertaining to the asset-for-transaction is not taken into account in determining the taxable income or assessed loss of the liquidating company. This circumstance will most likely arise if the transferor is not subject to tax. In this case, no rollover treatment should be desired by the parties because the transferor is not subject to tax and the transferee would not benefit from rollover capital gain treatment.

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## **SHARE ISSUE ANOMALIES**

### **Current Law**

In terms of section 24B(1), if shares are issued by a company in exchange for an asset, the company is deemed to have incurred expenditure equal to the market value of that asset at the time of its acquisition by the company. In addition, the person disposing of the asset is deemed to have disposed of the asset for the asset's market value.

Section 24B(2) is an anti-avoidance rule that prevents the artificial creation of base cost if a company acquires shares or debt instruments issued “directly or indirectly” in exchange for its shares or those of a connected person. In terms of this rule, the company is deemed not to have incurred any expenditure in respect of the acquisition. Consequently, a zero base cost (or cost price) will be triggered if Company A issues shares to Company B “in exchange for” shares issued by Company B. A similar zero base cost (or cost price) rule exists when shares are issued in exchange for the issue of a debt instrument.

### **Reasons for change: Consideration without an exchange**

Section 24B(1) only applies if shares are issued by a company “in exchange for” an asset. This subsection does not apply if consideration is given by a person for shares in circumstances where there is no exchange between the company issuing the shares and the person providing the consideration. This problem may be illustrated by the following example:

*Example. Facts.* Company X is indebted to Individual Y in an amount of R1 000. Individual Z wishes to acquire shares in Company X. Company X issues 1 000 shares to Individual Z. As consideration for the issue of shares in Company X, Individual Z settles the debt owed by Company X to Individual Y by transferring cash of R1 000 to Y.

*Result.* Since Company X did not receive an asset from Individual Z, section 24B may not technically apply to the issue of the shares by Company X to Individual Z. Individual Z did, however, provide consideration for the shares, and consideration was received by Company X (by discharging the liability owed to Individual Y).

### **Proposal: Consideration without an exchange**

Applicable clause and Income Tax Act provision:  
Clause 39(1)(a); section 24B(1)

In order to address the anomaly illustrated above, proposed legislation replaces the words “in exchange for” in section 24B(1) with the words “as consideration for”.

### **Reasons for change: Market value mismatch**

Section 24B(1) arguably does not require that the value of the shares issued equals the market value of the asset exchanged for those shares. However, the disposal amount and the acquisition amount of the asset are deemed to equal the market value of the asset at the time of acquisition. This deeming rule has the potential to create opportunities for avoidance, as is illustrated by the following example:

*Example. Facts.* Taxpayer A owns an asset that has a market value of R100 000. Taxpayer A forms a trust that is not a resident of South Africa, and contributes R100 to that trust. Company B, also not a



resident of South Africa, is formed and issues 100 000 shares (comprising 100 per cent of its issued share capital) to the trust in exchange for the R100 cash contributed to the trust by Taxpayer A. Taxpayer A then transfers the asset to Company B in exchange for the issue of 100 shares in Company B.

*Result.* The total value of the shares in Company B is R100 100. The base cost of the asset for Company B is deemed to be R100 000. However, the asset-for share exchange is mismatched (an asset of R100 000 is exchanged for shares with a market value of R100). No donations tax seemingly applies because the deemed market value rule arguably overrides the donations tax

**Proposal: Market value mismatch**

Applicable clause and Income Tax Act provision:  
Clause 39(1)(a); section 24B(1)

In order to address the potential for avoidance as just-described, it is proposed that the expenditure that is deemed to have been incurred by the company issuing shares be limited to the lesser of: (i) the market value of the asset, or (ii) the market value of the shares issued as consideration for the acquisition of the asset.

**Reasons for change: Cross-issues**

A third problem with section 24B relates to the interpretation of sections 24B(2) and 24B(3). It has been incorrectly argued by taxpayers that where Company A issues shares for cash from Company B and Company B issues shares for cash from Company A (i.e. an issue for cash followed by another issue for cash), this will not necessarily trigger a zero base cost since there is no “indirect” issue of shares for shares. The two transactions are simply viewed as separate transactions. Similar arguments have been raised in respect of section 24B(3), which also uses the term “indirect”.

**Proposal: Cross-issues**

Applicable clause and Income Tax Act provisions:  
Clause 39(1)(b) and (c); section 24B(2) and (3)

In order to address the above problem, it is proposed that sections 24B(2) and 24B(3) be amended by replacing the words “directly or indirectly in exchange for” with the words “by reason of or in consequence of”. This new language has broader scope. It is further proposed that an 18-month test apply as an objective measure of clearly defining the scope of the revised rule.

## INTELLECTUAL PROPERTY ARBITRAGE

### Current law

The main principle underlying the current version of section 23I is that where intellectual property (“IP”) is or was previously owned by a “taxable person” (i.e. a person within the South African tax net), no tax arbitrage should result from a royalty-type payment by a taxable person to a person in whose hands the corresponding receipts are outside the tax net. This underlying principle also applies to corresponding derivative and/or contractual expenditure, as well as to payments made to a controlled foreign company (“CFC”) to the extent that the amounts are not taken into account in determining the income of resident shareholders in the CFC.

### Reasons for change

Section 23I, as originally introduced in 2007, was overly broad in some respects and overly narrow in others. Initial concerns in this regard led to a delayed 1 January 2009 effective date. The goal is to provide an objective rule that targets situations that are most likely to raise avoidance concerns without undermining foreign investment in South African research and development.

### Proposal

Applicable clause and Income Tax Act provision:  
Clause 38; section 23I

In order to illustrate the operation of the modified provisions of section 23I, a number of practical examples are set out below.

#### 1. *Examples*

- a. *Development of IP by an end user or a connected person (see paragraph (a) of the “tainted intellectual property” definition)*

The examples below illustrate the application of section 23I. The basic rules are designed to target situations where the end-user (or a connected person) was the previous owner of the IP.

*Example 1. Facts.* SA Developer develops and sells IP to Foreign Person. SA Developer then licenses the IP from Foreign Person. SA Developer uses the IP in the production of income, and does not sublicense the IP (i.e. SA Developer is an “end user” as defined in section 23I(1)). As consideration for the use of the IP by SA Developer, SA Developer makes royalty payments to Foreign Person.

*Result.* The royalty payments received by Foreign Person do not constitute “income” in the hands of Foreign Person. Section 23I(2) therefore denies SA Developer deductions in respect of the royalty

payments. (The result would be the same where a connected person in relation to SA Developer licensed the IP from Foreign Person.)

*Example 2. Facts.* The facts are the same as in Example 1, except that Foreign Person licenses SA Developer via SA Intermediary Licensee (who is a taxable person). In other words, SA Developer will pay royalties to SA Intermediary Licensee, and SA Intermediary Licensee will make corresponding royalty payments to Foreign Person.

*Result.* SA Developer (the end user) will be entitled to a deduction in respect of the royalty payments made to SA Intermediary Licensee. However, section 23I(2) will deny SA Intermediary Licensee a deduction in respect of the corresponding royalty payments made to Foreign Person.

*Example 3. Facts.* Licensor (a tax exempt person) licenses IP previously developed by Licensee (a taxable person). Licensor and Licensee are not connected persons to one another. Licensor concludes a credit default swap (“CDS”) with Third Party. The CDS provides for variable payments by Licensor to Third Party. These variable payments are linked to the royalties received by Licensor from Licensee. The variable payments received by Third Party do not constitute “income” in the hands of Third Party.

*Result.* Licensor will be denied deductions in respect of the variable payments paid in terms of the CDS. Licensor is paying amounts that do not constitute income upon receipt, and Licensor is making payments that are directly or indirectly linked to the IP of a taxable person.

*Note:* Securitisation transactions, linked loans and similar transactions in respect of which the incurral of expenditure or the amount of expenditure is linked to the payment of royalties may also fall within the scope of this section.

*b. Licensing arrangements involving Controlled foreign companies (“CFCs”) (section 23I(2))*

Section 23I addresses arbitrage resulting from the payment of royalties to a CFC by disallowing the deduction of royalties paid to a CFC to the extent that an amount equal to the net income of the CFC attributable to royalties is not included in the income of residents.

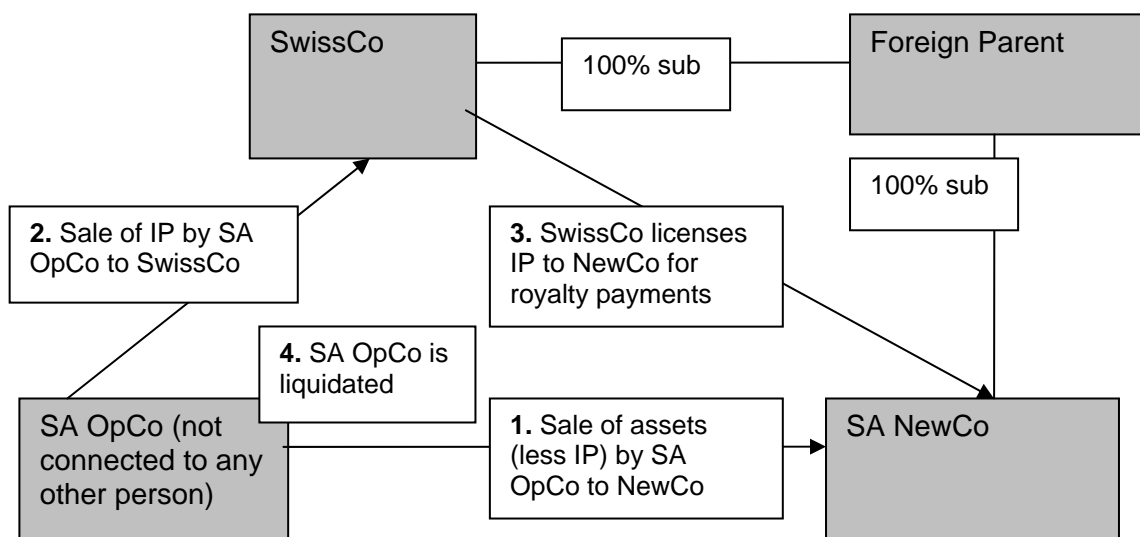
*Example 4. Facts.* SA Developer develops and sells IP to CFC (with the CFC being wholly owned by South African residents unconnected to SA Developer). SA Developer then licenses the IP from CFC. SA Developer uses the IP in the production of income, and does not sublicense the IP (i.e. SA Developer is an “end user” as defined in section 23I(1)). As consideration for the use of the IP by SA Developer, SA Developer makes royalty payments to CFC.

*Result.* Section 23I will deny any deduction for the royalty payments made to Foreign Person (the CFC), except to the extent the royalties generate section 9D income for the South African residents.

c. *Licensing arrangements associated with the acquisition of a business as a going concern (paragraph (c) of the “tainted intellectual property” definition)*

One key aspect of the revised intellectual property anti-arbitrage rules is the rules designed to prevent the stripping of IP as part of a business takeover. Of concern is foreign taxpayers that acquire South African business with the stripping of IP previously used in a taxable business so as to permanently deprive the South African tax base of those royalty earnings. More specifically, if: (i) a taxable person previously owned IP and used the IP in carrying on its business; and (ii) the current end user of the IP acquired that business as a going concern, any tax arbitrage generated through associated royalty payments (or payments in terms of associated contractual obligations/derivatives) will be denied in terms of section 23I. Section 23I will therefore impact various arrangements whereby foreign multinationals acquired South African businesses through the sale of assets. It must be noted that no connection between any of the parties is required in order for these provisions of section 23I to apply.

*Example 5. Facts.* SA OpCo (which is not connected to any other party) sells IP to SwissCo and the rest of the business (in which that IP was used) as a going concern to SA NewCo. SwissCo then licenses the IP to SA NewCo. SA NewCo makes royalty payments to SwissCo as consideration for the use of the IP.

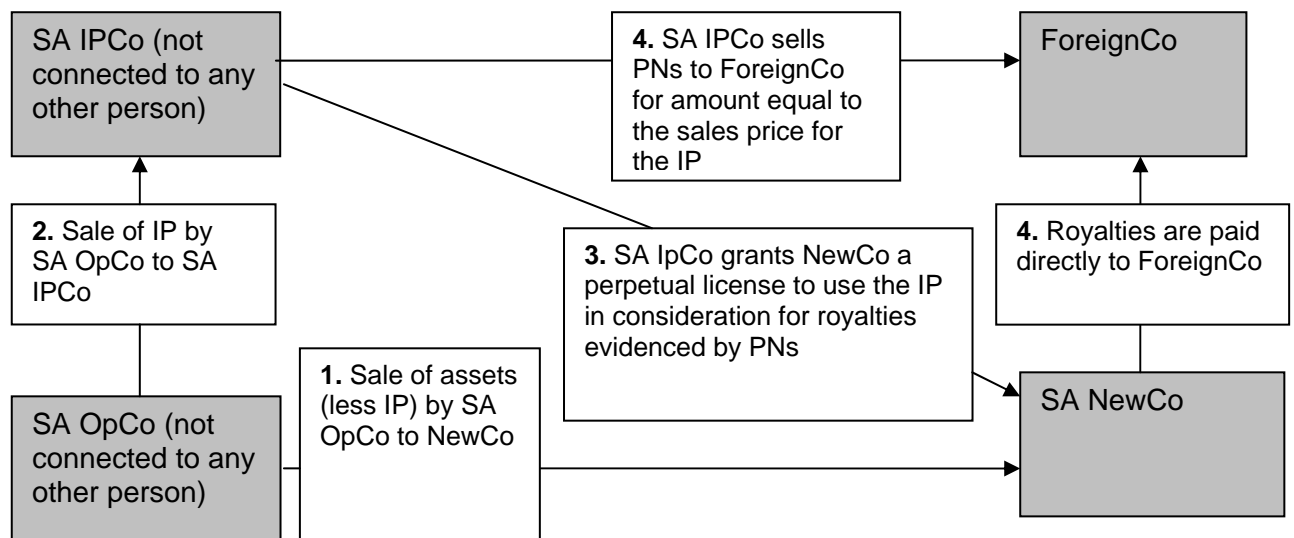


*Result.* SA NewCo will be denied a deduction of the royalties paid to SwissCo. Successors in title of SA NewCo (i.e. any taxable person that acquires the business of SA NewCo as a going concern) will similarly fall within the scope of section 23I.

d. *Bare dominium transactions (paragraph (b) of the “tainted intellectual property” definition)*

These rules apply to bare dominium intellectual property schemes (i.e. where the royalty interest is separated from the bare dominium). More specifically, these rules apply if: (i) a taxable person owns IP (i.e. is the registered proprietor/legal owner of the IP); and (ii) the IP is used by a taxable end-user, any tax arbitrage generated through the payment of associated royalties or derivative/contractual obligations will be denied as a result of the application of section 23I. Once again, a connected person relationship between the parties involved is not relevant.

*Example 6.*



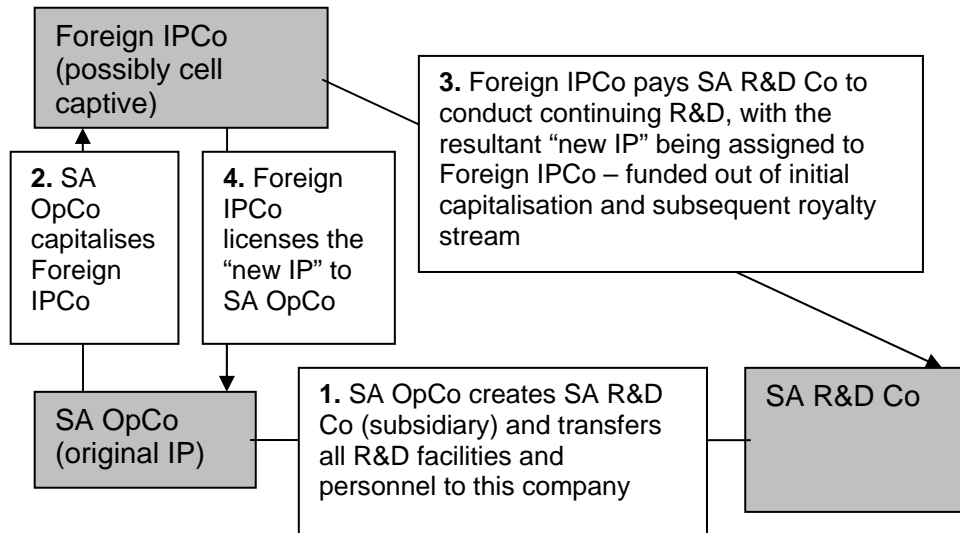
*Result.* SA NewCo will be denied a deduction of the amount paid to ForeignCo.

e. *IP is developed in SA in terms of R&D arrangements (paragraph (d) of the definition of “tainted intellectual property”)*

Concerns have been expressed that an overly broad anti-avoidance provision in the context of R&D arrangements may dissuade foreign companies from using South African subsidiaries as IP developers. With this in mind, it is proposed that the scope of section 23I be tailored to address those concerns.

Consequently, section 23I will only apply to IP developed by South African entities in terms of an R&D arrangement if: (i) the IP is developed by the end user or a connected taxable person; and (ii) the end-user (together with any taxable connected person) either directly or indirectly holds at least 20 per cent of the participation rights (as defined in section 9D(1)) in the non-taxable licensor.

*Example 7. Facts.* SA OpCo forms a foreign IP company (“Foreign IPCo”). SA OpCo holds 30 per cent of the shares in Foreign IPCo. Foreign IPCo engages SA R&D Co (which is a connected person in relation to SA OpCo) to conduct various R&D activities in SA. The R&D is fully funded by foreign IPCo, and the IP is assigned to Foreign IPCo. Foreign IPCo licenses the resultant IP to SA OpCo.



*Result.* SA OpCo will be denied deductions in respect of royalties paid to Foreign IPCo.

## 2. Note on apportionment

The Revenue Laws Amendment Act does not specifically address what happens if a taxpayer concludes a license in respect of various items of IP. However, as a matter of general tax principles, the royalty payable for the bundle of IP must be apportioned between the various portions of IP. Each royalty component must be analysed to determine whether that component is denied deduction in terms of section 23I. This determination should be consistent with transfer pricing principles given the cross-border nature of these transactions.

## CFC ROYALTIES

### Current law

Royalties earned by CFCs are generally viewed as tainted income (paragraph (iii) of the proviso to section 9D(9)(b) with two exceptions. Intra-group royalty receipts or accruals are exempt with a matching denial of any deduction for intra-group royalties incurrals (sections 9D(2A)(c) and 9D(9)(fA)). More notably, CFC royalty income may receive relief from section 9D inclusion via SARS ruling request under section 9D(10)(a)(iii). One ground for relief exists

if SARS is convinced that the royalties are associated with underlying intellectual property that is regularly created, developed or upgraded.

### **Reasons for change**

The current rules for CFC royalties are overly narrow. No reason exists to exclude most royalties *per se* but for a ruling procedure.

### **Proposal**

#### Applicable clause and Income Tax Act provisions:

Clause 13(1)(c), (d) and (f); paragraphs (ii)(dd) and (iii)(dd) of the proviso to section 9D(9)(b) and deletion of 9D(10)(a)(iii).

CFC royalties will be placed on par with other CFC activities. Passive royalties will remain subject to tainted section 9D treatment (like other forms of passive CFC income). Royalties generally fall outside of tainted section 9D treatment (*per se* without ruling request) if the CFC “directly, and regularly creates, develops or substantially upgrades” the underlying intellectual property. However, even active royalties (like other forms of active income) are subject to the section 9D taint under the diversionary rules. These diversionary rules apply if the CFC generates royalty income from a connected South African resident. These diversionary rules (like other forms of CFC income) can be overcome by requesting a SARS ruling under section 9D(10)(a)(iv) or (v).

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## **SHORT TERM INSURERS – DEDUCTION OF LIABILITIES**

### **Current Law**

In terms of section 28(2)(cA) of the Income Tax Act, a short term insurer is effectively entitled to a deduction of certain liabilities, subject to an adjustment by the Commissioner. Such liabilities include unearned premium provisions (as contemplated in section 32(1)(b) of the Short-Term Insurance Act, 1998) and unexpired risk provisions (as contemplated in section 32(1)(d) of the Short-Term Insurance Act).

### **Reasons for change**

Infrequently, some insurers have, in their tax returns, combined and aggregated the liabilities contemplated in sections 32(1)(b) and 32(1)(d) of the Short-Term Insurance Act. In principle, the Commissioner will, in such circumstances, make an adjustment that has the effect that liabilities contemplated in section 32(1)(d) are excluded. Nevertheless, there appears to be some uncertainty in the minds of certain insurers to the effect that section 28(2)(cA), in its present form, allows an insurer to include both types of liability.

## **Proposal**

The proposed amendment clarifies that liabilities in respect of unexpired risk provisions (i.e. as contemplated in section 32(1)(d) of the Short-Term Insurance Act) may not be included for purposes of section 28(2)(cA), subject, as always, to such adjustments as may be made by the Commissioner.

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## **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

### **Introduction**

Small businesses have the potential to grow the economy, generate jobs and reduce poverty. Research, however, indicates that they face many obstacles, including relatively high tax compliance costs as a percentage of turnover. This is due to the fixed costs associated with systems necessary to comply with the requirements of the tax system.

According to independent research commissioned by SARS and the National Treasury, South African tax practitioners charge their small business clients an average of R7 030 per annum (2007) to ensure that tax returns for income tax, provisional tax, value-added tax (VAT) and employees' tax are prepared, completed and submitted as required.<sup>1</sup> As a percentage of turnover, tax compliance costs range between 2.2% for businesses with a turnover of up to R300 000 and 0.1% for businesses with a turnover around R14 million. Tax compliance costs therefore tend to be regressive, especially for businesses with a turnover under R1 million. In addition, it costs small businesses an average of R36 343 for a range of related services including accounting services.

The reality is that many small businesses are outside the income tax net either because they generate small profits or because they are overwhelmed by the tax system. Many were also historically marginalised. Government, therefore, announced a small business amnesty in 2006 to encourage informal and other small businesses with a turnover of up to R10 million per annum to enter the tax system and regularise their tax affairs.

In addition to this outreach, SARS and National Treasury agreed to explore various options to reduce the tax compliance burden, especially for very small businesses, and to streamline the tax system for such businesses.

It was therefore proposed in the 2008 Budget Review that an elective presumptive turnover tax system be implemented for very small businesses

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<sup>1</sup> FIAS Study: Tax Compliance Burden for Small Businesses: A Survey of Tax Practitioners in South Africa (2007)



with a turnover up to R1 million per annum. This instrument will effectively replace income tax, capital gains tax (CGT), secondary tax on companies (STC) and VAT. Payroll taxes such as employees' tax (SITE and PAYE) and unemployment insurance fund (UIF) contributions are excluded as they are taxes generally borne by employees and collected by employers on behalf of the State. In terms of existing law, however, businesses whose employees are not liable for employees' tax will not be required to register for employees' tax and businesses with a payroll of up to R500 000 will not be liable for the skills development levy (SDL).

## **Structural Design**

The presumptive turnover tax (turnover tax) is a stand alone tax and does not form part of the usual calculations for determining income tax payable by a taxpayer on his or her taxable income. Receipts of a business forming part of the turnover tax system will therefore be exempted for purposes of calculating a taxpayer's income tax liability in terms of the Act. For ease of reference the turnover tax will be housed in a new Sixth Schedule to the Income Tax Act, 1962, (the Act).

An important feature of the presumptive tax system is that the tax liability imposed is aligned with the tax liability under the current income tax system, but on a simplified base with reduced compliance requirements. However, the tax burden on micro businesses at the higher-end of the turnover range (R750 000 to R1 million) is increased to encourage them, as they grow, to maintain sufficient accounting records to migrate to the normal income tax system. Special consideration was given so as not to artificially or inadvertently encourage micro businesses to remain trapped in the turnover tax system, but to grow and migrate into the standard tax system.

As a packaged approach, the compulsory VAT registration threshold will be increased for all vendors to coincide with the turnover tax cap of R1 million. Businesses will not be permitted to voluntarily register for VAT if they are registered for the turnover tax.

## **Overview of the Proposals**

### Applicable clauses and Income Tax Act provisions:

Clause 54(1); sections 48 to 48C

Clause 55(1); section 64B(18) and (19)

Clause 71(1); Sixth Schedule

#### *1. Who will qualify as a micro business?*

The provisions of the new Sixth Schedule will apply to both incorporated (i.e. companies, close corporations and co-operatives) and unincorporated businesses (i.e. natural persons who trade as sole proprietors and partnerships). Where the qualifying turnover of such a

business does not exceed the amount of R1 million in any year of assessment, it can elect to be taxed in terms of this system unless one of the grounds for disqualification discussed below applies.

Where a person trades in different types of businesses, the total turnover of all business activities will be taken into account for purposes of determining the R1 million cap.

Public benefit organisations and clubs are not permitted to access the turnover tax system as they also conduct activities other than business activities and already enjoy a special dispensation. However, the exempt amounts for public benefit organisations and clubs will be adjusted upwards to alleviate the administrative burden of accounting for income.

## 2. *What is qualifying turnover?*

Qualifying turnover is defined to mean the total amount received by a natural person or company for the year of assessment from carrying on business activities. The following amounts will be excluded from qualifying turnover for purposes of determining the R1 million cap:

- any receipt of a capital nature received from conducting business, for example, an amount received from the sale of business equipment; and
- certain government grants that are exempt from income tax in terms of the Act.

The main reason for excluding these receipts is to prevent amounts, which would not normally form part of the trading income (i.e. turnover) of a micro business, from being taken into account for purposes of determining the R1 million cap. A scenario to illustrate the need for these provisions is that of a micro business that generates a turnover of less than R1 million per annum but occasionally disposes of a rather large business asset during the year of assessment, which could disqualify it from the scope of the turnover tax system. A separate provision, which is discussed below, is proposed to ensure that large capital gains are not regularly routed through a micro business.

## 3. *Specific anti-avoidance rule for qualifying turnover*

An anti-avoidance rule to guard against income splitting by a micro business has been incorporated into the legislation. This will cater for circumstances where the micro business is broken up between connected persons (e.g. a family) to ensure that each business component remains within the R1 million cap. In such instances the turnover of the connected persons' business activities will be added together for purposes of applying the cap.

4. *What disqualifications apply to a micro business?*

a. *Limit on interests in other companies*

A person is disqualified if that person and any shareholder in that person holds shares or has any interest in the equity of another company or close corporation. The specific relief to be afforded in terms of the turnover tax system is aimed at the very small start-up type of business. Multiple shareholdings indicate more complex legal structures belonging to more sophisticated taxpayers and hence have been excluded for purposes of this system. This disqualification is also an anti-avoidance measure to guard against income splitting where a business is conducted by more than one entity with the same shareholder in order to ensure that each business component remains within the R1 million cap.

Certain investments are, however, permitted because they are more of a public or social nature and present fewer opportunities for tax arbitrage. These are interests—

- in listed South African companies;
- in collective investment schemes;
- in body corporates and share block companies;
- in venture capital companies;
- of less than 5% in social or consumer co-operatives;
- of less than 5% in co-operative burial societies or primary savings co-operative banks; and
- in friendly societies.

b. *Limit on investment income*

A person is disqualified if more than 10% of total receipts consist of “investment income”, as defined in section 12E of the Act. “Investment income” includes income in the form of dividends, royalties, rental income, annuities, interest or proceeds derived from investment or trading in financial instruments, marketable securities or immovable property. The intended relief in terms of the turnover tax system is mainly aimed at benefiting the micro business that **actively** engages in entrepreneurial business activities thereby stimulating the economy and creating employment. A typical micro business will usually not have substantial capital from which it can generate passive investment income.

c. *Personal service providers excluded*

A person that is a “personal service provider” or a “labour broker” (defined in the Fourth Schedule to the Act) that has not been issued with a tax exemption certificate by SARS is disqualified. These entities have been targeted in specific anti-avoidance measures. As a result, it

is not the intention for them to obtain any benefits from the turnover tax system.

*d. Professional services excluded*

A person that renders a “professional service” as defined is disqualified. Such services are generally rendered by more sophisticated, high income earning taxpayers, with profit margins that are significantly higher than those assumed in the design of the turnover tax. Professional services include, amongst others, any service in the field of accounting, broking, consulting, engineering, law, management, real estate, surveying or veterinary science.

*e. Limit on capital disposals*

See discussion of CGT below.

*f. Only interests and shares by natural persons permitted*

It is highly unlikely that a micro business will find itself within a complex legal structure or multi-level corporate structure that requires professional legal, accounting and tax services. Such sophisticated legal structures often present opportunities for tax avoidance and hence need to be excluded for purposes of this simplified tax system. Furthermore, these are not considered to be the simple, truly small, start-up type of businesses that are targeted for assistance in the simplified tax dispensation. This disqualification is also an anti-avoidance measure to guard against income splitting where a business is conducted by more than one entity with the same shareholder in order to ensure that each business component remains within the R1 million cap.

A partnership, co-operative, close corporation or company will be disqualified if all the partners, members or shareholders of that company are not natural persons at all times during the relevant year of assessment.

*5. Special rules relating to partnerships*

Partnerships are taxed on a flow-through basis in that the turnover of the partnership will be taxed in the hands of each partner based on the profit sharing ratio according to the partnership agreement.

However, it is important to look at the collective turnover of the partnership to ensure that only micro businesses access the turnover tax system. Hence the qualifying turnover of a partnership as a whole must not exceed the amount of R1 million for the year of assessment in order for each individual partner to qualify for the turnover tax.

A partner in a partnership will be disqualified from the turnover tax where–

- at any time during the tax year, that partner is a partner in another partnership; or
- any of the partners is not a natural person.

6. *What is the tax base?*

a. *Taxable turnover*

The turnover tax rates are applied to “taxable turnover” in a year of assessment. “Taxable turnover” is the amount, not of a capital nature, that is received (i.e. cash basis) from conducting business activities in the Republic, with specific inclusions and exclusions.

(i) *Specific inclusions in taxable turnover*

- 50% of the receipts on disposal of certain capital assets. See discussion of CGT below.
- In the case of a company, close corporation or cooperative, the investment income received. Dividends may be included at a later date. The reason for excluding dividends until a later date is that dividends are currently exempt from income tax, but will be subject to a dividend withholding tax at a later stage. Since the withholding tax will not apply to dividends paid to companies and the simplified tax system will exempt shareholders in micro businesses from the withholding tax, it may be necessary to tax dividends as part of the turnover of a small incorporated business to mitigate revenue leakage.
- Certain income tax allowances granted in the previous year of assessment, and which would have been added back to taxable income in the following year of assessment in the current income tax system, will be included in taxable turnover e.g. a doubtful debts allowance. In order to avoid double taxation this inclusion will be limited to the excess of the allowances over any balance of an assessed loss that the micro business will be prevented from carrying forward.

(ii) *Specific exclusions from taxable turnover*

- Investment income received by sole proprietorships (individuals) and partnerships. This income will be taxable under the current personal income tax provisions in the hands of the individual recipients. The rationale for this is to cater for the common law principle that businesses operated by natural persons are not distinct or separate legal entities from the natural persons who own them. It will also allow for the capped annual exemptions for interest and dividend income that are currently granted to natural persons.

- Certain government grants that are exempt from income tax.
- Any amount that accrued to the business, and was subject to income tax in the hands of the business, in a year of assessment prior to it registering for the turnover tax.
- Salary income, excluding a notional salary “payment” made by a sole proprietor to himself or herself, will be taxed in terms of the current personal income tax system.

## 7. *CGT*

A micro business that registers for the turnover tax will be exempted from CGT. As a substitute for CGT, the qualifying micro business will simply have to add, to taxable turnover, 50% of:

- receipts from the sale of immovable property to the extent that it was used for business purposes; and
- receipts of a capital nature from the sale of any other assets used mainly in the business.

A typical micro business will not have substantial capital assets. As the proposed turnover tax system has a favourable dispensation for capital gains, specific measures need to be put in place to avoid abuse.

Accordingly, a person is disqualified as a micro business if the receipts from the disposal of capital assets exceed the amount of R1,5 million in a three year period that covers the year of assessment during which the capital proceeds were received and the immediately preceding two years of assessment. A generous cap over a three year period accommodates the occasional disposal of a higher value asset such as immovable property.

## 8. *STC*

If the qualifying micro business is a cooperative, close corporation or company, it will also be exempt from STC (to be replaced with a dividend withholding tax), to the extent that the dividend distribution does not exceed R200 000 per annum.

Where the dividend distribution exceeds R200 000 per annum, the excess will be subject to the relevant tax.

## 9. *Administration*

### *a. Year of assessment*

A year of assessment will run from 1 March to the last day of February of the following year.

### *b. Registration*

As participation in the turnover tax system is elective, a qualifying micro business may elect to register as a micro business with SARS for a year of assessment before the beginning of the year of assessment, or where that micro business commences business activities during the course of the year of assessment, within two months from the date of commencement.

### *c. Deregistration*

There are two circumstances when a registered micro business is deregistered from the turnover tax by SARS, namely—

- Voluntary deregistration, i.e. where a registered micro business elects to deregister. Unless it closes down, a micro business may only elect to deregister as a micro business after three years of being part of the turnover tax system. This election must be made before the beginning of the year of assessment for which it no longer wants to be registered for the turnover tax.
- Compulsory deregistration i.e. where a registered micro business no longer qualifies as a micro business in terms of the provisions of the Sixth Schedule. For example, where the qualifying turnover of that micro business from carrying on business activities exceeds the R1 million cap and the micro business cannot demonstrate that this will be a small and temporary event. The registered micro business must notify SARS within 21 days from the date on which it no longer qualifies as a micro business.

In the event of a compulsory deregistration of the micro business, that micro business will move back into the normal income tax system from the first day of the month following the month during which the business no longer qualified to be a micro business. It will therefore be assessed for two periods in the year of assessment – one under the turnover tax system and the other under the normal income tax system. The business will also have to register for VAT where it exceeds, or is likely to exceed, the R1 million per annum cap.

If the micro business is deregistered from the turnover tax, be it voluntary or compulsory deregistration, that micro business may not re-enter the turnover tax system for a period of three years from being deregistered. This period matches the minimum period the micro business must remain in the turnover tax system.

### *d. Payments of turnover tax*

Registered micro businesses will be required to submit two interim payments and one final payment on assessment, where necessary.

The **first** interim payment must be based on an estimate of the taxable turnover of that micro business for the year of assessment and amounts to 50% of the turnover tax payable on the estimate. This estimate must not be less than the taxable turnover for the previous year of assessment unless SARS accepts the lower estimate. The payment must be submitted to SARS within six months from the beginning of the year of assessment.

The **second** interim payment will also be based on an estimate of the taxable turnover for the year of assessment and a calculation of the turnover tax payable on the estimate. The payment, equal to the amount of turnover tax payable on the estimate less the first interim payment, must be submitted to SARS before the end of the year of assessment.

Where the estimate of the taxable turnover for the second interim payment is less than 80 per cent of the actual taxable turnover for the year of assessment, additional tax, equal to 20 per cent of the difference between the tax payable on 80 per cent of the actual taxable turnover for the year of assessment and the tax payable on that estimate, will be charged. The additional tax may be waived in certain circumstances.

SARS may estimate the interim payments that are due by a micro business where the micro business fails to make a payment that is due or where SARS is not satisfied with the amount of the interim payment that was made.

An annual tax return must be submitted with the actual amount of taxable turnover for the year of assessment. A further payment will be necessary where the assessed turnover tax on the actual taxable turnover for the year of assessment exceeds the interim payments that were made.

Where a registered micro business fails to submit the annual tax return, or where SARS is not satisfied with the return submitted, SARS may estimate the taxable turnover for the year of assessment and issue an assessment for the turnover tax due on the estimate, less the interim payments received.

Interest at the prescribed rate will be charged on all late payments and underpayments.

*e. Record keeping*

A registered micro business must retain a record of—

- (i) amounts received by that registered micro business during a year of assessment;
- (ii) dividends declared by that registered micro business during a year of assessment;



- (iii) each asset of that registered micro business as at the end of a year of assessment with a cost price of more than R10 000; and
- (iv) each liability of that registered micro business as at the end of a year of assessment that exceeded R10 000.

*f. General administrative provisions*

The general administrative provisions relating to, for example, returns, assessments, dispute resolution, interest, refunds and anti-avoidance provisions contained in the Act will also apply to the turnover tax system.

*10. Rate Table for turnover tax*

The rates that were announced in the 2008 National Budget were revised downwards following further analysis of micro business profitability.

The revised rates that are envisaged for 2009/10 are as follows:

Turnover	Tax Liability
On the first R100 000	0%
R100 001 to R300 000	1% of each R1 above R100 000
R300 001 to R500 000	R2 000 + 3% of the amount above R300 000
R500 001 to R750 000	R8 000 + 5% of the amount above R500 000
R750 001 and above	R20 500 + 7% of the amount above R750 000

*11. Value-Added Tax (VAT)*

*a. Increase in compulsory registration threshold*

Surveys amongst small businesses clearly identify VAT as the most burdensome tax to comply with. This is because it is transaction based and requires diligent record-keeping.

The importance of a compulsory VAT registration threshold in designing a turnover tax system for micro businesses is that businesses above this threshold are required to comply with the usual VAT obligations, which are record-keeping intensive, and should be reasonably capable of complying with the standard income tax system. In this regard, the proposed turnover tax system includes the proposal to increase the compulsory VAT registration threshold to R1 million per annum as a packaged proposal. This is one of the ways that will alleviate the compliance burden both on micro businesses that elect to register for the turnover tax and those that do not but choose to remain outside the VAT system.

*b. Micro businesses registered for the turnover tax*

Micro businesses should not be allowed to register for VAT and at the same time remain within the turnover tax system. The VAT system requires a high standard of record-keeping and thus a micro business that is registered for VAT should be in a position to comply with normal income tax requirements. A micro business that is registered for the turnover tax will, therefore, not be permitted to register for VAT.

A micro business registered for the turnover tax must notify SARS within 21 days of its qualifying turnover exceeding R1 million for the year of assessment, or where there are reasonable grounds to believe that the amount will be exceeded. The business will then be deregistered from the turnover tax, unless SARS is of the view that the excess will be small and temporary. The deregistration from the turnover tax and the liability for VAT will take effect from the beginning of the month following the month in which the qualifying turnover exceeded, or was likely to exceed, the prescribed cap.

SARS may also deregister a micro business from the turnover tax where it is satisfied that the taxable turnover of the micro business is sufficient to render that business liable to register for VAT i.e. where the taxable supplies of the micro business has exceeded or is likely to exceed R1 million in any period of 12 months. SARS must consult with the micro business before deregistering it on this basis

*c. VAT relief on exit*

The rule is that when any vendor deregisters from the VAT system, it is required to pay VAT (exit VAT) on the lesser of the cost or value of the assets held before deregistering.

All vendors that deregister from the VAT system in light of the increase in the VAT registration threshold to R1 million will be allowed to pay the exit VAT over a period of six months.

Where a vendor deregisters from the VAT system in order to register for the turnover tax, further relief will be granted to that vendor by way of a deduction of up to R100 000 of the value of the assets held by that vendor prior to such deregistration. This equates to an approximate reduction of up to R12 281 in the exit VAT that will be payable.

If a person deregistered as a VAT vendor in order to register for the turnover tax and subsequently re-registers for VAT, the deduction that the vendor can claim on the value of assets upon re-entering the VAT system will be reduced by R100 000.

## 12. *Income tax and VAT transition rules*

Transition rules have been put in place to cater for situations where micro businesses migrate between the turnover tax, income tax, and VAT systems. These rules are necessary to facilitate the migration and to avoid revenue leakage.

The transition rules cover the deregistration of a business from the turnover tax where it is liable to be registered for VAT, deemed wear and tear allowances, determination of base cost for CGT purposes, valuation of trading stock, and timing differences that arise where the date of accrual of income and date of receipt of the income differ.

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## **VENTURE CAPITAL COMPANIES**

### **Current law**

Share investments are treated as an expenditure of a capital nature. As such, these investments are not deductible by the shareholder. Dividends on shares are subject to the Secondary Tax on Companies (or the Dividends Tax once the new rules are in place). Debt of a company, on the other hand, generally generates taxable income for the creditor and a deduction for the company payor.

### **Reasons for change**

As announced in the 2008 Budget Review, access to equity finance by small and medium-sized businesses and junior mining exploration companies is one of the main challenges to the growth of these sectors of the economy.

Setting aside tax consequences, equity financing offers some key advantages for small businesses. Equity financing allows for small businesses to better weather economic downturns. Equity financing also allows small businesses to use cash surpluses for reinvestment rather than being forced to use that cash for debt servicing. It has been said that equity is patient capital.

### **Proposal**

Applicable clauses and Income Tax Act provisions:

Clause 12(1); section 9C(2A)

Clause 14(1); section 9E(1)(paragraph (k) of the “excluded company” definition)

Clause 27(1); section 12J

## 1. *General overview*

In order to assist small and medium-sized businesses and junior mining exploration companies in terms of equity finance, a tax incentive is proposed for investors in such enterprises through Venture Capital Companies ("VCCs"). The VCC is intended to be a marketing vehicle that will attract retail investors. It has the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector.

The VCC incentive is subject to a 12 year sunset clause (see section 12J(11)). The purpose of the sunset clause is to provide an opportunity to evaluate the effectiveness of the VCC like other incentives (see sections 12H and 13*quat*).

## 2. *Tax benefits of a VCC investment*

### *a. Individual Investors (section 12J(3)(a))*

An individual who invests in the shares of a VCC is eligible for a 100 per cent deduction of the amount invested. This deduction, however, is limited to R750 000 per tax year. Although secondary trading in VCC shares is allowed, the deduction is only available for contributions to the VCC in exchange for newly issued VCC shares. The deduction is recouped if an individual disposes of the VCC shares to the extent of the initial VCC investment (under the general recoupment rules of section 8(4)(a)). In all other respects, standard income tax and CGT rules apply in respect of VCC shares.

Individual investors will be subject to a life-time deduction limit of R 2 250 000. The limit will be replenished to the extent to which a section 8(4) recoupment is triggered on the sale of the VCC shares. Hence, if an individual investor makes a R2 250 000 investment in VCCs over three years and subsequently recoups R1 million of a VCC investment in later years, the investor can obtain a further R1 million deduction for future VCC investment.

### *b. Entity investors (section 12J(3)(b))*

Unlisted companies and trusts are not generally eligible for any special deductions when investing in VCC shares. This exclusion prevents individual investors from overcoming the ceiling of R750 000 by making investments through controlled entities.

However, an exception exists for listed companies and their 70 per cent held controlled group companies when providing consideration to a VCC for newly issued equity shares in a VCC. Listed companies (and their group companies) are eligible for the 100 per cent deduction without regard to any monetary limit. However, these entities (and their controlled group companies) do not receive any deductions for their share investments exceeding a 10 per cent equity share interest in a VCC.

*c. Investor Receipts (section 12J(4))*

The deduction is only available to investors (individuals and companies) who are in possession of a VCC investor certificate (i.e. stating the amounts invested in that company and that SARS has approved that the company qualifies for VCC status). This system of certificates is comparable to that used for donations to section 18A public benefit organisations.

*d. Tax treatment of the VCC*

The VCC itself is a fully taxable entity. No special dividend or other tax rules generally apply (except possibly for penalties if VCC status is withdrawn).

*3. VCC approval requirements (section 12J(5))*

As a general matter, the applicant company must satisfy all requirements before VCC approval can be granted. However, many of the requirements are given a 36-month waiting period to allow for companies to reach the intended target.

*a. Preliminary entry requirements (definition of “qualifying company” in section 12J(1))*

The company must be a resident company and not be a controlled group (i.e. more than 50 per cent) company. The company must be a taxpayer in good standing and must be an “unlisted company” as defined in section 41 or a “junior mining company” as defined in section 12J(1).

*b. Minimum aggregate asset requirements (section 12J(5)(e)(i))*

The company must have acquired qualifying shares of at least R30 million. However, if the company invests in one or more junior mining companies as part of its qualifying portfolio, it must have acquired qualifying shares of at least R150 million. This higher minimum threshold reflects the fact that junior mining companies (including those engaged in high risk exploration activities) have much higher minimum asset requirements than other forms of start-up businesses.

*c. Gross income requirements (section 12J(5)(b))*

Substantially all of the gross income of the company must be derived from financial instruments or from services rendered to qualifying (small business) companies owned by it. This financial instrument gross income includes dividends, interest and the proceeds on the sale of shares and other financial instruments held as trading stock. Other forms of gross income are permitted only to the extent this other gross income does not exceed 10 per cent of total gross income.

d. *Investee company requirements*

*Qualifying shares (section 12J(1) – “qualifying share” definition):* Investments count toward the “small business percentages” only to the extent these investments consist of shares in the equity share capital of the investee company. In addition, an equity share does not meet the requirements of a qualifying share if the VCC has an option to dispose of the share or the investee company has an obligation to redeem the share for an amount other than its market value at the time of disposal redemption. The purpose of this test is to ensure that the VCC is closing the equity gap and not merely making explicit or disguised loans.

*Maximum portfolio limits (section 12J(5)(e)(iv)):* Investments disqualify a company from being a VCC if more than 15 per cent of the company’s investment in qualifying shares is invested in shares of any one investee company at any time from 36 months after applying for approval as a VCC. The purpose of this test is to ensure that the VCC maintains a reasonable portfolio of investments.

*No Control (section 12J(5)(c)):* A VCC may not control (alone or together with connected persons) a qualifying (small business) investee company. The VCC should act as a financier (e.g. angel investor) to various independent small businesses, not as a controlling owner.

e. *Small business percentages (section 12J(5)(e)(ii) and (iii))*

The company’s investment portfolio must satisfy the following allocations in respect of expenditure:

- At least 10 per cent of the company’s expenditure to acquire assets held by the VCC will be for qualifying shares of small companies (i.e. companies with assets that have a book value of no more than R5 million immediately after those shares were issued).
- At least 80 per cent of the company’s expenditure to acquire assets held by that company will be for shares in medium-small companies (i.e. companies with assets that have a book value of no more than R10 million immediately after those shares were issued). (It must be noted that this 80 per cent includes the expenditure to acquire assets in small companies.)  
*Junior Mining Companies:* Junior mining investee companies can have total gross assets with a book value of up to R100 million. This category of companies counts toward the 80 per cent threshold.

4. *Qualifying (investee) company requirements (section 12J(1) “impermissible trade” and “qualifying company” definitions)*

a. *Investee Entry Requirements*

Permissible investee companies must be residents and not be a controlled group (i.e. more than 50 per cent) company. The investee company must be a taxpayer in good standing and must be an “unlisted company” as defined in

section 41 or a “junior mining company” as defined in section 12J(1). A junior mining company may be listed on the AltX board of the JSE. (See paragraphs (a) to (d) of the “qualifying company” definition).

*b. General Trade Requirements*

The investee company must conduct a trade within 18 months of the investment. An amount of tax deductible expenses at least equal to the funds received for the issue of equity shares must be incurred for purposes of any trade carried on by the investee company. These expenses must be incurred within 18 months from the issue of the equity shares (or within 36 months in the case of junior mining companies).

However, a company is disqualified from being a qualifying investee company if it carries on or is mainly carrying on within 18 months from the issue of its shares (36 months in the case of a junior mining company) any of the following trades:

- Developing or renting of immovable property, except trade as a hotel keeper (including bed and breakfast establishments);
- Financial service activities such as banking, insurance, money-lending and hire-purchase financing;
- Provision of financial or advisory services including legal, tax advisory, stock broking, management consulting, auditing or accounting services;
- Gambling, e.g. operating a casino or any other games of chance;
- Manufacturing, buying or selling liquor, tobacco, arms or ammunition;
- Trading as a franchisee; or
- Conducting a trade mainly outside the Republic.

In addition, not more than 20 per cent of the gross income of the investee company may be derived from investment income.

*c. Junior Mining Company*

An investee company can qualify as a junior mining company if that company is not engaged in any trade other than mining exploration or production.

*5. Withdrawal of approval (section 12J(6) through (8))*

Failure to satisfy the VCC requirements will trigger the withdrawal of VCC status from the current tax year, after SARS has given due notice to the company, if the company fails to take corrective steps acceptable to SARS within a period specified in the notice. This withdrawal triggers income for the former VCC equal to 125 per cent of the expenditure incurred by investors to acquire VCC shares. The 125 per cent amount is roughly equal to the grossed-up 28 per cent VCC tax rate to the maximum individual marginal tax rate of 40 per cent. It is likely that individuals who invest in VCC equity shares will probably benefit from the VCC investment deduction at a tax rate of 40 per cent.

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## MISCELLANEOUS INCOME TAX ISSUES

### RESIDENTIAL AND COMMERCIAL BUILDING INITIATIVES

#### Current law

The Income Tax Act (“the Act”) offers several incentives in respect of residential and commercial buildings.

Section 13*ter* provides for a deduction in respect of residential buildings. Under this section, a deduction is available for residential accommodation used by a taxpayer to derive rental income or to be occupied by the taxpayer’s full-time employees. The deduction is effectively equal to 12 per cent of the cost of the residential unit in the first year in which it is let or occupied. A further 2 per cent of the cost is deductible in each of the succeeding 44 years.

Section 13*quin* provides for a deduction in respect of commercial buildings. This deduction is equal to 5 per cent of the cost of the new and unused building or improvement. The deduction is allowed if the taxpayer uses the building for purposes of producing income in the course of trade.

Section 13*quat* (“the UDZ incentive”) provides for an accelerated depreciation allowance for new and unused buildings (and improvements) situated in areas in need of urban renewal. New and unused buildings are subject to a first year depreciation allowance equal to 20 per cent of the cost of the building, followed by 5 per cent over each of the next 16 years. Improvements are subject to a depreciation allowance of 20 per cent each year over five years. New and unused buildings acquired from a developer qualify for 55 per cent of the allowance, while new and unused improvements acquired from a developer qualify for only 30 per cent of the allowance. The UDZ incentive is available for buildings brought into use on or before 31 March 2009.

#### Reasons for change

1. *Low-cost housing*

Given the inherent risks involved in the property market, the construction and provision of low-cost housing poses a unique challenge within the domestic environment. While Government has many outreach programmes in place to overcome these challenges, further support for low-cost housing in a tax environment could prove beneficial.



## 2. *Urban development zones*

In respect of the UDZ incentive, various considerations necessitated the proposed adjustments. Some of these considerations are as follows:

- some municipalities made submissions to National Treasury requesting that the UDZ demarcations in the municipalities need to be adjusted. Furthermore it was requested that the expiry date of the incentive of 31 March 2009 be extended.
- the introduction of other depreciation regimes, such as the depreciation regime for commercial buildings, had an impact on the value of the UDZ incentive. The level of incentive *vis-à-vis* other depreciation allowance regimes and other technical hurdles occasioned the need for a reconsideration of the UDZ incentive.

### **Proposals**

#### Applicable clauses and Income Tax Act provisions

Clause 4(1)(j) and (w); section 1 (“low cost residential unit“ and “residential unit” definitions)

Clause 18(1)(i); deletion of section 11(t)

Clause 28; section 13ter(1) (“residential unit” definition)

Clause 29(1); section 13quat(2), (3)(a), (3A), (3B), (5)(c) and (9) and the deletion of subsections 2(e) and (7)(d)(iii)

Clause 30(1); section 13quin(7)

Clause 31(1); section 13sex

Clause 32(1); section 13sept

Clause 44(1)(a) to (e); section 36(d)(11) (paragraphs (d) to (f) of the “capital expenditure” definition)

Clause 57(1)(b) and (e); paragraph (1)(f) of the First Schedule and the deletion of paragraph 12(5) of the First Schedule

1. *Core definitions* section 1 (“low cost residential unit“ and “residential unit” definitions)

In order to bring the depreciation for residential buildings into a unified structure, the definitions of “residential unit” and “low-cost residential unit” are introduced in section 1.

A “residential unit” is defined as a building or self-contained apartment mainly used for residential accommodation. This definition specifically excludes buildings or apartments used in carrying on a trade as a hotel keeper.

A “low-cost residential unit” is defined as a building or apartment located within the Republic. For an apartment to qualify as a “low-cost residential unit”, the cost must not exceed R250 000, and the owner thereof may not charge a monthly rental in excess of one per cent of that cost. For a building to qualify as a “low-cost residential unit”, its cost must not exceed R200 000, and the owner thereof may not charge a monthly rental in excess of one per

cent of that cost (plus the proportionate cost of the land and bulk infrastructure).

The monthly rental charge referred to above can be increased (at the option of the owner) by up to ten per cent per annum (cumulative) of the cost.

*Example. Facts:* In 2011, Business X constructs a residential apartment building and the cost of each apartment is R 250 000. In that same year, Business X rents these apartments to various families.

*Result.* In order to qualify for a deduction under this section, X may charge a monthly rental that does not exceed –

- (i) In 2011, R2 500 (1 per cent of R250 000));
- (ii) In 2012, R2 750 (1 per cent of (R250 000 plus 10 per cent));
- (iii) In 2013, R3 025 (1 per cent of (R275 000 plus 10 per cent));

inclusive of a ten per cent uplift for each succeeding year. Business X need not increase the rental every year. For instance, Business X could maintain the rent at R2 500 until 2013 and then increase the rent to R3 025.

## 2. Residential rentals (section 13sex)

### a. Basic rules (section 13sex(1) and (2))

The depreciation regime under section 13ter for residential units will be replaced by section 13sex for acquisitions and erections commencing from 21 October 2008. Section 13sex provides for a five per cent depreciation allowance per annum over 20 years (similar to the depreciation allowance for commercial buildings under section 13quin). The new regime will apply only to new and unused residential units (and new and unused improvements to residential units). In addition:

- the unit or improvement situated in South Africa must be used by the taxpayer solely for the purposes of a trade carried by that taxpayer; and
- the taxpayer must own at least five residential units within South Africa, for use in a trade carried on by that taxpayer.

A “low-cost residential unit” benefits from an additional allowance of five per cent. The effect for low-income housing units is to be depreciable at ten per cent per annum over a ten year period.

### b. Collateral rules (section 13sex(3) to (7))

Section 13sex contains similar anti-avoidance rules as section 13quin. For instance, the cost of a residential unit (or an improvement thereto) is deemed to be the lesser of (i) the actual cost thereof to the taxpayer or, (ii) if that residential unit has been acquired by the taxpayer under an arm’s length transaction on the date of purchase of that unit or an improvement thereto, the

direct cost which a person would have incurred in acquiring or erecting the unit or improvement. The purpose of this rule is to prevent taxpayers from disguising finance costs as depreciable costs.

The allowance under this section is not allowable in respect of the cost of a residential unit (or an improvement thereto) that has been disposed of in any previous year of assessment. In other words, no deduction is allowable in terms of this section in respect of a unit or improvement if the taxpayer no longer owns that unit or improvement. Any deduction allowed in terms of this section or any other section of this Act must not in the aggregate exceed the amount of such cost. Moreover, section 13sex does not apply if another provision applies (e.g. section 13quat).

c. *Special rules for mining (section 36(11)(paragraph (d) of the “capital expenditure” definition))*

The provisions of section 13sex do not apply to new and unused low cost residential units (or improvements thereto) for occupation by employees of a taxpayer who carries on a trade of mining. This form of depreciation is dealt with under section 36 as capital expenditure. The 5 per cent and 10 per cent rates are the same as for section 13sex. However, under section 36 the expenditure is subject to the full ring-fencing and disposal rules of section 36 as well as disposal rules of paragraph (j) of the definition of “gross income”.

3. *Urban development zones (UDZs) (section 13quat)*

a. *Extended time-frame and increased depreciation rates (section 13quat(2), (3)(a), (3A) and (5)(c))*

The special depreciation rules for structures within the urban development zone are extended and enhanced.

Firstly, the expiry date for the UDZ incentive will be extended to 31 March 2014.

Secondly, the rate of depreciation for new buildings (plus extensions and additions) under the UDZ regime is adjusted to 20 per cent for the first year and 8 per cent for the succeeding ten years (*versus* the previous initial 20 per cent rate followed by 16 years of depreciation at 5 per cent). At the same time, the rate of depreciation for improvements will remain at 20 per cent over five years. The rate for new buildings (plus extensions and additions) has been enhanced since residential and commercial buildings now qualify for a 5 per cent annum write off over 20 years.

New and unused low-cost residential units located in a UDZ area will be subject to an accelerated depreciation allowance. Thus, the rates will be:

- (i) 25 per cent in the first year;
- (ii) 13 per cent in the succeeding 5 years; and

- (iii) 10 per cent in the year following the last year contemplated in paragraph (ii) above.

Improvements to low-cost residential units located in a UDZ area will be subject to an annual depreciation allowance of 25 per cent over a four year period.

- b. Miscellaneous (deletion of subsections (2)(e) and (7)(d)(iii) of section 13quat)*

Nothing in the current law prohibits a municipality from requesting an extension to the UDZ demarcated area. However, current law prohibits a municipality with two areas from requesting further extensions. Henceforth, designated municipalities will be allowed to request an extension of the UDZ demarcated areas, provided that the other requirements under section 13quat are satisfied.

The proposed legislation also eliminates the certificate of occupancy requirement (leaving only the location certificate). The certificate of occupancy was often problematic in the case of improvements because this certificate was often not otherwise required by municipalities.

- 4. Part building acquisitions (sections 13quat((3B), 13quin(7), 13sex(8) and 36(11)(proviso (dd) to paragraph (d) of the “capital expenditure” definition)*

Under the current UDZ regime, new and unused buildings purchased from a developer benefit from only 55 per cent of the allowance, while a new and unused improved building purchased from a developer benefited from only 30 per cent of the allowance. The purpose of the current rule is to prevent taxpayers from artificially allocating the cost of non-depreciable land to the building or improvement. However, the real concern is that only part of a building (e.g. an apartment) is purchased with the land cost inherently included. Hence, it is proposed that the 55 per cent/30 per cent rule will apply only when a new and unused part of a building or improved building is acquired from another party. This revised rule will apply to acquisitions in the context of residential, commercial, mining residential and urban development zone buildings.

- 5. Sales of low-cost residential units to employees on loan account (section 13sept)*

- a. General overview*

Employers are increasingly moving away from leasing low-cost employer-owned residential units to employees and rather selling residential units to employees on a preferential basis. This shift is preferable to employers because the letting of residential units often represents an inconvenient deviation from the employer’s core business activities. This shift is also

preferable to employees because they obtain the freedom and security of property ownership.

The Income Tax Act currently provides a depreciation allowance for employers providing residential rental accommodation to employees. No relief is available for employers seeking to transfer ownership of residential units to employees (other than a deduction of the cost of the units) even though the sale occurs on very favourable terms for the employee.

Employers will now be given tax relief (in the form of a 10 per cent deduction) for the transfer of ownership of employer-provided “low-cost residential units” (as defined in section 1) to employees to the extent the sale occurs pursuant to an interest-free loan granted by the employer.

#### *b. Requirements*

In order for an employer to qualify for the special deduction upon a sale of a residential unit to an employee, certain requirements must be satisfied. First and foremost, the regime applies only to disposals of low-cost units to employees (or employees of associated institutions as defined in the Seventh Schedule). Secondly, the disposal must be on loan account by the employer. In addition to these core requirements:

- the amount owing (i.e. the loan account) in respect of the disposal may not bear interest; and
- the disposal amount must not exceed the employer’s actual cost of that low-cost residential unit.

As a final matter, the disposal of the low-cost residential unit by the employer may only be subject to a limited set of conditions. More specifically, the employee may be required to transfer the low-cost residential unit back to the employer: (i) upon termination of employment, or (ii) upon a consistent failure (for a minimum period of three months) by the employee to pay an amount owing to the employer in respect of the low-cost residential unit. In these circumstances, the employer can reacquire the low-cost residential unit for an amount equal to the actual cost (other than borrowing or finance costs) of the unit and the land on which it is erected to the employee. No other rights of reacquisition are permitted.

*Example. Facts.* Employer sells a low cost residential unit to Employee X for R200 000 on an interest free loan account. The sale is subject to a condition that Employee X must sell the low-cost residential unit to Employer if Employee X leaves the employ of the employer within a period of 5 years. Employee X repays R20 000 in year 1, R 10 000 in year 2 and R 10 000 in year 3. In year 4, Employee X resigns.

*Result.* If Employer wishes to exercise any rights of reacquisition, Employer must purchase the low-cost residential unit from Employee X for an amount equal to R40 000 (i.e. the actual cost of the low-cost residential unit to Employee X).

c. *Mechanical operation*

To the extent this section applies, the employer is allowed to deduct an amount equal to 10 per cent of the amount owing by the employee at the end of the employer's year of assessment. Deductions are allowed for a maximum period of 10 years. This allowance roughly compensates the employer for the interest-free nature of the loan.

*Example 1 .Facts.* Employer sells a low cost residential unit to Employee X for R150 000. Of this amount, R100 000 is incurred via an interest free loan account from Employer; the remaining R50 000 amount is paid upfront by Employee in cash. Employee is not required make any payments on the loan for the first four years.

*Result.* Employer is eligible for a R10 000 per annum deduction for the first four years. This deduction is then reduced as the loan is repaid (with the repayment also causing a recoupment – see below).

All repayments of the amount owing on the loan trigger a potential deemed recoupment. The amount deemed recouped by the employer equals the lesser of (i) the amount so paid or (ii) the amount allowed as a deduction in terms of this provision in the current or previous tax years.

*Example 1. Facts.* In Year 1, Employer sells a low cost residential unit to Employee X for R200 000 on an interest-free loan account from Employer. Employee X repays R30 000 in Year 2, R25 000 in Year 3 and makes no repayment in Year 4.

*Result.*

In Year 1, Employer is entitled to a R20 000 deduction due to the interest-free loan account (10 per cent of R200 000).

In Year 2, Employer is entitled to a deduction of R17 000 (10 per cent of (R200 000 less the R30 000 repaid)). In addition, Employer is deemed to have recouped an amount of R 30 000 (i.e. the amount repaid).

In Year 3, Employer is entitled to a deduction of only R14 500 (10 per cent of (R200 000 less a total of R55 000 repaid)). In addition, Employer is deemed to have recouped an amount of R 21 500 (i.e. the remaining prior deduction of R7 000 and the current deduction of R14 500).

d. *Special rules for mining (section 36(11) paragraph (f) of the definition of "capital expenditure")*

The deduction for low-cost residential unit disposals to employees is addressed separately in the case of mining. Mining employers engaging in the same form of disposals fall under the special capital expenditure regime for mining. Mining has been kept separate because this deduction needs to be part of the capital expenditure rules associated with mining.

## 6. *Deletion of obsolete housing incentives*

Both section 11(t) and paragraph 12(5) of the First Schedule provided a special deduction for employee housing assistance. These deductions were set at R6 000 many years ago, thereby effectively rendering these regimes obsolete. Both provisions will be deleted given the new housing incentives contained in the Revenue Laws Amendment Bill.

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## **ALLOWANCES IN RESPECT OF EXPENDITURE ON GOVERNMENT BUSINESS LICENSES**

### **Current law**

Businesses are often required to obtain Government licenses in order to conduct specified business activities (for example, telecommunications and mining). These businesses may be required to make monetary outlays to acquire these licenses. These acquisition outlays may involve direct cash payments to the Government or outlays at the behest of Government for certain categories of the public (e.g. community social expenditure or labour).

### **Reason for change**

The Income Tax Act generally does not provide for any specific deduction or depreciation allowance for expenditures incurred by a taxpayer to acquire the kind of licenses mentioned above. The license acquisition fee is not deductible because this fee constitutes capital expenditure (despite its business nature). Thus, contrary to the accounting treatment (in terms of which the acquisition cost of the license is written off over the economic life), no Income Tax relief exists for this type of expenditure.

### **Proposal**

#### Applicable clauses and Income Tax Act provisions

Clause 18(1)(d); section 11(gD)

Clause 44(1)(d); section 36(11)(paragraph (e) of the “capital expenditure” definition)

Under this proposal, provision is made for a deduction of expenditure incurred by a taxpayer to acquire a license necessary for the carrying on of a trade. The license may be required by national government, provincial administration, and municipality or by a regulatory entity governed by the Public Finance Management Act 1 of 1999 (“PFMA entities”). Obtaining the license must be a pre-condition for the taxpayer to conduct a trade.

Normally, payments made pursuant to general Charter requirements to facilitate procurement would not qualify because these requirements are not a pre-requisite for conducting a trade (but these requirements would be eligible for relief in the case of mining because mining cannot be conducted without satisfying the Charter scorecard). The deduction proposed is limited to taxpayers who carry on the trade of mining, providing gambling facilities, telecommunication services and the production or distribution of petroleum since these are the sectors in which licenses of this kind are required.

The license fee may be paid in cash or in kind. The license fee payable can be for any purpose required by Government to acquire the license (including social expenditure for the benefit of certain categories of the community). The proposed deduction, however, is to be contrasted with expenditures for environmental remediation since environmental remediation is a contingent cost arising after the license acquisition (and environmental remediation is more specifically covered elsewhere (see section 37A)). Infrastructure is also specifically excluded because infrastructure often can have nearby enduring benefits (e.g. nearby access roads, reservoirs).

This provision does not cover the cost of maintaining a license (e.g. annual license fees). Generally, expenditure incurred in order to maintain a license may be deductible under section 11(a) due to its recurrent (i.e. non-capital) nature.

The proposed deduction for license acquisition fees will generally be allowed proportionately over the remaining number of years for which the taxpayer has a right to the license. However, the duration of the period for which the taxpayer is entitled to tax deductions in respect of a particular license cannot exceed 30 years. Thus, the deduction allowed in terms of this section in any one year of assessment is the amount of the expenditure divided by the lesser of: (i) the remaining number of years the taxpayer is entitled to the use of that license, or (ii) 30 years.

*Example. Facts.* Company X is required to pay R5 million to the Department of Communications for the acquisition of a license to operate a cellular network communications business. The license covers a period of 20 years. Company X pays R3 million in Year 1 and R2 million in Year 2.

*Result.* Company X will be allowed a deduction of R150 000 per annum starting in Year 1 (that is, R3 million divided by 20). Company X is additionally allowed an additional deduction of R105 263.16 per annum for the R2 million amount, which is spread over 19 years starting in Year 2.

As a final point, the deduction of the business license acquisition expenditure is addressed under a general provision (section 11(gD)). However, a special provision applies in relation to mining (paragraph (e) of the definition of "capital expenditure" in section 36(11)). Mining licence expenses are not provided for under the general provision as such expenses need to be dealt



with under the capital expenditure rules associated with mining. Mining license expenses are accordingly subject to the normal ring-fencing and other rules unique to mining capital expenditure.

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## **ALLOWANCES IN RESPECT OF INDUSTRIAL POLICY PROJECTS**

### **Current law**

Currently, the Act provides for depreciation of manufacturing capital assets (i.e. buildings and plant and machinery). The rate allows for a 40:20:20:20 rate over four years, which is accelerated compared to the useful economic life in accounting terms. An incentive also exists for learnership programs in order to facilitate on-the-job skills training.

At one time, an additional allowance (above the 40:20:20:20 rate) existed for projects that had significant benefits for the South African economy. Contained in section 12G, this incentive was aimed at encouraging investment in strategic industrial projects by granting an additional investment allowance in respect of industrial assets used for these projects. Government allocated R3 billion over a four-year period for this purpose. This amount has been exhausted and no new projects are being approved in terms of section 12G. However, a number of projects that are utilising the benefits of the section 12G incentive are still in operation.

### **Reasons for change**

The main objectives of the National Industrial Policy Framework are to diversify South Africa's industrial output, support a knowledge-based economy and nurture labour intensive industries. Increased productivity in the South African manufacturing sector would require transformation of current production processes and methods to attain cost reductions and greater efficiency in the use of resources.

An incentive programme is required to assist this transformation by supporting investment in manufacturing assets that will improve the productivity of the South African manufacturing sector. Concurrent and complimentary to that, support should be given to training of personnel to improve labour productivity and the skills profile of the labour force. To this end, the Government has made available R5.6 billion over 5 years for incentives in aid of industrial policy objectives (this amount translates into R20 billion of additional deductions). The new incentive for the manufacturing sector will be fully available for new projects as well as expansions or upgrades of existing projects.

## Proposal

### Applicable clauses and Income Tax Act provisions

Clause 9; section 8(4)(n)

Clause 26; section 12I

#### 1. *General overview*

This incentive is aimed at benefiting projects in the manufacturing sector with certain exclusions. The incentive takes the form of an immediate additional allowance for an industrial policy project as determined according to the type (greenfield or brownfield) and status (qualifying or preferred).

The incentive programme is designed for greenfield investments (i.e. new industrial projects that utilise only new and unused manufacturing assets) as well as brownfield investments (i.e. expansions or upgrades of existing industrial projects). The new incentive offers support for both capital investment and training. Thus, firms or projects benefit from the incentive only if they invest in improved production equipment and contribute towards the labour market. Qualification for the incentive will be based on regulatory criteria reviewed by an adjudication committee constituted in terms of section 12I.

#### 2. *Entry criteria (subsection 7)*

For a project to qualify for this incentive (i.e. to qualify as an “industrial project”), the project must be solely or mainly for the manufacture of products, goods, articles or other things as classified under “Major Division 3: Manufacturing” in the recent Standard Industrial Classification Code issued by Statistics South Africa (or if the adjudication committee is of the view that will be so classified). However, projects that manufacture alcoholic and tobacco products, arms and ammunition and certain bio-fuels are disqualified from this incentive (see definition of “industrial project” in subsection 1).

If classified as an “industrial project” as outlined above, the Minister of Trade and Industry (based on the recommendations of the adjudication committee) must also be satisfied that certain minimum criteria exist. This minimum criteria consists of the following:

- (i) the project must satisfy a minimum asset threshold (see below);
- (ii) the project must not constitute an industrial participation project or receive any specified concurrent industrial incentives provided by any national sphere of government (both these issues will be determined by regulation);
- (iii) the project cannot be divided into subparts so as to receive multiple incentives under this provision for a single integrated project (see below);
- (iv) the project must satisfy a minimum standard of skills development and cleaner production (including energy efficiency) criteria (as determined by regulation);

- (v) the company and group members must be taxpayers of good standing (i.e. their tax affairs are in good order); and
- (vi) at least 50 per cent of the manufacturing assets to be utilised must be brought into use within four years from the date of approval.

In relation to the minimum asset threshold (as referred to in item (i) above), two sets of asset thresholds exist – one for greenfield projects and the other for brownfield projects. The asset minimum threshold for greenfield projects is R200 million, which will be based on the cost of new and unused manufacturing assets. In the case of the asset minimum threshold for brownfield projects, the cost of existing manufacturing assets must be increased by the higher of:

- 25 per cent of the cost of the pre-existing assets (but not more than R200 million); or
- R30 million.

The purpose of these thresholds is to ensure that the projects that benefit from this incentive will provide a substantial benefit to the economy.

Also as discussed above, the incentive is further designed so as not to allow for projects to be split up into smaller projects so that each of the smaller projects qualifies separately. This restriction will prevent the splitting up of single projects into multiple projects that are integrally related within a single company (or with a group of companies).

### 3. *Scoring criteria (subsections 8 and 10)*

The bulk of the qualifying criteria will be determined by regulations (subsection 10). These criteria are not only important as a sub-minimum for project approval, but also for determining whether a project will have preferred or merely qualifying status. The status of a project will be determined by a point scoring system. The regulatory criteria will entail a combination of the following:

- upgrading an industry within South Africa (via innovative process, cleaner production technology and improved energy efficiency);
- providing general business linkages within South Africa;
- acquiring goods and services from small, medium and micro enterprises;
- creating direct employment within South Africa;
- providing skills development in South Africa; and
- in the case of a Greenfield project, location within an Industrial Development Zone.

The extent to which the project will meet these criteria in aggregate will also determine whether the project has preferred or qualifying status.

4. *Project cut-off mark (subsection 7(d) and 9)*

The total amount of the allowable deductions in terms of this incentive is R20 billion. As a result, no approval will be granted where the potential additional investment allowance in respect of an industrial project will in aggregate for all project exceed R20 billion. Furthermore only applications received by no later than 31 December 2014 will be considered.

5. *Capital incentive (subsections (3) and (4))*

a. *Basic rules*

The incentive will be available for new and unused manufacturing buildings, plant and machinery acquired, contracted for or brought into use for the first time by the applicable company within four years from the date of project approval. Buildings, plant and machinery acquired or contracted for before the approval date will not be eligible for the incentive (because an incentive in this instance would represent a deadweight loss). Furthermore, manufacturing assets must be used in South Africa and qualify for a deduction in terms of section 12C(1)(a), 13 or 13quat.

In determining the additional allowance as described below, the cost of the asset for tax purposes is limited to the lesser of the arm's length market value on the date of acquisition or the actual cost to the taxpayer. This limit ensures that taxpayers do benefit from an additional allowance on financing costs (subsection 24)). If project assets are disposed of, the recoupment rules will mirror those of section 12G (see section 8(4)(n)).

b. *Preferred status*

Projects with preferred status will receive an additional investment allowance equal to 55 per cent of the cost of the manufacturing asset in the first year that the asset is brought into use. The amount of the allowance will be capped at R900 million per project for Greenfield projects and R550 million per project for Brownfield projects.

c. *Qualifying status*

Projects with qualifying status will receive an additional investment allowance equal to 35 per cent of the cost of the manufacturing asset in the first year that the asset is brought into use. The amount of the allowance will be capped at R550 million per project for Greenfield projects and R350 million per project for Brownfield projects.

*Example. Facts:* A taxpayer whose Greenfield project qualifies for preferred status purchases machinery for R300m. The machinery qualifies for a section 12C deduction.

*Result:* In the year that the machinery is brought into use, a section 12C deduction of R120 million (R300 million x 40 per cent) will be

allowed. In addition, a section 12I deduction of R165m (R300 million x 55 per cent) will be allowed. In each of the following 3 years, further section 12C deductions of R60 million (R300 million x 20 per cent) per year will be allowed.

6. *Training incentive programme (subsection (1) – “cost of training” definition; subsections (4) and (5))*

a. *Basic rules*

An additional training allowance will be available for training provided by the employer to employees. In determining the cost of training for purposes of this additional allowance, the rules are designed to ensure that taxpayers can only deduct the genuine costs of training (as opposed to normal salary expenses disguised as training). Three sources of training are envisaged: (i) wholly external, (ii) internal, and (iii) by connected persons.

The additional training allowance will cover all costs (personnel plus materials) that are charged by wholly external (i.e. contracted) parties providing training to employees engaged in an industrial policy project. A more limited allowance will be available for internal training. In this regard, the employees providing the training must specifically and exclusively be dedicated to providing training for the additional allowance to apply. An additional allowance is also allowed for the cost of training materials. If the training is provided by connected persons, a similar limited deduction follows. In this instance, the allowable deduction will be limited to the portion of the charge that is attributable to employees of the connected person providing the training (plus the cost of training materials).

b. *Preferred status*

For companies with preferred status, the additional training expense tax allowance will be capped at R36 000 per employee over a period of 6 years. A company will be allowed an overall maximum of R30 million in any six-year period.

c. *Qualifying status*

For companies with qualifying status, the additional training expense tax allowance will be capped at R36 000 per employee over a period of 6 years. A company will be allowed an overall maximum of R20 million in any 6-year period.

7. *Inflationary increase for unused losses*

It has been acknowledged that the investors without an existing tax base will generally not be able to use the additional allowance immediately because large-scale capital projects may take several years to bring into operation and to become profitable. As a result, inflation would erode the value of the capital portion of the incentive if this portion is not adjusted. More specifically, excess

deductions (i.e. assessed losses) are of little value if they cannot be used until several years later.

In order to offset this concern, the assessed loss rule contains an adjustment based on the time value of money. Once an asset is brought into use, any unused deductions (i.e. assessed losses) stemming from the capital portion of the incentive will be automatically adjusted for inflation. This inflationary adjustment will exist for a maximum period of four years, and will be made by using the standard SARS interest factor (see section 1 (paragraph (a) of the definition of “prescribed rate”)).

As indicated, the inflationary adjustment will only apply to capital expenditure losses that arise from the application of this section. The adjustment does not apply to losses arising from the training programmes or other deductions.

#### 8. *Administrative aspects*

##### a. *Extension of certain periods (subsection 19(a))*

Upon recommendation by the adjudication committee, the Minister of Trade and Industry may extend certain periods by one year. The periods for which this one-year extension may be granted are:

- the four-year period during which the manufacturing asset should be brought into use in terms of subsection 2; and
- the four-year period during which an inflationary increase may be applied to the balance of assessed loss in terms of subsection 6(b)

##### b. *The adjudication committee (subsections 16 and 17)*

An adjudication committee will be created the functions of which will include the evaluation of applications and the making of recommendations to the Minister of Trade and Industry for the purposes of the approval of projects and the monitoring of projects. This committee will consist of officials employed by the Department of Trade and Industry, National Treasury and SARS.

##### c. *Withdrawal of approval (subsections 12 to 15)*

The Minister of Trade and Industry may withdraw project approval if the company ceases to comply with the qualifying criteria in terms of subsections (7) and (8), fails to submit the required progress report in terms of subsection (11) or determines that the approval was granted based on fraudulent information, misrepresentation or non-disclosure of material facts.

For instance, the Minister of Trade and Industry may withdraw project approval prior to the expiry of the four years if the Minister is of the opinion that the taxpayer will not be able to bring at least 50% of the manufacturing assets into use within four years from the approval date. The Commissioner for the SARS would accordingly disallow any deductions granted under this incentive if the approval is withdrawn.

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## **PUBLIC BENEFIT ORGANISATIONS: ADDITIONAL TAX DEDUCTIBLE DONATIONS**

### **Current law**

As a general rule, donations made by a taxpayer represent expenditure of a private and philanthropic nature. Donations are not deductible as a general matter unless they fall within the special dispensation provided for in section 18A. This special tax dispensation is only available for donations made by taxpayers to Public Benefit Organisations (PBOs) conducting certain categories of approved public benefit activities. This limitation stems from revenue collection and anti-avoidance concerns. The Income Tax Act requires the recipient to be an approved PBO in South Africa in order to be eligible for tax deductible donation status.

### **Reasons for change**

Multilateral humanitarian organisations, such as United Nation specialised agencies, enjoy diplomatic immunity status in South Africa in terms of the Diplomatic Immunities and Privileges Act, 2001 (Act No 37 of 2001). These organisations are accordingly exempt from South African tax. However, donations made to these agencies are not tax deductible in terms of section 18A. In order to qualify for section 18A tax deductible donation status, these agencies must be approved in South Africa as a local PBO. This requirement exists even though the programmes offered would be viewed as a tax deductible public benefit activity if offered by a domestic PBO.

This local approval requirement appears to be unfair because the United Nation Specialised agencies are not as a practical matter registered locally. This lack of a tax-deductible donation status may even have the unintended effect of discouraging offshore support from these agencies.

### **Proposal**

#### Applicable clause and Income Tax Act provisions

Clause 34(1)(a), (c) and (d); section 18A(1)(bA), (2) and (5)

In view of the fact that it might be impractical for the United Nations agencies to qualify as local PBOs, the proposed amendment creates a mechanism so that donations to these agencies can qualify for tax deductible donation status. Under the proposal, donations made to United Nations Specialised Agencies (set out in Schedule 4 to the Diplomatic Immunities and Privileges Act, 2001) will qualify for section 18A tax deductible donation status if three conditions exist. Under the first condition, the agency must conduct within South Africa any public benefit activity stipulated in Part II of the Ninth Schedule or any other activity determined by the Minister of Finance by notice

in the Government *Gazette*. Under the second condition, the agency must furnish SARS with a written undertaking that the agency will comply with the provisions of section 18A. Under the third condition, the agency must waive diplomatic immunity for purposes of taxing the agency under section 18A(5) (which deems certain donations to be taxable income of the agency for failing to comply with the rules of that subsection).

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## **PROMOTION OF LAND CONSERVATION AND BIODIVERSITY**

### **Current law**

In an effort to preserve nature and the environment, Government (through the Department of Environmental Affairs and Tourism (“DEAT”)) has created a system for entering into bilateral agreements with private landowners to conserve and maintain particular areas of land for the public good. The legislative framework for these agreements is the National Environmental Management: Protected Areas Act, 2003 (Act No. 57 of 2003) and the National Environmental Management: Biodiversity Management Act, 2004 (Act No. 10 of 2004), both of which are laws for determining the geographic areas of land and biological systems to be protected or conserved. Private landowner entry into any of these agreements is wholly voluntary.

The National Environmental Management: Protected Areas Act, 2003, provides for at least three sets of possible conservation areas, namely, National Parks, Nature Reserves and Protected Environments. On the other hand, the National Environmental Management: Biodiversity Management Act, 2004, provides a list of critical species that must be conserved and seeks to protect the habitats of these critical species. The prescribed activities within a declared area and the details of expenses are stated in a management plan.

Management plans are published in the Government *Gazette* and are subject to review every five years. Currently, only expenditure incurred in the production of income on this land is allowed as a deduction. Therefore, the income tax system often does not allow for the deduction of all expenditure incurred by a landowner in the above-mentioned circumstances.

### **Reasons for Change**

*Maintenance:* In entering into these agreements, the landowner agrees to maintain and conserve land for the public good. The landowner (and perhaps other taxpayers utilising the land) incur maintenance expenses and perform activities that would otherwise have required Government intervention.

*Loss of Land Use Rights:* In addition, the landowner’s right of use of the land is restricted by (and limited to) stipulations in the agreement. For example, the landowner cannot use the land to construct a building or conduct a



business. By entering into such agreements, the landowner loses these valuable rights.

*The Tax System:* The Income Tax system fails to recognise that landowners incur nature conservation maintenance expenses for the public good and forfeit the right of use to land. Hence, an economic loss is not matched by a tax loss, even though this economic loss is essentially being incurred for the benefit of society at large (as opposed to private consumption, which should not be deductible).

## **Proposal**

### Applicable clauses and Income Tax Act provisions

Clause 46; section 37C

Clause 57(1) (a), (c) and (d); paragraph 12(1)(a), (1A) and (1D) of the First Schedule

#### *1. General overview*

The proposed amendment creates a mechanism for deducting environmental conservation and maintenance expenses. It also allows for the deduction of the loss of land use rights associated with formal conservation agreements in limited circumstances.

#### *2. Deduction of conservation and maintenance expenses in terms of Biodiversity Agreements (subsections (1) and (2))*

Land conservation and maintenance expenses incurred in terms of section 44 of the National Environmental Management: Biodiversity Act can potentially be treated as expenditure incurred in the production of income and for purposes of trade. This treatment effectively allows the taxpayer to treat the cost as a deductible expense under section 11(a) as long as the expenditure is not of a capital nature.

Deductions under the proposed provisions are available if two conditions exist. Under the first condition, the management agreement must last for a minimum period of five years. Under the second condition, the taxpayer must utilise the land or other land in the immediate proximity (e.g. adjacent, across the road) for the production of income and for purposes of trade.

Any deduction of expenses permitted under this rule will be limited to income derived by the taxpayer from the land (or land in the immediate proximity). To the extent that the deduction exceeds the income so derived by the taxpayer, the excess amount will be deemed to be expenditure incurred by the taxpayer in the following year of assessment. In effect, the excess is carried forward as if that amount arose in the subsequent year.

3. *Deduction of conservation and maintenance expenses in terms of Protected Area Agreements (subsection (3))*

Land conservation and maintenance expenses incurred in terms of sections 20, 23 or 28 of the National Environmental Management: Protected Areas Act (dealing with declared national parks, nature reserves and protected environments) are treated as a deemed section 18A deductible donation. This deemed deductible donation is conditional on the underlying declaration lasting a minimum of 30 years.

4. *Conservation and maintenance recoupment for breach (subsection (4))*

Where a taxpayer that has been allowed deductions under the proposed legislation contravenes the relevant biodiversity management and protected areas agreements or declarations, such deductions are subject to recoupment. This recoupment equals deductions previously allowed under the section to the extent those deductions were in respect of expenditure incurred within five years before the contravention.

5. *Special rules in the case of land declared as a national park or nature reserve for at least 99 years (subsection (5))*

The cost of land declared as a national park or nature reserve with an endorsement to the title deed for a duration of at least 99 years is treated as a deemed section 18A tax deductible donation. The tax deductible amount is equal to 10 per cent of the lesser of the cost or the market value of the land with the deduction applying in the first tax year of declaration and in each of the nine succeeding years. In addition, the taxpayer qualifies for a capital gains tax exemption on the amount of the deemed donation in terms of paragraph 62 of the Eighth Schedule.

6. *National park or nature reserve: Circumstances in which a taxpayer retains partial use of the land (subsection (6))*

Taxpayers retaining partial right of use in land declared as a national park or nature reserve with a title deed endorsement of at least 99 years qualify for only a partial deemed section 18A tax deductible donation in respect of that land. The amount of the deemed section 18A donation is adjusted by multiplying 10 per cent of the lesser of the cost or the market value of the declared land by the ratio that the market value of the declared land reduced by the market value of the right of use (technically referred to as “the market value of the land subject to the right of use”) bears to the market value of the declared land as if the declared land had been donated in full (i.e. without regard to the right of use). Stated differently; the deemed donation equals:

$$10\% \times \frac{\text{lesser of cost or market value of the declared land}}{\text{market value of the declared land}} \times \frac{\text{market value of the declared land} - \text{market value of the retained right of use}}{\text{market value of declared land}}$$

*Example. Facts.* Individual X agrees to have land declared as a national park. The cost to Individual X of the declared land is R3 million with the total market value at the time of the agreement equalling R12 million. As part of the agreement, Individual X retains some commercial rights of use with respect to two-thirds of the property. These commercial rights are valued at R7 million. The market value of the declared land excluding the right of use equals R5 million (R12 million minus R7 million).

*Result.* For each of 10 years,

$$\text{Tax deductible Donation} = 10\% \times 3\,000\,000 \times \frac{5\,000\,000}{12\,000\,000} = \text{R}125\,000$$

7. *National park or nature reserve recoupment breach (subsection (7))*

Where a taxpayer that has been allowed deductions under the proposed legislation violates the declaration of land as a national park or nature reserve in terms of an agreement under section 20(3) or 23(3) of the National Environmental Management: Protected Areas Act, such deductions are subject to recoupment. This recoupment equals all deductions previously allowed under this section that have occurred within five years before the contravention.

8. *Farming Conservation and maintenance expenses (paragraph 12(1)(a), (1A) and (1D) of the First Schedule)*

In order to cater for conservation and maintenance expenses incurred in terms of the Biodiversity Agreements, the list of expenses allowable as a deduction for farming purposes is amended to include expenses incurred in respect of the eradication of alien and invasive vegetation. Similar to non-farm trade expenses, land conservation and maintenance expenses incurred in terms of an agreement entered into in terms of section 44 of the National Environmental Management: Biodiversity Act are treated as expenditure incurred in the carrying on of farming operations if two conditions are met. Under the first condition, the biodiversity management agreement entered under section 44 of the National Environmental Management: Biodiversity Act must last for a minimum period of 5 years. Under the second condition, the taxpayer must utilise the land or other land in the immediate proximity (e.g. adjacent, across the road) for carrying on of farming operations.

The above treatment effectively allows the taxpayer to treat the relevant conservation and maintenance expenditure as a deductible expense under paragraph 12(1) of the First Schedule. Any deduction of expenses permitted under this rule will be limited to income derived by the taxpayer from farming activities (just like any other farming expenses of a capital nature under paragraph 12).

Again, as with non-farming trade expenses of this kind, there is a five year breach rule. Where a taxpayer that has been allowed deductions under the proposed legislation contravenes the relevant biodiversity management agreement, such deductions are subject to recoupment. This recoupment equals all deductions previously allowed under this section within five years before the contravention.

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## **EXPLANATION OF MAIN AMENDMENTS: OTHER TAX ACTS**

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### **VALUE-ADDED TAX**

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#### **INDUSTRIAL DEVELOPMENT ZONES (IDZs)**

##### **Current law**

If movable goods are temporarily removed from a customs controlled area (CCA) and are not returned within 30 days of their removal (or within a period approved by the Controller), a supply is deemed to occur (section 8(24) of the VAT Act). The consideration for that supply is the open market value of those goods, and the vendor is required to account for output tax on the supply.

##### **Reasons for change**

The late expiry charge of section 8(24) inadvertently gives rise to a double VAT charge on the same item. This charge arises in two situations: (i) when goods are supplied (e.g. sold) before their required return, and (ii) when goods are returned late followed by a supply (e.g. sale).

1. *Goods supplied before their required return*

If a vendor supplies the movable goods in the course or furtherance of the vendor's enterprise before their required return under section 8(24), the vendor must charge output tax on the actual supply (under the basic rule of section 7(1)(a)). In addition, because the vendor no longer holds the goods, the section 8(24) return date will not be satisfied, thereby triggering a second charge on the same goods under section 8(24).

2. *Goods supplied after those goods are returned late*

If a vendor returns goods after the required section 8(24) period, the vendor must charge output tax pursuant to section 8(24). In addition, the vendor is

required to charge output tax a second time on any subsequent actual supply of that same good (under the basic rule of section 7(1)(a)).

## **Proposal**

### Applicable clauses and VAT Act provisions:

Clause 106(d); section 8(24) proviso

Clause 111(b); section 16(3)(n)

The proposed amendment remedies the double charge as outlined above. Firstly, section 8(24) will no longer apply if goods temporarily removed from a CCA are supplied by the vendor during the interim section 8(24) period. The output charge of section 8(24) remains if goods are returned late without an interim supply. However, the section 8(24) charge entitled the vendor (as a CCAE or IDZ operator) to an input tax deduction against the subsequent supply. This input tax deduction is based on the tax fraction of the lesser of: (i) the open market value, or (ii) the output tax accounted for in terms of section 8(24).

*Example 1. Facts.* A vendor (i.e. a Customs Controlled Area Enterprise) removes computer equipment, used in the course of making taxable supplies, from the CCA to a supplier located in South Africa. The removal occurs in order to have the equipment repaired. The South African supplier instead purchases the equipment within the 30 day removal period (the proceeds are then used by the vendor as an offset against another computer equipment purchase from the supplier). Assume that the computer equipment is actually supplied for R10 000 (but has an open market value of R11 000 on the last day of the period envisaged in section 8(24)).

*Result.* The vendor charges output tax on the supply of the goods under the basic rule of section 7(1)(a). As a result of the proposed amendment, section 8(24) no longer applies to those goods (despite the failure to return those goods within the required period).

*Example 2. Facts.* A vendor (i.e. a Customs Controlled Area Enterprise) removes telephone equipment, used in the course of making taxable supplies, from the CCA to a supplier located in South Africa. The removal occurs in order to have the equipment repaired. The repairs take longer than expected and the goods are returned after the required section 8(24) period (30 days in this instance). The vendor then sells the equipment a few months later to another supplier. Assume that the telephone equipment has an open market value of R1 000 on the last day of the period envisaged in section 8(24) and a market value of R 1 400 on the day that it is returned to the CCAE. The actual sale price for the equipment is R1 600.

*Result.* In terms of section 8(24), the consideration for the deemed supply is R1 000. The vendor has to account for output tax of R122.80. The vendor now qualifies for relief of R122.80 ( $14/114 \times R1\ 000$  which

is the lower of the open market value or the consideration). This amount acts as an offset against the VAT output otherwise due on the actual sale.

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## **PUBLIC-PRIVATE PARTNERSHIPS (PPPs)**

### **Current law**

A Public Private Partnership (PPP) falls within the definition of a designated entity. Currently, all payments made by any public authority or municipality to a designated entity are subject to VAT if the payments are in respect of a taxable supply made by that designated entity.

### **Reasons for change**

The current legislation improperly assumes that the nature of the PPP is a special purpose entity when in fact a PPP is an agreement that may or may not result in a special purpose entity being created.

### **Proposal**

#### Applicable clause and VAT Act provision:

Clause 104(1)(a); section 1 (paragraph (iii) of the “designated entity” definition)

Under the proposal, all payments made to a PPP by any public authority or municipality are subject to a VAT charge of 14 per cent. Ring-fencing also applies to ensure that only the party’s activities in respect of the PPP agreement fall within the ambit of a designated entity. As a result, any payments made by a public authority or municipality to or on behalf of that designated entity’s ring-fenced activities will be subject to VAT at the standard rate.

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## **SUPPLY OF THE RIGHT TO RECEIVE MONEY UNDER A RENTAL AGREEMENT**

### **Current law**

The supply of financial services is exempt from VAT. The transfer of ownership of a debt security, *inter alia*, is an example of a financial service that qualifies for the exemption. A debt security is defined to mean, *inter alia*, an interest in or right to be paid money owing by any person. If a debt

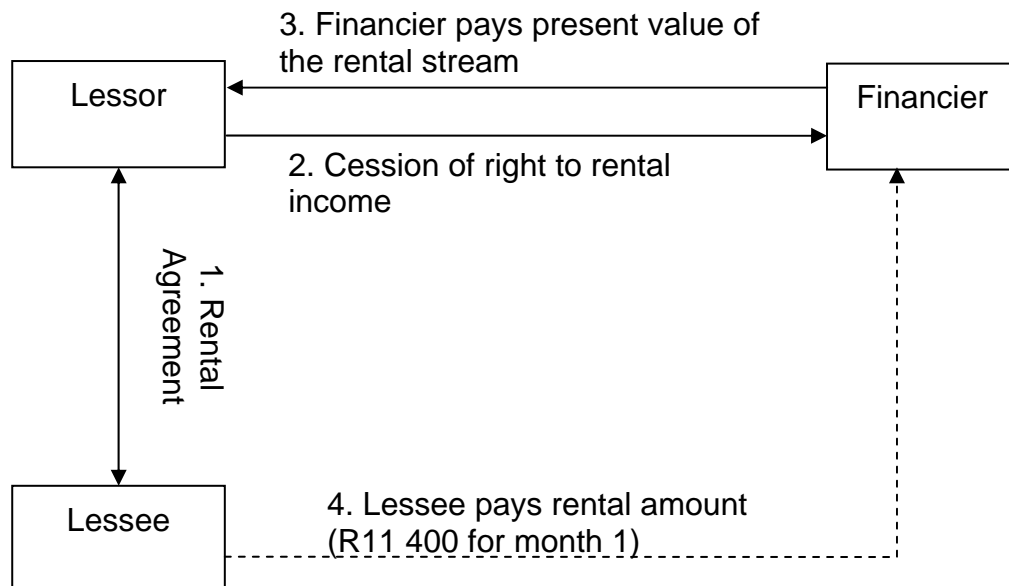
security is in relation to a rental agreement, the transfer of ownership of that debt security is no longer exempt but is subject to VAT at the 14 per cent rate. This charge is in light of the anti-avoidance provision of section 2(4)(b), which excludes from the ambit of financial services the transfer of any interest in or right to be paid money owing by any person under a rental agreement.

### Reasons for change

It has come to the attention of Government that certain practices have been contrived to abuse the provisions of section 2(4)(b). In this regard, the following observation regarding VAT and bare dominium structures was made in Annexure C of the 2007 Budget Review:

*“It was mentioned in last year’s Budget that certain taxpayers were entering into bare dominium structures designed to disguise actual financial services as rental payments, thereby misusing the statutory exception to the financial services definition. As a result input credits are claimed even though no subsequent taxable supplies are made. The investigation has now been completed and the VAT implications will be clarified by legislative amendment.”*

A typical supply of the right to receive money under a rental agreement [section 2(4)(b)] can be explained as follows:



*Step 1:* The lessor and lessee enter into a 20-year rental agreement with rent being payable on a monthly basis. (In this example the rental amount payable for the first month is R11 400, including VAT).

*Step 2:* The lessor cedes the right to its income under the rental agreement. Excluded from the cession are the obligations of the lessor in terms of the

rental agreement. The obligation to make the property available to the lessee therefore remains with the lessor.

*Step 3:* The financier pays to the lessor the present value of the aggregate rental amounts (excluding VAT) payable in terms of the rental agreement.

*Step 4:* The lessee pays the financier the rental amounts in terms of the rental agreement. These rental amounts are inclusive of VAT at 14 per cent. Under a different structure, the lessee would pay the VAT exclusive rental amount to the financier and the VAT component to the lessor.

The VAT implications of the transactions are as follows:

*Pre-cession:* The lessor declares VAT on the monthly rentals (i.e. R1 400), and the lessee claims input tax on the rental paid (R1 400).

*Post-cession:* The lessor must charge VAT on the supply of the right to receive money under a rental agreement to the financier. The VAT implications for the lessor and the lessee are the same as above. (It should be noted that the lessor, and not the financier, is legally responsible for making the property available to the lessee; only the right to receive the income was supplied to the financier and not the obligations attaching to the rental agreement).

The VAT levied on the supply made to the financier (i.e. of the right to receive the income under the rental agreement) is not subject to input tax in the hands of the financier. This result follows because the financier did not incur the input tax to make taxable supplies – the transaction is a pure financing/lending arrangement. It is understood that some financiers have argued that the incurred input tax was deductible as the role of the lessor was subrogated to that of the financier.

## **Proposal**

Applicable clause and VAT Act provision:  
Clause 105; deletion of section 2(4)(b)

It is proposed that section 2(4)(b) be deleted. Henceforth, the transfer of a right to receive money (i.e. a debt security) in terms of a rental agreement will be exempt from VAT.



## LAND REFORM TRANSACTIONS

### Current law

The VAT Act does not contain any provisions aimed at providing relief for land reform transactions. As a result, normal VAT principles apply. Application of the VAT is accordingly an added acquisition cost for Government. In terms of a now defunct ruling issued by SARS, land reform transactions were zero-rated for VAT purposes on the basis that such transactions constituted transfer payments.

### Reasons for change

The land reform programme consists of two components: restitution and redistribution programmes. Land restitution envisages the restitution of rights in land to persons or communities dispossessed of these rights as a result of past racial discriminatory laws or practices. Land redistribution envisages: (i) the designation of certain land; (ii) regulation of the subdivision of land (and the settlement of persons thereon), and (iii) provision for the rendering of financial assistance for the acquisition of land and for the securing of tenure rights.

Key transactions that occur within the land reform programme can be summarised as follows:

- Government purchases land from the seller (who may or may not be a vendor) and pays for the purchase wholly from designated funds. The land is then designated for certain beneficiaries; or
- The beneficiary purchases the land from a seller (who may or may not be a vendor) and pays for a portion of the purchase price. Government pays the purchase price of the other portion of the land from designated funds.

In the first scenario, Government transfers the land to the beneficiaries after a period of time, normally ranging from one to three years. Some of the beneficiaries may or may not be vendors that carry on a VAT enterprise.

If Government purchases land from VAT registered vendors, the VAT paid by Government is an added cost (as Government is not a VAT vendor). If the seller is not VAT registered, no Transfer Duty is leviable on these acquisitions by the Government (as Government is exempt from the Transfer Duty). However, the Transfer Duty may represent an added cost when Government transfers the land to an ultimate beneficiary.

### Proposal

#### Applicable clauses and VAT Act sections:

Clause 104(f); section 1 (paragraphs (b)(iv) and (b)(v) of the “second-hand goods” definition)

Clause 108(a); section 11(1)(s) and (t)

It is proposed that all land supplied as part of the land reform regime and paid for by Government be supplied at the zero rate for VAT purposes if the seller is a VAT vendor. An exemption from Transfer Duty on the transfer of land is also proposed if the land is transferred by Government to land reform beneficiaries. However, beneficiaries will be prohibited from claiming a notional input tax on the land (if these beneficiaries are VAT vendors). As a collateral matter, it is proposed to zero rate the quantum of the grant or advance contributed by Government if Government and the beneficiary contributed to the purchase price of the land.

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## **STORAGE WAREHOUSES**

### **Current law**

If imported goods are entered for storage in a licensed Customs and Excise storage warehouse and have not been entered for home consumption, any supply of those goods (before they are entered into home consumption) is zero rated.

### **Reasons for change**

Foreigners who store and supply goods in a licensed Customs and Excise storage warehouse fall within the ambit of an enterprise and are liable to register for VAT upon compliance with section 23 of the VAT Act. The reason for allowing the zero rating of goods imported and entered into a storage warehouse was to unlock input tax that was borne by the vendor. It has, however, become apparent that certain foreign businesses would prefer not to register for VAT.

### **Proposal**

#### Applicable clauses and VAT Act provisions:

Clause 108(1)(a); section 11(1)(u)

Clause 109(b); section 12(k)

Clause 110; paragraph (ii) of the proviso to section 13(1)

It is proposed that the supply of goods imported and entered for storage in a licensed Customs and Excise storage warehouse (provided that it has not been entered for home consumption) no longer be zero rated but instead be exempt from VAT. If the person storing and supplying goods in a licensed Customs and Excise storage warehouse elects to register as a vendor, the supplies made by that person in the licensed Customs and Excise storage warehouse will be zero rated in terms of section 11(1)(u) of the VAT Act.

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## ESTATE DUTY – PENSION BENEFITS

### Current Law

Estate duty is levied on lump sum amounts payable in terms of a pension benefit on the basis that the benefit is deemed to be property of the deceased's estate. Pension annuities are exempt from Estate Duty.

### Reasons for change

Most people rely on a pension benefit to address the potential financial problems of the surviving spouse and dependant children upon the death of the family's income provider. This tax treatment will depend on the form of savings. For instance, an annuity interest provided by a pension fund is exempt from estate duty, but lump sum payments on death are taxable. It is not, however, in line with Government's social objectives to penalise the beneficiaries by reducing the value of the benefit, especially if the family's overall economic circumstances have declined.

### Proposal

#### Applicable clause and Estate Duty Act provisions

Clause 2(1); section 3(2)(i) and the deletion of section 3(a)bis

In order to alleviate financial difficulties that a family may face upon the death of the family's income provider, it is proposed that any lump sum benefit from a retirement fund (i.e. pension fund, pension preservation fund, provident fund, provident preservation fund and retirement annuity fund) be exempt from Estate Duty. In addition to the proposed exclusion from "deemed property", retirement lump sums will be specifically excluded from property of the estate, to ensure that certain forms of retirement lump sums do not inadvertently remain within the Estate Duty net. This change is in line with Government's efforts to promote long-term retirement savings.

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## REPEAL OF STAMP DUTIES ACT

### Current Law

In theory stamp duties acted as a form of *ad valorem* user charge for obtaining the right of Government enforcement for certain contractual rights and obligations. The ambit of the Stamp Duties Act has been steadily narrowed over the last number of years in accordance with modern trends. Currently the Stamp Duties Act No. 77 of 1968 ("the Stamp Duties Act") only imposes a 0.25 per cent duty on rent payable in terms of lease agreements with a duration exceeding five years. The most important item on which

stamp duties were imposed, the duties on marketable securities, was folded into the Securities Transfer Tax Act, 2007 (Act No. 25 of 2007) (“STT Act”).

### **Reasons for change**

Given the remaining scope of the Stamp Duties Act, the actual cost of tax administration and compliance outweighs the benefits of the tax. Moreover, as a matter of theory, the tax is at odds with other aspects of the South African tax system. South Africa has generally avoided an approach that allows two sets of indirect taxes to be imposed on a single transaction. For instance, in the case of immovable property, either Transfer Duty or Value-Added Tax applies (not both). However, under current law, both stamp duty and value-added tax can apply to a single commercial real estate leasing transaction.

### **Proposal**

Applicable clause and Stamp Duties Act provisions  
Clause 103; repeal of the Stamp Duties Act

In view of the above, it is proposed that the Stamp Duty charge on leases be abolished and that the Stamp Duties Act be repealed. The Stamp Duties Act will be repealed with effect from 1 April 2009. Notwithstanding the repeal, the provisions of the Stamp Duties Act will continue to apply to all obligations arising from transactions executed prior to the date of repeal.

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## **SECURITIES TRANSFER TAX – *DE MINIMIS* EXEMPTION**

### **Current law**

The Securities Transfer Tax currently applies to any transfer of securities regardless of whether the securities exist in certificated (paper) or uncertificated (electronic) form. The transfer charge per share is relatively small (a flat 0.25 per cent of the purchase price).

### **Reasons for change**

Since the introduction of Securities Transfer Tax on 1 July 2008, a number of complaints have been received from taxpayers having to pay Securities Transfer Tax of less than R1 on the transfer of securities. In these instances, the administration and compliance costs associated with the charge exceed any potential tax amount due.

### **Proposal**

Applicable clause and Securities Transfer Tax Act provisions  
Clause 127(1); section 8(1)

It is proposed that a *de minimis* exemption be introduced for payments of small amounts of Securities Transfer Tax. Because all payments of the Securities Transfer Tax are made by intermediaries to SARS, the exemption is linked to the amount of tax (of less than R100) that, in the absence of this exemption, would have been payable to SARS by the intermediary in respect of all the transfers of securities during a month. The proposed *de minimis* threshold is measured over a monthly period because a per transaction threshold would result in a significant reduction of the tax base and could easily be subject to avoidance (i.e. the breaking up of a single transaction into smaller parts so as to effectively multiply the potential application of the *de minimis* exemption).

## CLAUSE BY CLAUSE EXPLANATION

### CLAUSE 1

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

See notes on **LAND REFORM TRANSACTIONS**

### CLAUSE 2

#### ***Estate Duty: Amendment of section 3 of the Estate Duty Act, 1955***

See notes on **ESTATE DUTY – PENSION BENEFITS**

### CLAUSE 3

#### ***Pension Funds Act: Amendment of section 37D of the Pension Funds Act, 1956***

The amendment corrects a technical problem contained in the Financial Services Laws General Amendment Act, which inadvertently removed a provision contained in the Revenue Laws Amendment Act of 2007. The net effect of the oversight was to improperly limit the fund's ability to deduct amounts from retirement savings. The amendment ensures that the fund can fully withdraw amounts as required for divorce and maintenance orders as well as any pay-as-you-earn tax associated with these withdrawals.

### CLAUSE 4

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

*Subclause (1)(a):* The proposed amendment deletes a superfluous "or."

*Subclauses (1)(b) to (1)(d):* See notes on **SECONDARY TAX ON COMPANIES REFORMS**

*Subclause (1)(e):* See notes on **CONSOLIDATION OF DEEMED EMPLOYEE REGIMES**

*Subclause (1)(f):* See notes on **RETIREMENT ISSUES**

*Subclause (1)(g):* The definition of "living annuity" is clarified in line with the current practice. The current wording only allows "living annuities" to be offered by independent insurers; whereas, retirement funds themselves

should also be allowed to directly offer “living annuities” to their members or former members.

*Subclause (1)(h):* Due to a recent judicial decision, some confusion exists as to whether assets held for purposes of providing an annuity are held by the annuity provider or the annuitant. The proposed amendment adjusts the language so as to clarify the position. Under the proposed change, the value of the annuity is determined with reference to the value of assets specified and held to provide the annuity. The reference to “by or on behalf of that person” has been deleted.

*Subclause (1)(i):* The definition of “living annuity” is again clarified in line with current practice. Under current practice, if an annuitant dies, sums are paid to nominees or the deceased’s estate. The current reference to “dependant” has been dropped as inconsistent with current agreements.

*Subclause (1)(j):* See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

*Subclause (1)(k):* In the Taxation Laws Amendment Act of 2007, the rules for various preservation funds were formalised from SARS practice into statutory law. The reference to pension preservation funds was inadvertently omitted from this aspect of the “pension fund” definition and is now added accordingly.

*Subclause (1)(l):* In prior years, the retirement funds were required to pay surplus apportionment amounts to members and former members. The tax definition of “pension fund” must similarly be adjusted so that the rules of the fund can allow these payments without technically violating the Income Tax Act.

*Subclause (1)(m):* This amendment allows pension funds to pay out all amounts as a lump sum upon death (i.e. the two-thirds annuity requirement should not apply on death).

*Subclause (1)(n):* See notes on **RETIREMENT ISSUES**

*Subclause (1)(o):* Regarding the amendment of paragraph (b) of the proviso to the “pension preservation fund” definition, see notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE**. Regarding the amendment of paragraph (c) of the proviso to the “pension preservation fund” definition, this amendment allows pension preservation fund members to make multiple withdrawals if two or more payments or transfers described in paragraph (b) were made to the fund.

*Subclause (1)(p):* This amendment allows pension preservation fund members to fully withdraw all amounts as a lump sum upon death (i.e. the two-thirds annuity requirement should not apply on death).

*Subclause (1)(q):* See notes on **RETIREMENT ISSUES**

*Subclause (1)(r):* In the Taxation Laws Amendment Act of 2007 the rules for various preservation funds were formalised from SARS practice into statutory law. References to preservation funds were inadvertently omitted from this aspect of the “provident fund” definition and are now added accordingly.

*Subclause (1)(s):* In prior years, retirement funds were required to pay surplus apportionment amounts to members and former members. The tax definition of “provident fund” must similarly be adjusted so that the rules of the fund can allow these payments without technically contravening the Income Tax Act.

*Subclause (1)(t):* See notes on **RETIREMENT ISSUES**

*Subclause (1)(u):* Regarding the amendment of paragraph (b) of the proviso to the “provident preservation fund” definition, see notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE**. Regarding the amendment of paragraph (c) of the proviso to the “provident preservation fund” definition, this amendment allows provident preservation fund members to make multiple withdrawals if two or more payments or transfers described in paragraph (b) were made to the fund.

*Subclause (1)(v):* See notes on **RETIREMENT ISSUES**

*Subclause (1)(w):* See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

*Subclause (1)(x):* This amendment allows retirement annuity fund members to fully withdraw all amounts as a lump sum upon death (i.e. the two-thirds annuity requirement should not apply on death).

*Subclause (1)(y):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

*Subclause (1)(z):* The proposed amendment is consequential to the repeal of the Uncertificated Securities Tax Act, 1998, and the promulgation of the Securities Transfer Tax Act, 2007.

*Subclause (1)(zA):* The proposed amendment clarifies that administrative penalties imposed in terms of section 75B of the Act constitute “tax” as defined.

## CLAUSE 5

### ***Income Tax: Amendment of section 3 of the Income Tax Act, 1962***

This amendment corrects an incorrect reference to a “retirement annuity fund”.



CLAUSE 6

***Income Tax: Amendment of section 5 of the Income Tax Act, 1962***

See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 7

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

See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 8

***Income Tax: Amendment of section 7 of the Income Tax Act, 1962***

*Subclause (a):* The amendment corrects a spelling error.

*Subclause (b):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 9

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

See notes on **ALLOWANCES IN RESPECT OF INDUSTRIAL POLICY PROJECTS**

CLAUSE 10

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

See notes on **BROAD-BASED EMPLOYEE SHARE SCHEMES**

CLAUSE 11

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

See notes on **FURTHER LIMITATION OF BENEFITS OF EXECUTIVE SHARE SCHEMES**

## CLAUSE 12

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

See notes on **VENTURE CAPITAL COMPANIES**

## CLAUSE 13

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

*Subclause (1)(a):* It is proposed that the concept of “participation rights” as defined in section 9D be used in relation to passive holding companies. As a “passive holding company” (as defined in the proposed section 9E) is by definition not a foreign company, it is necessary to remove the reference to “foreign company” in the definition of “participation rights” in section 9D. This does not change the effect of the definition in section 9D.

*Subclause (1)(b):* Section 9D(9)(fA) was amended by the Taxation Laws Amendment Act, 2008. The effect of that amendment was to exclude, from the net income of a CFC, reductions or discharges of debts owed to that CFC by another CFC. The proposed amendment is consequential to that amendment to section 9D(9)(fA) and provides that corresponding exchange item hedging losses and the reduction or discharge of debt of another CFC is to be disallowed as a deduction in determining the net income of a CFC.

*Subclauses (1)(c), (1)(d) and (1)(f):* See notes on **CFC ROYALTIES**

*Subclause (1)(e):* The amendment corrects an incorrect cross-reference.

*Subclause (1)(g):* The proposed amendment removes superfluous wording.

## CLAUSE 14

### ***Income Tax: Insertion of section 9E into the Income Tax Act, 1962***

See notes on **PASSIVE HOLDING COMPANIES**

## CLAUSE 15

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

The purpose of the proposed amendment is to clarify that the rules contained in section 9G (which relate to the incurral of expenditure and accrual of amounts in respect of foreign equity instruments) are only applicable in respect of foreign equity instruments acquired during any year of assessment ending before 8 November 2005.

## CLAUSE 16

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

*Subclauses (1)(a) and (1)(b):* See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

*Subclause (1)(c):* Currently, in terms of proviso (cc) to section 10(1)(k)(i), certain dividends that constitute consideration paid in respect of the disposal of shares held as trading stock are exempt where the taxpayer has made an election in respect of affected shares in terms of section 9B. Proviso (cc) does not, however, make provision for an exemption in respect of shares to which section 9C applies. The proposed amendment removes this anomaly.

*Subclause (1)(d):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

*Subclause (1)(e):* Section 10(1)(z) of the Income Tax Act provides for an exemption in respect of certain farming subsidies granted by the State. In the past, the Department of Agriculture granted subsidies for interest payable on loans utilised for purposes of farming operations. Since the Department of Agriculture no longer grants these subsidies, it is proposed that section 10(1)(z) be deleted as obsolete.

*Subclause (1)(f):* Section 10(1)(zD) of the Income Tax Act provides for an exemption in respect of reimbursements by the State for expenditure incurred in relocating to an economic development area. Paragraph (B) of the definition of "gross income" (which included in gross income subsidies or reimbursements from the State aimed at encouraging the growth of economic development areas) was deleted in 2005. It is therefore proposed that section 10(1)(zD) be deleted as a consequence of the deletion of paragraph (B) of the definition of "gross income".

*Subclause (1)(g):* See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

## CLAUSE 17

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

The rules for various preservation funds were formalised from SARS practice into statutory law in the Taxation Laws Amendment Act of 2007. The cross-references to preservation funds were inadvertently omitted from the “annuity contract” definition in section 10A. The proposed amendment inserts these cross-references.

## CLAUSE 18

### ***Income Tax: Amendment of section 11 of the Income Tax Act, 1962***

*Subclause (1)(a):* The proposed amendment deletes an obsolete cross-reference.

*Subclause (1)(b):* See notes on **CONSOLIDATION OF DEEMED EMPLOYEE SYSTEM ANTI-AVOIDANCE RULES**

*Subclause (1)(c):* This amendment is consequential upon the introduction of the presumptive tax for micro businesses and caters for the situation where a taxpayer who is subject to income tax elects to be taxed under the presumptive tax and is in a later tax year again subject to income tax.

*Subclause (1)(d):* See notes on **ALLOWANCES IN RESPECT OF EXPENDITURE ON GOVERNMENT BUSINESS LICENSES**

*Subclause (1)(e):* See notes on **BROAD-BASED EMPLOYEE SHARE SCHEMES**

*Subclause (1)(f):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

*Subclause (1)(g):* See notes on **REPAYABLE EMPLOYEE BENEFITS** The proposed amendment deletes an obsolete cross-reference.

*Subclause (1)(h):* Paragraphs (p) and (q) of section 11 have been rendered obsolete by recent changes in legislation dealing with research and development. It is therefore proposed that they be deleted.

*Subclause (1)(i):* See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

## CLAUSE 19

### ***Income Tax: Amendment of section 11D of the Income Tax Act, 1962***

Whilst section 11D provides for a deduction of 150 per cent of so much of any expenditure incurred by a taxpayer directly in respect research and development expenditure, it does not, on its current wording, explicitly provide for a deduction by the developer itself. Because it was always intended that the developer should be so entitled, the proposed amendment rectifies this problem.

## CLAUSE 20

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

This amendment is consequential upon the introduction of the presumptive tax for micro businesses and caters for the situation where a taxpayer who is subject to income tax elects to be taxed under the presumptive tax and is in a later tax year again subject to income tax.

## CLAUSE 21

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

This amendment is consequential upon the introduction of the presumptive tax for micro businesses and caters for the situation where a taxpayer who is subject to income tax elects to be taxed under the presumptive tax and is in a later tax year again subject to income tax.

## CLAUSE 22

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

This amendment is consequential upon the introduction of the presumptive tax for micro businesses and caters for the situation where a taxpayer who is subject to income tax elects to be taxed under the presumptive tax and is in a later tax year again subject to income tax.

## CLAUSE 23

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

*Subclause (1)(a) and (b):* The proposed amendments effect technical corrections.

*Subclauses (1)(c) and (d):* The proposed amendments are of a textual nature

*Subclause (1)(e):* Small business relief is intended for a stand-alone small business, not a single large business broken into parts. Consequently, In order to prevent avoidance, small business companies are generally not entitled to relief if these companies hold shares in other companies unless the shares can only be viewed as part of a portfolio investment (listed shares). The proposed amendment adds venture capital company shares to the list, thereby allowing for these portfolio investment holdings.

*Subclause (1)(f) and (g):* See notes on **CONSOLIDATION OF DEEMED EMPLOYEE ANTI-AVOIDANCE RULES**

#### CLAUSE 24

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

This amendment is consequential upon the introduction of the presumptive tax for micro businesses and caters for the situation where a taxpayer who is subject to income tax elects to be taxed under the presumptive tax and is in a later tax year again subject to income tax.

#### CLAUSE 25

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

See notes on **ADDITIONAL DEDUCTIONS FOR LEARNERSHIPS/ APPRENTICESHIPS**

#### CLAUSE 26

***Income Tax: Insertion of section 12I into the Income Tax Act, 1962***

See notes on **ALLOWANCES IN RESPECT OF INDUSTRIAL POLICY PROJECTS**

#### CLAUSE 27

***Income Tax: Insertion of section 12J into the Income Tax Act, 1962***

See notes on **VENTURE CAPITAL COMPANIES**

CLAUSE 28

***Income Tax: Amendment of section 13ter of the Income Tax Act, 1962***

See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

CLAUSE 29

***Income Tax: Amendment of section 13quat of the Income Tax Act, 1962***

See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

CLAUSE 30

***Income Tax: Amendment of section 13quin of the Income Tax Act, 1962***

See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

CLAUSE 31

***Income Tax: Insertion of section 13sex into the Income Tax Act, 1962***

See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

CLAUSE 32

***Income Tax: Insertion of section 13sept of the Income Tax Act, 1962***

See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

CLAUSE 33

***Income Tax: Amendment of section 18 of the Income Tax Act, 1962***

***Subclause (1)(a), (b), (d) and (e):*** See notes on **DEDUCTIONS IN RESPECT OF DISABILITY EXPENSES**

***Subclause (1)(c):*** See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

## CLAUSE 34

### ***Income Tax: Amendment of section 18A of the Income Tax Act, 1962***

*Subclause (1)(a), and (d):* See notes on **PUBLIC BENEFIT ACTIVITIES: ADDITIONAL TAX DEDUCTIBLE DONATIONS**

*Subclause (1)(b):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

*Subclause (1)(c):* Regarding the amendment of paragraph (a) of subsection (2) of section 18A, see notes on **PUBLIC BENEFIT ACTIVITIES: ADDITIONAL TAX DEDUCTIBLE DONATIONS**. Regarding the amendment of paragraph (b) of subsection (2) of section 18A, see notes on **PAYROLL GIVING**

## CLAUSE 35

### ***Income Tax: Amendment of section 20 of the Income Tax Act, 1962***

See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

## CLAUSE 36

### ***Income Tax: Amendment of section 22 of the Income Tax Act, 1962***

*Subclause (1)(a) and (b):* The proposed amendment provides for amounts included in the income of a taxpayer as a result of a reduction of the purchase price of a leased asset in terms of section 8(5) to be added to the cost price of the asset held as trading stock.

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

*Subclause (1)(d):* Under current law, there is no mechanism in section 22 to increase the cost price of shares in a CFC (that are held as trading stock) by the net income imputed to the resident holding those shares. There is also no mechanism by which the cost price of such shares may be reduced by the amount of any dividends received by that resident which are exempt from tax under the participation exemption in section 10(1)(k)(ii)(cc). The proposed amendment addresses these issues together with that of shares held as trading stock by CFCs in other CFCs in a multi-tier CFC structure. The proposed amendment mirrors the adjustments made to the base cost of such shares for CGT purposes under paragraph 20(1)(h)(iii) of the Eighth Schedule.



*Subclause (1)(e):* Regarding the amendment to the words preceding the proviso to section 22(4), the proposed amendment establishes the cost price of an asset held as trading stock which was previously leased by the taxpayer. Regarding the deletion of the first proviso to section 22(4), it is proposed that this proviso be deleted as being superfluous. The issue of capitalisation shares by a company by itself has no effect on the respective interests of the shareholders in the company. There is therefore no need for this proviso. Regarding the deletion of the second proviso to section 22(4), see notes under clause 47 below regarding the insertion of section 40C.

#### CLAUSE 37

***Income Tax: Amendment of section 23 of the Income Tax Act, 1962***

*Subclause (1)(a):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

*Subclause (1)(b):* See notes on **CONSOLIDATION OF DEEMED EMPLOYEE SYSTEMS**

*Subclause (1)(c):* See notes on **REPAYABLE EMPLOYEE BENEFITS**

#### CLAUSE 38

***Income Tax: Substitution of section 23I of the Income Tax Act, 1962***

See notes on **INTELLECTUAL PROPERTY ARBITRAGE**

#### CLAUSE 39

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

See notes on **SHARE ISSUE ANOMALIES**

#### CLAUSE 40

***Income Tax: Amendment of section 28 of the Income Tax Act, 1962***

See notes on **SHORT TERM INSURERS – DEDUCTION OF LIABILITIES**

#### CLAUSE 41

***Income Tax: Amendment of section 30 of the Income Tax Act, 1962***

The proposed amendment deletes superfluous wording.

#### CLAUSE 42

##### ***Income Tax: Amendment of section 30A of the Income Tax Act, 1962***

The proposed amendment requires a recreational club to have at least three unconnected persons who accept fiduciary responsibility for the club in order to qualify for approval by the Commissioner in terms of the Income Tax Act. No single person may have the ability or authority to directly or indirectly control the decision making powers of the club.

#### CLAUSE 43

##### ***Income Tax: Amendment of section 31 of the Income Tax Act, 1962***

The effect of the proposed amendment is to ensure that the transfer pricing rules that apply in respect of “intellectual property” as defined in section 23I also apply in respect of know-how.

#### CLAUSE 44

##### ***Income Tax: Amendment of section 36 of the Income Tax Act, 1962***

*Subclause (1)(a), (b), (c) and (e):* See notes on **RESIDENTIAL AND COMMERCIAL BUILDINGS INITIATIVES**

*Subclause (d):* See notes on **ALLOWANCES IN RESPECT OF EXPENDITURE ON GOVERNMENT BUSINESS LICENSES**

#### CLAUSE 45

##### ***Income Tax: Amendment of section 37B of the Income Tax Act, 1962***

This amendment is consequential upon the introduction of the presumptive tax for micro businesses and caters for the situation where a taxpayer who is subject to income tax elects to be taxed under the presumptive tax and is in a later tax year again subject to income tax.

#### CLAUSE 46

##### ***Income Tax: Insertion of section 37C into the Income Tax Act, 1962***

See notes on **PROMOTION OF LAND CONSERVATION AND BIODIVERSITY**

#### CLAUSE 47

##### ***Income Tax: Insertion of section 40C into the Income Tax Act, 1962***

Under current law, two sets of rules exist when a company issues shares for nil consideration - one for trading stock and one for capital gains. The trading stock rule (the second proviso to section 22(4)) covers both the issue of shares and the issue of options (plus similar rights). The capital gains rule (paragraph 78(1) of the Eighth Schedule) covers only the issue of shares. The proposed amendment unifies both sets of rules. If shares and options (as well as other rights for the issue of shares) are issued no consideration, no expenditure is deemed incurred by the holder for the receipt or accrual of those shares/options/rights.

#### CLAUSE 48

##### ***Income Tax: Amendment of section 41 of the Income Tax Act, 1962***

The proposed amendment addresses the interaction between the reorganisation rollover rules and the reinvestment-replacement rollover rules. In essence, the proposed amendment ensures that the disposal of replacement assets within a reorganisation does not trigger tax for those replacement assets. The reorganisation rollover transferee also obtains the replacement asset with the same characteristics as the transferor (i.e. is deemed to be one and the same).

#### CLAUSE 49

##### ***Income Tax: Amendment of section 42 of the Income Tax Act, 1962***

*Subclauses (1)(a), (c), (d) and (i):* See notes on **COMPANY REORGANISATIONS: ELECTIONS**

*Subclause (1)(b):* As a general matter, the switch in character of assets from a capital nature to trading stock (or from trading stock to a capital nature) is taxable. The reorganisation rules do not generally override this principle. One exception is the asset-for-share rules of section 42. The switch from capital to trading stock is permitted because this switch often occurs between two parties who are unconnected. This rule is to be contrasted with section 45, which does not permit any switching from capital to trading stock (or from

trading stock to capital). The charge for switching exists in a section 45 because a single taxpayer faces the same charge for switching. In order to reduce the conflict between sections 42 and 45, no switching will be permitted in the context of a section 42 transfer occurring between members of the same group of companies.

*Subclause (1)(e):* As a general matter, persons transferring assets to a company in exchange for shares are deemed to hold those shares as of the same date as the assets transferred were initially acquired. This rollover of time, however, does not apply for purposes of the three-year deemed capital rule of section 9C. This non-application of section 9C is designed to prevent taxpayers from converting non-share assets to shares solely to benefit from the three-year deemed capital rule. However, no reason exists to prevent the rollover of time if the section 42 transaction involves a share-for-share transfer (both prongs of which could benefit from section 9C before the section 42 transfer).

*Subclause (1)(f):* If a listed company receives assets in a section 42 transaction, the listed company receives a rollover base cost/cost in the assets received unless the shareholder-transferor fails to own at least 20 per cent of that company. In the latter case, the listed company transferee obtains a market value base cost/cost. The market value rule exists because the listed company transferee cannot be expected to know the base cost/cost of smaller transferors. The proposed amendment extends this same principle to collective investment schemes receiving assets in a section 42 transaction.

*Subclause (1)(g):* See notes on **SECONDARY TAX ON COMPANIES REFORMS**

*Subclause (1)(h):* The proposed amendment eliminates a superfluous word.

## CLAUSE 50

### ***Income Tax: Amendment of section 44 of the Income Tax Act, 1962***

*Subclause (1)(a):* See notes on **SECONDARY TAX ON COMPANIES REFORMS**

*Subclause (1)(b):* The proposed amendment clarifies the law by providing a cross-reference.

## CLAUSE 51

### ***Income Tax: Amendment of section 45 of the Income Tax Act, 1962***

*Subclause (1)(a), (b), (c), (g), (i), (j) and (k):* See notes on **COMPANY REORGANISATIONS: ELECTIONS**

*Subclause (1)(d):* See notes on **COMPANY REORGANISATIONS: DE-GROUPING CHARGE**

*Subclause (1)(e):* The proposed amendment effects a technical correction.

*Subclause (1)(f)* The Taxation Laws Amendment Act, 2008 introduced rules to prevent section 45 rollovers from being misused as a form of tax-free sale. As part of this change, consideration received or accrued from the section 45 disposal will trigger a de-grouping charge if the consideration is removed from the group. In addition, amounts directly or indirectly derived from section 45 consideration will also trigger a de-grouping charge if removed from the group.. While both de-grouping triggers limit one from of misuse, the breadth of the latter trigger has given rise to unintended anomalies (especially in the case of listed company groups that ordinarily produce dividends). This latter trigger is accordingly narrowed to exclude de minimis amounts. More specifically, amounts derived directly or indirectly from section 45 consideration will only trigger a de-grouping charge if these amounts are more than 10 per cent of the section 45 consideration.

*Subclause (1)(h):* The proposed amendment updates cross-references.

## CLAUSE 52

### ***Income Tax: Amendment of section 46 of the Income Tax Act, 1962***

*Subclause (1)(a):* The Taxation Laws Amendment Act, 2008 introduced rules that permit the unbundling of section 9D controlled foreign companies as long as those companies are more than 95 per cent owned by a single person. The amendment at hand eliminates certain technical anomalies associated with that change.

*Subclause (1)(b):* See notes on **SECONDARY TAX ON COMPANIES REFORMS**

*Subclause (1)(c):* Unbundling relief contains a prohibition against foreign shareholders in order to ensure unbundling shares are not shifted from a fully taxable shareholder to a wholly or partially non-taxable shareholder. More specifically, the current rule prevents unbundling relief from applying if 20 per cent or more of the unbundled company's shares are distributed to non-

taxable persons. The prohibition has been revised so the focus is shifted away from the unbundled company's shares distributed to the unbundling company's total shares after the distribution. Hence, under the new prohibition, 20 per cent or more of the unbundling company shares after the unbundling cannot be held by non-taxable shareholders.

#### CLAUSE 53

##### ***Income Tax: Amendment of section 47 of the Income Tax Act, 1962***

*Subclause (1)(a) and (c):* The proposed amendment eliminates the generic exclusion of exempt transferees (i.e. parent entities) in favour of a more specific list. This list roughly matches similar lists found in the other reorganisation rules.

*Subclause (1)(b) and (d):* See notes on **COMPANY REORGANISATIONS: ELECTIONS**

#### CLAUSE 54

##### ***Income Tax: Insertion of Part IV into Chapter II of the Income Tax Act, 1962***

See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

#### CLAUSE 55

##### ***Income Tax: Amendment of section 64B of the Income Tax Act, 1962***

See notes on **SECONDARY TAX ON COMPANIES REFORMS**

#### CLAUSE 56

##### ***Income Tax: Insertion of Part VIII into Chapter II of the Income Tax Act, 1962***

See notes on **SECONDARY TAX ON COMPANIES REFORMS**

CLAUSE 57

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

See notes on **PROMOTION OF LAND CONSERVATION AND BIODIVERSITY**

CLAUSE 58

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

***Subclause (1)(a):*** See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

***Subclause (1)(b):*** This amendment is a transition measure from the “old” system applicable to retirement lump sums (e.g. utilising the section 5(10) averaging formula) to the “new.” In essence, the proposed amendment allows tax-free amounts received in the 2007/08 tax year under the “old” system to be deducted from the tax-free amounts to be received in the same tax year but under the “new” system.

***Subclause (1)(c) and (d):*** See notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE, DEFAULT PRESERVATION OF WITHDRAWAL BENEFITS and UNCLAIMED BENEFIT FUNDS**

***Subclause (1)(e):*** See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 59

***Income Tax: Amendment of paragraph 2 of the Second Schedule to the Income Tax Act, 1962***

***Subclause (1)(a):*** See notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE**

***Subclause (1)(b):*** With regard to subparagraph (b)(iA), see notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE**. With regard to subparagraph (b)(iB), see notes on **TRANSFERS FROM PENSION TO PROVIDENT FUNDS**

***Subclause (1)(c):*** See notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE and TRANSFERS FROM PENSION TO PROVIDENT FUNDS**

CLAUSE 60

***Income Tax: Amendment of paragraph 2B of the Second Schedule to the Income Tax Act, 1962***

See notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE**

CLAUSE 61

***Income Tax: Amendment of paragraph 2C of the Second Schedule to the Income Tax Act, 1962***

The proposed amendment addresses special payments from retirement funds caused by one-off interventions to rectify issues of unfairness. One-off prior interventions have included payments stemming from the Statement of Intent with the insurance industry, secret profit bulking payments and surplus apportionment. This amendment provides that withdrawals of this nature should be tax-free because the special payments presumably will act as only partial compensation for the underlying economic loss.

CLAUSE 62

***Income Tax: Amendment of paragraph 3 of the Second Schedule to the Income Tax Act, 1962***

See notes on **ANNUITISATION OF DEATH BENEFITS**

CLAUSE 63

***Income Tax: Amendment of paragraph 4 of the Second Schedule to the Income Tax Act, 1962***

*Subclause (1)(a):* See notes on **DEFAULT PRESERVATION OF WITHDRAWAL BENEFITS**

*Subclause (1)(b):* See notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE**



CLAUSE 64

***Income Tax: Amendment of paragraph 6 of the Second Schedule to the Income Tax Act, 1962***

*Subclause (1)(a) and (b):* See notes on **ALLOCATIONS TO SPOUSES UPON DIVORCE** and **TRANSFERS FROM PENSION TO PROVIDENT FUNDS**

*Subclause (1)(c):* See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

*Subclause (1)(d) and (e):* With regard to item (C), see notes on **TRANSFERS FROM PENSION TO PROVIDENT FUNDS**. With regard to item (D), see notes on **UNCLAIMED BENEFIT FUNDS**.

*Subclause (1)(f):* The proposed amendment updates cross-references.

CLAUSE 65

***Income Tax: Repeal of paragraph 7 of the Second Schedule to the Income Tax Act, 1962***

See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 66

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

See notes on **CONSOLIDATION OF DEEMED EMPLOYEE ANTI-AVOIDANCE RULES**

CLAUSE 67

***Income Tax: Amendment of paragraph 2 of the Fourth Schedule to the Income Tax Act, 1962***

*Subclause (1)(a):* See notes on **CONSOLIDATION OF DEEMED EMPLOYEE ANTI-AVOIDANCE RULES**

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

*Subclause (1)(c):* See notes on **PAYROLL GIVING**

CLAUSE 68

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

See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 69

***Income Tax: Amendment of paragraph 11 of the Fourth Schedule to the Income Tax Act, 1962***

See notes on **CONSOLIDATION OF DEEMED EMPLOYEE ANTI-AVOIDANCE RULES**

CLAUSE 70

***Income Tax: Amendment of paragraph 11B of the Fourth Schedule to the Income Tax Act, 1962***

See notes on **(PRE-RETIREMENT) WITHDRAWALS FROM RETIREMENT FUNDS**

CLAUSE 71

***Income Tax: Insertion of the Sixth Schedule into the Income Tax Act, 1962***

See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESS**

CLAUSE 72

***Income Tax: Amendment of paragraph 6 of the Seventh Schedule to the Income Tax Act, 1962***

See notes on **PERSONAL USE OF BUSINESS CELL-PHONES AND COMPUTERS**

CLAUSE 73

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

See notes on **PERSONAL USE OF BUSINESS CELL-PHONES AND COMPUTERS**

CLAUSE 74

***Income Tax: Amendment of paragraph 11 of the Eighth Schedule to the Income Tax Act, 1962***

In view of the proposed introduction of paragraph 13(1)(a)(iiA), this provision is no longer required. The effect of the latter amendment is to backdate the distribution of the asset to the time of vesting. As a result, the distribution of the asset becomes a no gain or loss disposal and there is no need to treat it as a non-disposal.

CLAUSE 75

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

Where the foreign business establishment exemption applies, a CFC that becomes a resident is deemed to have disposed of assets that were not in the tax net for an amount equal to their market value. For purposes of establishing a base cost for such assets, the proposed amendment treats the CFC as having reacquired those assets for an amount equal to their market value on the date that the CFC becomes a resident.

CLAUSE 76

***Income Tax: Amendment of paragraph 13 of the Eighth Schedule to the Income Tax Act, 1962***

*Subclause (a):* Under current law a disposal is triggered in the hands of a beneficiary of a trust when that beneficiary acquires an asset from the trust in respect of which that beneficiary had a pre-existing vested right. This follows from paragraph 13(1)(d) which stipulates that the time of disposal in respect of the vesting of an asset is the date of vesting. When the beneficiary receives the actual asset there is a further disposal in the form of an exchange of a vested right for a real right in the asset, and the time of that disposal is the date when the change of ownership occurs (paragraph 13(1)(a)(ix)). This treatment is inconsistent with the treatment of other assets when delivery is deferred. In such cases, paragraph 13(1)(a)(ii) ensures that the exchange of personal and real rights is backdated to the date of the agreement, thereby ensuring that the disposal is tax neutral. The tax neutrality flows from the fact that the base cost of the vested (personal) right is equal to the market value of the real right received (proceeds), resulting in no capital gain or loss when the rights are exchanged.

It is proposed that a similar approach be applied to the acquisition of an asset by a beneficiary to the extent that the beneficiary had a vested right in the asset. To achieve this it is proposed that a new paragraph 13(1)(a)(iiA) be introduced.

*Subclause (b):* The deletion of paragraph 13(1)(d) is consequential to the introduction of paragraph 13(1)(a)(iiA) (see notes under subclause (a)).

## CLAUSE 77

### ***Income Tax: Amendment of paragraph 20 of the Eighth Schedule to the Income Tax Act, 1962***

*Subclause (1)(a) and (b):* The proposed amendments effect technical corrections.

*Subclause (1)(c):* Under current law, there is some uncertainty as to whether paragraph 38 applies to assets acquired from a non-resident by donation, for a consideration not measurable in money or from a connected person at a non-arm's length price. This is because paragraph 38(1) refers to a person who has "disposed of an asset ...". In terms of paragraph 2, the Eighth Schedule does not apply to disposals of assets by non-residents (except in the case of immovable property in South Africa and assets of a permanent establishment in South Africa). It may thus be suggested that the reference to "disposed of" only applies to deemed SA-source assets such as immovable property in SA, and hence paragraph 38 does not apply to other assets acquired from a non-resident. To clarify this point it is proposed that a new paragraph 20(1)(h)(vi) be inserted to establish a base cost for assets acquired from a non-resident that are acquired by donation, or for an expenditure not measurable in money or for a non-arm's length price when the non-resident is a connected person in relation to the resident acquirer.

*Subclause (1)(d):* The words 'or is deemed to have been allowed' were inserted to deal with assets of a micro business referred to in the Sixth Schedule to the Act. The depreciation provisions make provision for the circumstances where a trade had not been subject to tax and depreciation on assets used in such a trade is deemed to have been allowed. Under sections 11(e)(ix), 12C(4A), 12D(3A), 12DA(4), 12F(3A) and 37B(4), a taxpayer is deemed to have been allowed the applicable capital allowances granted under those sections during years of assessment when the asset has been used in the taxpayer's trade but the receipts or accruals from that trade were not included in the taxpayer's income during those years of assessment. (see clauses 18(1)(c), 20, 21, 22, 24 and 45). This addresses the situation where a small business was claiming depreciation, became a micro business subject to the presumptive turnover tax regime where depreciation cannot be claimed and then moved out of the presumptive turnover tax regime into the mainstream again.

## CLAUSE 78

### ***Income Tax: Amendment of paragraph 24 of the Eighth Schedule to the Income Tax Act, 1962***

*Subclause (1)(a):* The proposed amendment is designed to match the proposed paragraph 12(4). The market value rule is designed only for assets outside the South African taxing jurisdiction (i.e. assets that enter South African taxing jurisdiction for the first time). Hence, not only should the disposal of South African assets potentially subject to CGT be excluded but also the disposal of assets potentially subject to section 9D.

*Subclause (1)(b) and (c):* The proposed amendments correct cross-references that were inadvertently omitted from the Taxation Laws Amendment Act, 2008.

## CLAUSE 79

### ***Income Tax: Amendment of paragraph 40 of the Eighth Schedule to the Income Tax Act, 1962***

*Subclause (1)(a):* The deletions eliminate unnecessary overlap and clarify the provision. The exemptions for public organisations are fully covered under paragraph 62.

*Subclause (1)(b):* The change effects a technical correction. The deemed sale should be deemed to occur for an amount received or accrued equal to market value (i.e. for specified amounts entering into the paragraph 35 calculation, not the calculation itself).

*Subclause (1)(c):* This amendment is proposed to enable a PBO to establish a market value base cost for its inherited assets and is also consequential upon the deletion of paragraph 40(1)(b). The reference to 'or a trustee of a trust' is considered to be superfluous, as a trust inheriting assets would be an heir or legatee. It is proposed that the amendment be effective from 1 March 2006, which was the date on which PBOs became partially taxable under paragraph 63A.

## CLAUSE 80

### ***Income Tax: Insertion of paragraph 57A into the Eighth Schedule to the Income Tax Act, 1962***

See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

## CLAUSE 81

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

Two sets of participation exemption rules exist. Under paragraph 64B(2), a general participation exemption exists. Under paragraph 64B(5), a special participation exemption exists for capital distributions. An exclusion from the general rule of paragraph 64B(2) exists for transfers of foreign financial instrument holding companies and for South African immovable property companies. This same exclusion should exist for the capital distribution rule of paragraph 64B(5).

## CLAUSE 82

### ***Income Tax: Amendment of paragraph 67A of the Eighth Schedule to the Income Tax Act, 1962***

Paragraph 67A contains the CGT rules for dealing with holders of participatory interests in South African-registered collective investment schemes in property shares (CISP). Such a scheme is a trust in which the holders have vested rights. The conduit principle is, however, blocked by paragraph 67A and a holder must determine any capital gain or loss on disposal of the relevant interest.

#### *Treatment of distributions of a capital nature*

Under the Collective Investment Schemes Control Act, 2002, it is possible for a CISP to make a distribution of a capital nature to a holder on a going concern basis while the portfolio remains in force. Under the previous Act such capital distributions were specifically debarred except on winding-up. There was therefore no need for rules to deal with such distributions before valuation date.

Before 1 October 2007 such distributions of a capital nature received from a CISP before disposal of the holder's interest were treated as proceeds on disposal of the holder's interest, even when the weighted average method in paragraph 32(3A)(b) was adopted. The absence of a specific rule for the weighted average method seems to have been an oversight as it is at odds with the base cost reduction treatment applicable before 1 October 2007 of capital distributions in the case of shares under paragraph 76(2)).

The purpose of the amendments effected to paragraph 67A(3) and the insertion of paragraph 67AB by the Revenue Laws Amendment Act 35 of 2007 (RLAA 35 of 2007) was to introduce part-disposal treatment for distributions of a capital nature received by or accrued to a holder on or after 1 October 2007.

*Subclause (1)(a):* The amendments to paragraph 67A(3) by RLAA 35 of 2007 have a number of deficiencies. For example, paragraph 67A(3) –

- does not state how distributions of a capital nature received or accrued on or after 1 October 2007 must be dealt with; and
- states that proceeds are “limited” to the amount of a distribution of a capital nature from a CISP before 1 October 2007 thereby disregarding any proceeds from the actual disposal of an interest, which could never have been intended.

The proposed amendment addresses these issues and lays down clear rules for dealing with pre- and post-1 October 2007 distributions of a capital nature.

*Subclause (1)(b):* As noted above, paragraph 67A never dealt with the weighted average base cost method under paragraph 32(3A)(b). It is proposed that the treatment of holders of participatory interests who adopted this method be brought in line with company shareholders adopting the same method. To this end, it is proposed that the base cost of interests still held on 30 September 2007 be reduced by any distributions of a capital nature received by or accrued to a holder before 1 October 2007. If the base cost is negative on 30 June 2011, the negative amount will be treated as a capital gain and the base cost will be reset to nil (proposed paragraph 67AB(1A)). Persons adopting weighted average who receive distributions of a capital nature on or after 1 October 2007 must determine a capital gain or loss on the part-disposal basis in the same way as persons who adopt other asset identification methods.

*Subclause (2):* In order to address the uncertainties created by the amendments effected by the Revenue Laws Amendment Act 35 of 2007, it is proposed that the amendments in subclause (1) be deemed to come into operation on 1 October 2007.

## CLAUSE 83

### ***Income Tax: Amendment of paragraph 67AB of the Eighth Schedule to the Income Tax Act, 1962***

*Subclause (1)(a):* The amendment is consequential upon the amendments to paragraph 67A.

*Subclause (1)(b):* The amendment is consequential upon the insertion of paragraph 67A(3A) to deal with the situation in which a holder of a participatory interest has adopted the weighted average method under paragraph 32(3A) of the Eighth Schedule in respect of that holder’s participatory interests in collective investment schemes. Should the base cost of the particular holding be negative on 30 June 2011 the negative amount will be deemed to be a capital gain and the base cost will be reset to nil. This proposal is similar to that applied to shares under paragraph 76A(2).

*Subclause (2):* In order to address the uncertainties created by the amendments effected by the Revenue Laws Amendment Act 35 of 2007 it is proposed that the amendments in subclause (1) be deemed to have come into operation on 1 October 2007.

#### CLAUSE 84

***Income Tax: Amendment of paragraph 76 of the Eighth Schedule to the Income Tax Act, 1962***

See notes on **SECONDARY TAX ON COMPANIES REFORMS**

#### CLAUSE 85

***Income Tax: Amendment of paragraph 78 of the Eighth Schedule to the Income Tax Act, 1962***

Under current law, two sets of rules exist when a company issues shares for nil consideration - one for trading stock and one for capital gains. The trading stock rule (the second proviso to section 22(4)) covers both the issue of shares and the issue of options (plus similar rights). The capital gains rule (paragraph 78(1) of the Eighth Schedule) covers only the issue of shares. The proposed amendment unifies both sets of rules. If shares and options (as well as other rights for the issue of shares) are issued no consideration, no expenditure is deemed incurred by the holder for the receipt or accrual of those shares/options/rights.

#### CLAUSE 86

***Income Tax: Amendment of paragraph 80 of the Eighth Schedule to the Income Tax Act, 1962***

*Subclauses (a) and (b):* Based on the current wording of paragraphs 63 and 63A of the Eighth Schedule, when a trust vests an asset or a capital gain it would appear that the exempt/partially exempt entity concerned (for example, a PBO) is not entitled to disregard any capital gain attributed to it under paragraph 80(1) or (2). This is because the capital gain concerned did not arise from the disposal of an asset by the entity itself.

It is proposed that paragraph 80(1) and (2) be amended to exclude attribution to a person, organisation, entity or recreational club contemplated in paragraph 62(a) to (e). The effect will be that the capital gain will remain in the trust unless subject to attribution back to a donor under paragraphs 68 to 72. In the case of the vesting of an asset under paragraph 80(1), the trust must disregard the capital gain or capital loss on the donation under paragraph 62. However, this is not the case under paragraph 80(2), since



paragraph 62 only applies when an asset is disposed of to the exempt or partially exempt entity. Thus any capital gain or loss arising from the disposal of an asset to a third party must be accounted for by the trust.

Furthermore, the wording of paragraph 80(2) is more closely aligned with the wording of paragraph 80(1). Some commentators have suggested that a capital gain arising under paragraph 80(2) can be attributed through multiple discretionary trusts. This view has not been accepted and the amendment clarifies this by referring to a capital gain determined in respect of the disposal of an asset by a trust instead of a capital gain arising in a trust.

*Subclause (c):* This proposed amendment attempts to correct a paragraph alignment error that arose in the Revenue Laws Amendment Act 35 of 2007 and merely requires a technical correction.

#### CLAUSE 87

***Income Tax: Amendment of paragraph 4 of Part I of the Ninth Schedule to the Income Tax Act, 1962***

The proposed amendment provides for the inclusion of the provision of study loans by public benefit organisations in the list of public benefit activities.

#### CLAUSE 88

***Income Tax: Amendment of paragraph 11 of Part I of the Ninth Schedule to the Income Tax Act, 1962***

If a PBO is not itself engaged in carrying on a public benefit activity but only raises funds and acts as a conduit by distributing the funds to other organisations, the provision of such funds to other organisations constitutes an approved public benefit activity qualifying for tax exempt status, provided that the benefiting organisations are approved as PBOs in terms of section 30 of the Income Tax Act. If an approved fundraising PBO distributes funds to non-profit organisations outside South Africa, the provision of such funds outside South Africa will not constitute an approved public benefit activity.

The proposed amendments provide for the inclusion of the funding of offshore organisations by public benefit organisations to the list of public benefit activities if the offshore organisation receiving the funding is exempt from tax in its home country.

CLAUSE 89

***Income Tax: Amendment of paragraph 3 of Part II of the Ninth Schedule to the Income Tax Act, 1962***

See notes on clause 87.

CLAUSE 90

***Income Tax: Amendment of paragraph 2 of the Tenth Schedule to the Income Tax Act, 1962***

The proposed amendment adjusts the tax rates applicable to oil and gas companies to give effect to the reduction of the corporate income tax rate announced by the Minister of Finance in the 2008 Budget.

CLAUSE 91

***Customs and Excise: Amendment of section 38 of the Customs and Excise Act, 1964***

*Subclause (1)(a):* The proposed amendment empowers the Commissioner to permit the removal of imported dutiable goods from a licensed customs and excise storage warehouse on the basis of an invoice or certificate or such other document as the Commissioner may prescribe, provided that both the licensee of the warehouse and the importer of the goods have been accredited by the Commissioner.

*Subclause (1)(b):* In line with the aim of reducing industry compliance costs and of easing SARS' administration, the proposed amendment simplifies the customs procedure in relation to the storage and movement of bulk goods.

CLAUSE 92

***Customs and Excise: Amendment of section 43 of the Customs and Excise Act, 1964***

*Subclause (1)(a):* Section 43 deals with, *inter alia*, the disposal of goods on failure to make due entry. The proposed amendment is consequential to the amendment to section 38 insofar as it affects the time when imported goods must be removed to the State warehouse or dealt with otherwise as section 43 requires.

*Subclause (1)(b) to (d):* Under current legislation, the client could conceivably be liable for both State warehouse rent charged by the Commissioner and storage charges charged by a facility deemed to be a State warehouse. The proposed amendment rectifies this problem by removing the entitlement of a

deemed State warehouse to State warehouse rent, thereby providing a more equitable dispensation for the client. Consequential amendments will also be effected to the rules for section 17.

The effect of the amendment is that State warehouse rent will not be charged on such goods but the person concerned will be entitled to share in the proceeds of sale for storage charges in terms of the amendment to subsection (3).

*Subclause (1)(e) and (f):* Currently, section 43(6) provides for situations in which a person who imported counterfeit goods is not known. It might, however, be the case that the person is known but cannot be located despite reasonable efforts because that person has provided a false address. The proposed amendment addresses this problem.

#### CLAUSE 93

##### ***Customs and Excise: Amendment of section 44 of the Customs and Excise Act, 1964***

In terms of both the Income Tax Act, 1962 and the Value-Added Tax Act, 1991, the Commissioner may not authorise a refund or raise an assessment if the initial amount was paid in accordance with the practice generally prevailing at the date of payment. The proposed amendment inserts a corresponding provision into the Customs and Excise Act, 1964.

#### CLAUSE 94

##### ***Customs and Excise: Amendment of section 47 of the Customs and Excise Act, 1964***

Section 47(2) provides for Year 2000 compliance requirements. It is therefore proposed that section 47(2) be deleted as obsolete.

#### CLAUSE 95

##### ***Customs and Excise: Insertion of section 54EA into the Customs and Excise Act, 1964***

The proposed amendment expands the powers of the Commissioner in respect of the licensing requirements imposed in terms of section 54E and in respect of the payment of environmental levy. More specifically, it is proposed that the Commissioner be given wide powers in relation to the exemption from such licensing requirements and in relation to the payment of environmental levy.

#### CLAUSE 96

***Customs and Excise: Amendment of section 65 of the Customs and Excise Act, 1964***

*Subclause (1)(a)*: The proposed amendment effects a technical correction.

*Subclause (1)(b)*: The amendment aligns the definition of “buying commission” with the definition thereof in the WTO Agreement on the Implementation of Article VII of the General Agreement on Tariffs and Trade (“the WTO Agreement”), to which the Republic is a signatory.

#### CLAUSE 97

***Customs and Excise: Amendment of section 66 of the Customs and Excise Act, 1964***

The WTO Agreement does not discriminate between containerised and break bulk cargo in respect of inland freight charges.

The effect of the proposed amendment is that the place where the goods packed into a container in a foreign country, for export to the Republic, will no longer be regarded as the port or place of export. In addition, the full cost of transporting the goods from an exporter’s premises to the port or place where they are to be loaded on board a ship or any vehicle (inland freight charges) will be dutiable, thereby aligning containerised goods with break bulk cargo.

#### CLAUSE 98

***Customs and Excise: Amendment of section 67 of the Customs and Excise Act, 1964***

*Subclause (1)(a) and (c)*: See notes on Clause 97.

*Subclause (1)(b)*: The WTO Agreement does not provide for the deduction of buying commission from the price actually paid or payable, on the basis that such buying commission is payable to the buying agent by the purchaser of the goods in the Republic. Section 67(2)(b) is therefore amended by the deletion of subparagraph (v) where “buying commission” is listed.

#### CLAUSE 99

***Customs and Excise: Amendment of section 75 of the Customs and Excise Act, 1964***

*Subclause (1)(a)*: Limitation periods for refunds and drawbacks: Currently, section 75 is unclear regarding the application of the limiting circumstances

contained in section 76B. The proposed amendment aligns the provisions with those of section 76B regarding the time within which application for a refund must be submitted.

*Subclause (1)(b):* Administration of International Agreements: The proposed amendment empowers the Minister to amend Schedules No. 4 or No. 5 in order to provide for a rebate or refund of duty in circumstances where it may be necessary to give effect to an agreement contemplated in section 49.

*Subclause (1)(c):* In terms of the proposed amendment, any rebate of duty on destroyed goods must be reduced where any waste or scrap therefrom enters home consumption. Such waste or scrap is deemed to have been imported at the time it is entered for home consumption and is liable to duty. This proposed amendment accords with the Kyoto Convention.

#### CLAUSE 100

***Customs and Excise: Amendment of section 76B of the Customs and Excise Act, 1964***

In terms of both the Income Tax Act, 1962 and the Value-Added Tax Act, 1991, the Commissioner may not authorise a refund or raise an assessment if the initial amount was paid in accordance with the practice generally prevailing at the date of payment. The proposed amendment inserts a corresponding provision into the Customs and Excise Act, 1964.

#### CLAUSE 101

***Customs and Excise: Continuation of certain amendments of Schedules to the Customs and Excise Act, 1964***

The proposed amendment extends the date of applicability of certain schedules.

#### CLAUSE 102

***Customs and Excise: Date of implementation of Free Trade Agreement between EFTA and SACU in Schedules No. 1 and 10 of the Customs and Excise Act, 1964***

The proposed amendment provides for the date of implementation of the Free Trade Agreement between EFTA States and SACU States.

CLAUSE 103

***Stamp Duties: Repeal of the Stamp Duties Act, 1968***

See notes on **REPEAL OF STAMP DUTIES ACT**

CLAUSE 104

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

*Subclause (1)(a)*: See notes on **PUBLIC-PRIVATE PARTNERSHIPS**

*Subclause (1)(b)*: The proposed amendment is consequential to the Road Accident Fund now being classified under Schedule 3A of the Public Finance and Management Act, 1999.

*Subclause (1)(c)*: The proposed amendment serves to clarify that electricity falls within the ambit of “goods” as defined.

*Subclause (1)(d)*: The proposed amendment requires the definition of an inbound duty and tax-free shop to be determined by Customs.

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

*Subclause (1)(f)*: See notes on **LAND REFORM TRANSACTIONS**

CLAUSE 105

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

See notes on the **SUPPLY OF THE RIGHT TO RECEIVE MONEY UNDER A RENTAL AGREEMENT**

CLAUSE 106

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

*Subclause (1)(a)*: See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

*Subclause (1)(b and c)*: The proposed amendment reinforces the policy that all payments made to a designated entity by a public authority or municipality are inclusive of VAT at 14% to the extent that such payments are received in the course or furtherance of the enterprise of the designated entity.

*Subclause (1)(d)*: See notes on **INDUSTRIAL DEVELOPMENT ZONES**

CLAUSE 107

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

See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

CLAUSE 108

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

*Subclause (1)(a):* Regarding the proposed insertion of subsections (s) and (t) into section 11, see notes on **LAND REFORM TRANSACTIONS**. Regarding the proposed insertion of subsection (u) into section 11, see notes on **STORAGE WAREHOUSES**. Regarding the insertion of subsection (v) into section 11, this amendment is proposed in order to make provision for the zero rating of supplies of goods in an inbound duty and tax free shop.

*Subclause (1)(b):* See notes on **STORAGE WAREHOUSES**

CLAUSE 109

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

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

*Subclause (b):* See notes on **STORAGE WAREHOUSES**

CLAUSE 110

***Amendment of section 13 of the Value-Added Tax Act, 1991***

See notes on **STORAGE WAREHOUSES**

CLAUSE 111

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

See notes on **INDUSTRIAL DEVELOPMENT ZONES**

CLAUSE 112

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

See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

CLAUSE 113

***Amendment of section 23 of the Value-Added Tax Act, 1991***

*Subclause (1)(a):* See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

*Subclause (1)(b):* The proposed amendment clarifies that the bank or institution referred to in the envisaged section must be a South African bank. It is important that the vendor has an account with a South African bank to facilitate the easier processing of payments and refunds.

*Subclause (1)(c):* See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

CLAUSE 114

***Amendment of section 39 of the Value-Added Tax Act, 1991***

*Subclause (1)(a):* See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

*Subclause (1)(b):* The proposed amendment is consequential to the amendment proposed by subclause (1)(a).

CLAUSE 115

***Insertion of section 78A of the Value-Added Tax Act, 1991***

See notes on **PRESUMPTIVE TAX FOR MICRO BUSINESSES**

CLAUSE 116

***Amendment of section 85 of the Value-Added Tax Act, 1991***

The deletion relates to an obsolete provision in the VAT Act that relates to Sales Tax.

CLAUSE 117

***Repeal of section 60 of the Income Tax Act, 1993***

The proposed amendment repeals obsolete provisions.



CLAUSE 118

***Repeal of section 41 of the Income Tax Act, 1994***

The proposed amendment repeals obsolete provisions.

CLAUSES 119 and 120

***Amendment of sections 42 and 42A of the Restitution of Land Rights Act, 1994***

See notes on **LAND REFORM TRANSACTIONS**

CLAUSE 121

***Repeal of Decree 2 of 1994 (of former Republic of Ciskei)***

The proposed amendment repeals an obsolete decree.

CLAUSE 122

***Repeal of the Tax Amnesty Act, 1995***

The proposed amendment repeals an obsolete Act.

CLAUSE 123

***Repeal of the Final Relief on Tax, Interest, Penalty and Additional Tax Act, 1996***

The proposed amendment repeals an obsolete Act.

CLAUSE 124

***Income Tax: Amendment of Schedule 1 to the Revenue Laws Amendment Act, 2006***

*Subclause (1)(a):* In terms of the Special Tax Measures Relating to the 2010 FIFA World Cup certain goods and services supplied within the Championship Sites (such as the FIFA stadiums, the exclusion zones around the stadiums and training sites) are free of income tax and VAT during certain periods of the Championship duration.

As regards the tax-free services rendered in the Championship sites they must be rendered by the entities referred to in paragraph 6 of the Special Tax Measures and be—

- intrinsic to the staging of the Championship;
- enjoyed or partially utilised at a Championship site; and
- paid for by an individual member of the general public or by FIFA, a FIFA subsidiary or the Local Organising Committee.

Concern has been expressed that the use of the word “individual” in the third requirement will have the effect of preventing companies from enjoying the benefit of the tax-free acquisition of services in the Championship sites. It is, therefore, proposed that this matter be clarified.

*Subclause (1)(b):* FIFA has entered into agreements with a limited number of commercial affiliates which are National Supporters and whose principal place of business is in the Republic. Part of the agreement between FIFA and the National Supporter is that in return for the supply of goods or services to FIFA, FIFA supplies services to the National Supporter. FIFA is exempt from all taxes in the Republic and the National Supporters are not liable to any VAT on the goods and services supplied to FIFA at a Championship site. Where the taxable barter supplies by the National Supporters are made outside the Championship sites, the National Supporters have to levy VAT and pay it to SARS. FIFA is entitled to claim a refund of the VAT from SARS. The net tax effect on the fiscus is neutral.

The volume of these transactions and the administrative and compliance costs are high although there are only a few National Supporters involved. In view of this it is proposed that the barter transactions entered into between the National Supporters and FIFA be zero rated. This will reduce the compliance and administration costs for all the parties involved.

*Subclause (1)(c) and (d):* In terms of paragraph 9(1) the receipts and accruals of non-resident staff members of commercial affiliates, merchandising partners, FIFA designated service providers and broadcasters, amongst others, are exempted from income tax to the extent they are derived from activities connected with the Championship. The Hospitality Service Provider appointed by FIFA also provides services on the same basis to FIFA as the other entities and it is proposed that the receipts and accruals of non-resident staff of the hospitality service provider also be exempted from tax.

## CLAUSE 125

### ***Income Tax: Amendment of Appendix I of the Taxation Laws Amendment Act, 2007***

The proposed amendment inserts the words “deceased estate” and “insolvent estate” which were inadvertently omitted from the Taxation Laws Amendment Act, 2007.

## CLAUSE 126

### ***Securities Transfer Tax: Amendment of section 5 of the Securities Transfer Tax Act, 2007***

Certain listed shares are still in certificated form and are not held in custody by either a broker or a participant. It is proposed that the Securities Transfer Tax, in the case of the transfer of listed shares in certificated form, must be paid by the person to whom the shares are transferred *via* the company which issued those shares.

## CLAUSE 127

### ***Securities Transfer Tax: Amendment of section 8 of the Securities Transfer Tax Act, 2007***

*Subclause (1)(a)*: The proposed amendment corrects a cross-reference.

*Subclause (1)(b) to (d)*: It is proposed that a *de minimis* exemption be introduced for payments of small amounts of securities transfer tax. Since the introduction of STT on 1 July 2008 a number of complaints have been received from taxpayers having to pay STT of less than R1 on the transfer of securities. In terms of the Stamp Duties Act an exemption of R100 was available for transferees of securities, which was linked to a time period. As all payments of STT are made by intermediaries to SARS, it is proposed that the exemption be linked to the amount of tax (of less than R100) which in the absence of this exemption would have been payable to SARS by the intermediary in respect of all the transfers of securities occurring during a month.

## CLAUSE 128

### ***Income Tax: Amendment of section 52 of the Revenue Laws Amendment Act, 2007***

Section 52 of the Revenue Laws Amendment Act, 2007 (“the original amendment”) amended the definition of “group of companies” in section 41 of the Income Tax Act, 1962. The proposed amendment effectively delays the effective date of the original amendment in the case of certain intra-group transactions that were, at the time of the original amendment, the subject of an application for an advance tax ruling regarding the interpretation or application of that definition of “group of companies”.

***Income Tax: Amendment of section 55 of the Revenue Laws Amendment Act, 2007***

Section 55 of the Revenue Laws Amendment Act, 2007 (“the original amendment”) amended section 44 of the Income Tax Act, 1962. The proposed amendment changes the effective date of the original amendment.

CLAUSE 130

***Income Tax: Amendment of section 56 of the Revenue Laws Amendment Act, 2007***

Section 56 of the Revenue Laws Amendment Act, 2007 amended section 45 of the Income Tax Act to deny the rollover relief afforded by section 45 (which deals with intra-group transactions) in certain circumstances.

This amendment to section 45 was deemed to have come into operation on 30 October 2007 and to be applicable to any transaction entered into during any year of assessment ending on or after that date. This creates an unintended anomaly. For example, it is possible that a company with a year end of 30 November 2007 and which entered into a section 45 transaction in December 2006 (i.e. long before the amendment to section 45 was announced) could retrospectively be denied the relief afforded by section 45.

It is therefore proposed that section 56 of the Revenue Laws Amendment Act be amended so that it is effective only in respect of transactions entered into on or after 30 October 2007 (with no regard being given to the year of assessment in which the transaction took place).

CLAUSE 131

***Income Tax: Amendment of section 59 of the Revenue Laws Amendment Act, 2007***

Section 59 of the Revenue Laws Amendment Act, 2007, amended section 64B(5)(c) of the Income Tax Act. This amendment was to have been effective from 1 January 2009. A further amendment was made to section 64B(5)(c) by section 32 of the Taxation Laws Amendment Act, 2008. The amendment to section 64B(5)(c) by the Taxation Laws Amendment Act, 2008 required the amendment to section 64B(5)(c) by the Revenue Laws Amendment Act, 2007, to be reconsidered. The effect of the proposed repeal of section 59 is that pre-1993 profits and pre-1 October 2001 capital profits on liquidation or deregistration will still fall outside the STC net from 1 January 2009.

CLAUSE 132

***Income Tax: Amendment of section 125 of the Revenue Laws Amendment Act, 2007***

Section 125 of the Revenue Laws Amendment Act, 2007, provides tax relief to the professional and amateur arms of sporting bodies and allows them to amalgamate on a tax neutral basis.

It has been found in practice that paragraph 12(5) of the Eighth Schedule to the Income Tax Act creates a tax liability when the bodies amalgamate and so defeats the intention of allowing a tax neutral amalgamation. It is therefore proposed that the operation of paragraph 12(5) be suspended in the case of these amalgamations.

CLAUSE 133

***Income Tax: Amendment of section 8 of the Taxation Laws Amendment Act, 2008***

The proposed amendment inserts an effective date that was inadvertently omitted.

CLAUSE 134

***Income Tax: Amendment of section 38 of the Taxation Laws Amendment Act, 2007***

The proposed amendment inserts an effective date that was inadvertently omitted.

CLAUSE 135

***Income Tax: Amendment of Appendix I of the Taxation Laws Amendment Act, 2008***

The proposed amendment inserts the words “deceased estate” and “insolvent estate” which were inadvertently omitted from the Taxation Laws Amendment Act, 2008.

CLAUSE 136

***Short Title and Commencement***

This clause provides for the name of the Act and the commencement date of the Act.