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

RESPONSES TO WRITTEN REPRESENTATIONS BY ORGANISATIONS TO THE PORTFOLIO COMMITTEE ON FINANCE AND SELECT COMMITTEE ON FINANCE ON THE TAXATION LAWS AMENDMENT BILL, 2004 (the Bill)

1 Introduction

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

Abbreviations used in this document:

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

2 Consultation

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

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

Annexure 1: Broad-Based Employee Share Initiative

Section 8B

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

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

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

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

Broad-based participation reduces the generally accepted benefit of acting as a reward. Therefore, there will be little opportunity of awarding on differential performance.
(BCSA)

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

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

provisions of section 9B to include a qualifying equity share held for a minimum period of 5 years.
(SAICA)

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

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

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

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

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

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

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

Restricted shares held for a period of 5 years or less will result in the same tax treatment under section 8A and 8B. Although exceptional situations may arise because of the maximum 5 year restriction of section 8B shares, as a general rule no problems should arise.

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

This comment is partially accepted.

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

- It is broad based meaning that it will be extended to at least 90 per cent of employees;
- It will limit abuse in the form of deferred compensation arrangements;
- It will limit the temptation to "cash-out" by resigning or entering into further schemes like the disposal of dividend rights;
- A deduction will be allowed to the employer hence the need to limit revenue exposure for the fiscus.

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

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

This comment is partly accepted.

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

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

This comment is not accepted. As the share scheme is intended to be broad based it should cover the whole group of companies. By permitting exclusions on an *ad hoc* basis would undermine the intention.

The right of acquisition of empowerment shares at market value appears to be limited to those rights imposed by the direct employer. Other companies within the group should have similar rights to acquire empowerment shares.
(PWC)

This comment is accepted. The legislation will not be restricted to specific employers.

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

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

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

This comment is not accepted.

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

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

No distinction is made between someone ceasing employment because of, for example, retirement in the normal course, disability or retrenchment and, on the other hand, for unacceptable reasons, e.g. being fired because of dishonesty. There is no reason why someone whose employment is terminated for anything other than the former reasons should be entitled to have the restriction lifted within five years.
(SAICA)
The scheme can become a deferred remuneration tool that will have the effect of reducing employees' take home pay. It also locks employees in to the current employer.
(BCSA)

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

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

The intention is to exclude labour brokers, personal service companies and personal service trusts from the benefits of the broad-based employee share scheme. The Fourth Schedule definition is necessarily wide because it is directed at anti-avoidance whereas section 8B is an incentive provision.

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

This comment is accepted. The legislation will be amended accordingly.

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

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

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

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

Section 11

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

Uncertainty exists as to which company obtains the deduction in a group situation. Is it the company issuing the shares or the company employing the person receiving the shares?
(PWC)

The employer gets the deduction in all cases.

Section 69

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

Comment accepted. The reporting requirement for the employer will be limited to 5 years.

Fourth Schedule

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

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

Effective date

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

An early effective date will be considered.

Stamp Duty and Uncertificated Securities Tax

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

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

Annexure 2: Full Taxation of Executive Equity Schemes

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

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

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

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

deemed interest charge should be imposed.

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

This comment is accepted and this aspect will be addressed.

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

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

Definition of "restricted equity instrument"

Paragraph (a) of the definition of 'restricted equity instrument' refers to "any restriction." Should this restriction not be limited to only those restrictions that will prevent the taxpayer from freely disposing of the equity instrument at market value by virtue of their employment?
(PWC)

This comment is supported and the definition of "restricted equity instrument" will be clarified.

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

These will be construed as restrictions in terms of the proposed amendment if they can be considered to be imposed otherwise than by way of legislation. The JSE will be consulted to determine whether the restrictions are imposed in terms of legislation or are contractual.

Section 10(1)(nE) exemption

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

The exemption in section 10(1)(nE) will still apply to affected executive share schemes that are covered by the old section 8A.

Annexure 3: Hybrid Financial Instruments

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

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

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

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

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

We urge a reconsideration of section 8F or alternatively for the recipient not to be taxed on the receipt of the interest where such interest is deemed not to be deductible by the payer in terms of section and is subject to STC.
(SAICA)

It is accepted that it is easy to create financial instruments which will fall outside the scope of the provisions of sections 8E and 8F. The reason for introducing a fixed 3 year term is to create a clear no-go zone for convertible instruments where the substance of the instruments clearly deviates from their legal form.

The 3 year period has not been extended as more information will have to be gathered to evaluate the concern a possible extension of the period will have on BEE transactions. If the 3-year period for purposes of sections 8E and 8F were to be extended consideration will be given to introduce a symmetrical treatment for the issuer and recipient.

Section 8E

It may happen that in the course of an ordinary commercial transaction a company which has, say, issued redeemable preference shares, assumes the obligation to redeem the shares as part of the restructuring of the company, e.g. prior to its sale. Thus the agreement might simply state that the issuer undertakes to redeem its redeemable preference shares, say, within seven days of the date of signature of the agreement. This means that the preference share is now deemed to have a date of issue on the date of signature, and because the redemption period is less than three years, it becomes an affected instrument.
(SAICA)

The intention is not to apply the provisions of section 8E retroactively, but only from the date that an instrument becomes an affected instrument.

Section 8F

The "date of issue" includes the date on which the instrument becomes convertible. This makes no sense as no deduction will be allowed if the instrument is at the option of the issuer convertible within three years from the date on which it becomes convertible. The words "if these rights are created subsequent to the actual date of issue" should be added.
(SAICA)
The section appears to disallow the interest payments totally where the instrument is convertible within three years. It is suggested that the interest be disallowed only to the extent that the instrument is convertible within 3 years so that equity may prevail. An instrument may be partially convertible within 3 years but the interest on the entire instrument, including that portion that is not convertible within 3 years will be disallowed, in terms of the proposed legislation.
(SAICA)

These comments are accepted. These provisions in its draft form are unintentionally retroactive.

Section 24J

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

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

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

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

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

This amendment has been withdrawn.

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

This amendment has been withdrawn.

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

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

The current proposed legislation seeks to disallow the excess interest in the borrower's hands and to also tax the difference between the cost of the share conversion rights and the issue value thereof. It is believed that the amendments should only disallow the so called "excess" interest incurred by the borrower. Essentially a group of companies should only be allowed a deduction on the "net" amount of the loan.
(SAICA)
The legislation proposes two remedies for the excessive interest deductions, each of which would suffice. The application of both would appear to place the taxpayer in double jeopardy.

(BUSA)

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

Section 64C

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

The general rules will apply to determine the point in time when the deemed dividend arises.

Annexure 4: Deferred Instalment Sales

If the future purchase price is undeterminable, there is in substance no sale. The seller should retain the asset until all economic benefit pass.
(BCSA)

This comment is not accepted. Tax law generally is independent from the accounting treatment of the transaction.

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

This proposal is not accepted. The introduction of the proposal should not be deferred. The Banking Council's concerns are overstated. The proposal is based on widely accepted concepts of case law.

Section 24M

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

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

The connected person test will be withdrawn.

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

Further consideration will be given to this aspect.

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

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

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

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

The provisions of the relevant tax treaties will override South Africa's domestic taxing provisions and have the effect that only business profits attributable to the permanent establishment will be taxed in South Africa.

Annexure 6: Public Private Partnerships

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

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

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

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

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

This comment is accepted. Discussions are ongoing with the JSE and Bond Exchange in order to ensure a smooth transition.

Annexure 8: Stamp Duties

It is submitted that it cannot be administratively efficient, either for the taxpayer or for SARS, to collect insignificant amounts by way of adhesive stamps. We therefore suggest that the proposed R100 limit be increased to cover cases where the duty does not exceed R250 or a higher amount.
(SAICA)

This comment is partially accepted. The R100 limit was based on the assumption that leases can be stamped for only 1 year. However, commercial or residential leases generally are fixed for 1 year and then open ended (i.e., terminate under a notice period). If the period of the lease is open-ended, the lease must be stamped for the fixed period plus 2 years. On this basis the R100 duty exemption will be adjusted upwards to R200.

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

immoveable property at that date of commencement of the lease at the market price.
(SAICA)

This comment is not accepted. Under current law no linkage exist between Stamp duty and Transfer Duty. The proposed stamp duty is 0.5% as opposed to the average of 5% transfer duty. The low rate of stamp duty is unlikely to reach the maximum transfer duty therefore the capping of the amount is not required.

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

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

Annexure 9: Transfer Duty

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

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

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

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

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

The provisions of the relevant controlling body should apply.

Annexure 11: Measures to Enhance Tax Administration

Regulation of tax practitioners

The section to regulate tax practitioners applies only to tax consultants who practice for their own account or in partnership but excludes all employees and directors of incorporated practices, private companies and close corporations since these persons will be advising clients of their employer. Persons who practice in partnership or individually are prejudiced. This deficiency should be rectified.
(SAICA)

Accepted. Although the proposed legislation already covers "Every natural person who for reward provides advice...", without specifying the source of the reward (which in the cases described would be the employer rather than the person obtaining the advice) the proposed legislation will be reworded to make it clear that natural persons will be required to register whether they or their employers are compensated for the provision of their services, etc.

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

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

It could be argued that all Chartered Accountants in public practice provide tax advice as incidental or subordinate to their accounting and audit mandate. Insurance brokers could argue

that they complete some hundreds of tax returns and provide tax advice as incidental or subordinate part of their main business as insurance brokers. Further, there is no reason why insurance brokers/consultants or other persons who provide tax advice should be specifically excluded.
(SAICA)

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

While it is appropriate to exclude lawyers who provide advice in anticipation of litigation, the fact is that most tax counsel at the Bar provide general tax advice and not only in anticipation of litigation.
(SAICA)

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

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

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

The following questions need to be addressed:

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

(SAICA)

The discussion paper on the regulation of tax practitioners that was released in 2002 prompted comments from certain sectors that the educational and experience requirements proposed were too onerous. The concept of setting tax type, or sub-tax type, requirements (e.g. Income Tax and Employees Tax) was also raised by certain commentators. The registration of tax practitioners by SARS has

therefore been proposed to obtain information to properly evaluate these comments and draft future legislation. This information will cover areas such as the nature of the advice or assistance provided, and the tax practitioner's current qualifications and experience. The legislation does not make provision for the refusal of a registration and it is not clear how the registration of the tax practitioner could be used to assess or risk profile his or her clients' returns. The time it will take to register a practitioner will depend on the quality of the data provided in the registration form but should be similar to that for an income tax assessment for an individual taxpayer. Finally, the proposed registration provisions are contained in the Income Tax Act, 1962, and will therefore be subject to the secrecy provisions contained in section 4 of that Act. It is, however, anticipated that legislative authority will be sought to transfer information regarding a tax practitioner's identity, contact details, qualifications, and experience to any regulatory authority for tax practitioners to be established by legislation.

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

No such regulatory authority is proposed in the draft Bill.

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

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

Advance rulings

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

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

Risks could include for example the issuing of incorrect rulings based

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

Although SARS has some experience on the issue of rulings as mentioned above, a formal rulings regime is something that will take time to develop, thus the reason for a more modest approach at this stage. Our past experience will certainly help to lay a foundation but we will still need to "walk" before we can say we can "run" in this regard. As an example advance pricing agreements and product rulings have been excluded from the system.

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

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

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

Points that were accepted included the:

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

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

(SAICA)

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

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

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

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

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

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

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

Accepted.

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

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

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

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

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

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

The proposal that the Commissioner may reject an application to give a ruling on section 103 severely dilutes the benefit of an advance ruling. That section is a discretionary section so if the transaction has already taken place he would, even under the current law, be bound to issue the ruling because he has to exercise his discretion and indicate how that discretion has been exercised.
(SAICA)

Ruling on application of anti-avoidance are a key function of the system (i.e. SARS acceptance of bona fide business reasons and not SA tax driven)
(PWC)

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

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

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

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

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

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

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

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

Not accepted. Exclusions of this type are common in other countries such as Australia, New Zealand and the United States and have proven necessary to ensure the proper functioning of the system and to prevent inefficient use or allocation of limited administrative resources, notwithstanding the presence of other checks and balances. The existence of these exclusions, moreover, has not noticeably affected the application or benefits of the ruling systems in those other jurisdictions.

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

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

application under proposed section 76G(2).

Our main concerns relate to the ability of SARS to retrospectively withdraw the binding private or class ruling. This undermines the very canons of certainty, which the Advance Tax Ruling system is meant to introduce. This provision should be withdrawn.
(SAICA)

Retrospective revocation creates uncertainty and casts doubt on value of system.
(PWC)

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

The provisions of this section attempt to strike an appropriate balance between competing interests and concerns, including the need to protect a taxpayer's reasonable reliance upon binding rulings that have been issued and the need to ensure that the tax laws are enforced in a fair and impartial manner that results in a level playing field for all members of the taxpaying community. It is well established both in South Africa and other jurisdictions that a taxpayer is not entitled to a windfall simply as a result of an erroneous interpretation of law by the tax authority and that the government is generally entitled to correct such errors and assess the amount of tax properly due at any time within the applicable statute of limitations. See generally *Carlson's Investment Share Block (Pty) Ltd. v. CSARS*, 2001 (3) SA 210 (W); *COT v. Astra Holdings (Private) Ltd t/a Puzey & Payne*, 66 SATC 79; *Commissioner of Inland Revenue v. McNab*, (1984) 6 NZTC 61; *Automobile Club of Michigan v. Commissioner of Internal Revenue*, 383 U.S. 180 (1957).

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

the proposed amendment, an applicant's reasonable reliance is protected unless it is outweighed by the harm to the country and the public interest.

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

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

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

Not accepted. Section 76O(4) provides that the Commissioner may consider, prior to publication, any comments and proposed edits and deletions to the draft of the ruling, edited for publication, that the Commissioner must send to the taxpayer. While the taxpayer's reasonable and legitimate concerns about confidentiality will be given consideration, the taxpayer cannot be given an effective veto over the content of the published ruling without potentially compromising the intelligibility of the published rulings and the underlying rationale for publication.

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

Partially accepted. Section 76O(4) will be amended to require that the Commissioner "must consider" the taxpayer's comments.

We would question whether an additional category of private rulings could not be introduced which would not be made public. Such non-published rulings would protect the intellectual property of the applicant for the ruling.
(SAICA)

The publication of rulings may expose the applicant's intellectual property in the transactions or structures they have designed.
(PWC)

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

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

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

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

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

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

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

Statistics from Canada for 1999 show that 18% of rulings requests were processed within four weeks, 34% were processed within eight weeks, and 56% within 12 weeks. Statistics from New Zealand for 2001 show a similar pattern: 18% of rulings were processed within four

weeks, 31% within eight weeks, and 65% within twelve weeks. (By way of comparison, the Canadian ruling system has been in place for more than a quarter century and is staffed by approximately 90 full-time lawyers and accountants.)

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

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

Not accepted. Certain issues, such as the classification of individuals as employees or independent contractors, are inherently and intensely factual. Experience in other jurisdictions has shown that the ruling function is not well suited to addressing such issues. These concerns have even been expressed in jurisdictions like India that have taken the rare step of establishing an independent ruling authority with the powers of a civil court, including discovery and inspection, examinations under oath, and the issuance of summonses and subpoenas. See, for example, *Hyder Consulting Ltd. v. CIT* 236 ITR 640, which held that whether reimbursement of actual expenses to sub-consultants should be subject to withholding or not constituted "a factual issue that will have to be examined at the time of assessment of the income of the applicant".

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

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

Annexure 12: Share for Property Transfers

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

The anti-avoidance proposals are targeted at the direct and indirect cross issue of shares (and notes). At issue is the scope of indirect cross issues within the ambit of these anti-avoidance provisions. The criticisms admittedly note that the use of the terms "transaction, operation or scheme" provide little assistance in limiting the ambit of the prohibited indirect cross-issues, the proposed emphasis on the taxpayer's "sole or main purpose of avoidance" leaves much to be desired. Subjective avoidance intent tests are difficult to enforce, especially since the parties often have the power to cloud their real tax avoidance intent behind artificial commercial labels. That said, consideration is being given toward narrowing the scope of indirect cross issues through other means.

Shares issued in exchange for shares or debt are excluded from the proposed section 24B as it is considered that this provides an easy opportunity to artificially inflate the value of both sets of shares. As it would be practically impossible to inflate the price of listed shares or debt instruments the exclusion of shares should exempt listed shares.
(SAICA)

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

The general rule provided base for property acquired with shares is welcomed. However, this rule should be made retroactive for

all share-for-property transactions dating back to 1 October 2001 (i.e., when CGT was enacted).
(PWC)

The general rule will be effective for years of commencement ending on or after the date of promulgation. The request to make the proposal retroactive back to capital gains tax implementation date of 1 October 2001 is rejected. The rule does not simply relate to the capital gains tax provisions, but also to depreciation and trading stock (aspects of the Income Tax act that greatly predate the 1 October 2001 date).

The interrelationship between the anti-avoidance rules of section 24B (cross-issues) and the company reorganisation relief rules is unclear. The relationship should also be clarified to ensure that the intra-group rules override the anti-avoidance rules of section 24B.
(PWC)

The request is partially accepted. The interrelationship of the company reorganisation provisions and section 24B needs clarification. The company reorganisations provisions should generally override the general market value tax cost rules of section 24B(1). However, the anti-avoidance cross issue rules of sections 24B(2) and (3) should generally override the company reorganization provisions (especially the intragroup relief provisions because cross issues create the biggest anti-avoidance concerns in intragroup settings).

Annexure 13: Technical and Textual Amendments

Section 10(1)(d)(iii)

The Bill should amend the date by which organisations and similar bodies established to promote the common interests of persons carrying on any particular kind of business profession are required to reapply for tax exemption. It is untenable that taxpayers should be required to reapply for tax exemption by 31 December 2004 without knowing the conditions which must be met in order to secure exemption from income tax

It is therefore submitted that the date by which the affected organisation should reapply for tax exemption should be extended until 31 December 2005 or at least a period of 6 months after the date upon which the conditions required under the section have been promulgated in the regulations to be issued under the Income Tax Act.
(SAICA)

Consideration will be given to extend the cut-off date for reapplication for exemption.

Section 11C

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

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

Section 25B

We have grave concerns regarding the proposed changes to this subsection as they will result in the conversion of both exempt amounts (e.g., foreign inheritances) or capital amounts (proceeds from the disposal of a capital asset) received by the trust into income of the beneficiary.
(PWC)

This comment is accepted. The provision has been reworded.

Section 45(4)(b)

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

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

Eighth Schedule: par 56(2)(b)

Whilst this new proviso dealing with capital gains and losses is welcomed to ensure symmetry, the problem is not entirely addressed in that if the acquiring person has the gain included in income as opposed to aggregate capital gain or aggregate capital

loss, the creditor will still be denied the deduction of the capital loss.
(SAICA)

This aspect is already catered for in current legislation under paragraph 56(2)*(c).*

Section 64B

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

This comment is accepted. The current provisions in the IT Act dealing with the indirect tracing of profits will be retained.

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

This comment is accepted.

Section 66

The proposed amendment creates uncertainty. Section 67 requires the person to register when he or she becomes liable for taxation, whereas section 66 requires any person in receipt of gross income to submit a return. Where that person, for example, then earns gross income that will be exempt or the final taxable income is less than the threshold, he or she must submit a return, but has no duty to register. Section 66(1B) should contain the following exemptions:

- **if the gross income consists solely of dividends exempt under section 10(1)(k); and**
- **if that person is not required to register under the provisions of section 67.**

(SAICA)
The income tax return registration reporting requirements for foreign parties should be eased or eliminated if those persons solely receive tax-exempt interest. Current requirements for non-

residents to register and file returns, even where earning only exempt income is at odds with encouraging portfolio investment.
(PWC)

This comment is accepted. The annual notice published by the Commissioner in terms of section 66 of the IT Act will deal with this issue.

Annexure 16: CGT Withholding: Non-Resident Sellers

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

This comment is noted for further attention.

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

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

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

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

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

The period of time within which the withholding tax should be paid should be compared and aligned with the royalty withholding tax which is payable within 14 days as well as PAYE which is payable within 7days.

A major concern we have is the transfer of the onus from the Commissioner to the purchaser who now has to determine whether the seller is a non-resident for taxation purposes. This is not an easy provision to determine and the penalty for the purchaser not complying is severe.

(SAICA)

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

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

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

The Commissioner's discretion in sub-section (9) should be subject to objection and appeal.
(SAICA)

This comment is accepted.

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

If the estate agent has not informed the buyer, the agent will also be held liable.

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

(SAICA)

Consideration will be given to introduce a time limit.

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

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

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

This comment is not accepted. See the final comment in this section in this regard.

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

The comment is not accepted. A purchaser is only liable if the purchaser knows or should reasonably have known that the seller is not a resident and fails to withhold the tax.

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

This aspect will be handled administratively.

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

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

4 General

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

This matter does not form part of the Bill under consideration. The

urban development zone tax incentive is already wide ranging. The incentive covers all construction costs related to the erection, extension, addition or improvement of commercial, residential or industrial buildings. These costs include the following:

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

The urban development zone tax incentive is available to any taxpayer (including individuals, companies, close corporations and trusts as well as partners in a partnership), who erects or constructs a new building or carries out improvements on an old building. The taxpayer must use the new building or improvement solely for purposes of that taxpayer's trade. Thus the buildings must either be used for business purposes or contribute to the increase of rental stock. Stated differently, the National Treasury does not want to incentivise private consumption through the tax system.

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

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

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

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

Prepared by SARS and the National Treasury