



**NATIONAL
TREASURY**



Office
Law Administration

Enquiries
F Tomasek

Telephone
012 422 5146

Facsimile
012 422 5195

Room
AG

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**THE CHAIRPERSON OF THE
PORTFOLIO COMMITTEE ON FINANCE
(PCOF)**

**South African Revenue
Service**

299 Bronkhorst Street,
Nieuw Muckleneuk, Pretoria
P O Box 402, Pretoria, 0001
SOUTH AFRICA
E-mail jdelarey@sars.gov.za

**RESPONSES TO WRITTEN REPRESENTATIONS BY ORGANISATIONS
TO THE PORTFOLIO COMMITTEE ON FINANCE ON THE DRAFT
REVENUE LAWS AMENDMENT BILL, 2005 (the Bill)**

1 Introduction

As indicated to you during the hearings on the above-mentioned Bill on 20 and 24 October 2005, 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:

| | |
|-------|--------------------------------------------------|
| ALP | Aids Law Project |
| BASA | Banking Association South Africa |
| BUSA | Business Unity South Africa |
| IPO | Independent Producers' Organisation |
| LOA | Life Offices' Association of South Africa |
| MCSA | Methodist Church of Southern Africa |
| NPC | Non-Profit Consortium |
| PWC | PricewaterhouseCoopers |
| SACC | South African Council of Churches |
| SAICA | South African Institute of Chartered Accountants |

2 Consultation

SARS and the National Treasury placed four batches of draft legislation as well as explanatory notes on their websites after the drafts were prepared during the period 28 July 2005 to 21 September 2005. After public comments were considered and incorporated where appropriate, updated versions of the Bill and explanatory memorandum were submitted to your committee on 3 October 2005 and again placed on the SARS and National Treasury websites. This, therefore, occurred 10 working days before the informal briefing on the draft Bill on 18 October 2005. A last few draft amendments were finalised, submitted to the Committee and published on 17 October 2005.

3 Responses to specific issues raised in representations by commentators to the PCOF

The responses will be dealt with under the following headings:

| <u>Topic</u> | <u>Page</u> |
|-----------------------------------------------------------------------|-------------|
| ▪ Public benefit organisations | 3 |
| ▪ Taxation of medical scheme contributions and other medical expenses | 9 |
| ▪ Transfer duty | 15 |
| ▪ Estate duty | 16 |
| ▪ Further income tax amendments | 17 |
| ▪ Donations tax | 44 |
| ▪ Secondary tax on companies | 45 |
| ▪ Provisional tax | 46 |

| | |
|-----------------------------|----|
| ▪ Taxation of capital gains | 47 |
| ▪ Customs duties | 51 |
| ▪ Stamp duties | 52 |
| ▪ Value-added tax | 52 |
| ▪ General | 56 |

PUBLIC BENEFIT ORGANISATIONS

3.1 Tax rebate for PBOs – section 6(3) of the Income Tax Act

We question the timing of the proposed introduction of section 6(3). Is it necessary to introduce the rebate now, given that it is likely to affect most PBOs for the first time in the year ended 28 February 2008? Would not next year be the right time to legislate the rebate, based on next year’s Budget?

(SAICA)

Where a PBO does produce taxable income, the introduction of a rebate equivalent to that granted to individuals of 65 years and older seems to unnecessarily complicate the affairs of the public benefit organisation. It is recommended that such organisations, where exceeding their permissible trading rules, be subject to tax at the normal corporate rate on such excesses, without the application of rebates.

(BASA)

In terms of proposed amendments to Section 6 of the Income Tax Act each PBO will be able to deduct from the normal tax payable a rebate of R10 800. This discriminates against denominations which have opted for a group PBO registration, illustrated by this example:

Assume a denomination has 100 individual congregations each earning “unrelated” trading taxable income (from renting manses) of R37 200 pa. This denomination opts for a single group PBO registration. The total group unrelated trading taxable income is R3 720 000 at an assumed tax rate of 29% = R1 078 800 less a single rebate of R10 800 means net tax payable of R1 068 000.

Alternatively if each congregation were to register separately as a PBO each would have unrelated trade of R37 200 which means there is no tax payable.

(MCSA)

Larger PBOs and groups registered as a single entity are most likely to be adversely affected by the change from the current 15% of gross receipts *de minimis* exemption for unrelated trading. These entities will only be entitled to a single rebate, while a collection of similar bodies that register independently will enjoy multiple rebates.

Consequently, we would propose that a variable tax rebate be introduced for PBOs that takes into account the size of an organisation (or group).

(SACC)

These proposals are accepted in part. The concept of a rebate will be withdrawn. In order to assist PBOs where trading income unrelated to the objective of the PBO constitutes a small part of the total income of the PBO, a *de minimis* threshold will be introduced. The exemption threshold for gross income which would otherwise have been taxable will be the greater of R50 000 or 5% of the PBO's total receipts and accruals. This threshold will ease the administrative burden on PBOs in acknowledgement of their public character.

We would propose that the proposed section 30(3A), requiring the independent registration of group members that earn taxable income, be deleted.

(SACC)

This proposal is accepted and the required independent registration of group members will be withdrawn.

We do not consider that a single rebate for all PBOs is appropriate. It would be appropriate to introduce a special tax rate for PBOs equal to, say, the company rate.

(SAICA)

Since the amendments to Section 6 make a provision for a uniform rebate for all PBOs, regardless of whether they are charitable trusts, Section 21 Companies or voluntary associations, there should be a uniform rate of taxation for all PBOs regardless of whether they are charitable trusts, Section 21 companies or voluntary associations.

(NPC)

These proposals are accepted as far as the single rebate is concerned. The proposal of a uniform tax rate for PBOs is noted as a matter requiring further research.

3.2 Exemption of receipts and accruals of PBOs – section 10(1)(cN)

The wording of Section 10(cN)(ii) in the amendment requires that income derived from business be for the “sole” purpose of funding the “sole” objective of the organisation. It seems inappropriate and unnecessary to refer always to the sole objective of a public benefit organisation instead of to its objects or objectives.

It is inappropriate because a public benefit organisation may have as its “sole objective” the carrying on of one or more public

benefit activities and those public benefit activities may not be so closely related that it is accurate to describe them as one objective. For example, an organisation may have the objectives of promoting a particular religious faith as well as providing a home for orphans.

(NPC)

This proposal is already addressed in existing legislation. Paragraph (b) of the definition of “public benefit organisation” in section 30, already provides for the sole object of a PBO to consist of the carrying on of one or more public benefit activities.

It is submitted that the words “integral and directly related to the sole object of the organisation” in (ii)(aa)(A) of the draft should be replaced by the words:

“incidental to the objectives of that public benefit organisation.”

It is submitted that the requirement that business activities be integral and directly related to the organisation’s objectives is too demanding if the words are to be strictly interpreted. The effect would be to discourage the use of an organisation’s income earning potential and disincentivise efforts to become financially sustainable.

(NPC)

This proposal is not accepted. The test is based on existing wording. The proposed wording would arguably exempt trading that is merely connected with or results from the objects of a PBO and would expand the scope of exempt trading activities too far. The statement that taxation of such trading would disincentivise efforts to become financially sustainable is misleading as the profits would simply be taxed, as is the case for any other business.

It is submitted that the words “carried out or conducted on a basis substantially the whole of which is directed towards the recovery of cost” should be omitted from (ii)(aa)(B) of the proposed amendments. It also contradicts the requirement of not causing unfair competition to taxable entities. There is nothing wrong with a public benefit organisation making profits.

(NPC)

This proposal is not accepted. The test is based on existing wording. The apparent contradiction between carrying on activity on a cost recovery basis and not competing unfairly may be resolved by, for example, considering the case where health care is provided to a community that cannot afford commercial care. In this case no question of unfair competition arises and it is appropriate that any charge for care be limited to cost recovery. On the other hand, where an organisation is active in the commercial environment it should be treated as a taxable enterprise.

The proposed taxation of unrelated trading income will require local churches and groups of societies of the MCSA to maintain separate accounting records for each type of trading activity and to accept responsibility for any possible tax liability. They will have to be registered separately with SARS. There are 330 local churches and over a thousand societies within the MCSA. There also are local churches and groups of societies which cover South Africa and another Southern African country – thus further complicating the administrative implications of such a route.
(MCSA)

Individual “branches” of a single juristic entity cannot be registered separately.

3.3 *Deductible donations to PBOs – section 18A*

Where a PBO has not complied with the requirements for tax exemption and notice to remedy the default is given, we suggest that there be a requirement in section 18A for the Commissioner to publish such notice so that the taxpaying public, as future donors, are aware of this invalidation, to avoid them making donations in the belief that their donations will qualify for deduction.

(SAICA)

The proposal is not accepted. Section 4 already provides that the Commissioner may publish a list of approved PBOs for purposes of section 30 and section 18A. The list will be updated when a PBO loses its section 18A status.

3.4 *Public benefit organisations – section 30*

We propose that the investment limitations applicable to PBOs should be revised in conjunction with the trading rules. Currently, a PBO is prohibited from investing in the shares of private companies. Given that, according to the amendment, PBOs will be allowed to carry on trading activities more extensively than before, there is no reason why a PBO should not choose to carry out its trading activities in a separate company set up for this purpose where that separate company will be fully subject to taxation.

(SAICA)

The proposal is accepted in part. Where trading activities of a PBO are carried on through a wholly owned subsidiary, the holding of shares may be acceptable.

The narrowing of the approved investments a public benefit organisation may invest in is clearly untenable and creates unfair playing fields between collective investment schemes (CISs), banks and other types of investments like insurance policies.
(SAICA)

This amendment has been withdrawn.

We propose that the legislation be amended so that a PBO would not lose its tax exempt status when it invests in the shares of a private company, as long as the dividends received are utilised for a public benefit purpose.
(SAICA)

The proposal is not accepted as it is not a prudent investment. Section 30(3)(b)(ii) provides for the investment of surplus funds which are not utilised to conduct public benefit activities. It would not be acceptable for a PBO to utilise funds to invest in general business undertakings.

We believe that PBOs could still be afforded greater scope to raise funds from trading activities without unduly harming commercial enterprises or causing significant economic distortions.
(SACC)

If the government is reluctant to relax the restrictions in a general way by increasing the taxation threshold or the *de minimis* rule, then we would urge the introduction of new categories of permitted trading.
(SACC)

The exemption threshold for gross income which would otherwise have been taxable will be the greater of R50 000 or 5 per cent of the PBO's total receipts and accruals.

We welcome the fact that the amendment does away with the all or nothing approach to regulating income generating activities. The proposed amendments would in some cases provide for a significantly lower threshold on exempt trading income compared to the current provisions. We believe that the scope to earn up to 15% of gross receipts from non-related business or trading activities, without paying tax, should be retained.
(NPC)

This proposal is accepted in part. It should be noted that the existing R25 000 or 15% threshold is a cumulative threshold that is reduced by other exempt trading activities. The R50 000 or 5% threshold now

proposed is not reduced by other exempt trading activities. As is noted, it is also proposed that exceeding the threshold no longer results in a PBO losing its exempt status for all its activities.

It is not obvious why SARS should wish to restrict public benefit organisations from trading if their trading income is for the purpose of funding their public benefit activities.
(NPC)

From a policy point of view the reason is that exempt institutions should not be in a position to compete unfairly with taxable entities conducting the same trading or business activities. Taxable entities may have to charge higher prices in order to pay tax on their profits and as a result may lose market share to tax exempt competitors.

We would urge that any rent accruing from a dwelling that is owned by a religious community for the purposes of housing a religious leader who officiates at a place of public worship, but which is not being used for that purpose for a period of time be designated as permitted trading income.
(SACC)

The Income Tax Act should provide, as a generic exemption, rental income from manses registered in the name of the PBO, in a manner similar to the Property Rates Act. If this is not practical the MCSA should apply for Ministerial approval for such rental received from letting manses to be regarded as exempt in terms of Section 30(3)(b)(iv)dd.
(MCSA)

The R50 000 or 5% threshold proposed will accommodate nominal income of this nature.

It is with some concern that we note there are no amendments to Section 30 that make the distinction between smaller and larger PBOs, or provide for simpler registration procedures and reporting requirements for smaller PBOs, and no attempt to align the reporting requirements with the reporting requirements in terms of the Non-profit Organisations Act of 1997. We would be more than willing to present suggestions for simplification if and when required.
(NPC)

These proposals are noted. No amendments may be required as the procedures could possibly be dealt with administratively.

3.5 *Assets used to produce exempt income - paragraph 64 of the Eighth Schedule*

The proposal would limit a PBO's exemption from Capital Gains Tax to capital gains accruing from the sale of assets used exclusively to carry out public benefit activities. We believe this

to be consistent with the logic of the partial taxation policy reflected in the Bill. However, we are concerned about its impact in the case of property that is used for more than one purpose, whether simultaneously (e.g., a religious training centre that hosts conferences out of term) or consecutively (e.g., a manse that is let out for several years during the tenure of a minister who owns her own home). We would propose that the test be primary use, rather than exclusive use.

(SACC)

A, we believe unintended, consequence is that where any building becomes subject to partial taxation because it is used for unrelated trading, such building automatically becomes subject to CGT in terms of the Act. This also will have major implications for the MCSA in that such buildings will have to be valued in terms of complex legislation and the payment of CGT will have to be made when they are sold.

(MCSA)

These proposals are accepted. The concept of the exclusive use of an asset will be replaced by the concept of the use of substantially the whole of an asset in carrying on a public benefit activity.

TAXATION OF MEDICAL SCHEME CONTRIBUTIONS AND OTHER MEDICAL EXPENSES

3.6 *Medical expenses – section 18*

The term “dependant” should be defined. An example can be taken from the Workmen’s Compensation Act, which defines “dependants” to include widows, children, parents, other family members and anyone wholly or partly dependent upon the worker for the necessities of life.

(SAICA)

In terms of the Medical Schemes Act, ‘beneficiary’ is defined quite broadly to mean:

- a) the spouse or partner, dependent children or other members of the member's immediate family in respect of whom the member is liable for family care and support; or
- b) any other person who, under the rules of a medical scheme, is recognised as a dependant of a member.

(ALP)

The proposal is accepted, the term “dependant” will be defined in the Income Tax Act with reference to the definition of “dependant” in the Medical Schemes Act. Medical scheme membership contributions for all “dependants” of the taxpayer will therefore qualify for tax deductible or tax-free treatment, subject to the monetary caps. The definition will not be expanded for other medical expenses due to the policy objective of encouraging wider medical scheme coverage. The tax-

free employer provided treatment has already been expanded as the initial proposal provided that only the employee treatment would be tax-free, but the revised amendment includes tax-free treatment for the taxpayer, his/her spouse and their children.

In view of the realities of South African society, where taxpayers often maintain family members and others who are not spouses, children or stepchildren, we suggest that the payments for medical services rendered and medicines supplied to the taxpayer, his/her spouse and any dependants should be taken into account.

(SAICA)

The benefit of deductible medical expenses should extend to the taxpayer and all of his/her dependants - and not limited to immediate beneficiaries (spouse, child/ren, 'child/ren of spouse'). This is particularly important given that the Discussion Document itself is hopeful that the proposed reforms will result in a broader class of dependants being registered, such as 'aging parents and other relatives'.

The taxpayer must be able to claim for the medical expenses on behalf of all his/her beneficiaries. Regulatory and oversight system already exists within schemes (with rights of recourse to the Council for Medical Schemes) to ensure that taxpayers do not claim on behalf of beneficiaries that do not exist or are in fact not dependant on the taxpayer.

(ALP)

These proposals are not accepted. Expanding the category of tax deductible medical expenses (other than medical scheme contributions) will be contrary to Government's overall health objectives of expanding medical scheme coverage.

It is imperative that the limits of R500, R500 and R300 in section 18 and the Seventh Schedule be adjusted annually to ensure that increases in medical aid tariffs and cost of medical expenses are taken into account. The annual adjustment should be based on medical inflation versus normal CPIX to ensure that the cap amounts remain in line with medical inflation.

(SAICA)

The proposal is noted. Consideration of adjustments to these caps will be given annually after consultation with the medical schemes industry and the Council for Medical Schemes as indicated in the "Discussion document on the proposed tax reform relating to medical scheme contributions and medical expenses".

Consideration will be given to defining the monetary cap based on the age of the beneficiary i.e., a higher cap for an adult dependent and a

lower cap for a child dependent to avoid family splitting. The administrative implications of such a measure will also be taken into account.

We are concerned about the extremely short deadlines imposed for public comment on both the 'Discussion Document on the Proposed Tax Reforms Relating to Medical Scheme Contributions and Medical Expenses' ("Discussion Document") and the Bill.

(ALP)

The discussion document was released on 1 September 2005 and comments were invited and had to be submitted on or before 21 September i.e. 3 weeks of consultation. Legislation was drafted based on more than 40 comments received and further comments have been considered, including the Aids Law Project's comments (presented to the PCOF on 24 October).

We believe that the current proposals should not be viewed in isolation from broader health policy reforms currently underway.

(ALP)

The Department of Health has been consulted and broader health policy objectives were taken into account. However, it is important to note that tax changes can only make a limited contribution toward achieving improved access to better healthcare services.

The clauses of the Bill dealing with medical contributions and expenses should be jointly considered by the Portfolio Committee on Health and the Portfolio Committee on Finance. A joint committee is necessary given that the proposals do not only have tax implications for individual taxpayers.

(ALP)

The proposed amendments constitute a tax reform and should therefore be considered by the Portfolio Committee on Finance. They were discussed with the Department of Health just as other tax proposals impacting on policy objectives of other government departments are discussed with those departments.

The rationale for choosing Option 1B must be explained by the NT (especially if it leads to an increase in the current tax subsidy for middle and high income earners).

(ALP)

Option 1B was selected based on the fact that it meets objectives set out in the "Discussion document on the proposed tax reform relating to medical scheme contributions and medical expenses". One of these objectives is that it brings about a more equitable system favouring persons earning between R35 000 and R200 000 per annum. This

option is also supported by the majority of the parties who commented on the discussion document.

While industry sources estimate the current subsidy to be in the region of ZAR 10 billion, according to the National Treasury, using Option 1A would cost an additional ZAR 3.7 billion in the form of tax subsidies. In other words, we need to be convinced that the proposed increase (by ZAR 3.7 billion) in the current tax subsidy is justifiable. We have great difficulty in understanding why it is necessary to spend more in the form of the proposed increase in tax subsidies on an already very highly subsidised and insured section of our population.

(ALP)

The highest cost estimate of this proposal will be approximately R2,8 billion whilst delivering financial benefits to low and middle-income earners. (See figure 2 on page 12 of the discussion document). Persons earning less than the tax threshold cannot benefit from a tax deduction, as they do not pay tax and the requested direct subsidy cannot be addressed through the tax system.

The tax threshold and its effect on low-income earners and elderly people who fall below it must be urgently reviewed.

(ALP)

The NT and NDoH need to investigate ways of creating other incentives for very low-income earners (less than ZAR 2971) and the elderly (who earn less than ZAR 5000) to join medical schemes. In particular, considering making a state subsidy available to these groups. A single funding mechanism should also be considered.

(ALP)

These proposals fall outside the scope of the proposed amendments. A tax reform providing a benefit to taxpayers by way of a tax deduction can by its very nature not address the affordability concerns of persons who do not pay tax.

Section 18(1)(d) provides for a deduction on “any expenditure necessarily incurred and paid by the taxpayer in consequence of any physical disability suffered by the taxpayer, his or her spouse or child or stepchild”.

It is unclear why ‘mental disability’ is not included alongside physical disability. We recommend that all forms of disability should be included.

(ALP)

Mental illness is already covered by the definition of “handicapped person” and the taxpayer would be able to claim contributions and

expenses in terms of section 18(2)(b) where the taxpayer, spouse, or child is a handicapped person.

We are worried about providing a rebate in all circumstances to a taxpayer who is making a contribution to a foreign benefit fund. In our view, in order to ensure that requisite regulatory oversight is exercised over foreign benefit funds, at a minimum, the section should ensure that a contribution to foreign benefit fund is only tax deductible if the fund complies with the MSA or it has been exempted from complying with some or all of the provisions thereof (and not just similarly regulated in another country). , the benefit should extend to all beneficiaries and not limited to the taxpayers immediate beneficiaries. The benefit applicable to a taxpayer that contributes to a foreign benefit fund must be carefully considered and re-drafted.

(ALP)

This is an existing provision in the Income Tax Act and does not form part of the proposed amendments. Although the concern raised relates to regulatory rather than tax issues, it has been noted for further review.

The word ‘step-child’ should be deleted and replaced with ‘child/ren of spouse’. The former is derogatory and an affront to the dignity of a child and his/her parent and/or caregiver. This applies to all references to ‘step-child’ and ‘step-children’ as it appears in the Bill.

(ALP)

This proposal is accepted. The legislation will be amended to refer to the taxpayer, his/her spouse and their children.

Section 18(2)(b) provides “... where the taxpayer, his or her spouse, child or stepchild is a handicapped person, the sum of the amounts ...”. The drafters have in error used the phrase ‘handicapped person’. This should be replaced with ‘person with disability’ in line with the earlier wording of the Bill.

(ALP)

The phrase “handicapped person” is an existing phrase and is defined in section 18(3) of the Income Tax Act. By replacing the concept “person with disability” for “handicapped person” in the definition of handicapped person, the scope of deductible expenditure in consequence of physical disability will be reduced. The concept of “handicapped person” versus “disabled person” will be considered as part of future Budget proposals.

3.7 Contributions to medical schemes – Seventh Schedule

In view of the realities of South African society, where taxpayers often maintain family members and others who are not spouses, children or stepchildren, we suggest that the payments for medical services rendered and medicines supplied to the taxpayer, his/her spouse and any dependants should be taken into account.

(SAICA)

The benefit should extend to all the beneficiaries of the employee and not limited to “spouse, child or step-child”.

(ALP)

These proposals are not accepted. Expanding the category of tax deductible medical expenses (other than medical scheme contributions) will be contrary to Government’s overall health objectives of expanding medical scheme coverage.

The term “dependant” should be defined. An example can be taken from the Workmen’s Compensation Act, which defines “dependants” to include widows, children, parents, other family members and anyone wholly or partly dependent upon the worker for the necessities of life.

(SAICA)

The proposal is accepted in part. The legislation will be amended to reflect the definition of “dependant” as defined in the Medical Schemes Act as part of qualifying medical scheme contributions.

The tax free benefit is premised on the employer “doing the business of a medical scheme”. The question is: what if it is not doing the business of a medical scheme, either according to the Council, the employer or a Court of law. No provision is made for such a possibility. The provision of relevant health services off site, irrespective of whether it falls within the definition of doing the business of a medical scheme or not, should be tax exempt.

(ALP)

This proposal is accepted. The medical treatment provided in terms of a scheme or programme by the employer, which does not constitute the carrying on of the business of a medical scheme, will not be a taxable fringe benefit to employees who are not members of a registered medical scheme.

The proposed paragraph 12B(3)(a)(ii) provides that “all employees of that employer are entitled to participate equally in that scheme or programme”. We disagree. The amendment should insist on equity in access not equality. For example, a worker who belongs to a medical scheme should NOT have access to employer-funded services on or off site.

(ALP)

This proposal is accepted as far as off-site medical services provided by an employer is concerned and will be incorporated in the proposed legislation.

Treatment / services provided off-site by employers should not be limited to prescribed minimum benefits but be extended to “relevant medical services” as defined in the Medical Schemes Act.

(ALP)

This proposal is not accepted. This requirement is aimed at containing the cost to the fiscus and at limiting the scope for abuse.

TRANSFER DUTY

3.8 Refunds – section 20

A taxpayer should not be denied the refund because it was made in accordance with practice generally prevailing, which is subsequently proved to be contrary to the law. There should be no reason why the taxpayer who had paid in terms of practice generally prevailing but having not taken the matter to court should not benefit from the decision of the court and obtain a refund of tax overpaid.

We can understand the need for the five year limitation on the refund. However, if tax is determined to be underpaid, all overpayments from such date should be allowed to be refunded to the taxpayer in order to ensure that there is equity.

(SAICA)

These proposals are not accepted.

In the case a payment was made where there is no practice generally prevailing or contrary to such practice a refund may be made if the Commissioner receives the claim for a refund within five years from the date of acquisition of the property.

Where a payment was made in terms of practice prevailing, a refund can only be made if the taxpayer lodged an objection in terms of

section 18 of the Transfer Duty Act. A person needs to object in order to protect his/her rights.

The proposal has, however, highlighted the need to introduce a provision that limits the collection of additional tax after five years from the date on which it became payable, absent fraud, non-disclosure, etc. to ensure closure for both taxpayers and SARS, as well as consistency with other fiscal legislation.

ESTATE DUTY

3.9 *Definition of farming value - section 1*

No justification is provided for reducing the market value by 30% in all cases in order to arrive at the “farming value”.

The use of 30% will not take into account all prevailing market conditions, the location of the property, availability of water and the nature of farming conducted.

(SAICA)

Productive value is assumed to be market value less 30%. However productive value will be one of the determinants of market value, as will be alternative use, zoning, subdivision and many other variables. Land bank values may well have been influenced by the Land bank’s role as a provider of credit, and valuation for security purposes, but for the purposes of Estate Duty, there does not appear to be justification for the 30% valuation reduction for farming operations.

(BASA)

By using the fair market value of the property as a basis of valuation the prevailing market conditions, location and suitability of the property for farming will be taken into account.

In recognition of the fact that Land Bank values have consistently been lower than the market value of the property a reduction of 30 per cent of the market value is proposed. This is considered to be a reasonable reflection of the farming value of property on which farming undertakings are being carried on.

The policy of reducing the market value of farming property by a fixed percentage to determine farming value was raised with Agri South Africa, who agreed that the proposed 30 per cent reduction was reasonable.

FURTHER INCOME TAX AMENDMENTS

3.10 *Definition of “beneficiary” – section 1*

The definition of “beneficiary” states “... a person who has a vested or contingent interest”. As the term “contingent” is in itself often open to interpretation, we suggest that the term “discretionary” should be used.

(SAICA)

This proposal is not accepted. A beneficiary has no discretion to vest income or assets of a trust in him/herself. The discretion rests with the trustees of the trust. The concept of a contingent right is used in the Income Tax Act, e.g. in section 7(5) and in paragraph 80 of the Eighth Schedule.

One of the main principles applied in the taxation of trusts and beneficiaries in South Africa is the differentiation between a vested and discretionary beneficiary. The proposed definition applies unless the context of the provision indicates otherwise. We do not see any need for the proposed amendment as it will either remain ineffective or confuse the issues further.

(SAICA)

The inclusion of a person with a “contingent” interest in a trust as a beneficiary could have the effect that such beneficiary may be taxed in certain circumstances, e.g. under section 25B. The introduction of “contingent beneficiaries” seems to serve no purpose.

(BASA)

These proposals are not accepted.

The amendment is in line with the practice that has always been followed by SARS. The purpose for introducing the definition is to put it beyond doubt that a beneficiary includes contingent beneficiaries in response to a recent Tax Court case where it was held that a beneficiary only includes beneficiaries with vested rights.

3.11 *Definition of “dividend” – section 1*

In order to exclude capital profits for STC purposes based on the market value of assets on 1 October 2001, the definition of “dividend” refers to “...the market value of that asset as contemplated in paragraph 29 of the Eighth Schedule”. Clarity is needed as to whether it is necessary that the market value must have been determined by 30 September 2004.

(SAICA)

The effect of the amendment is that it makes the valuation of assets compulsory whereas the legislature did not intend to make the performing of valuations compulsory but optional for

taxpayers.
(SAICA)

The proposed amendment to the definition does not in any way change the concept of applying a market valuation, which was clarified in the legislation in 2003.

It should be noted that the Explanatory Memorandum to the 2003 Revenue Laws Amendment Bill (clause 58(i)) stated that: "As part of the *quid pro quo* for the extension of the deadline for the preparation of valuations for CGT purposes, the proposal makes it clear that the deadline will also apply to valuations for the purposes of the exemption of the distribution of capital profits from STC."

3.12 *Definition of "group of companies" – section 1*

It has come to our attention that some taxpayers have inadvertently fallen into the section 45 'trap', having originally formed part of a group, then dropped below the, then, 75% requirement, only now to again form part of a group when the holding requirement drops to 70%.

We request that consideration be given to applying the reduction to 70% with retrospective effect, in order that taxpayers who pursued their BEE initiatives, in pursuance of government objectives, early are not unduly penalised.

(PWC)

The proposal is not accepted as this would be unfair towards companies who refrained from entering into certain transactions that were not covered by the group relief rules. It is proposed that the amendment becomes effective from 8 November 2005 (the date of tabling of the Bill).

3.13 *Definition of "spot rate" – section 1*

The terminology used to define the spot rate is ambiguous and open to various interpretations. It should rather state that "spot rate means the quoted exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of currency".

(SAICA)

The proposal is accepted, but the concept of an "appropriate" quoted exchange rate will be retained. This is intended to cater for differences between buy and sell rates, specific transactions where the actual spot rate on the date of the transaction is to be used, and translations of amounts in foreign currency to Rand where the exchange rate quoted by any authorised foreign exchange dealer for that day will be acceptable.

3.14 *Definition of “resident” – section 1*

The problem with the effective date of the amendment to the time-based test to determine tax residence is that if the person became a resident on 28 February 2005 as a result of the old provisions of the definition and with effect from 1 March 2005 no longer qualifies as a resident, such taxpayer is then required to account for CGT on a deemed disposal of assets on the date when he or she is no longer a resident, that is, 1 March 2005.
(SAICA)

This statement is not accepted. The draft Bill already provides that the amendment will only affect the persons who are already considered to be time-based tax residents during the 2004/5 tax year from the 2006/7 tax year. The current rules will apply to determine tax residence status of those persons for the 2005/6 year.

3.15 *Foreign tax credits – section 6quat*

Based on existing wording it would seem that a South African tax resident is prohibited from carrying forward permissible foreign tax credits where the resident is in a tax loss position.
(SAICA)

This proposal does not require a legislative amendment as the current practice of SARS is to allow the foreign tax credit where the foreign income has been taken into account in reducing an assessed loss.

The requirement that a foreign tax credit may only be allowed where the foreign tax is attributable to income that is not from a South African source causes undue hardship, e.g. commercial profits withholding tax. Legislators are urged to correct this position.
(SAICA)

Where a resident provides management services or licences intellectual property to countries such as Tanzania or Kenya, the source of the income is South African, no credit is available in South Africa in respect of foreign withholding taxes on that income. This is a problem that arises in many African countries where there is either no tax treaty or where the treaties are dated. The reference to “source” of income in section 6quat is inappropriate for a truly residence-based tax system and that section should be amended to provide relief to South African residents for all foreign taxes paid on their world wide income.
(BUSA)

These proposals do not form part of the Bill under consideration. However, the granting of foreign tax credits under those circumstances would be contrary to international tax principles,

including the framework of the model tax conventions developed by the Organisation for Economic Co-operation and Development and the United Nations.

These principles divide taxation between the jurisdictions of source and residence, with the jurisdiction of residence being responsible for relieving double taxation arising from the imposition of tax by the jurisdiction of source. Tax treaties may explicitly deal with the question of source for certain types of income, such as interest and royalties, to ensure that foreign tax credits are appropriately granted. Where South Africa is the jurisdiction of both source and residence, a foreign tax credit for tax paid to another country would be inappropriate. A commercial profits withholding tax imposed by a treaty partner, which conflicts with the business profits article in the treaty, should be taken up with the foreign tax authority. If this approach is not successful, the competent authority at SARS is available to explore mutual agreement proceedings to resolve the conflict.

Where a foreign tax credit in respect of South African sourced income is not available, South Africa will generally allow the foreign tax as a deduction against the foreign income of the South African resident.

3.16 *Taxation of broad-based share plans – section 8B*

The proposed insertion of the definition of “gain” refers. It is not clear how the consideration given by the taxpayer will be allocated if the taxpayer sells, for example, the right to dividends for 2 years, whilst retaining ownership in the share. A deduction for the cost of the share or part thereof needs to be allowed and this is not catered for.

(SAICA)

This proposal is accepted and the required amendments have been introduced.

3.17 *Vesting of equity instruments – section 8C*

We suggest that a restricted equity instrument should be deemed to vest immediately before the taxpayer dies if all the restriction will be lifted on or after death. The reason for our suggestion is that if the directors or trustees decide not to exercise their discretion in favour of the estate, the taxpayer will have been taxed on the date prior to death whilst neither the taxpayer nor the estate may in reality realise any gain.

(SAICA)

This proposed amendment has already been reworded. The reason for not referring to restrictions which will be lifted is that it may result in difficulties in taxing the value of equity instruments where the waiver of the restrictions is optional.

The gain or loss where the employee receives an amount in cash to balance the exchange of instruments must be calculated by attributing a part of the consideration paid by the employee for the original instrument. The proposed amendments make no reference to the basis of calculating the “consideration attributable to that payment”. This should be clarified to avoid uncertainty.

(SAICA)

This proposal is not accepted. The consideration attributable to a payment depends on the facts and circumstances of each specific case, but the general rule will be that the portion of the consideration attributable to the cash received must be determined in accordance with the ratio that the amount of cash received, bears to the sum of the cash received and the market value of the equity instrument received in exchange on the date of the exchange.

Whilst this is not part of the proposed amendments, we urge you to consider amending the definition of “restricted equity instrument” to exclude any restriction imposed in terms of a company’s Articles of Association which, for example, precludes a shareholder from disposing of his/her shares to any person other than a person who is an Historically Disadvantaged Individual (HDI). It is currently an impediment for broad-based black economic empowerment transactions.

(SAICA)

This proposal is not accepted. The experience has been that in these schemes there is a causal connection between the receipt of the financial instrument and the participants’ employment in the company. The connection includes substantial discounts for employees and directors, preferential allocations of the instruments and the possibility that employees and directors could take up all the shares on offer. This clearly brings these transactions within the ambit of section 8C. It follows that if these equity instruments are also subject to any restriction that prevents a taxpayer from freely disposing thereof they must be treated as restricted equity instruments.

If the schemes were restructured not to have the connection with employment they would not fall within the ambit of section 8C.

The expansion of the definition of “restricted equity instrument” to include an instrument which is not deliverable to the taxpayer until the happening of an event creates a practical and unintended consequence in the case of share options which

“vest” but the individual has chosen not to exercise the option until a further date notwithstanding that there are no restrictions. A possible reason may be that the employee believes that the share price has potential upside.

(SAICA)

This proposal is not accepted. Since the publication of the amendment in the third batch of amendments and after receipt of the comments, amendments were made to the proposed restriction to ameliorate the problem in the draft submitted to the PCOF.

At present, if an employee is granted an option to acquire shares, and the shares are restricted equity instruments, then the option is itself a restricted equity instrument, both because it itself is restricted (usually because it cannot be freely disposed of at MV, or is time limited) or because the equity instrument (shares) that can be acquired on exercise of the option is restricted. Should the employee then exercise the option, the option *qua* equity instrument vests and a gain/loss is required to be determined. When the share then vests, a further gain/loss is required to be determined, without any recognition being given to the gain/loss that arose when the option was exercised.

The proposed amendments avoid the present double tax issue, provided one accepts that the option will never vest. Should there not be a provision inserted in section 8C(3)(b)(i) whereby section 8C(3)(b)(i) will not trigger a vesting on termination of an equity instrument which is an option? This will make it clear that if an equity instrument is acquired on exercise of an option, then the vesting provisions of section 8C will not apply in relation to the option, but the equity instrument acquired on exercise of the option will continue to be subject to the section.

(BUSA)

As the potential problem raised and the proposal made to correct it have further implications, the matter requires further investigation and if necessary amendments will be proposed.

We would like to bring to your attention some problematic aspects of the interaction between section 8C and the Eighth Schedule. The example below illustrates that certain situations, which the legislature ostensibly wishes to relieve from tax, may lead to an unintended (or at least larger than intended) CGT liability. The example concerns a typical employee share incentive scheme where an employee forfeits scheme shares as a result of leaving employment.

Example

A company (“C”) issues 10 ordinary shares to a trust (“T”) at a subscription price of R1 each (being par value) when the market value of the shares is R5. Immediately afterwards T “vests” the shares (as contemplated in para 11(1)(d)) in C’s 10 employees (“the employees”). The employees do not pay any consideration for the shares. The shares are subject to various restrictions and constitute “restricted equity instruments” in the hands of the employees for section 8C purposes for a period of, say, 10 years. Two years later one of the employees (“E”) resigns from C’s employment. The shares are now worth R20 each. The trust deed provides for T to repurchase E’s share for R0 (alternatively, E simply forfeits his share).

Analysis

Assume that both C and E are beneficiaries of T. C, E and T will therefore all be connected persons in relation to each other, so that paragraph 38 may become relevant. The “vesting” by T of the shares to the employees is a CGT disposal by T - para 11(1)(d). However, this “vesting” does not lead to any CGT exposure for either T or the employees.

Summary of the issue

The aim with section 8C(5)(c) was ostensibly to ensure that an employee is not burdened with a tax liability resulting from the repurchase (or forfeiture) of his shares in these circumstances. But the example shows that E would on a strict interpretation incur a CGT liability, immediately after the section 8C vesting of the shares, on the full market value of the shares (R20), without the benefit of any uplift in base cost or indeed any base cost at all.

We assume that the legislature did not intend this CGT burden. In the example, E properly escapes income tax under section 8C by virtue of falling within section 8C(5)(c). It could presumably not have been the intent that E would nevertheless pay CGT on the full R20 as a result of the very same transaction with T. This is so particularly because E not only never made any economic gain, but in terms of the scheme restrictions actually could also not have done so – i.e. E could not have sold to any third party. In these circumstances any tax at all would mean hardship for E.
(PWC)

This proposal is accepted. The provisions of paragraph 20 of the Eighth Schedule will be amended appropriately.

3.18 *Immovable property holding companies – section 9(2)*

The proposed amendment applies to the situation where a non-resident disposes of an indirect interest in shares whose value is attributable primarily to immovable property located in the Republic. Extending the legislation in relation to immovable property interest to include “indirect” holdings is considered inappropriate. This wording implies that a foreign parent, two or three levels away from the direct foreign shareholder of the South African company which owns immovable property, could be taxed in the event that the indirect foreign parent sells its shares in the direct foreign parent.

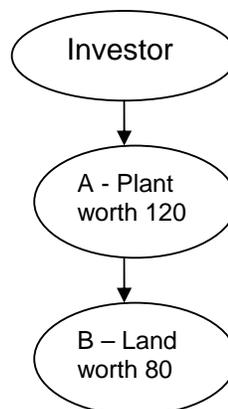
The use of this terminology could result in double taxation if several layers above the direct foreign shareholding foreign subsidiaries in the group were to leave the group one by one. Each party would need to account for the tax.

The issue of concern is how SARS plans to administer and enforce the South African CGT. We would therefore recommend that the wording be restricted to direct interest.
(SAICA)

The provision has applied to direct and indirect holdings by non-residents since its introduction so this amendment does not introduce a new principle.

The proposed amendment is, in fact, a relaxation of the test as it requires that the market value of shares being disposed of be analysed to determine whether 80 per cent or more of the market value of those shares is attributable to immovable property in the Republic.

Example



A foreign investor owns all the shares in A. A owns all the shares in B as well as plant worth 120. B owns land in the Western Cape with a market value of 80

Under the current provisions it could be argued that if foreign investor sold the shares in A for 200 that the 80 would be subject to CGT as B is disposed of indirectly and more than 80 per cent of the value of B is attributable to SA immovable property.

The proposed amendment will have the effect that the disposal of the shares in A by the foreign investor will not be subject to CGT as only 40 per cent of the value of the shares in A is attributable to SA immovable property.

It would be relatively easy to avoid tax if only direct interests in property holding companies were subjected to tax.

The proposed basis for taking indirect interests in immovable property into account on a consolidated basis is less stringent than the situation contemplated in the OECD Model Tax Convention, which allows for the taxation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property.

As regards the administration of the provision, section 35A was introduced last year to provide for the reporting of the transactions and the withholding of tax.

Regarding the inclusion of mining rights as immovable property, we would request that, for the purposes of this test only, these rights be attributed to trading stock and so be excluded.
(PWC)

This comment is not accepted. Trading stock has a regular turnover. This is not the case with mining rights. Furthermore, where these rights are disposed of before extraction of the minerals takes place, the capital/revenue test may still be applied, which could result in the realisation of a capital gain.

3.19 *Controlled foreign corporations: definition of controlled foreign company – section 9D(1)*

Concern exists that the revised definition (inclusion of voting rights) may result in certain foreign companies falling within the definition of a CFC when this would take the scope of CFC legislation further than intended and/ or result in negative foreign investor perceptions.

In addition, we would highlight that a proviso is required to the definition in the cases where, despite the definition applying, by

reason of the *de minimis* exception no resident has any amount imputed. It is submitted that, in such circumstances, the foreign company, and its subsidiaries, should not be regarded as CFCs.
(PWC)

This comment is accepted in part. It is understood that the primary concern related to widely held foreign listed companies. The definition of CFC will be amended to exclude foreign listed companies which would have qualified as CFCs as a result of the voting rights held by residents in foreign listed companies as well as the voting rights held indirectly through those foreign listed companies.

Finally, in considering the holdings of “connected persons”, in accordance with the changes proposed in Clause 16(1)(p) to subsections 9D(12) and (13), it is submitted that this be limited to residents who are connected persons.
(PWC)

This aspect has already been addressed in the draft Bill before the PCOF by only considering residents who are connected persons.

3.20 *Controlled foreign corporations: definition of participation rights – section 9D(1)*

We anticipate that difficulties would be encountered going forward using the voting requirement to tax residents on profits that they may never become entitled to. For example, in situations where a foreign insurance company is structured as a mutual and taxable income of the company for a specific year is calculated, the law may require that such taxable income be attributed to a resident based on voting rights but the profits of the mutual may actually ultimately be paid out to an alternate resident based on an insurance claim submitted. This may lead to double taxation of the same profits in the hands of separate residents, apart from the fact that one resident will be taxed on profits that it commercially never receives or will receive.
(SAICA)

This proposal is not accepted. The attribution of net income of a CFC using voting rights will only be applied where no person has any rights to the CFC’s capital, profits or reserves. Therefore, this method will only apply as a backup to attribute according to practical control and not legal control.

The practicalities of how to calculate a resident's participation rights have not been dealt with. Currently a great deal of uncertainty exists as to how to determine what percentage of the net income of a controlled foreign company should be attributed to a resident based on the current definition of "participation rights".

(SAICA)

This matter does not form part of the Bill under consideration. This is an extremely fact intensive issue which should be dealt with on a case by case basis. Consideration is being given to issuing an Interpretation Note to assist in generic cases.

We do not support the introduction of the rule for determining voting rights which can be exercised indirectly. The extent to which a shareholder can influence the company depends on the legislation of the country where the company is incorporated.

(SAICA)

This proposal is not accepted. A resident may exercise control over a foreign company in which indirect voting rights can be exercised.

It is not necessarily correct to hold that the shareholder exercising more than 50% of the voting rights has effective control over the company. Furthermore, the proposed amendment implies that tax will be levied on a higher amount than what the resident will be economically and commercially entitled to.

(SAICA)

The net income of a CFC would in the vast majority of cases be attributable to the residents by using the rights to participate in share capital, profits or reserves. Only in exceptional cases where these rights cannot be determined will the attribution be determined with reference to voting rights. In that case a resident will only be taxed to the extent of the effective voting rights in the CFC which could be exercised directly or indirectly through intermediary companies.

The term "voting rights" is not defined. A definition should be introduced.

(SAICA)

This proposal is not accepted, as the ordinary meaning of the concept should prevail.

3.21 *Controlled foreign corporations: foreign currency translation rules – section 9D(6)*

The provisions of section 9D(6) do not apply to assets which are not attributable to any permanent establishment of the CFC. It is unclear whether this permanent establishment refers to the fixed place of business, etc. of the CFC in the respective foreign jurisdiction or a permanent establishment of the CFC outside of the CFC's foreign jurisdiction. For example, in the case of a CFC located in Barbados that has a branch in Cyprus, does this refer to the head office in Barbados or the branch in Cyprus?
(SAICA)

The concept "permanent establishment" is defined in section 1 of the Income Tax Act. Where the activities of the controlled foreign company in both Barbados and Cyprus are conducted through permanent establishments the sale of assets attributable to a PE in either of the two countries will be dealt with under the general average rate translation rule. This would be the case even though the activities may be conducted in a recognised tax haven.

Although the aim of the amendment is appreciated, it seems that it would make more sense to be consistent with the terminology and it is therefore suggested that "business establishment" be used instead of "permanent establishment".
(SAICA)

The proposal is not accepted. The concept of "business establishment" is used in the context of the exemption of active business income. "Permanent establishment" is a wider concept, the use of which should benefit taxpayers who would not need to translate transactions in certain assets attributable to any permanent establishment to Rand but would determine the CFC's taxable income in its foreign reporting currency.

We feel that the obligation to convert an exchange item into Rand just because it cannot be attributed to a permanent establishment of the CFC would put an undue burden on a CFC.
(SAICA)

The proposal is not accepted. As the exchange item has no *nexus* to active business activities, the resident in relation to the CFC should be taxed on exchange differences with respect to the exchange items of the CFC.

As the law currently reads it is unclear whether the head office of a company would qualify as a permanent establishment for purposes of attributing an exchange item.
(SAICA)

The concept “permanent establishment” is defined in section 1 of the IT Act. Where the head office meets the requirements of the definition it will constitute a permanent establishment.

3.22 *Controlled foreign corporations: business establishment exemption – section 9D(9)*

It is not clear what is meant by “other than foreign currency gains which arise in the normal course of business of that controlled foreign company ...”. It is recommended that the term “normal course of business” either be replaced by alternative terminology or that this phrase be defined for clarity.

(SAICA)

The proposal is not accepted. The term “normal course of business” should be interpreted according to the facts and circumstances of each case.

The concept “business as a going concern” used in the exemption for intangible assets should be defined for income tax purposes as instances where, for example, the debtors book or the liabilities of the selling company are retained and do not form part of a sale should not negate the exemption.

(SAICA)

The proposal is accepted in part. The condition that all the assets which are necessary for carrying on the business should be disposed of will be added to the exclusion.

The 18-month restriction to qualify for the tax free disposal of foreign intangible assets acquired by a CFC seems very onerous. The listing of a CFC to fund further activities may cause a deemed disposal of the assets if the foreign entity should cease to be a CFC within 18 months of the development of the intangible assets.

(SAICA)

The proposal is not accepted. Where an intangible asset is developed by the CFC, the asset will not be subject to the 18 month holding period. The withdrawal of the 18 month holding period could result in the tax free disposal of intangible assets bought by the CFC which are subsequently transferred to foreign group companies. The 18 month holding period is a standard rule to address short term tax avoidance strategies and was the subject of substantial consultation when it was introduced in 2001.

We would recommend that the restriction on the tax free disposal of South African developed intangible assets by a CFC be removed as it is unlikely that intellectual property can be transferred out of South Africa tax free.

(SAICA)

The proposal is not accepted. Tax avoidance transactions involving the transfer of intellectual property to offshore companies have occurred on a number of occasions. A further reason for not accepting the proposal is that intangible assets with excellent growth potential could be transferred offshore in order to obtain tax-free treatment on the ultimate disposal thereof.

3.23 *Controlled foreign corporations: exemption of net income attributable to the disposal of an asset of another CFC – section 9D(9)*

It is unclear whether this is correctly worded. Possibly it should be worded as exempting from income any asset disposed of, which is attributable to the business establishment of that controlled foreign company.

(SAICA)

The proposal is not accepted. The amendment is consequential upon the introduction of an exemption in section 9D(9)(b) which allows for the tax free disposal of assets of a CFC forming part of the business establishment of the CFC. Exemptions for the disposal of assets of a CFC are dealt with in two paragraphs of 9D(9), i.e.:

- paragraph (b) for assets attributable to the business establishment of the CFC; and
- paragraph (B) for assets attributable to the business establishment of another CFC.

3.24 *Controlled foreign corporations: election that exemption provisions do not apply or to treat foreign company as a CFC – section 9D(12),(13)*

Whilst these are useful provisions, they will not apply where, for example, a CFC of a South African resident holds, say, 15% in another foreign company and the resident wishes to make the election in respect of the CFC's holding.

(SAICA)

The proposal is already provided for under the elective rules. The participation rights of the resident wishing to make an election includes direct and indirect rights to capital, profits or reserves of a foreign company.

3.25 *Effective dates of amendments – section 9D*

It has been stated previously by National Treasury and SARS that legislation will not be effected retrospectively unless this is taxpayer friendly. We would suggest that the effective dates proposed for section 9D be revisited with this in mind.

(PWC)

This comment is accepted in part. The effective dates were reviewed and the amendments which are taxpayer favourable will come into operation with reference to foreign tax years which ends during any year of assessment ending on or after 8 November 2005 (date of tabling of the Bill).

We suggest that the implementation dates of the amendments to section 41 and 9D be made consistent, by both applying to foreign tax years ending on or after 8 November 2005.
(BASA)

This comment is accepted. The effective date will be foreign tax years of CFCs which ends during any year of assessment ending on or after 8 November 2005 (date of tabling of the Bill).

3.26 *Exemption of government grants – section 10(1)(y)*

The introduction of tax exemption for specific activities identified by the Minister as in the furtherance of government policy may well have the effect of directing expenditure into specified areas. We would like to ask your consideration of a number of concerns:

- **The use of this enabling clause may well bypass established organisations with similar objectives, but which are required to conform to other stringent requirements. (Section 21 companies, Registered Non Profit Organisations and those compliant with the requirements of section 30). This may well require additional controls to ensure that the grant has been expended solely for the purposes intended.**
- **There may be instances where the targeted activities overlap with those of other taxpayers who are undertaking similar activities with profit making intentions. This could result in unfair competition and inefficient allocation of resources.**
- **The need to align VAT practices with Income Tax practices in respect of government grants is questioned, particularly as VAT is a transaction tax and Income Tax is a tax on income less expenditure.**

(BASA)

These comments are not accepted. A number of criteria have been incorporated in legislation to provide for additional controls to be in place and to ensure that the grant has been expended for the intended purpose. These control measures should also ensure that unfair competition and inefficient allocation of resources do not take place. The policy objective of exempting these grants from both VAT and Income Tax is the same and although these taxes differ in substance, the policy objective is met by exempting these grants from both taxes.

3.27 *Capital element of purchased annuities – section 10A*

Although not as a result of the proposed amendments, section 10A(11) refers only to the conversion of the “cash consideration” and makes no reference to the annuity amount. Both the cash consideration and the annuity amount are, however, needed to determine the exempt portion of a purchased annuity and the provision should therefore refer to both of these terms.
(SAICA)

The proposal is not accepted as it does not fully address the underlying issue raised by SAICA. It has been provided that the exempt capital element of an annuity must be determined in the foreign currency and be translated to Rand by applying the same exchange rate as the exchange rate applied to translate the annuity receipt or accrual in terms of section 25D.

3.28 *Wear and tear allowance for owners of assets – section 11(e)*

The reference to assets acquired in terms of an “instalment credit agreement” is too restrictive and does not cater for other types of financing of the acquisition of an asset which would still be “owned” by the taxpayer.
(SAICA)

The proposal is not accepted. As a basic rule wear and tear should only be allowed to the owner of an asset. The amendment provides for a clearly defined exception in the case of instalment credit agreements. This exception is in line with current practice.

3.29 *Doubtful debt allowance – section 11(j)*

Consideration should be given to defining what is meant by “doubtful” and “bad”.
(SAICA)

As was noted by SAICA, SARS is working on an Interpretation Note in this regard.

3.30 *Capital allowances: limitation of cost on acquisition from connected persons – sections 11(e) and 12C(4)*

We question whether the limitation of cost on acquisition of assets from connected persons is still required. It was originally inserted into the Act as an anti-avoidance measure to prevent companies with assets whose market value exceeded original cost from selling those assets to fellow subsidiaries at a stepped-up value to enable the purchaser to claim wear and tear on a higher value, whilst deriving a capital profit free of any taxation. With the introduction of capital gains tax the seller will now pay capital gains tax on the capital gain after any recoupments, which is a disincentive to this transaction.
(SAICA)

The proposal is not accepted as far as an amendment to legislation is concerned. The limitation is still required as–

- connected persons in an economic group would get the benefit of the difference between the rates at which income and capital gains are taxed;
- the party disposing of the asset may have an assessed loss which would eliminate the effect of the recoupment or taxable capital gain; and
- accelerated capital allowances granted to the transferee more than offset the capital gains tax within a year.

3.31 *Allowance for the production of renewable energy – section 12B(1)(h)*

It is particularly true that commercial viability of bio-industry will take some years to achieve. Accelerated allowances will not be able to be availed of by the manufacturer while he/she establishes commercial viability. Where the benefit can be passed on to the entrepreneur, is through bank intermediation under relaxation of the ring-fencing of leasing allowances.

An alternative to the granting of accelerated Income Tax allowances for ventures of this sort is to create direct subsidies payable independently of the SARS processes. There are obvious shortcomings in this alternative, but they could be considered as more effective than the granting of accelerated allowances that cannot be availed of through the start-up phase of production.
(BASA)

These comments are not accepted. Start-up businesses with assessed losses would get the benefit of allowances not utilised during future tax years when they become profitable.

3.32 *Ring-fencing of assessed losses of certain trades – section 20A*

As is seen in the proposed amendments, the calculations become complex and remain discriminatory against high-income taxpayers. It is therefore suggested that the income criteria be scrapped and that the provisions of section 20A be applied to all taxpayers.

(BASA)

This proposal is not accepted. The attempt to deduct hobby-like expenses undermines the ability to pay principle of the income tax system. For this reason the section 20A ring-fencing is targeted solely at higher income individuals and the threshold is linked to the maximum marginal rate of tax because wealthier individuals have more means to disguise hobby expenses as a trade.

3.33 *Deduction for contributions to income protection policies – section 23(m)(iii)*

The proposed change refines the exclusion to bring it in line with Revenue’s original intentions for deductions in relation to qualifying income protection policies. We request that the date of operation be changed to 1 March 2002, the date on which the limitation of deductions by salaried employees came into operation.

(LOA)

The proposal is accepted.

3.34 *Bribes, penalties and fines not deductible – section 23(o)*

While the desired objective is supported, it is suggested that the explicit exclusion of certain expenses may unnecessarily complicate Income Tax law administration.

(BASA)

The proposal is not accepted. The exclusions emphasize government’s commitment to fighting corruption and to good governance. Exclusions of this nature are encountered internationally.

3.35 *Film allowance – section 24F*

The restriction of the deduction of production costs in terms of section 24F to “production costs incurred and paid or payable in the Republic” does not take into account that:

- the film may be shot in a location outside South Africa, although it may be a South African film; and
- it is normal practice to use foreign talent in order to increase the worldwide appeal and marketing viability of the film, with

the effect that some production costs may be payable outside the Republic even though the film is a South African film.

It is suggested that production costs be allowed as a deduction in all cases where the income from the film flows to South Africa, irrespective of where the production costs are incurred or paid.
(SAICA)

The proposals are accepted. Production costs or post-productions costs incurred by a film owner in the production of income which relate to South African activities or co-production agreements qualify for an accelerated deduction. The production costs and post-production costs of a film which do not relate to South African activities or co-production agreements will be allowed as a deduction over a period of 10 years from the tax year during which the film is completed.

It is submitted that in calculating total production and post-production costs for purposes of section 24F(2), the film owner should be entitled to exclude a maximum number of 4 (four) designated or nominated persons who are compensated in connection with the production of the film from the total production or post-production costs prior to calculating the 75% of the total production and post-production costs to be paid or payable in the Republic for services rendered or goods supplied in the Republic. This retains the exclusion in the previous definition of "South African export film". In as much as the Draft Bill is intended to encourage the production of South African films, a certain degree of flexibility should be entertained to allow for some costs that may be incurred (as a production cost) in engaging artists, actors and other skills from outside of South Africa with the view to making the film more commercially viable, both in South Africa and internationally.
(IPO)

The proposal is not accepted. There appears to be a misunderstanding of the proposed amendments. Previously the definition of "South African export film" required that payments be made to persons ordinarily resident in South Africa and contained an exception catering for four nominated persons who were not ordinarily resident. The proposed amendments delete this requirement. The accelerated film allowance is now available where foreign stars and other creative skills from outside South Africa render their services in South Africa and are paid in South Africa.

The limitation of the deduction of production or post-production costs to amounts incurred within 18 months of the completion date may disadvantage film owners who have entered into an agreement to pay costs from income derived from the film. In

many instances a film may only derive income more than 18 months after the completion of such a film.
(SAICA)

The proposal is not accepted. The deduction of production and post-production costs will not be limited where the costs are paid within a period of 18 months from the completion date of the film. Payment would include obtaining financing from third parties in order to settle debts to the suppliers of goods and services relating to the costs.

If it is deemed necessary to single out a specific industry for special development, it may be more cost effective to consider a system of grants. It is quite evident, from the complexity of the allowance conditions, that compliance costs will be significant.
(BASA)

The Department of Trade and Industry is currently offering a film incentive in the form of a film and television production rebate.

In recognition of South Africa's dominant and developmental role in Southern Africa, the IPO submits that production and post-production costs incurred by film owners in the Southern African Development Community (SADC) (rather than only the Republic of South Africa) form part of the section 24F film allowance calculations.
(IPO)

The proposal is not accepted. It is not appropriate at this time to extend the allowance granted in terms of section 24F to the SADC Region. This matter may be considered once the SADC Finance and Investment Protocol is finalized.

The IPO submits that the 10 year limitation proposed to be introduced in section 24F(8) should be changed to a 15 year period. This would be in line with the loan period of the sale and leaseback structure that stimulated and helped to develop the United Kingdom film industry.
(IPO)

This proposal is not accepted. The 10 year period is in line with the 10 year limited recourse loan concept introduced in New Zealand and in Canada before the change to a different incentive system. The experience in the UK was that sale and leaseback film financing schemes which have been developed making use of the 15 year period—

- have resulted in the significant deferral of tax payable by investors;
- completely insulated investors from film risk and upside potential; and

- resulted in an incentive mainly benefiting high net worth investors in films as opposed to the film industry which only got 11 – 13 per cent of the amount financed.

The sale and leaseback film schemes in the UK have been described as tax deferral schemes offering investors a relatively cheap loan from the Inland Revenue for fifteen years. For that reason it was in the film *buyer's* interest to obtain the highest possible purchase price for the film and thereby increase the amount of tax deferred.

In order to create greater certainty for film investors, SARS should provide binding rulings on film investment proposals with immediate effect.

(IPO)

The advance ruling system will be introduced by SARS in the near future.

SARS should seek to work with the industry to develop acceptable sale and leaseback arrangements that would encourage local financial institutions to invest in the film industry in a manner that is transparent, tax efficient and provides income certainty for both SARS and film owners in a high risk industry.

(IPO)

The advance ruling system which will be launched in the near future should provide clarity to film owners. Further legislative amendments will be considered taking into account international experience and practices with regard to sale and leaseback agreements.

It is recommended that SARS embarks on a media and publicity campaign that expresses positive support for film investment.

(IPO)

Such a campaign has already commenced. During the last year SARS has published a guide on the taxation of film owners, attended film industry events and made a presentation at the National Film and Video Foundation Indaba, which was subsequently published in an industry publication.

3.36 *Determination of taxable income in foreign currency – section 25D*

We suggest that this amendment be made effective for all years of assessment ending on or after the date of tabling of the Bill.

(SAICA)

The proposal is accepted. The necessary amendments have been introduced.

3.37 *Non-residents who derive income from royalties – section 35*

There may be a need to amend section 66 to provide that persons in receipt only of income in terms of section 35 are not required to submit income tax returns.

(SAICA)

The proposal is not accepted. The introduction of the proposed section 66(1A) allows the Commissioner to exempt any person from furnishing a return.

3.38 *Corporate restructuring rules: definitions – section 41*

The definition of “associated group of companies” only allows a “look down” approach within the group i.e. fellow associated companies or companies above will not qualify. It is not clear whether this is intentional.

(SAICA)

The excluded debts in the definition of domestic financial instrument holding in section 45 considers companies on a “look down” basis, what about debts with fellow subsidiaries and holding companies?

(SAICA)

These proposals are not accepted. The purpose of the tests in which the definitions are used is to determine whether the company and companies influenced or controlled by that company meet certain requirements. It would only be the shares in the influencing or controlling company which would be transferred in terms of the intra-group transaction.

Definitions of “domestic financial instrument holding company” and “foreign financial instrument holding company”: As regards the exclusion of financial instruments whose market value is equal to their base cost, we understand that these are not considered ‘bad’ assets as they do not give rise to the loss trafficking concerns which drove the financial instruments and financial instrument holding company exclusions from the reorganisation relief.

Financial instruments which would not give rise to the perceived loss trafficking concern are nevertheless not excluded. Simple examples include fixed rate loans where the market rate has moved since the loan was granted but the base cost remains constant or refunds due from SARS where, due to uncertainties as to when the amounts may be repaid, it is unlikely that the market value could be said to equate to base cost.

It is submitted that the following wording, which we understand to meet the underlying principle, be adopted to provide the relief intended;

“(iii) any financial instrument where repayment of the full principal amount, without any reduction or discharge, would give rise to neither a gain nor loss for tax purposes”.

(PWC)

This proposal is not accepted. Although such a financial instrument will generally not generate a capital gain or loss if held to maturity, it could generate a capital gain or loss if disposed of before maturity.

We are concerned that there is a restriction, which requires a foreign company, in order to qualify for favourable treatment, to "mainly conduct business" in "the country of residence of that company" (contained in proviso (b) to the definition of a "foreign financial instrument holding company" on page 66 of the draft Bill). It appears that there is no good reason for this restriction, and it does not take into account the reality that financing companies may conduct business in many jurisdictions. We request that this restriction should be deleted, alternatively expanded to include all countries in which the foreign company has any permanent establishment.

(BASA)

In the definition of “foreign financial instrument holding company” the reference to “... bank or financier, insurer, dealer or broker that mainly conducts business in the country of residence of that company” does not take into account instances where a controlled foreign company (“CFC”) may be resident in more than one country. Even though a wide interpretation may include all locations where there are *bona fide* activities conducted with clients outside the CFC’s country of incorporation/effective management, we are of the opinion that this issue needs to be clarified.

It is submitted that “(including any permanent establishment thereof in any other country)” be inserted after “country of residence”.

In order to ensure that the proviso, which excludes the application of this wording to tax haven jurisdictions, also takes into account all of the jurisdictions where the CFC is operating, it is submitted that the same wording be inserted after “to a foreign company” in the proviso.

(PWC)

These proposals are not accepted. A *nexus* should exist between the country of residence of the CFC and the conduct of the business.

3.39 *Recovery of capital distributions on transfer of shares – section 41(8)*

We are concerned that, in the case of intra-group transactions in terms of section 45, the proposed section 41(8)(b)(ii) departs from the accepted principles under which that section operates.

Unlike sections 42, 43 and 44, each of which double up an inherent tax gain, section 45, whilst ‘rolling over’ the tax history of one leg of a transaction, provides a step-up for the other leg. This was accepted by National Treasury and SARS in their briefing to the Portfolio Committee at the time section 45 (in its current form) was introduced in 2002.

The proposed inclusions for both transferor and transferee in terms of the proposed section 41(8)(b)(i) and 41(8)(b)(ii) respectively negates this treatment in respect of capital distributions.

Accordingly, whilst we agree that s41(8)(a)(i) cover section 45 transactions (as detailed in subsection (8)(a)) such that any distributions be included in the calculation of a subsequent disposal by the transferee, it is recommended that s41(8)(a)(b)(ii) be restricted to instances other than section 45.

(PWC)

This proposal is accepted and section 41(8)(b)(ii) will not apply to the transferor in a section 45 intra-group disposal.

3.40 *Company formation transactions – section 42*

We are concerned that the exclusion of personal goodwill from the rollover provisions effectively negates the more positive aspects, effectively permitting the incorporation of professional partnerships, of the changes proposed.

Whilst we acknowledge the concern that scope would exist for taxpayers to effectively convert otherwise taxable income amounts into capital gains (taxed at lower rates), it is our view that this could be addressed in other ways such that legitimate business formations are not negatively impacted.

(PWC)

This proposal is not accepted. Although personal goodwill may be transferred to the new company as part of the business operations it need not be since it is most closely related to the individual concerned.

3.41 *Intra-group transactions – section 45*

Consider the following structure: Company A owns 50% of company B and 100% of company C. Company C owns the other 50% of company B. One way or another company B is wholly-owned, but subsection (4)(c) is not available to it. Surely the test to qualify should simply be that the company is part of the same group of companies?

(SAICA)

This proposal is not accepted. Only companies which would qualify for the liquidation distribution relief measures contained in section 47 are able to liquidate without triggering the degrouping charge. In order to achieve administrative simplicity only one successor is allowed.

It is submitted that the requirement in s45(6) for the shares to be in a “controlled group company” in relation to the transferor is no longer appropriate and should be to an “influenced company”.

(PWC)

This proposal is accepted and the reference has been changed to “influenced company”.

3.42 *Unbundling transactions: definition – section 46*

It is a requirement that the unbundling company holds more than 50% of the unbundled company. This does not seem to be correct. Consider the following example: Company A has two wholly-owned subsidiaries, ie company B and company C. Company B and company C each holds 45% of company D. Thus despite the fact that company A, through B and C, holds 90% of company D, companies B and C are not eligible to unbundle their shares in company D to company A. Surely the 50% requirement should be if it is held together with any other group company?

(SAICA)

This proposal is noted for consideration at a later date.

We submit that the time at which the financial instrument holding company (“FIHC”) test should be performed in terms of subsection (7) is immediately prior to an unbundling transaction and not afterwards.

Whilst it is appreciated that it could be argued that the unbundling of a non-FIHC which leaves the unbundling company as a FIHC is tantamount to the unbundling of a FIHC itself we would disagree with this viewpoint, considering it to be fatally flawed from a commercial perspective.

(PWC)

This proposal is not accepted. The purpose of unbundling transactions is to unlock value, which is only achieved post-unbundling.

3.43 *Taxation of non-resident entertainers and sportspersons*
– section 47A

The definition of “entertainer or sportsperson” in section 47A is stated in rather broad terms and it is clear that this paragraph is intended as a “catch-all” provision. This may have unintended consequences, however and guidance would need to be provided as to what activities would be regarded as of an entertainment character. Reference could be made to the Organisation for Economic Co-operation and Development (“OECD”) commentary on the application of Article 17 of the OECD Double Taxation Conventions (“DTCs”) dealing with the taxation of artistes and sportspersons.

In terms of section 47B(1), “any other person” (non-resident) to whom any amount accrues in respect of a “specified activity” (that is, personal activity exercised by a person as an entertainer or sportsperson) in South Africa is also subject to tax. This reinforces the question about support staff and other persons.

It is essential that an explanation be provided of how all the categories of persons would be treated in terms of the new provisions.

(SAICA)

These proposals are partly accepted. The relevant tax treaty entered into with a foreign jurisdiction would in any event override or limit the activities of non-residents taxable under Part IIIA. The activities of support staff are not subject to tax in terms of the charging section. The explanatory memorandum provides examples of the application of the new rules.

Section 47B(3) removes the application of the section where the non-resident sportsperson or entertainer is an employee of a resident employer where the latter is required in terms of the Fourth Schedule to withhold PAYE. An employer is defined in the Fourth Schedule essentially as a person who pays remuneration, while “remuneration” is very widely defined and, for example, where there are regular payments, can even bring independent contractors within the net. It could therefore be quite easy for a person who ought really to be subject only to the 15% withholding tax to be brought unnecessarily into the Fourth Schedule.

(SAICA)

This proposal is already addressed in the proposed legislation. The reference to the deduction of PAYE has been deleted and a 183 day rule has been introduced.

Section 47G stipulates that where the resident does not withhold the tax, it will be recovered from him and he can claim a corresponding amount from the non-resident. However, the door is left open to the Commissioner to claim payment also from the non-resident recipient in terms of section 47C and 47G. The former section provides that the tax that has not been withheld is a liability of the non-resident recipient, and the latter one contemplates the possibility that the tax is recovered from the non-resident recipient before SARS has succeeded in claiming it from the resident payer. We suggest that these provisions should be clarified in order to establish a clear procedure on how the tax will be collected, should the resident not withhold it.

(SAICA)

This proposal is already addressed in the proposed legislation. Once the tax is recovered from the resident the liability for payment by the non-resident is suspended.

In our view the deadline of 14 days for reporting from the conclusion of the agreement in section 47K is unreasonable. After the agreement has been reached, it could take a year or longer before the event itself will take place. It would make more sense to notify SARS within a certain time limit before the actual event. Alternatively, if reference to the conclusion of the agreement is deemed necessary, we suggest that the 14 days be amended to 21 days to allow sufficient reporting time from the time of conclusion of the agreement which in most cases is concluded offshore.

(SAICA)

This proposal is not accepted as the obligation to report is on the resident promoter and the agreement could in certain instances be concluded less than 14 days before the event takes place.

With this being a new tax, there will be problems for the entertainers' resident country to grant a tax credit for this withholding tax as such tax is generally not covered in the Double Tax Treaties.

(SAICA)

This proposal is not accepted. All tax treaties entered into by South Africa would treat the non-resident tax on entertainers and sportspersons as a tax on income. This is also in accordance with the OECD Model Convention.

3.44 *Payment of tax pending appeal – section 88*

Considering that section 102 allows the Commissioner to set off the refund against alleged (not proven) tax debts of the taxpayer, we do not consider it reasonable to extend the right of set-off also to the refunds paid subject to the outcome of appeal.

(SAICA)

This proposal is not accepted. There is no reason why a refund of an amount which was subject to an appeal should be treated differently from any other refund.

DONATIONS TAX

3.45 *Definition of farming value - section 55*

No justification is provided for reducing the market value by 30% in all cases in order to arrive at the “farming value”. The use of 30% will not take into account all prevailing market conditions, the location of the property, availability of water and the nature of farming conducted.

(SAICA)

By using the fair market value of the property as a basis of valuation the prevailing market conditions, location and suitability of the property for farming will be taken into account.

In recognition of the fact that Land Bank values have consistently been lower than the market value of the property a reduction of 30 per cent of the market value is proposed. This is considered to be a reasonable reflection of the farming value of property on which farming undertakings are being carried on.

The policy of reducing the market value of farming property by a fixed percentage to determine farming value was raised with Agri South Africa, who agreed that the proposed 30 per cent reduction was reasonable.

3.46 *Exemption for taxable share incentive scheme gains – section 56*

Given that the amendment is to exempt the benefits granted by employers to employees that are subject to sections 8A, 8B and 8C, the effective date does not take into account that section 8B and 8C came into effect on 26 October 2004 whilst the exemption will be effective 8 November 2005. Does this mean that awards granted between 26 October 2004 and 7 November 2005 will be subject to donations tax? As this is clearly not the intention, we recommend that the effective date of the amendment be made retrospective to 26 October 2004.

(SAICA)

This proposal is accepted.

SECONDARY TAX ON COMPANIES

3.47 *Exemption of intra-group dividends*

The amendment to section 64B(5)(f) is difficult to understand and needs to be simplified. Furthermore, while we think we understand the intention behind this amendment we believe practically this will be very difficult to implement.

(SAICA)

The proposed insertion of the terminology “directly or indirectly” cannot be supported as it has a negative "retrospective" effect on current reserves and it would appear to give rise to difficulties in tracking the original source of profits in instances such as:

- **where profits flow up through a chain of companies and are blended with losses in other companies;**
- **where groups grow through acquisitions and cash flows up from subsidiaries of acquired sub-groups. profits are only earned in a company receiving a dividend when that dividend is received, not when the profits were earned by the company declaring the dividend.**

(PWC)

These proposals are not accepted. From a tax policy point of view only profits that arose within a group companies which are subsequently declared by way of a dividend should qualify for the exemption for intra-group dividends. The concern with the current exemption is that it is argued that profits are earned by a company receiving a dividend when that dividend is received from a group company without reference to when the profits were generated by the company declaring the dividend.

No rules are set forth or guidance given as to what order (e.g. FIFO, LIFO) profits must be treated as being used up.
(PWC)

No specific ordering rules are proposed. SARS will rely on company law in administering section 64B(5)(f) as is already the case for section 64B(5)(c).

The move from “earned” as was previously used in section 65B(5)(f) to “arose” has given rise to uncertainty. In the absence of guidance, and the underlying reason for the proposed change, we would recommend that the existing use of “earned” be retained.
(PWC)

This proposal is accepted and the reference to “arose” will be changed to “earned”.

PROVISIONAL TAX

3.48 *Definition of “representative taxpayer – Fourth Schedule*

There is a technical correction in the Fourth Schedule which has never been made, and that is in the definition of “representative employer” in paragraph 1. Sub-paragraph (d) still refers to an employer who is not “ordinarily resident” in South Africa: surely the word “ordinarily” should be deleted?
(SAICA)

This proposal is accepted and the proposed amendment will be included in the Bill.

Directors of companies will no longer need to be provisional taxpayers as PAYE is deducted from their remuneration. This will lead to problems where a taxpayer is a director of numerous companies and his/her remuneration from each may be below the tax threshold. For example if a director earns R30 000 from one company and R30 000 from a second company, each company will tax the remuneration as if the amount paid by each is the only income of the director. Further, it would be far better and administratively easier if additional tax could be paid via the provisional tax system rather than via the PAYE system on bonuses paid to directors after year ends.
(SAICA)

This proposal is not accepted. The additional tax, if any, will be collected on assessment of the director.

TAXATION OF CAPITAL GAINS

3.49 *Taxation of capital gains realised by non-residents on the disposal of interests in immovable property in South Africa - paragraph 2(2) of the Eighth Schedule*

We request that, for the purposes of determining whether a foreign company is to be subject to SA CGT on the disposal of shares in a SA property holding company mining rights be attributed to trading stock and so be excluded from the test, notwithstanding that they remain of a capital nature. The key motivations for the requested change are that the fiscus ultimately benefits from a higher rate of tax on the assets (ore) derived from mining rights as these rights are effectively converted to trading stock over their life and will be subject to income tax as revenue income.

Accordingly we would suggest that subparagraph 2(2) be amended.
(PWC)

This comment is not accepted. Trading stock has a regular turnover. This is not the case with mining rights. Furthermore, where these rights are disposed of before extraction of the minerals takes place, the capital/revenue test may still be applied, which could result in the realisation of a capital gain.

3.50 *Deemed disposal of assets when a CFC ceases to be a resident – section 9D(2A) and paragraph 12(2) of the Eighth Schedule*

A deemed disposal is argued to apply in the case of a controlled foreign company (“CFC”) ceasing to be a CFC. This we consider to be wholly inappropriate, out of line, and far more draconian, than that of other jurisdictions globally.

In light of the above comments, and for purposes of certainty, we submit that a proviso be introduced to paragraph 12(2)(a) (with retrospective effect to 1 October 2001) to ensure that this deemed disposal does not apply in the case of CFCs who cease to be resident by virtue of their disposal to a non-resident.
(PWC)

This proposal is accepted in part. Although a deemed disposal of the assets of a foreign company is triggered when the company ceases to be a CFC a specific exemption is provided for in paragraph 64B of the Eighth Schedule for the deemed disposal of equity shares by a CFC.

3.51 *Exclusion of connected person loans discharged on liquidation - paragraph 12 of the Eighth Schedule*

While we understand the intention to limit the exclusion to shareholders' loans, the reference to "connected person" will have negative implications for minor shareholders that are not "connected persons" as defined to the company, but that waive loans owing in order to expedite the winding up of the company.
(SAICA)

By limiting the relief to waivers of debt between connected parties a large portion of the benefits otherwise obtainable will be foregone. The relief offered by paragraph 12(5) could permit many insolvent or dormant companies to liquidate thus reducing administrative burden on taxpayers and SARS alike. However no detail is given for the restriction to current 'connected party' limitation.

(PWC)

The proposals are not accepted. If the concession was allowed to all persons who are owed money by companies then the restriction in paragraph 56 of the Eighth Schedule would be bypassed. Unconnected persons would be able to claim a capital loss but there would not be a corresponding capital gain.

Surely the tax must be recovered from the company or the creditor, not the company and the creditor?

(SAICA)

The proposal is accepted.

3.52 *Time apportionment base cost - paragraph 30 of the Eighth Schedule*

One aspect that the current depreciable asset formula does not cater for is the situation where an asset acquired prior to 1 October 2001 qualifies for a capital allowance but additions/improvements subsequent to 1 October 2001 do for one or other reason not qualify. Should the pre 1 October 2001 expenditure be fully claimed for normal tax purposes only the post 1 October 2001 expenditure will qualify as part of base cost.

As the depreciable asset formula would not apply the provisions of paragraphs 30(1) and 30(2) will apply. This will result in the whole capital gain being treated as attributable to the period subsequent to 1 October 2001.

(SAICA)

The proposal is not accepted. There appears to be a misunderstanding of the proposed legislation. The opening words of the proposed subparagraph (3) read as follows:

- “(3) A person must determine the time-apportionment base cost of a pre-valuation date asset in terms of subparagraph (4) where—
- (a) that person has incurred expenditure contemplated in paragraph 20(1)(a), (c) or (e) on or after the valuation date;
 - (b) any part of the expenditure contemplated in paragraph 20(1)(a), (c) or (e) is or was allowable as a deduction in determining the taxable income of that person before the inclusion of any taxable capital gain; and...

It appears that item (b) is being read as being expenditure incurred on or after valuation date whereas it is all expenditure incurred prior to, on and after valuation date. The depreciable assets formula would, therefore, apply in the circumstances outlined in the example given.

The effective date of the amendment is 8 November 2005. A number of taxpayers have disposed of assets since 1 October 2001 using the time-apportionment basis, with the consequent effect of selling expenses being included in base cost. SAICA amongst others has been calling for the past three years for this concession, and it is unreasonably prejudicial to those taxpayers who have already sold assets. We suggest that the amendment should be retroactive to 1 October 2001 and those persons who have sold assets should be allowed to re-compute the capital gain and claim a refund. If the amendment is not made retroactive to 1 October 2001 we suggest that it should become effective as soon as possible, as any delay will lead to distortions in the marketplace as taxpayers will prefer to defer any sale agreements to take advantage of the new provisions.

Taxpayers have been faced with significant liability for CGT simply because the provisions of the Eighth Schedule did not allow them to reduce the proceeds by the selling costs and in the interests of fairness and equity, we strongly advocate that the amendment be made retro-active and allow these taxpayers to claim a refund of such taxes “overpaid”.

(SAICA)

These proposals are not accepted. It is proposed that the amendment come into operation on 8 November 2005 and apply in respect of any asset disposed of during any year of assessment ending on or after that date

3.53 *Part disposals – paragraph 33 of the Eighth Schedule*

We are in agreement that leasehold improvements are not part-disposals but, in order to avoid any confusion that may result due to the numerous changes since 2001, we recommend that the effective date of the amendment be 1 October 2001.

(SAICA)

This proposal is not accepted. It is proposed that the amendment come into operation on the date of promulgation of the Act and applies in respect of any improvement or enhancement effected on or after that date.

3.54 *Transfer of equity instruments – paragraph 38 of the Eighth Schedule*

The exclusion of equity instruments subject to section 8C should be made retrospective to 26 October 2004, being the date that section 8C became effective to avoid paragraph 38 applying to equity instruments acquired and taxable in terms of section 8C between 26 October 2004 and the date of promulgation of the amending Act.
(SAICA)

This proposal is accepted.

3.55 *Short term disposals and acquisitions of identical financial instruments – paragraph 42 of the Eighth Schedule*

We would like to propose that paragraph 42 also works to roll-over a gain made by a taxpayer on the disposal of an asset (it could be restricted to listed equities initially) where the taxpayer reacquires the same or a similar asset within a 45 day period, so that the base cost of the asset disposed of will roll-over and become the base cost of the new asset. The reason for our recommendation is that many listed companies are forcing their shareholders to sell a portion of their holding of listed equities in that company in order to enable that company to implement broad-based empowerment transactions. This disposal is a forced disposal and such taxpayers often repurchase the same or a similar number of shares in the same company to “restore” their holdings to that which they had prior to the forced disposal.
(SAICA)

This proposal is not accepted. The amendment was not announced in the Budget. In addition, after the BEE transaction and the acquisition of the equities the shareholders' proportional holdings in the company will have changed. A single shareholder cannot reverse this change except at the expense of the BEE partners or other fellow shareholders.

3.56 *Assets disposed of or acquired in foreign currency – paragraph 43 of the Eighth Schedule*

The amendment should not distinguish between assets acquired before and after the commencement of the amendment to use spot rate again. The amendment should apply to all assets disposed off after date of promulgation of the amending Act.
(SAICA)

This proposal is accepted.

3.57 *Disregarding of gains on disposal of shares in foreign shares – paragraph 64B of the Eighth Schedule*

The proposed amendment disregards the conflict between paragraph 12 and this paragraph, where paragraph 12 deems an exit charge for a CFC which is no longer a CFC due to having been sold and exempted under paragraph 64B. This substantially reduces the benefit of the participation exemption and seems to be contrary to National tax policy.

(SAICA)

It is unclear why the extension of the relief to deemed disposals, as was contemplated in the previous draft has now been removed. This should be reinstated to cover scenarios such as those envisaged in paragraph 12(2).

(PWC)

These proposals are accepted. A deemed disposal by a CFC of equity shares under paragraph 12(2) of the Eighth Schedule will get the benefit of the exemption.

We are concerned that the deeming of market value consideration paid by connected parties to be non-market related is taking anti-avoidance measures too far.

(PWC)

This proposal is accepted and the treatment of consideration by group companies as non-arm's length has been withdrawn.

CUSTOMS DUTIES

3.58 *Notice of action and period for bringing action – section 96*

The amendment is welcomed but the absence of specific provisions stipulating how the extinctive prescription periods may be interrupted in matters dealt with under the internal appeal, ADR and settlement procedures will result in uncertainty. This aspect should be clarified.

(SAICA)

This proposal is not accepted as the proviso to section 96(1)(b) specifically provides for the interruption of periods provided for in Chapter XA: Parts A, B and C.

STAMP DUTIES

3.59 *Lease agreements – item 14*

We have some reservations whether the cross-references to sections 5, 6, 7 and 8 of the Transfer Duty Act are appropriate or helpful. Most of the provisions of these sections deal with the consideration payable for the acquisition of immovable property, and adjustment to, inclusions in and exclusions from the consideration, which are clearly not relevant for the 10% value cap. Similarly, the provisions dealing with fair value, as determined by the Commissioner, are mostly irrelevant for this purpose. It is submitted that it would be simpler and more appropriate to refer to the fair value or, as was previously the case, selling value of the leased property on the date of the execution of the relevant lease agreement.

(SAICA)

This proposal is not accepted.

It is necessary that the manner in which the value of the property is determined be the same for both Transfer Duty and Stamp Duty when determining whether the 10% cap is applicable or not.

VALUE-ADDED TAX

3.60 *Definition of “enterprise” – section 1*

We recommend that more clarity be given around the issue of the person that needs to register as a VAT vendor as well as the practicalities around such registrations.

Often SA agencies are appointed to manage and oversee the projects, while the donor itself will have no SA presence or a SA bank account.

(SAICA)

This proposal is accepted. An Interpretation Note to deal with the registration and other relevant VAT issues in respect of the foreign donor funded projects will be issued.

While this issue is more closely linked to Government Policy, consideration should be given to including donor funding where the Government is not a party to the international agreement. Currently there is preferential treatment of grants where Government is a party to the international agreement. This situation could be construed as utilising the tax system (which is supposed to be neutral) to interfere with the economy.

(SAICA)

International agreements to which the Government is a party are approved by the National Assembly and the National Council of Provinces and become law. These agreements often contain clauses that the funds may only be used for the agreed purpose and not be spent on tax. The amendments proposed create the mechanism to give practical effect to the agreements.

3.61 *Corporate restructuring rules – section 8*

The introduction of section 8(25) is welcomed and will hopefully assist with the problem of transferring partially taxable businesses where goodwill is also transferred. There is a small technical problem in that it is required that all the provisions of sections 42, 44, 45 and 47 of the Income Tax Act are complied with, which is clearly nonsensical. Also, “complied with” is not necessarily the right term. We would suggest that the wording be changed to: “provided the provisions of any of sections 42, 44, 45 and 47 of the Income Tax Act are applicable to the supply in question”.

Consideration should be given to extending the section to further categories of inter-group transactions.
(SAICA)

These proposals are accepted in part.

The concession granted in respect of transactions falling within the ambit of sections 42, 44, 45 or 47 of the Income Tax Act are intended to ensure that the transaction does not have any tax consequences for either party. The usual inter-group transactions do not encounter difficulties in applying the provisions of the VAT Act and accordingly are subject to the normal VAT rules.

3.62 *Zero-rating of certain goods supplied to foreigners - section 11*

The proposed new section only applies to “goods”. Often services are supplied as an integral part of the total supply. We recommend that section 11(2) of the VAT Act be extended to include such services.
(SAICA)

Section 11(2)(l) of the VAT Act already caters for the supply of services in similar circumstances.

The section requires that the goods must be supplied to a person who is not a resident and not a vendor. We recommend that more clarity be given on the issue of when a non-resident person is regarded as conducting an enterprise in South Africa by virtue of having been awarded a contract in South Africa. In essence the

question that needs addressing is clarity on SARS' formal stance on the status of the legal obligation to supply goods or services in South Africa (without a physical presence) constituting an enterprise. In the light of the fact that a vendor is defined as, inter alia a person who is required to be registered under the VAT Act, we submit that it places an undue burden on the supplier to establish whether a non-resident is required to register as a vendor in South Africa. This can give rise to very harsh consequences as the SA supplier will be held liable for the VAT not recovered.

(SAICA)

This proposal is not accepted.

The decision on whether a person should register as a vendor is dependent on whether the person's enterprise or activity is carried on continuously or regularly in the Republic and has to be decided on a case by case basis. It is the intention to introduce place of supply rules into the Act to provide further clarity and South Africa is participating in the OECD study on this subject.

Sub-paragraph (ii) refers to goods that "form part of a supply". Consideration should be given to extending the ambit of the section to the situation where the entire supply is made by the SA supplier due to a sub-contracting agreement. As it currently reads, it would seem that there needs to be at least two parties involved in the total supply before the section will apply.

(SAICA)

This proposal is not accepted.

There are three parties to the agreement, the non-resident who has contracted with a vendor to supply goods to him or her, a vendor who has been sub-contracted by the non-resident to supply goods and the vendor who is the recipient of the goods. There is nothing stopping the sub-contracting by the non-resident of the supply of all the goods by a vendor but it must still form part of the supply by the non-resident.

Sub-paragraph (iii) requires that the recipient must use the goods wholly for the purpose of making taxable supplies. On a technical point, the term proposed in the section is "used ...for the purpose of making taxable supplies". Technically it should read "are acquired by the registered vendor for the purpose of consumption, use or supply in the course of making taxable supplies". The application of the section cannot, in our opinion, be narrowed in its application to goods on-supplied. The second issue for consideration in this regard is again a question of proof that the supply qualified to be zero-rated by the supplier. The onus of proof placed on the supplier is almost an impossible one

to discharge as the supplier does not generally have access to the required information.
(SAICA)

This proposal is accepted in part.

The burden on the supplier to establish whether the recipient will apply the goods to make taxable supplies is catered for in section 11(3) of the VAT Act, read with Interpretation Note No. 31, which will be updated accordingly. It will provide for a declaration by the recipient vendor. However, if the declaration from the recipient is false or incorrect, section 61 of the VAT Act allows the Commissioner to recover the tax from the recipient. The supplying vendor is, therefore, not penalised for zero rating the supply.

3.63 *Irrecoverable debts – section 22*

The intention behind the introduction of proviso (ii) to section 22(3) is questioned. The current thrust within the Ministry of Justice is to promote corporate recovery as opposed to liquidation or insolvency, with a view to saving companies, jobs, etc. One would have thought that, in these circumstances, a compromise arrangement with creditors or an arrangement in terms of section 311 of the Companies Act aimed at restoring the company back to solvency should not, at one and the same time, suddenly give the company an additional cost and cash flow burden in the form of having to pay output tax in respect of liabilities which it cannot pay. Moreover, why should private sector creditors who have given credit to the company be in a weaker position than the State?
(SAICA)

These proposals are not accepted.

Section 22(3) of the VAT Act currently requires a vendor to account for output tax, where the vendor claimed the input tax but did not pay the full consideration for the supply within 12 months of claiming the input tax. Where a vendor enters into an arrangement as envisaged in the proposed legislation, the input tax originally claimed has to be paid back as the current provisions of section 22(3) of the VAT Act will not be applicable if the arrangement is entered into prior to the expiry of the 12 month period.

4 General

The Banking Association and PricewaterhouseCoopers proposed a number of amendments in respect of provisions which are outside the scope of the Bill currently under consideration by the PCOF. For that reason no responses are presented to those proposals.

Prepared by the National Treasury and SARS