



Municipalities . . .

RSC Levy Repeal & VAT Simplification



Regional Services Levy Repeal (Clause 72)

- The RSC Levy (both the turnover and employee elements) will be repealed with effect from 1 July 2006
- This repeal provides:
 - R7 billion of tax relief; and
 - Simplifies taxpayer compliance (especially for small business)
- Repeal technically requires:
 - Repeal of section 93(6) of the Local Government: Municipal Structures Act; and
 - Replacement legislation: Municipal Fiscal Powers and Functions Bill (which will be presented to Parliament shortly)

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Municipalities and VAT: Objectives (Clauses 49, 52, 63, 64 and 66)



1. Revenue Shifting: Zero-rating of property rates is designed to shift revenue from the National Government to Municipalities due to RSC Levy repeal (the rest is financed via national grants).
2. Administrative Ease: The proposal also simplifies VAT administration by eliminating allocation issues for input credits

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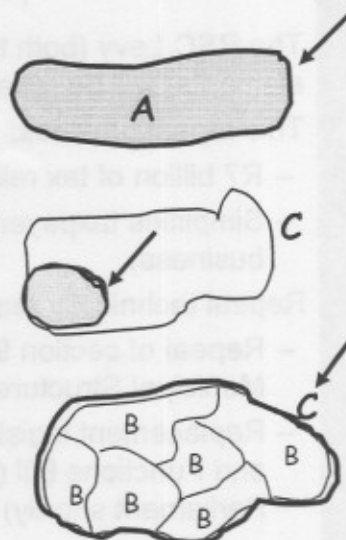


Note: Municipal As, Bs & Cs



Local Government consist of:

- Category A municipalities have exclusive municipal executive and legislative authority in their areas (x6)
- Category B municipalities share municipal executive and legislative authority in an area with a category C municipality (x231)
- Category C municipalities have municipal executive and legislative authority in an area that includes more than one municipality (x46), which may include "District Management Areas" (certain Cs, such as nature reserves)



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Zero Rating of Property Rates

- As of July, property rates will go from “out of scope” status to zero rating status
- As a result, all VAT cost inputs relating to property rates will be unlocked
- The proportion of municipal exempt/out of scope revenues will decrease, thereby reducing input allocation issues

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Property Rates as Cross-Subsidies

- Zero rating for property rates will apply even if those rates act as a hidden subsidy for standard rated services (e.g sewage, refuse, etc...)
- Opportunity for misuse is limited because of municipal rate guidelines and external pressures
- However, “flat fee” rate funding covering all services will be viewed as a standard rated service (historic relic in certain townships) (old section 8(6)(a) continued)

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Modernising the "Local Authority" Definition (Clause 56)



- The current VAT local authority definition predates recent changes to the Municipality acts
- Local authority currently means:
 - (a) any divisional council, rural council, municipal council,
 - (b) any other body, council, board, committee or institution established or deemed to be established by or under any law which has functions similar to those of the councils, boards and committees in paragraph (a) and which may levy rates on the value of immovable property within its jurisdiction or receive payments for services rendered or to be rendered; and
 - (c) any water board or regional water services corporation or any other institution which has powers similar to those of any such boards or corporations
- Proposals:
 - **Point #1:** Parts (a) and (b) part of the definition will be modernised into the Category A, B and C municipal definitions
 - **Point #2:** The water boards will fall under the "designated entity" (PFMA) definition

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Removing the Special "Enterprise" Definition (Clause 49)



- VAT only applies to an enterprise. A special "enterprise" definition exists for local authority activities (other local authority activities are simply out of scope)
- The following supplies by local authorities will always be part of an enterprise:
 - Electricity, gas or water;
 - Drainage, removal or disposal of sewage or garbage;
 - Goods or services incidental to or necessary for making the above-mentioned supplies
- However, when it comes to any other types of supplies, the following activities will trigger the enterprise definition only if all of the following conditions are met
 - The supplies must be of the same kind or similar to taxable supplies made by any private vendor (i.e. the competition clause);
 - The income derived from the activity (including amounts received as a grant) should be sufficient to cover all the costs of conducting that activity (i.e. cost coverage clause); and
 - The business activity must fall within the Ministerial list - see Government Notice No. 2570
- Proposal:
 - Delete the special local authority definition;
 - All local authorities will potentially fall under the general enterprise definition

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Simplified Municipal Revenue Streams

- By mainstreaming the enterprise definition, municipal supplies will generally be standard rated (not just listed items)
- Areas to be clarified by way of SARS interpretation:
 - Licenses and fees will be standard rated
 - Penalties and fines will be exempt

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Housing (Basic Principle Retained)

- Municipal rental housing will remain exempt
- The sale of housing by municipalities will remain subject to VAT
- Housing grants:
 - National grants for subsidised rentals remain exempt
 - National grants for subsidised sales remain zero rated (special rule for housing)

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Transport (Basic Principal Retained)

- Public transport will remain outside the VAT net
- This result matches the private sector (e.g taxis and other passenger transport)

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Grants TO Municipalities

- VAT treatment of grants will remain dependent on the ultimate use of the funds (sections 8(5A) and 11(2)(f)):
 - Grants are zero rated if the municipality uses the funds to offer standard rated or zero rated supplies
 - Grants are out of scope if the municipality uses the funds to offer exempt/out of scope supplies
- However, grants are not to be confused with services (the latter of which is subject to VAT)

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Payments FROM Municipalities TO Municipal Entities



- Payments from municipalities to municipal entities will:
 - Generally be standard rated; unless
 - The Minister views the entity as being regulatory
- Standard rated treatment will not have any adverse impact because the municipalities can claim VAT input credits
- National/provincial payments to municipal entities will remain subject to the grant/service distinction

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Effective Date Issues (Clauses 57 and 59)



- Municipalities may have difficulty shifting their systems by 1 July 2006; therefore, a 6-Month Penalty/Interest Waiver will be added as a transitional measure
- Input credits for pre-1 July 2006 municipal purchases will be blocked even if the purchase subsequently relates to a VATable output due to the proposed change

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Effective Date Changes (Cont.) SARS (Clause 62)

- Under old law, confusion existed as to whether a grant to a municipality was subject to VAT
- This confusion led to legislative clarification in 2005
- While the 2005 change solved the problem on a going forward basis, the same confusion still exists for pre-2005 years
- Hence, a retroactive amendment cures the problems arising for the pre-2005 years by :
 - Foreclosing SARS from prosecuting underpaid amounts relating to this issue (even if a SARS notice was already issued); and
 - Foreclosing municipalities from claiming refunds on overpaid amounts relating to the same issue

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Customs & Excise . . .



Yearly "Sin Tax" Adjustments (Clause 44 and Schedule 2)



- Increase charges on alcohol:
 - Sparkling wine: +20%
 - Unfortified wine: +12,5%
 - Fortified wine: +9,4%
 - Malt beer: +9%
 - Alcoholic fruit beverages: +9%
 - Spirits: +9,5%
 - Traditional beer: 0% change
- Increased charges on tobacco:
 - Cigarettes: +10,2%
 - Cigarette tobacco: +4,7%
 - Pipe tobacco: +8,3%
 - Cigars: +4,8%

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Deletion of *De Minimis* Items



- Certain de minimis items need to be deleted from ad valorem excise duty list because the cost of administration largely outweighs the revenue raised
- These *de minimis* items presently include:
 - Aqueous distillates and aqueous solutions of essential oils
 - Automatic goods vending machines
 - Fax machines (and certain transmission parts)
 - Road tractors

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Biodiesel

- General fuel levy concession of 30% announced in the 2002 Budget Review
- Enabling legislation enacted that same year
- Industry and standard setters subsequently engaged
- The 2006 Budget review announced an increase to 40%
- Implemented as of 1 April 2006

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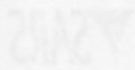


Miscellaneous Amendments & Technical Corrections

“Annexure C”



THANK YOU



UST and the Sale of Partial State Rights (Clause 19)

In 2005, Government took steps to ensure that taxpayers could not avoid UST by selling listed shares off-market. These rules treated all off-market sales as occurring at a market value at least equal to the "total" listed share value. This deemed rule inadvertently applied to the sale of partial rights (dividend and voting ceptions), triggering a tax on value equal to the "total" share value. The change limits the deemed rule to the market value of the partial right.



Treasury Access to PFMA and MFMA Data (Clauses 25 and 51)

- Treasury generally has only limited access to SARS taxpayer data (i.e. retrievable only at an aggregate level)
- Given its role in appropriating funds, Treasury will obtain full access to SARS taxpayer data for:
 - PFMA entities, and
 - MFMA entities

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UST and the Sale of Partial Share Rights (Clause 70)

- In 2005, Government took steps to ensure that taxpayers could not avoid UST by selling listed shares off-market
- These rules treated all off-market sales as occurring at a market value at least equal to the "total" listed share value
- This deeming rule inadvertently applied to the sale of partial rights (dividend and voting sessions), triggering a tax on value equal to the "total" share value
- The change limits the deeming rule to the market value of the partial right

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Transfer Duty & Divorce (Clause 21)



- Transfer Duty currently does not apply to:
 - Transfers between spouses upon death regardless of whether the marriage is “in or out of” community of property; or
 - Transfers between spouses upon divorce only if the marriage was “in” community of property
- Proposal:
 - Extend the Transfer Duty to all divorce transfers regardless of community of property

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Stamp Duty Exemption for Collective Investment Schemes (Clauses 48 and 71)



- Collective Investment Schemes are currently exempt from Stamp Duty if in the form of an unlisted Unit Trust
- In order to provide equal exemption for Collective Investment Schemes:
 - All schemes will be exempt from Stamp Duty/UST regardless of whether:
 - The scheme is in the form of a trust or company; and
 - The scheme invests in shares, bonds or land
 - All listed schemes will be exempt from UST regardless of trust of company form (provides relief for listed Index Funds)
- Exemption limits the Stamp Duty/UST charges to one level:
 - No charge for participatory interests in a scheme; but
 - The Scheme is subject to a charge for its shareholdings

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Minor Items: Income Tax



- Liquidating dividend terminology alignment (Clause 24)
- Deemed disposal for listed shares inadvertently limited to company holders (Clause 28)
- Deletion of exemption for previously defunct RIDP and SRIDP programmes (Clause 29)
- 2005 currency printing error (Clause 32)
- Fringe benefit formula for employer-subsidised employee accommodation will utilise a R40 000 input (versus the former R20 000) (Clause 35)
- Deletion of R500 de minimis exemption for cross-border travel fringe benefits (Clause 36)
- 2005 anti-avoidance dividend-outflow errors (Clause 41)

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Minor Items: Other Taxes



- VAT: Clarifying that premiums for option are an exempt financial service (Clause 50)
- VAT: References to leaded fuel deleted as obsolete (Clause 54)
- Customs: Empowering SARS to detain ships, vehicles and containers (Clauses 42 and 43)
- UST: Clarifying that UST applies to redemptions (Clause 69)
- Stamp Duty: Phasing-out of adhesive stamps and franking machines for Stamp Duty (Clause 46)

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