REPUBLIC OF SOUTH AFRICA

DRAFT EXPLANATORY MEMORANDUM

ON THE

REVENUE LAWS AMENDMENT BILL, 2007

[W.P. –- ‘07]

CONTENTS

EXPLANATION OF MAIN AMENDMENTS

Introduction

Adjustments to the base for the Secondary Tax on Companies (“STC”)
1. Broadening the taxable dividend definition
2. Simplifying STC intra-group relief
3. Anti-distribution stripping (Pre-sale extraordinary dividends (paragraph 19 of the Eighth Schedule)
4. Capital distributions (paragraphs 76 and 76A of the Eighth Schedule)

Capital versus ordinary shares

Company reorganisations
1. Removal of the financial instrument limitations (sections 42 – 47)
2. Repeal of share-for-share relief (section 43)
3. Intra-group transactions
4. Collective Investment Schemes (sections 42(1), 44(1) and 46(1))
5. Prohibitions against transfers to wholly or partially exempt transferees (section 44(14), 45(6) and 47(6))
6. Share cross-issues (section 24B)
7. Share buybacks of listed shares (section 42A of the Eighth Schedule)
8. Connected person transfers of depreciable property

Intellectual property payments
1. Intellectual property arbitrage (section 23I)
2. Cross-border intellectual property transfer pricing

Long-term insurers and controlled foreign companies (“CFCs”)

Depreciation
1. Rolling stock (section 12DA)
2. Port assets (section 12F)
3. Environmental assets and activities (section 37B)
4. Commercial buildings (section 13*quin*)

Amalgamation of sporting bodies

Tax relief for co-operative banks

Exemption of occupational death benefits

Oil and Gas Fiscal Stability

Customs and Excise

1. Customs and Excise definitions
2. Improved control over counterfeit goods

CLAUSE BY CLAUSE EXPLANATION

Clause	Section
Transfer Duty Act, 1949	
Clause 1	Section 3
Clause 2	Section 9
Clause 3	Section 14
Pension Funds Act, 1956	
Clause 4	Section 4C
Income Tax Act, 1962	
Clause 5	Section 1
Clause 6	Section 5
Clause 7	Section 6*quat*
Clause 8	Section 8
Clause 9	Section 8B
Clause 10	Section 8C
Clause 11	Section 9B
Clause 12	Section 9C
Clause 13	Section 9D
Clause 14	Section 10
Clause 15	Section 11
Clause 16	Section 11C
Clause 17	Section 11D
Clause 18	Section 11E
Clause 19	Section 12B
Clause 20	Section 12C
Clause 21	Section 12D
Clause 22	Section 12DA
Clause 23	Section 12E
Clause 24	Section 12F
Clause 25	Section 12G
Clause 26	Section *13quin*
Clause 27	Section 15
Clause 28	Section 18
Clause 29	Section 20
Clause 30	Section 23A

Clause 31	Section 23D
Clause 32	Section 23G
Clause 33	Section 23H
Clause 34	Section 23I
Clause 35	Section 23J
Clause 36	Section 24B
Clause 37	Section 24I
Clause 38	Section 28
Clause 39	Section 30
Clause 40	Section 31
Clause 41	Section 35
Clause 42	Section 36
Clause 43	Section 37A
Clause 44	Section 37B
Clause 45	Section 37C
Clause 46	Section 37D
Clause 47	Part III
Clause 48	Section 41
Clause 49	Section 42
Clause 50	Section 43
Clause 51	Section 44
Clause 52	Section 45
Clause 53	Section 46
Clause 54	Section 47
Clause 55	Section 64B
Clause 56	Section 64C

Second Schedule to the Income Tax Act, 1962

Clause 57	Paragraph 2

Fourth Schedule to the Income Tax Act, 1962

Clause 58	Paragraph 1
Clause 59	Paragraph 11A

Seventh Schedule to the Income Tax Act, 1962

Clause 60	Paragraph 9
Clause 61	Paragraph 10
Clause 62	Paragraph 12B

Eighth Schedule to the Income Tax Act, 1962

Clause 63	Paragraph 19
Clause 64	Paragraph 20
Clause 65	Paragraph 42
Clause 66	Paragraph 42A
Clause 67	Paragraph 43
Clause 68	Paragraph 65

Clause 69	Paragraph 66
Clause 70	Paragraph 76
Clause 71	Paragraph 76A
Clause 72	Paragraph 79

Tenth Schedule to the Income Tax Act, 1962

Clause 73	Paragraph 1
Clause 74	Paragraph 8

Customs and Excise Act, 1964

Clause 75	Section 1
Clause 76	Section 4
Clause 77	Section 10
Clause 78	Section 21A
Clause 79	Section 43
Clause 80	Section 44
Clause 81	Section 46
Clause 82	Section 47
Clause 83	Section 47B
Clause 84	Section 52
Clause 85	Section 54B
Clause 86	Section 65
Clause 87	Section 69
Clause 88	Section 75
Clause 89	Section 77C
Clause 90	Section 77G
Clause 91	Chapter XB
Clause 92	Section 78
Clause 93	Section 79
Clause 94	Section 86A
Clause 95	Section 92
Clause 96	Section 94
Clause 97	Section 95
Clause 98	Section 111
Clause 99	Section 113A
Clause 100	Section 114
Clause 101	Section 114A
Clause 102	Section 114B
Clause 103	Section 120

Stamp Duties Act, 1968

Clause 104	Section 1
Clause 105	Section 7
Clause 106	Section 8
Clause 107	Section 23
Clause 108	Section 28C

Clause 109	Item 15 of Schedule 1

Value-Added Tax Act, 1991

Clause 110	Section 1
Clause 111	Section 6
Clause 112	Section 8
Clause 113	Section 9
Clause 114	Section 11
Clause 115	Section 16
Clause 116	Section 17
Clause 117	Section 28
Clause 118	Section 33
Clause 119	Section 33A
Clause 120	Section 55
Clause 121	Schedule 1
Clause 122	Schedule 2

Uncertificated Securities Tax Act, 1998

Clause 123	Section 6

Skills Development Levy Act, 1999

Clause 124	Section 4

Collective Investment Schemes Control Act, 2002

Clause 125	Section 99

Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

Clause 126	3rd Schedule

Taxation Laws Amendment Act, 2007

Clause 127	Section 3
Clause 128	Section 15
Clause 129	Section 54
Clause 130	Section 56
Clause 131	Section 64
Clause 132	Section 67
Clause 133	Section 112
Clause 134	Section 115
Clause 135	Appendix I
Clause 136	Appendix III
Clause 137	Appendix III

2007 ICC 20 20 WC (South Africa)

Clause 138

Amalgamation of sporting bodies
Clause 139

Short title and commencement
Clause 140

EXPLANATORY MEMORANDUM ON THE REVENUE LAWS AMENDMENT BILL, 2007

INTRODUCTION

The Revenue Laws Amendment Bill, 2007, introduces amendments to the Transfer Duty Act, 1949, the Pension Funds Act, 1956, the Income Tax Act, 1962, the Customs and Excise Act, 1964, the Stamp Duties Act, 1968, the Value-Added Tax Act, 1991, the Uncertificated Securities Tax Act, 1998, the Skills Development Levy Act, 1999, the Collective Investment Schemes Control Act, 2002, the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006, and the Taxation Laws Amendment Act, 2007. In addition, the Bill proposes the certain supplies relating to the ICC 20 20 WC (South Africa) be subject to value-added tax at the rate of zero percent and proposes further for the tax-free amalgamation of sporting bodies.

ADJUSTMENTS TO THE BASE FOR THE SECONDARY TAX ON COMPANIES (“STC”)

The switch of the STC from a company-level tax to a shareholder-level tax was announced in the 2007 Budget Review. The interim step of base-broadening and simplification was also announced at that time. As a prelude to the overall improvements to the STC base, the proposed legislation makes a number of preliminary adjustments to broaden the base and curb ongoing avoidance schemes. This stage of the base-broadening effort is accompanied by a reduction of the STC rate from 12, 5 per cent to 10 per cent.

1. Broadening the taxable dividend definition

Current legislation

The STC falls on distributions only if those distributions qualify as dividends. In order for a distribution to qualify as a dividend, it must, as a rule, come from profits. The dividend definition is found in section 1 of the Income Tax Act, 1962, but the definition is also assumed to take account of the principles of company law. The rules for the STC with respect to dividend taxation are contained in section 64B (along with the rules for deemed dividends under section 64C).

Problem statement

The dividend definition contains many historic anomalies that create unintended inconsistencies. Some unintended inconsistencies give rise to avoidance

potential while others simply complicate the dividend calculation and lead to uncertainty. The proposed changes are intended as a step toward streamlining the definition and closing some obvious shortcomings.

Proposed amendment: (Section 1 – "dividend" definition)

A. Basic principles

Some confusion exists regarding basic principles in calculating dividends. Firstly, dividends should account for all profits, whether realized or unrealized (even if not reflected in a company's financial statements). For instance, if a company owns appreciated property and borrows against that property to make a distribution, the dividend calculation should account for the unrealized profits attributable to the property (even though the property remains unsold). Similarly, if an asset is distributed in specie, any unrealized profit associated with that distribution should be taken into account regardless of whether it is reflected in the company's financial statements. Secondly, the law technically excludes distributions of share premium from the dividend definition but is silent as to share capital.

B. Redemptions (and reconstructions)

The dividend definition provides special rules for redemptions, reductions or any other acquisition by a company of its own shares (as well as reconstructions). Share nominal value acts as an offset against the definition as opposed to share premium (and share capital). However, no difference should exist because the removal of funds from a company in these circumstances is no different than any other distribution. To the extent any difference exists, the difference occurs at a shareholder level (which is fully taken into account as a disposal under the Eighth Schedule). The concept of a nominal value offset for these transactions is accordingly removed.

C. Removal of transitional calculations

The dividend definition continues to exclude certain forms of profits pre-dating effective dates when companies make liquidating distributions. The most notable of these exclusions is the exclusion for liquidating dividends to the extent those dividends arise from pre-2001 capital profits. The other exclusion (in section 64B(5)(c)) is for liquidating dividends arising from pre-1993 profits. Consideration is being given to removing the profits concept altogether in the longer-term as part of broader base broadening measures. Therefore, the pre-effective date profit exclusions will no longer be compatible with the new regime and must be entirely removed. This proposed removal will take effect for all distributions on or after 1 January 2009. The delayed effective date will give taxpayers time to plan accordingly.

D. Allocation of share capital (and share premium)

Share capital (and share premium) can be freely allocated to specific share distributions even if that share capital (and share premium) arose from other sources. Taxpayers are seemingly using this free allocation to disguise shareholder sales in the form of shareholder contributions and distributions. In order to prevent this practice, the proposal limits the amount of share capital (and share premium) that can be allocated to any share based on the pro rata value of that share in relation to the total value of the company.

> *Example. Facts.* Company has two classes of shares – ordinary and preference shares. Shareholders of the ordinary shares previously contributed share capital and share premium of R10 000. Shareholders of the preference shares previously contributed R30 000. In a subsequent year, shareholders of the preference shares receive a R25 000 distribution. At the time of the distribution, the preference shares have a value of R50 000 and the preference shares have a value of R150 000.
>
> *Result.* In order to limit undue shifts of share capital (and share premium) at the shareholder level, the pro rata rule applies to limit the amount of share capital (and share premium) that can be potentially distributed in respect of the preference shares. In this case, the preference shares represent only 25 per cent of the total company value. Therefore, no more than 25 per cent (i.e. R10 000) of the total R40 000 share capital and share premium can be allocated to the R25 000 distribution.

2. Simplifying STC intra-group relief

Current legislation

Group relief exists for dividends between companies falling within the same group of companies (e.g., having a 70 per cent shareholder connection). In effect, intra-group dividends have exemption based on the premise that the underlying profits will ultimately become subject to the STC once those profits leave the group as dividends. One condition of this exemption is that the intra-group dividends must stem from profits arising while the distributing company was part of the group. Comparable group relief exists for deemed dividends.

Problem statement

STC relief for intra-group dividends plays an important role in legitimate intra-group restructuring but is also the subject of tax avoidance. Experience with the regime indicates that certain aspects of the relief must be narrowed while some anti-avoidance obstacles create unintended problems without significantly curbing anti-avoidance. The STC regime will accordingly be adjusted to account for these realities.

Proposed amendment

A. Narrowed group definition (sections 41 and 64B(1) – "group of companies" definition)

All intra-group relief should essentially operate as a deferral regime. Therefore, intra-group dividends cannot be allowed in the case of dividends to group companies falling outside the STC because deferral will be effectively converted into exemption. In view of this reality, fully or partially exempt companies will fall outside the intra-group definition. The proposal also tightens the rules on the shares counting toward the 70 per cent ownership criteria needed for group status. More specifically, the group members involved must genuinely have a permanent association with the group (i.e. the shares cannot be trading stock or subject to an option (or other instrument for sale). All of these changes will mirror the narrowed group definition to be used for intra-group relief. The narrowed group definition will equally apply for determining the deemed dividend exemption for intra-group deemed dividends.

B. Profits limitation (section 64B(5)(f))

As discussed above, intra-group relief applies only to the extent that the intra-group dividend involves profits arising while company members are part of the same group. Relief does not apply to profits arising before a company member becomes part of a group. The same limitation applies to the intra-group relief rules for deemed dividends. While this limitation makes sense as a matter of tax theory, tracing profits to pre- and post-acquisition periods is administratively problematic, especially in the case of deemed dividends (because profits are not actually distributed). The prohibition against pre-acquisition profits is also inconsistent with the intra-group rules, which apply to all intra-group asset transfers even if the asset partially appreciated or depreciated before becoming part of the group. Given these difficulties, intra-group (actual and deemed) dividends will be fully eligible for relief even if those dividends can be traced to pre-acquisition profits. Any avoidance scheme stemming from this change will be addressed in paragraph 19 of the Eighth Schedule (see pre-sale extraordinary dividends).

However, a new profit limitation will be added to prevent loss to the fiscus. Certain taxpayers have created intra-group structures that involve actual intra-group dividends that reduce the profit levels of the distributing intra-group company payor without adding additional profits for the shareholder intra-group company payee. This stems from the accounting treatment prescribed by IAS 18 (AC 111) in terms of which dividends received out of pre-acquisition profits are not recognised as income but reduce the cost of investment in a subsidiary. The net effect is to turn intra-group relief from a deferral regime to an exempt regime because profits ultimately disappear from the group without STC. In order to

curb this threat to the tax base, intra-group relief for actual dividends will be allowed only to the extent the intra-group company receiving the dividends includes profits as a result of those dividends.

3. Anti-distribution stripping (Pre-sale extraordinary dividends (paragraph 19 of the Eighth Schedule)

Current legislation

Current law seeks to prevent the artificial creation of capital losses stemming from extraordinary dividends. More specifically, taxpayers must disregard losses stemming from the devaluation of any share sold at a loss if the shareholder received an extraordinary dividend within two years after the share was initially acquired. The anti-loss rule does not apply to devaluations caused by extra-ordinary dividends that are exempt from STC by virtue of intra-group relief.

Problem statement

The initial regime was mainly designed to prevent dividend stripping stemming from short-term holdings in shares. In transactions of the type initially envisioned, the taxpayer would purchase a share, receive an extraordinary dividend, and then sell the share at a capital loss shortly thereafter. The capital loss generally stems from the fact that the share lost value due to the loss of cash from the outgoing extraordinary dividend.

The initial regime has two shortcomings. Firstly, the devaluation of shares via extraordinary dividends can equally occur in respect of long-term holdings as opposed to short-term holdings. Secondly, the scheme of using extraordinary dividends to generate capital losses has a particularly high value if the pre-sale extraordinary dividends do not give rise to STC. The current regime fails to reflect this reality, and indeed, provides an escape hatch from the anti-loss regime when the extra-ordinary dividends are exempt by virtue of the STC intra-group relief provisions.

Proposed amendment

The Paragraph 19 anti-extraordinary dividend stripping provisions will be fundamentally revised. Under the new anti-avoidance regime,

(1) All dividends (including exempt dividends by virtue of the intra-group relief provisions or otherwise) will be subject to the anti-avoidance charge; and

(2) The regime will apply whenever extraordinary dividends are distributed within two years before disposal of the share (as opposed to the old rule focusing on extraordinary dividends arising within two years after purchase).

If the new anti-avoidance regime applies, the seller of the shares must be deemed to have received additional proceeds on the disposal equal to the exempt extraordinary dividend. Hence, the new rule applies to add gain or deny loss (not just to deny loss).

> *Example. Facts.* Parent Company has owned all the ordinary shares of Subsidiary since 2000. Parent Company purchased the shares for R20 million. Since that date, Subsidiary has increased in value to R35 million. On 15 March 2008, Subsidiary makes an exempt (section 64B(5)(f) distribution to Parent of R10 million. Parent then sells the Subsidiary shares for R25 million.
>
> *Result.* The exempt dividend is an extraordinary dividend (i.e. exceeds 15 per cent of the R25 million sales proceeds). Therefore, Parent must add the R10 million amount to the sales proceeds, thereby increasing the R5 million gain to R15 million.

4. Capital distributions (paragraphs 76 and 76A of the Eighth Schedule)

Current legislation

Special rules apply for purposes of the capital gains tax regime under the Eighth Schedule when companies make a capital distribution (e.g. a distribution of share capital or share premium falling outside the dividend definition). Under these circumstances, all distributions of this nature arising on or after 1 October 2001 will be added to proceeds upon the eventual disposal of shares (and all pre-2001 distributions reduce expenditure in the share). The outstanding deemed proceeds of this nature can even exceed the shareholder's total expenditure (leaving the shareholder with an effective "negative" base cost).

Problem statement

The additional proceeds rule for capital distributions was designed as a rule for administrative convenience. The additional proceeds concept had the benefit of avoiding complex calculations for the capital gains tax every time a company distributed share capital or share premium over the life of the share investment. Unfortunately, taxpayers have sought to use this rule of administrative convenience as a mechanism to disguise the sale of shares in order to avoid the imposition of capital gains tax. These mechanisms are especially problematic when the deemed proceeds from the capital distribution exceed the underlying expenditure in the share (i.e. the share is left with an effective negative base cost). In order to avoid eventual gain on the shares, the holder of the share generating the capital distribution merely holds onto the shares without any expectation of further profit from those shares.

Proposed amendment

A. General rule

For the reasons outlined above, the tax rules will be shifted for capital distributions so that each capital distribution will generally trigger a part-disposal of the share. While this rule requires additional calculations, the new rule is essentially better from a tax policy standpoint and has the advantage of eliminating the avoidance concern.

More specifically, under the new part-disposal rule, the capital distribution will fall under the part-disposal rule of paragraph 33. The allocation of expenditure between the part sold and the total share will be based on the ratio between the amount of the distribution (i.e. the cash and market value of property *in specie*) and the total value of the share. The new dispensation will apply from 1 July 2008.

> *Example. Facts.* Taxpayer holds a share with a value of R200, which was acquired for R120. Taxpayer receives a capital distribution of R20 in cash during July 2009.
>
> *Result.* The capital distribution gives rise to a part sale. Ten percent of the R120 expenditure is allocated to the part sale (R20 capital distribution over R200 total share value). Taxpayer accordingly has R8 of gain on the distribution (R20 proceeds less R12 allocable expenditure).

B. Effective dates

The shift of emphasis from delayed proceeds to part-disposal for capital distributions gives rise to transitional issues. In the main, the issue arises in respect of distributions occurring from 1 October 2001 up to the day before 1 July 2008. These distributions will have to be brought into the new regime as a matter of administrative simplicity. Therefore, all distributions during this interim period will be deemed to trigger a part sale on 1 July 2008. The delayed 1 July 2008 effective date for the new capital distribution regime was set specifically in anticipation of this deemed disposal event.

Other effective date issues address pre-1 October 2001 distributions (reducing expenditure but not below zero), and capital distributions of shareholders relying on the weighted average method. In respect of the weighted average method, the general part-sale rules will apply with special rules again required for the transitional period from 1 October 2001 until the close of 30 June 2008. Under these rules, negative base cost will trigger gain on 1 July 2008.

C. Capital distributions, unbundlings and the weighted average method

In terms of section 46(3) of the Income Tax Act when an unbundling transaction takes place, a portion of the base cost of the shares in the unbundling company must be allocated to the shares in the unbundled company. Under paragraph 76(1) of the Eighth Schedule, a capital distribution of an asset *in specie* must be treated as proceeds on disposal of the share to which it relates. However, in view of the base cost allocation treatment under section 46(3), it would not be appropriate to treat the capital distribution as proceeds as this would lead to double taxation. It is for this reason that capital distributions received as part of an unbundling transaction are excluded from paragraph 76(1). The problem, however, is that paragraph 76(1) only applies to persons who use the specific identification or first-in-first-out methods. No provision is made for the exclusion of such capital distributions by shareholders who use the weighted average method under paragraph 32(3A). Such shareholders are required to deduct the capital distribution from the base cost of their shares under paragraph 76(2). It is accordingly proposed that a capital distribution of shares in an unbundled company also be excluded from paragraph 76(2).

D. Repeal of matching contribution/distribution avoidance rule (paragraph 79 of the Eighth Schedule)

Under current law, matching capital contributions and capital distributions can trigger immediate capital gains at the shareholder level as if one shareholder sold to another party. This rule has largely proven to be ineffective, and its intended target of concern will be addressed by the new part-disposal rules for share capital distributions. The matching contribution/distribution rule will accordingly be repealed.

CAPITAL VERSUS ORDINARY SHARES

Current legislation

Capital gains and ordinary income are effectively taxed at different rates, but no clear dividing line exists between the two regimes. The facts and circumstances analysis of case law accordingly prevails. The only legislative intervention is section 9B, which treats shareholders of listed company shares as having per se capital gain or loss from the sale of listed shares held for longer than 5 years. Shareholders have to make an election that section 9B should apply to all their share transactions.

Problem statement

Although section 9B provides a degree of certainty for the sale of listed shares, this section should be expanded to provide a greater degree of certainty with respect to share transactions on a more generalised basis. Continued reliance on case law often leads to unintended differences of application. The result is that some sectors of the economy are facing one standard while other sections are facing a different standard. The use of objective rules will eliminate this uneven playing field.

Proposed amendment

From 1 October 2007, the current 5-year rule (section 9B) will be replaced with a new rule (Section 9C). The new rule will apply to all "shares" held for at least 3 continuous years.

A. Definitions (subsection (1))

The definition of "connected person" has a slightly lower threshold in section 9C than the normal connected person test. More specifically, company shareholders will be viewed as connected to the company in which they hold 20 per cent of the shares (even if another shareholder holds a majority interest). This definition plays a role in the 3-year real estate/bare dominium anti-avoidance rule.

The definition of "Shares" will include all listed shares on the JSE (domestic and foreign), private company shares, interests in close corporations and certain (i.e. share portfolio) collective investment schemes. However, the share definition excludes certain hybrid instruments (i.e. shares with both equity and debt features), shares involved in former section 24A rollover-schemes, interests in share block companies and unlisted foreign companies. The exclusion for unlisted foreign companies can be justified on the grounds that foreign shares already have many tax differences. For instance, the sale of foreign shares is often completely exempt from tax if of a capital nature (by virtue of the participation exemption under paragraph 64B of the Eighth Schedule); whereas, domestic shares can only benefit from the reduced capital gains tax rate.

B. General rule (subsection (2))

Sales of shares held for the three year period will be deemed to be of a capital nature. This rule applies equally to gains and losses. The new three-year rule is mandatory (unlike section 9B which is elective).

C. Immovable property/bare dominium anti-avoidance rule (subsection (3))

Concern exists that the new section 9C could create potential for avoidance if shares are held in companies mainly holding real estate (and bare dominions), as follows:

> *Example.* Taxpayer owns many shelf companies. Taxpayer plans to buy real estate, followed by resale after six months. To benefit from new section 9C, Taxpayer provides a guarantee to the shelf company so that the shelf company can buy the real estate with bank loan proceeds. The shelf company has been held by Taxpayer for 3 years. Taxpayer sells the shelf company shares (instead of the real estate) six months after the shelf company purchased the real estate.

To prevent the above avoidance, new section 9C will not apply to equity shares in companies if:

- (i) more than 50 per cent of the total value of the company (implied net asset calculation) consists of immovable property acquired within three years before disposal of the shares; and/or
- (ii) any other asset was acquired within the three years if: (1) encumbered by a lease or license, and (2) the lease or license payments are wholly or partly received or accrued to someone other than that company within the same three year period.

In determining the more than 50 per cent threshold, financial instruments acquired within the last three years are excluded from the denominator if those shares were acquired for shares (note: borrowed financial instruments have no impact because the new asset will be offset by the corresponding liability).

The anti-stuffing rule prevents the 3-year presumption from applying only for shareholders with a meaningful level of shares in the company. To have a meaningful level of ownership, the shareholder must be viewed as a connected person (as defined in subsection (1)) to the company at issue.

The normal facts and circumstances test will apply to gains realised on the sale of shares that do not qualify in terms of the new rule. Failure to satisfy the more than 50 per cent test will not create an ordinary revenue presumption.

D. Timing rules (subsection (4))

The 3-year time period for section 9C generally takes into account various rollover regimes throughout the Income Tax Act. For instance, the Part III reorganisation rules rollover dates, and the share substitution rules of paragraph

78 of the Eighth Schedule) rollover dates. This date rollover will automatically apply to the 3-year rule, subject to the exceptions listed below.

> *Example.* Parent Company owns shares of Subsidiary. Subsidiary owns shares in Company A. The Company A shares were acquired on 1 July 2008. Subsidiary liquidates on 1 November 2009 with Parent Company acquiring the Company A shares. Under these facts, Parent Company is deemed to have held the Company A shares since 1 July 2008.

In the case of the Part III rollover regime, new rules have been added so that the 3-year date rollover will not apply to section 42 asset-for-share transactions (section 42(2)(a)) nor to section 46 unbundlings (section 46(3)). Without this exclusion, concerns exist that both sections 42 and 46 can be used to convert non-three years assets into three year shares. Section 42 is a problem because 3-year non-share trading stock assets can be stuffed into a new shelf company. Section 46 is a problem because a 3-year active company can acquire new assets as trading stock and dump that trading stock into a Newco that is unbundled with the shareholders being treated as having the Newco shares for the minimum three year period.

The law also clarifies the impact of other rollover regimes. For instance, securities lending transactions should provide a date rollover (section 9C(4)). The sale-repurchase rollover regime for loss and gain shares (paragraphs 42 and 42A of the Eighth Schedule) will have general date rollover rules similar to the Part III reorganisation rules.

E. Recoupment (subsection (5))

The net effect of section 9C may be to turn certain shares claimed to be held as trading stock into capital at point of disposal. For instance, a taxpayer may have claimed interest deductions in respect of shares claimed to be trading stock up until the point of disposal. Under these circumstances, all interest must be recouped at point of the section 9C capital disposal.

F. Identical shares (subsection (6))

If a taxpayer acquires identical shares on different dates, ordering rules are required to determine which shares were actually sold at the point of disposal for purposes of the 3-year rule under section 9C. Like old section 9B, section 9C takes a first-in-first-out approach with the oldest shares being deemed sold first.

G. Interaction with the deemed disposal rules for trading stock (subsection (7))

The deemed capital treatment for disposals under section 9C must work in conjunction with the deemed disposal trading stock rules of section 22(8). In

particular, issues exist upon disposal to prevent section 22(8) from undermining the benefits of section 9C. Without special rules, the deemed disposal would trigger ordinary gain upon the deemed capital conversion upon disposal. In order to remedy this problem, taxpayers must only recoup their section 11(a) cost upon the section 9C disposal (the market value recoupment of section 22(8) will not apply).

> *Example. Facts.* Taxpayer acquires shares for R150 in 2008. Taxpayer holds the shares as trading stock. In 2013, Taxpayer sells the shares for R290.
>
> *Result.* Taxpayer claims an opening section 22 trading stock deduction of R150 in 2013. The sale triggers a R150 recoupment of the R150 deduction. Taxpayer then calculates capital gain of R140 (R290 minus R150) by virtue of section 9C.

H. Effective dates

Section 9C shall come into effect on 1 October 2007 and will apply to qualifying shares disposed of on or after this date. Section 9B will no longer apply for disposals occurring from the same date.

I. Private equity carried interests

It has come to Government's attention that a number of private equity deals involve management "carried interests." These carried interests represent a form of services, which should be taxed at ordinary rates. However, these carried interests are often arranged so that they are instead taxable as a capital gain. One mechanism for disguising these interests may be through the use of shares. The proposed 3-year deemed capital rule may accordingly be adjusted at a later date to eliminate this potential for arbitrage. Any changes in this regard will be subject to further analysis.

COMPANY REORGANISATIONS

The South African tax rules for company reorganisations have made significant advancements since the core provisions were introduced in 2001. Nonetheless, certain isolated provisions within the reorganisation rules pose undue compliance and enforcement burdens. In addition, a number of collateral provisions are also a cause for concern. The legislative proposals below seek to eliminate these highlighted areas.

1. Removal of the financial instrument limitations (sections 42 – 47)

Current legislation

The company reorganisation rules provide rollover relief in a variety of circumstances (e.g., asset-for-share transaction, intra-group transfers and unbundlings). However, this relief is generally unavailable if the company reorganisation mainly entails the transfer of financial instruments or companies mainly consisting of financial instruments. The anti-financial instrument provisions had a two-fold purpose. Firstly, rollover relief should only entail the reorganisation of active operations. Secondly, concerns existed that the reshuffling of financial instruments was often a prelude for tax avoidance transactions.

Problem statement

Experience indicates that the anti-financial instrument provisions are unwieldy and do not appreciably prevent avoidance. While the movement of financial instruments often can be a predicate for tax avoidance, other practical mechanisms exist to achieve this movement without reliance on the reorganisation rules. The cumbersome nature of these rules has instead added unnecessary compliance costs for legitimate reorganisations with little protection against avoidance.

Proposed amendment

It is proposed that all of the financial instrument limitations be completely removed from the company reorganisation rollover provisions. All reorganisations contemplated in Part III can now be conducted without regard to any of these limitations. It should be noted, however, that the financial instrument limitations will remain for cross-border transactions. In the context of the controlled foreign company rules (section 9D), the financial instrument rules serve the important function of neutralising offshore treasury operations. In the context of the participation exemption for the disposal shares, the usefulness of the financial instrument provisions requires further analysis along with the potential tax avoidance that the exemption may cause.

2. Repeal of share-for-share relief (section 43)

Current legislation

Two sets of rollover provisions exist that are mainly intended to address the transfer of appreciated items to an acquiring company in exchange for the issue of shares by the acquiring company. In the case of a company formation, the transferor transfers appreciated non-share assets to an acquiring company in exchange for the acquiring company's issue of shares. In the case of a share-

for-share transaction, the transferor transfers a significant shareholder stake in a target company to an acquiring company in exchange for the acquiring company's shares. Both sets of provisions allow for tax-free rollovers, but the price of this deferred gain is duplication of that gain at two levels.

Problem statement

A reason does not exist to have a duplicate set of provisions for two comparable sets of transactions that essentially achieve the same result. The reason for a second set of rules for share-for-share transaction was mainly to ensure that the target company transferred did not mainly consist of financial instruments. With the financial instrument provisions removed, little reasons exists for the special rules associated with share-for-share transactions.

Proposed amendment

The share-for-share rollover regime will be repealed. All transfers of appreciated assets (including shares) will receive rollover relief under the revised section 42. The appreciated shares transferred need not involve the transfer of shares representing a significant stake in a target company. Any level of shares in the target company will suffice.

3. Intra-group transactions

Current legislation

Transfers between companies that form part of the same group of companies are fully eligible for rollover relief. The object of this relief is to place a single group of companies on par with a single company containing multiple branch operations. Just as the transfer of assets between two branches of a single company should be a non-event for tax purposes, so too should the transfer of assets between two companies within the same group.

One price of intra-group relief is the de-grouping charge. The de-grouping charge triggers a deemed disposal if the group companies engaged in the transfer subsequently become severed from one another so that they are no longer part of the same group. This charge again stems from the branch analogy, which would trigger gain if the two branches were no longer part of the same company.

Problem statement

The group rules have given rise to two sets of difficulties. Firstly, the group definition is overly inclusive, including many companies operating on a different tax plane. This over-inclusiveness has created undue opportunities for tax avoidance. Secondly, the de-grouping charge is often viewed as harsh.

Complaints exist that the de-grouping charge arises no matter how many years the de-grouping occurs after the initial intra-group transfer. The de-grouping charge also allegedly contains a potential double tax element.

Proposed amendment

A. Narrowed group definition (section 41)

A group of companies eligible for intra-group rollover relief must all operate on the same tax plane (in respect of their potential substantive tax liability and tax enforcement). Therefore, fully or partially exempt companies will now fall outside intra-group relief (including foreign companies falling wholly or partially outside the South African tax net and enforcement). As a result of these changes, the intra-group relief provisions will be mainly limited to fully taxable companies and close corporations.

The proposal also tightens the rules on shares counting toward the 70 per cent ownership criteria needed for group status. The proposal essentially adds two restrictions. Shares held as trading stock will no longer count towards the 70 per cent threshold. These shares are ignored because the shareholder intends to sell the shares at issue (i.e. not to hold the shares as a long-term extension of the group). In addition, shares subject to derivatives that contain rights or obligations of sale are similarly ignored.

B. De-grouping charge (section 45(4))

The proposal eases the de-grouping charge by adding a time limit. Under the new rule, the de-grouping charge applies only if the transferor and transferee companies involved in the intra-group transfer become severed from one another (i.e. no longer form part of the same group) within six years after the intra-group transfer. Group separations after the six-year period are ignored. This time limit is consistent with the U.K. de-grouping charge and is sufficient to protect against normal third party sales being disguised in intra-group form. It is also roughly consistent with the record-keeping rules of sections 73A and 73B.

The proposal also clarifies the nature of the de-grouping charge. Separations within the six-year period trigger a deemed sale and repurchase of the asset in the hands of the former group transferee. This deemed sale and repurchase occurs at market value on the date of the group severance. However, the former group transferee's losses stemming from the deemed sale are restricted (under section 11(o) or paragraph 39 of the Eighth Schedule). In addition, all further depreciation allowances will be limited as if the deemed repurchase was from a connected person (i.e. is subject to the type of limitations found in section 23J).

C. Prohibition against certain shares transfers (section 45(6))

The intra-group rules will no longer apply to the transfer of assets to a transferee group company if that transferee company issues its own shares in exchange. This prohibition is designed to prevent any overlap with the "asset-for-share" rollover rules of section 42 (which, unlike section 45, trigger a duplication of gain while triggering immediate loss (the latter of which would be clogged in a group context by virtue of paragraph 39 of the Eighth Schedule)).

The intra-group rules will also not apply to the liquidating transfer of assets by a transferor in cancellation of its own shares (thereby preventing any overlap with the section 47 liquidation rules). Similarly, the intra-group rules will not apply to any distribution of shares of a company within the same section 41 group of companies (thereby preventing any overlap with section 46).

4. Collective Investment Schemes (sections 42(1), 44(1) and 46(1))

Current legislation

Collective investment schemes have a limited place in the Part III reorganisation rules. At present, explicit relief for collective investment schemes exists only to the extent that one portfolio is merged into another via a section 44 amalgamation.

Problem statement

In practical terms, collective investment schemes are more likely to be engaged in section 44 amalgamation-type transactions than any other Part III provision for rollover relief. However, it now appears that collective investment schemes are also engaged in other forms of reorganisations that should similarly receive Part III rollover relief.

Proposed amendment

Taxpayers engaged in the transfer of assets to portfolio funds in exchange for the issue of participatory interests in that fund will now be eligible for section 42 relief. The need for this relief most typically arises upon the formation of new funds (by institutional investors such as insurance companies). The division of a single portfolio into two portfolios will also be entitled to section 46 unbundling relief. Application of section 42 and 46 rollover relief to collective investment schemes will mirror that of listed companies (e.g., no 20 per cent ownership threshold will be required).

5. Prohibitions against transfers to wholly or partially exempt transferees (section 44(14), 45(6) and 47(6))

Current legislation

The section 45 intra-group and section 47 liquidation rollover rules do not apply if transfers are made to companies that are wholly or partially exempt (or fall outside the South African tax base) by virtue of their nature as an entity which is not fully taxable. For instance, rollover relief does not apply if the transferee is an exempt public benefit organisation (or if the transferee is not a resident). The purpose of this prohibition is to ensure that rollover relief is limited to the benefit of deferral for the assets transferred. Rollover relief should not be used as an indirect mechanism to obtain permanent exemption.

Problem statement

The prohibition against transfers to wholly or partially exempt transferees fails to account for untaxed policyholder funds of a section 29A long-term insurer. The prohibition against transfers to wholly or partially exempt transferees is also missing from the section 44 amalgamation rollover rules even though this form of rollover raises the same policy concerns.

Proposed amendment

The prohibition against transfers to wholly or partially exempt transferees will be extended to section 44 amalgamation rollovers. The prohibition against transfers to wholly or partially exempt transferees will also be extended to untaxed policyholder funds of long-term insurers in the case of section 44, 45 and 47 rollovers. Lastly, it should be noted that the prohibitions against transfers of this nature (along with transferees to non-residents) will be partially excluded from the section 45 intra-group rules because the section 45 group definition has been narrowed to exclude these possibilities.

6. Share cross-issues (section 24B)

Current legislation

Companies that issue their own shares for assets are subject to three different sets of rules in terms of the assets acquired. As a general matter, the company is eligible for a base cost (or a section 11(a) expenditure) equal to the market value of the asset (section 24B(1)). However, this rule is subject to two exceptions:

(i) Companies issuing their own shares for assets pursuant to a section 42 rollover will only inherit a base cost (or section 11(a) expenditure) in the asset acquired equal to the cost (or expenditure) in the hands of the former transferor.

(ii) In addition, a company that issues its own shares in exchange for the issue of shares by another company will receive a zero base cost (or section 11(a) expenditure) in the newly issued shares acquired (section 24B(2)).

All three sets of rules essentially provide the issuing company with a base cost (or section 11(a) expenditure) in the asset acquired equal to the tax cost (or expenditure) of the asset in the hands of the former transferor with upward adjustments for any income or gain realised by the transferor as a result of the transaction.

Problem statement

The zero base cost (or expenditure) rule of section 24B(2) is sound as a matter of legal tax theory. However, the rule can create some harsh results in a South African context, especially given the difficulties that certain parties have in obtaining third party financing. In view of these difficulties, certain cross-issue structures have emerged that essentially allow certain investors to obtain financing to acquire a target company without resort to third party lending.

One such structure involves the issue of shares by an operating company in exchange for redeemable preference shares issued by an investor company. The preference shares have a value equal to the value of the operating company shares issued in exchange (but the operating company shares have more growth potential). The investor company then obtains funds via dividends from the operating company or by selling the investor company shares after those shares have appreciated (partly due to the involvement of the investor company). Once the investor company has sufficient funds, the investor company redeems the preference shares, leaving the investor company as an unencumbered holder of operating company shares.

At issue is the redemption of the redeemable preference shares. Under current law, the operating company recognises as gain the full value of the redeemable preference shares. This result is seemingly problematic because the redemption of the preferences shares is said to be economically akin to the return of principal on a loan (which should not, as a theoretical matter, give rise to tax). In other words, restoration of deemed lending finance is not an item that should be viewed as taxable gain for the operating company.

Proposed amendment

The proposal seeks to provide tax relief for operating companies that are essentially receiving repayment of principal on the self-financing of their shares. However, the proposed exception to the zero base cost (or section 11(a) expenditure) rule will be narrowly tailored because the cross-issue of shares can

easily give rise to potential tax avoidance. In view of the above, the exception will apply only if the following three conditions are met:

1. The (operating) company must issue ordinary shares (or preference shares convertible into ordinary shares at the option of the holder) in exchange for the issue of redeemable preference shares by another (investor) company;

2. The preference shares must be held for a period of not less than 5 years; and

3. The triggering event is a redemption (as opposed to other forms of disposition).

If the exception applies, the (operating) company is deemed to have expenditure in the redeemable preference shares equal to the lesser of the market value of those preference shares on the date of initial issue or the amount received or accrued on redemption. The "lesser of" test effectively limits the gain triggered on redemption without allowing for any loss.

> *Example 1. Facts.* Operating Company has 4 million ordinary shares outstanding. Investor Company seeks to obtain a slightly greater than 25 per cent interest in Operating Company. Operating Company accordingly issues 1 000 001 ordinary shares to Investor Company. Investor Company issues redeemable preference shares in exchange. The ordinary shares and the preference shares are each worth roughly R2 million. Operating Company redeems the preference shares 10 years later for a price of R2,5 million.
>
> *Result.* Operating Company is deemed to have expenditure of (roughly) R2 million by virtue of the proposal. The gain on redemption is therefore limited to R500 000. Without the proposed amendment, Operating Company would have been taxable on the full R2,5 million amount.
>
> *Example 2. Facts.* The facts are the same as *Example 1*, except that the preference shares are redeemed for only R1,5 million. No gain or loss results from the redemption because the expenditure is limited to R1,5 million (the amount received or accrued).

Other aspects of the rule relate to intra-group transfers. If a holder of the redeemable preference share (i.e. the operating company) transfers the redeemable preference share to another group company via a section 45 intra-group rollover, the recipient group company will be viewed as one and the same as the transferor for purposes of this rule. Hence, the five year rule can be satisfied by taking into account the holding periods of both the transferor and transferee group companies.

7. Share buybacks of listed shares (section 42A of the Eighth Schedule)

Current legislation

Under current law, the sale of shares at a profit triggers tax, even if identical shares of the same company are repurchased shortly thereafter. On the other hand, the sale of shares at a loss in comparable circumstances does not give rise to an immediate tax loss pursuant to paragraph 42 of the Eighth Schedule (often referred to as the "wash-sale" or "bed and breakfast" anti-avoidance rules). Any loss in the devalued shares is instead subject to deferral, only being realised if the repurchased shares are subsequently sold.

Problem statement

As a general matter, the split treatment of taxable gain and deferred loss under comparable circumstances can be justified because taxpayers largely have control over when they wish to dispose of their shares. For instance, the "wash-sale" anti-avoidance rules are essentially designed to prevent taxpayers from selling off loss shares at taxable year-end, merely to trigger tax losses (only to repurchase identical shares so that the long-term investment portfolio remains). On the other hand, taxpayers with appreciated shares generally hold those shares as long as desired without any interim sale (because the interim sale would trigger tax).

At issue are circumstances where taxpayers are essentially forced to dispose of their shares, even though they have no desire to ultimately reduce their long-term share investment profile. For instance, shareholders may be forced to surrender their shares via a court order under section 311 of the Companies Act, 1973 (Act No. 61 of 1973). Then, in order to restore their initial level of desired investment, these shareholders (especially management) respond by purchasing other shares in the company from other remaining shareholders outstanding. Without relief, these involuntary sellers will be subject to tax on gains for the short-term cash-out even though they seek to maintain the same level of investment in the long run (by re-using the cash received).

Proposed amendment

The proposed regime essentially provides for tax deferral comparable to the "wash-sale" loss deferral rules if a taxpayer is forced to undertake an involuntary interim sale and then seeks to restore the same investor profile. More specifically, these gain deferral rules apply if:

1. A taxpayer is forced to dispose of shares pursuant to a court order under section 311 of the Companies Act (Act No. 61 of 1973);

2. The shares disposed of are listed company shares; and

3. The taxpayer acquires (or has entered into a contract to acquire) shares of the same kind or quality within 90 days after the forced disposal.

To the extent these rules apply, the shares disposed of pursuant to the forced sale are deemed sold at cost (i.e. no gain is recognised on the forced sale). However, similar to the "wash-sales", the deferred nature of the transaction is rolled over into the shares. More specifically, if the repurchased shares have a cost equal to or greater than the gain deferred on the forced disposal of the initial shares, any expenditure for the new share is reduced by the gain deferred. If the repurchased share has a cost that falls below the gain deferred, the repurchased share has an expenditure of nil and gain is immediately recognised to the extent the otherwise deferred gain exceeds the cost of the repurchased share.

> *Example 1. Facts.* Taxpayer owns 2 000 ordinary shares in Company X, a company listed on the JSE. Taxpayer is forced to dispose of 25 per cent (i.e. 500) of those shares pursuant to a section 311 court order. The base cost of the disposed of shares is R90 000 and their value is R110 000. Within 40 days after the redemption, Taxpayer repurchases 500 of Company X ordinary shares for R135 000 from other remaining shareholders on the open market.
>
> *Result.* Under the new regime, Taxpayer does not have any gain on the disposal of the 500 ordinary shares. The sale occurred pursuant to a section 311 court order, the shares involved are listed and the repurchase occurred within 90 days. However, the base cost of the newly repurchased shares is only R115 000 (R135 000 less the R20 000 of deferred gain on the redemption).
>
> *Example 2. Facts.* The facts are the same as *Example 1,* except that the Company X ordinary shares are repurchased for R15 000.
>
> *Result.* The Taxpayer has no gain on the initial disposal as described in *Example 1.* However, Taxpayer has a base cost of nil in the new shares, and gain of R5 000 because of the low purchase price of the repurchased shares (i.e. the R15 000 purchase price falls below the R20 000 of deferred gain).

8. Connected person transfers of depreciable property

Current legislation

The Income Tax Act, 1962, contains a number of identical scattered provisions dealing with the purchase of depreciable property from connected persons. These depreciable property connected persons rules essentially have an anti-avoidance thrust. The purpose of these rules (most of which pre-date capital gains taxation in the Eighth Schedule) is to prevent tax-free or low-taxed sales

between connected persons of depreciable property, followed by depreciation against ordinary rates. Much of this depreciation was of special concern because the depreciable tax cost was often set at artificially high values.

Problem statement

The anti-avoidance rules to prevent connected person sales of depreciable property at artificially elevated values should be uniform, regardless of the depreciable property involved. In essence, the avoidance concern follows the same basic paradigm regardless of the depreciable property.

Also of concern is the fact that these anti-avoidance rules may be overly harsh, especially in view of the fact that connected person sales of depreciable property can no longer occur tax-free due to the introduction of the capital gains tax in the Eighth Schedule. In many instances, the transferor is subject to tax without the base cost of the transferee obtaining any recognition of this new reality.

Proposed amendment

A. Creation of a new regime (section 23J)

The proposal eliminates all of the scattered depreciable property connected person regimes in favour of a single regime under one new section. While the old regime limited depreciable cost to the lower of the connected seller's cost or the market value at the time of the connected person sale, the new regime gives credit to intervening taxation arising from the connected person sale. More specifically, the depreciable tax cost for the connected person purchaser will equal the sum of:

(a) the cost (taking into account any subsequent tax adjustments) of the depreciable asset to the connected person seller; plus

(b) all ordinary revenue triggered upon the connected person sale as well as any inclusion stemming from the capital gain triggered on the sale.

Example. Facts. Company X owns 60 per cent of the shares of each Company Y and Company Z. Company Y sells depreciable equipment to Company Z. Company Y initially purchased the equipment for R100 and depreciated the equipment by R30. Company Y sells the equipment to Company Z for R110 (triggering R30 of ordinary recoupment and R5 of taxable income (after taking into account the 50 per cent company percentage inclusion for capital gains).

Result. Company Z has a depreciable cost of R105 despite the fact that Company Z paid R110 for the equipment. This R105 amount is calculated

as follows: R70 depreciation adjusted presale cost to Company Y, plus R30 of recoupment plus the R5 inclusion stemming from the capital gain.

B. Depreciable asset definition (section 1: depreciable asset)

The rule for connected person sales will apply to all depreciable assets (as defined in section 1 of the Income Tax Act). Moreover, the current "depreciable asset" definition (also used in provisions, such as section 11(o) and 24M) will be clarified. The new definition will cover assets that: (i) are eligible for a depreciation allowance, (ii) can calculate that allowance wholly or partly determined with reference to the cost to the taxpayer or a connected person (so as to account for the depreciable asset connected person rules). Debts owing are excluded (see section 11(i) and (j)).

INTELLECTUAL PROPERTY PAYMENTS

1. Intellectual property arbitrage (section 23I)

Current legislation

The development of intellectual property is often fully deductible. The payment of royalties is also deductible for the payor (if the payor is a fully taxable entity within the South African tax net). The receipt of royalties is includible for the payee (if the payee is a fully taxable entity within the South African tax net).

Problem statement

The Income Tax Act lacks effective mechanisms to prevent tax arbitrage resulting from:

(i) assigning South African intellectual property to entities with a lower effective tax rate, followed by

(ii) the licensing of that intellectual property back to fully taxable South African taxpayers.

The disparity in tax rates levied on income between different parties often creates arbitrage opportunities. The purpose of these arbitrage opportunities is to shift income from parties fully within the tax net to parties wholly or partly outside the tax net. In the case of intellectual property, this result is mainly achieved by shifting the intellectual property from a fully taxable party to a party wholly or partly outside the tax net. This shift is usually designed so that the shift triggers little or no tax. After the shift, deductible payments are made from the fully taxable party (now the licensee) to the other party operating wholly or partly outside the South African tax net. These payments operate as a permanent tax difference.

In many instances, the tax benefits have no corresponding impact on cash flow as royalty payments are simply returned to the licensee-payor in the form of dividends. Meanwhile, the tax deductions for the licensee-payor may be so large as to effectively wipe-out the payor's tax base. The proposal described below represents the first of a series of mechanisms to be introduced into the Income Tax Act that will prevent tax leakages stemming from intellectual property.

Proposed amendment

A. Subsection (1)(definitions)

The proposal targets "affected intellectual property." This definition has two aspects. First, the property at issue must qualify as "intellectual property," which is defined widely. Intellectual property includes all South African protected inventions, patents, designs, trade marks and copyrights. Intellectual property additionally covers inventions, patents, designs, trade marks and copyrights protected by foreign laws. Property of a similar nature of both sets described above is also covered.

The main limitation is the "affected intellectual property" rules, which require the intellectual property above to fall into one of three categories:

(i) intellectual property that was at any time owned by a resident;
(ii) intellectual property that was developed by the taxpayer or a resident who is a connected person in relation to the taxpayer (at the time of development or at the time of the royalty/license payment); or
(iii) intellectual property that was developed by the taxpayer or a connected person in relation to the taxpayer (at the time of development or at the time of the royalty/license payment) if the development expenditure was subsidised by deductions previously granted in terms of the Income Tax Act.

The definition of "connected person" has a slightly lower threshold in section 23I than the normal connected person test. More specifically, company shareholders will be viewed as connected to the (company) taxpayer in which they hold 20 per cent of the shares (even if another shareholder holds a majority interest). This lower threshold matches the new rule for section 31.

B. Subsections (2) and (3) (Denial of deductions)

According to section 23I(2)(a), licensees will be denied deductions in respect of royalty expenditure incurred for the use of affected intellectual property to the extent that the royalty receipts do not constitute income of the licensor. These situations arise where the licensor has tax-exemption in respect of that income or where a foreign person treats that income as falling outside the South African tax net. However, if the payment of royalties for the use of affected intellectual

property triggers a section 35 withholdings tax (of 12 per cent), the licensee will be permitted to deduct an amount equal to a third of the royalty expenditure (section 23I(3)).

The underlying rationale for this general denial is that much of the intellectual property created by taxable South African residents is subsidised by government funding, South African tax allowances (such as amortisation allowances under sections 11(gA) and 11(gC) as well as the 150 per cent research and development allowance) and general South African infrastructure. South African subsidised intellectual property should not then be permitted to be used as a tool to erode our tax base. If this erosion tool is left unchecked, the potential loss to the South African company tax base can be massive.

Finally, section 23I(2)(b) prevents taxpayers from circumventing this anti-avoidance provision by simply interposing a third party that converts royalty streams into financial instruments (e.g. promissory notes (PNs) and credit default swaps (CDSs)) and on-routing these payments to entities with lower effective tax rates. This general anti-avoidance rule should be interpreted broadly.

> *Example 1. Facts.* A resident previously developed an invention, which was assigned to a foreign resident. The foreign resident filed a corresponding patent application in South Africa and now licenses the South African patent to the resident's company in consideration for an annual licence fee of R1 million.
>
> *Result.* Assuming that royalty payments triggers withholdings tax of 12 per cent (or R120,000), despite the deemed source provisions in s9(1)(b) and s9(1)(bA) relating to royalty income, the exemption in s10(1)(l) acts to exclude the royalty receipts in the hands of the licensor from income. Consequently, the deductions available to the South African licensee are reduced by virtue of section 23I(2)(a) from R1 million to R333,333 (i.e. by two-thirds).
>
> *Example 2. Facts.* A licence is concluded between two South African entities. The royalties are "evidenced" by way of promissory notes that are discounted by the licensor to a tax exempt entity or fund outside the South African tax net.
>
> *Result.* Sections 23I(2)(a) and 23I(2)(b) will deny the licensee deductions in respect of all royalties payable to the tax exempt entity or fund. Alternatively, where the royalty payments are structured to accrue first to the licensor before being on-paid to the tax exempt entity, the licensor will be denied corresponding deductions in terms of section 23I(2)(b).
>
> *Example 3. Facts.* A licence is concluded between two South African entities. The licensor concludes a credit default swap with an exempt or

foreign entity in terms of which all royalties received by the licensor are effectively passed on to the exempt or foreign entity.

Result. Section 23I(2)(b) will deny the licensor deductions in respect of payments made in terms of the CDS to the exempt or foreign entity.

2. Cross-border intellectual property transfer pricing

Current legislation

The South African tax system, like most tax systems, contains rules to prevent cross-border transfer pricing. These transfer pricing rules prevent various avoidance schemes, including the use of below market sales of intellectual property and royalty free (or discounted) usage of South African developed intellectual property. The essence of these rules is to require recalculation of the transfer at arm's length prices. Because the problem of transfer pricing most frequently arises between parties not dealing at arm's length, the South African transfer pricing rules apply only between connected persons.

Problem statement

Taxpayers are entering into intellectual property structures that defeat the South African transfer pricing rules by ensuring that both parties to the intellectual property transaction are not technically "connected." For instance, some structures are arranged so that the South African developer of intellectual property transfers that property at artificially low levels to a 49 per cent controlled foreign entity. The other 51 per cent is owned by an outsider, but a side agreement exists so that the South African developer largely retains the benefits of the intellectual property transferred.

Proposed amendment: (section 31)

In order to remedy the above structures, the connected person threshold will be reduced in the case of the transfer pricing rules addressing intellectual property. The definition of "connected person" will have a lower threshold than the normal connected person test. More specifically, company shareholders will be viewed as connected to the foreign company in which they hold 20 per cent of the shares (even if another shareholder holds a majority interest).

LONG-TERM INSURERS AND CONTROLLED FOREIGN COMPPANIES ("CFCs")

Current legislation

South African taxpayers with a controlling interest in foreign companies are subject to Section 9D (known as the CFC anti-deferral rules). In terms of this section, income/gains generated by a foreign company are imputed back to the South African taxpayers if they hold a minimum 10 per cent interest after taking into account connected persons. Section 9D was introduced to stop South African taxpayers from transferring investments abroad to avoid South African tax on the growth of these investments (and to prevent certain forms of transfer pricing).

Problem statement

Under the four funds approach, the insurance company is viewed as the owner of all policyholder funds (i.e. the company policyholder fund, the individual policyholder fund and the untaxed policyholder fund) in addition to its ownership of its (shareholder) corporate fund. The insurer is taxed on these policyholder funds under the trustee principal as a proxy for the policyholders. The tax on the insurer is designed to fully approximate the tax that would have fallen on the policy holders as a collective.

At issue is how the four funds approach for local long-term insurance companies (i.e. section 29A) works with the CFC regime. All policyholder assets are held in the name of a long-term insurer and are accordingly regarded as the long-term insurer's participation rights in the foreign company for section 9D purposes. The net result is that foreign entities (typically collective investment schemes, unit trusts or mutual funds) held in the name of a local long-term insurer are often classified as a CFC subject to section 9D income inclusions, even though the bulk of the underlying interests are held in the name of policyholders (none of whom would have triggered any section 9D inclusions had they invested in the CFC directly).

In analysing this situation, one must also be cognizant of the fact that long-term insurers offer different types of products to policyholders which can be divided into two distinct categories. The first category is investment-type products with policy holders paying premiums and selecting the investment. In these situations, the investor is the beneficial owner of the underlying assets (including the growth on these assets). The second category is risk products with policyholders paying premiums and receiving a fixed payment upon the happening of a risk event (e.g. death or disability). The policy holder is therefore indifferent as to the underlying investment because the insurer bears the risk.

Section 9D income treatment for section 29A policyholder funds creates a much higher level of tax on foreign entity funds than would have arisen had the policyholders invested in the foreign entity directly (violating the policy behind the trustee principal). This result seems especially unfair in the case of investment-type products as the asset allocation and the beneficial ownership of these assets rests not with the long-term insurer, but with the policy holder. A further problem arises as the foreign funds at issue are in many instances open-ended (i.e. shareholders buy and sell shares directly from the company and the company issues and cancels shares on a daily basis). The South African insurer (and other relevant parties) therefore have little control (or knowledge) of their percentage shareholding in the foreign fund.

Proposed amendment (proviso to section 9D(2)(b))

The goal is to exclude investment-type policies from the 10 per cent attribution rule. More specifically, participation rights held by a section 29A long-term insurer do not have any section 9D income inclusions to the extent those rights relate to linked policy or market-related policies (as defined in the Long-term Insurance Act, 1998 (Act No. 52 of 1998)). The net result is that any interest associated with investor policies will not trigger any income inclusion for the insurance company, but the controlled foreign entity will remain a CFC. If the long-term insurer otherwise possesses interests in the CFC amounting to 10 per cent (taking into account the policyholder funds), the insurance company will have income attributed to it to the extent of those other (non-investment-type policyholder fund) interests.

The exclusion for investment-type policies applies in full regardless of any potential connected persons. Specific tracing of ownership levels for policyholders with investment-type policies was rejected because this form of tracing is extremely difficult for enforcement as well as for insurance company compliance. However, in order to prevent this rule of administrative convenience from being misused, the wholesale exclusion of investment-type products from section 9D inclusions is subject to a subjective anti-avoidance rule. Under this subjective rule, taxpayers seeking to misuse this rule of administrative convenience to disguise significant policyholder interests will not benefit from the rule.

DEPRECIATION

The proposals contained in this Bill add additional classes of assets eligible for tax depreciation. The purpose of these new regimes is to ensure that these classes of assets are given parity with other depreciation assets already benefiting from the Income Tax Act.

1. Rolling stock (section 12DA)

Current legislation

The Income Tax Act provides for a general depreciation of movable machinery used by taxpayers in the production of income to the extent that the value of such machinery has depreciated by reason of wear and tear. The depreciation rates are intended to be linked to the useful lives of the machinery involved. However, this is not always the case. For example trucks are allowed a write-off period of three to four years depending on their size. Meanwhile, rolling stock has a useful life of 14 years and accordingly has a 14-year write-off.

In addition to this depreciation regime, certain specific movable business items are afforded special depreciation rates based on their identity. The rates in this case do not have a bearing on the useful life of the items involved. For example, ships and aircraft are allowed a five-year write-off period.

Problem statement

The government has an overriding objective of reducing the cost of doing business in South Africa. Research shows that there is a huge imbalance between the South African transportation network and the current status of the economy. In this regard, government intends to encourage investment in the rail transportation industry – a key cost item for primary product sales.

Furthermore, the depreciation rates for rolling stock places rolling stock at a disadvantage vis-à-vis trucks (a less efficient mode of transport for primary products). The 14-year depreciation rate is also unduly long when compared to other large ticket transport items, such as ships and aircraft (both of which are depreciable at 20 per cent per annum over 5 years).

Proposed amendment

In order to encourage the infrastructural development for rail transportation, it is proposed that rolling stock (e.g. trains and carriages) be allowed accelerated depreciation. Note that railway lines are already subject to a 5 per cent rate of depreciation under section 12D.

A. Subsection 1 (general rule)

Accelerated depreciation generally applies only to owners of rolling stock that will directly use the rolling stock wholly or mainly for the transport of persons, goods or things. Hence, passenger rail, like rail for goods, will receive the benefit of this new regime. Mere lessors of rolling stock fall outside this regime. However, persons purchasing rolling stock via an installment credit agreement are treated as owners for this purpose (see also section 11(e) applying the same rule).

B. Subsection 2 (rate)

The proposed rate of depreciation is 20% of the cost of acquisition per year (i.e. a 5-year straight-line write off period). This is the same rate as used for ships and aircraft.

C. Subsection 3 (depreciable cost)

The cost to be depreciated is the taxpayer's cost of acquiring the rolling stock or arm's length value of the rolling stock, whichever is the lesser. This rule also applies to the cost of the improvements. If the rolling stock is acquired to replace rolling stock that has been damaged or destroyed, the cost will be reduced by the value that has been recovered from the replaced rolling stock to the extent this recovery has not been included in the taxpayer's income.

D. Subsection 4 (exemption periods)

If the taxpayer uses the rolling stock to produce exempt income, the years in which the taxpayer used the asset are discounted for purposes of determining the depreciation. For example, if the taxpayer uses the asset in years 1 and 2 to produce exempt income, the taxpayer will only be allowed a 20 per cent depreciation rate for the following three years when the income produced is taxable.

E. Subsection 5 (prior disposal)

A taxpayer cannot depreciate buildings once that building is no longer owned by that taxpayer in any particular year (i.e. the building was disposed of in a prior year).

F. Subsection 6 (maximum percentage)

This subsection makes it clear that the 20 per cent depreciation write-off cannot exceed 100 per cent (i.e. five years).

2. Port assets (section 12F)

Current legislation

Depreciation of permanent structures is available to certain specific trades and business undertakings. Taxpayers who do not undertake these trades are generally not entitled to any depreciation for their permanent structures despite their business usage.

Problem statement

Government has an objective of building up the efficiency of the transportation network, including ports. While both aircraft and the underlying aircraft infrastructure (e.g. aircraft hangers and runways) are tax depreciable, only the ships themselves are entitled to tax depreciation. No tax depreciation exists for port assets.

Proposed amendment

Tax depreciation will now apply to new and unused port infrastructure assets (as well as supporting structures that form part of port assets). This depreciation regime is only available to taxpayers who carry on a sole business as port operator. The proposed regime will be added to the regime for aircraft infrastructure. The rate of depreciation for port assets will accordingly be 5 per cent per annum.

The overall regime is also being adjusted to cover periods in which both aircraft infrastructure and port infrastructure produce exempt income. As with other depreciation regimes, depreciable cost is fully reduced for these exempt periods.

3. Environmental assets and activities (section 37B)

Current legislation

Certain permanent environmental capital expenditures relating to manufacturing are granted depreciation relief under the Act while other permanent comparable expenditures are not. At issue is whether these capital expenditures can qualify as machinery or plant directly used in the process of manufacture. If so, a 40:20:20:20 rate applies. If not, the capital expenditure is not entitled to any tax depreciation. As a result, environmental capital expenditure of a permanent nature has tended to be afforded tax depreciation by happenstance rather than by design.

Questions also exist as to the deductibility of environmental costs incurred after closure of a trade. As a technical matter, an ongoing trade and production of income are pre-requisites for business expense deductions. Hence, decommissioning, remediation and restoration costs incurred after a trade are generally not deductible.

Problem statement

Much of the tax law pre-dates considerations relating to environmental expenditure. Environmental capital expenditure of a permanent nature should be entitled to some level of depreciation, even though only ancillary to the process of manufacture. Environmental capital expenditure is a legal precondition for

operation and should be encouraged as a matter of sound government policy. Therefore, a new regime for environmental capital expenditure of a permanent nature is proposed. It should be noted that no regime is necessary for environmental moveable equipment because this equipment is depreciable like any other moveable equipment used to carry on a trade (see section 11(e)).

Post-trade environmental expenses (decommissioning, remediation and restoration) should similarly be granted relief. These expenses are not optional. They represent activities to remedy a potential legal liability arising from a trade. The proposal accordingly seeks to provide deductions for these post-trade environmental expenses.

Proposed amendment

A. Subsection 1 (definitions environmental production and post-production assets)

Depreciation relief is afforded to environmental production assets (i.e., waste treatment and recycling facilities - and improvements thereto) and post-production assets (waste dumps and dams – and improvements thereto). Both sets of assets must be ancillary to the manufacturing process (or process of a similar nature), and the assets must be of a permanent nature (as opposed to moveable assets which are already covered under section 11(e)). Both production and post-production assets must be utilised for purposes of fulfilling legal environmental obligations.

Only new and unused production and post-production assets (and improvements) will be depreciable under this provision. Production and post-production assets that have been used by the taxpayer prior to the effective date cannot be depreciated. Similarly, production and post-production assets purchased by the taxpayer from a seller who used such assets prior to the sale also cannot be depreciated.

B. Subsection 2 (rates)

The new regime provides for two sets of rates.

Environmental production assets are eligible for a 40:20:20:20 rate of depreciation. These assets (e.g. treatment facilities) are effectively on par with other manufacturing machinery and plant (also depreciable at a 40:20:20:20 rate) because they are so closely associated with the manufacturing process. No reason exists to provide environmental production assets of this kind with a lesser rate, especially given Government’s increased emphasis on environmental pollution control.

On the other hand, the rate of relief for environmental post-production assets is only 5 per cent per annum (i.e. a 20-year straight-line write off period). These assets usually are required to handle resultant pollutants outside the ongoing process. These 5 per cent assets (e.g. dams, reservoirs, evaporation ponds, etc.) are more akin to the longer useful life of a manufacturing building (which is also depreciable at a 5 per cent rate).

C. Subsection 3 (depreciable cost)

In respect of a production or post-production asset, the value depreciated is the cost of the asset to the taxpayer. The depreciable cost of such asset (or improvement) is the lesser of the cost of the asset to the taxpayer or the arm's length price of the asset at the time of the acquisition. This rule prevents purchasers from artificially tagging-on related costs onto the new acquisition of such an asset.

D. Subsection 4 (exemption periods)

A select number of taxpayers may hold environmental assets during a period of exemption. This provision deems depreciation to occur during this period of exemption.

E. Subsection 5 (prior disposals)

A taxpayer cannot depreciate a production or post-production asset once that asset is no longer owned by that taxpayer (i.e. the building was disposed of in a prior year).

F. Subsection 6

Many business items eligible for deduction must be part of an ongoing trade and for the production of income. Decommissioning, remediation and restoration generally fall outside the ongoing process of trade and production but represent a legal obligation arising out of that trade. This subsection effectively allows the items contemplated in section 11 (such as section 11(a) trade expenses and section 11(e) machinery) to be deductible as if the initial trade were continuing. Unlike the treatment of pre-trade expenditures and losses under section 11A, these post-trade losses and expenditures are not ring-fenced.

G. Subsection 7

This section prevails for environmental capital expenditure even if the environmental production or post-production asset is eligible for depreciation relief under sections 12C or 13 of the Income Tax Act.

4. Commercial buildings (section 13*quin*)

Current legislation

Depreciation allowances are generally granted by the Act for movable assets used by taxpayers involved in any form of trade. On the other hand, in the case of buildings and permanent structures, depreciation is greatly dependant on the specific trades or business activities for which the buildings or structures are used (for example, mining capital expenditure is eligible for an immediate 100 per cent write off; whereas, manufacturing capital expenditure is eligible for a 5 per cent rate). Taxpayers who do not undertake trades covered by specified depreciation regimes generally are not entitled to any depreciation for their buildings and permanent structures despite their business usage.

Problem statement

All buildings and other permanent structures depreciate in value due to their limited useful life. Accounting practice reflects this fact by requiring an annual depreciation write-off for all buildings and permanent structures, regardless of the business for which the building or structure is used. Therefore, no reason exists for the tax system to wholly exclude commercial buildings from potential write-offs for depreciation. The wholesale denial of depreciation for certain business buildings and structures raises the carrying cost of doing business without any meaningful policy rationale.

Proposed amendment

In order to level the playing fields, the proposed amendment seeks to allow depreciation for all commercial buildings used by taxpayers in the production of income to the extent those buildings fall outside other available depreciation regimes.

A. Subsection 1 (coverage)

This provision allows for the depreciation of buildings (and improvements thereto) that are used wholly or mainly in the production of income. However, the provision of residential accommodation is specifically excluded. Therefore, a taxpayer who owns a block of flats for residential lease cannot generally depreciate the building (except for the five unit rule in section 13*ter*).

The proposed rate of depreciation is 5% per annum (i.e. a 20 year straight-line write-off period). The value depreciated is the cost of the building to the taxpayer.

Only new and unused buildings (and improvements) will be depreciable under this provision. Buildings that have been used by the taxpayer prior to the

effective date cannot be depreciated. Buildings purchased by the taxpayer from a seller who used the building prior to the sale also cannot be depreciated.

B. Subsection 2 (depreciable cost)

The depreciable cost of a building (or improvement) is the lesser of the cost of the building to the taxpayer or the arm's length price of the building at the time of the acquisition. This rule prevents purchasers from artificially tagging related costs onto building acquisition.

C. Subsection 3 (exemption periods)

A select number of taxpayers may hold commercial buildings during a period of exemption. This provision deems depreciation to occur during this period of exemption.

D. Subsection 4 (prior disposal)

A taxpayer cannot depreciate buildings once that building is no longer owned by that taxpayer at no point in the year (i.e. the building was disposed of in a prior year).

E. Subsection 5 (interaction with other regimes)

The proposed new depreciation regime for commercial buildings should be viewed as a catch-all provision. If another regime applies, the other regime prevails for purposes of depreciation.

F. Subsection 6 (maximum percentage)

This subsection makes it clear that the 5 per cent depreciation write-off cannot exceed 100 per cent (i.e. 20 years).

AMALGAMATION OF SPORTING BODIES

Current legislation

National sporting organisations typically have a professional arm and an amateur arm. Some organisations have split these two arms into separate entities in order to enjoy public benefit organisation status for the amateur arm.

Problem statement

In certain cases the split has proven to be to the organisation's disadvantage. The professional arm's sponsorships and other sources of income are fully taxable, but it cannot claim a tax deduction for the development and promotion of amateur sport that will serve as its feeder both for future fans and professional players. The 2007/08 Budget Review therefore proposed measures to assist in the re-integration of the separate entities.

Proposed amendment

The proposed amendment provides relief for amalgamation transactions between the two arms. In short the professional arm will dispose of all its assets to the amateur arm on a tax neutral basis and will then cease to exist. The unified entity will be a taxable entity as it no longer complies with the requirements of section 10(1)(*c*N) of the Income Tax Act, 1962. As the relief is only applicable to a limited number of organisations, it will be available for a limited window-period of two years which will end on 31 December 2009.

Furthermore, in terms of the proposed section 11E, a special deduction is available to the unified entity. It may deduct from its income all expenditure, not of a capital nature, incurred by it on the development and promotion of qualifying amateur sport falling under the same code of sport as the professional sport it carries on. Payments to other entities for the development and promotion of amateur sport will not qualify for the special deduction.

TAX RELIEF FOR CO-OPERATIVE BANKS

Current legislation

As an alternative to utilising the banking system in South Africa, many people organise themselves into groups to form savings clubs and financial services co-operatives. These organisations are often a result of inaccessible banking facilities for people in the remote and rural areas in the country (or otherwise high cost of banking services). These member-owned financial services co-operatives are generally taxed at the same rate and under the same conditions as commercial banks.

Problem statement

As a general rule, financial services co-operatives have the main objective of providing financial services, not to produce income for their owners (i.e. the structure of co-operatives does not allow for profit-taking shareholders). In many

cases, these co-operatives are barely breaking even (especially in the case of rural banking co-operatives).

The Co-operatives Banks Bill seeks to formalise this industry by increased regulation and recognition. In terms of the tax system, the application of standard banking tax rules will only serve to dissuade formalisation. Therefore, some form of relief is required, especially for fledging banking co-operatives.

Proposed amendment (section 12E)

The proposal seeks to provide relief for financial services co-operatives (referred to as “co-operative banks” in the proposed Co-operative Banks Bill) be allowed to access the small business tax relief. Under this regime, smaller business (i.e. with income not exceeding R14 million), are subject to a marginal rate of less than the normal 29 per cent rate is so far as taxable income does not exceed R300 000. In addition, small businesses are eligible for the threshold exemption for individuals (currently R43 000). Relief of this kind will help to formalise more fragile co-operatives, many of whom have net profits falling below the R43 000 threshold.

A. Subsection (4)(a)(ii)(prohibition against multiple small business companies)

Membership in co-operative banks by members would not disqualify those members from receiving relief in respect of another small business company. However, such members could only hold up to a 5 per cent interest in the banking co-operative not to trigger the disqualification.

B. Subsection (4)(c)(ii)(prohibition against investment income)

Small business companies are prohibited from having more than 20 per cent of investment income. This prohibition is designed to prevent the small business relief regime from become a simple way for high net worth individuals to store passive wealth at a low tax cost. However, this prohibition will not apply to interest earned by a co-operative bank because this form of interest is active income that is core to the co-operative banking operation.

EXEMPTION OF OCCUPATIONAL DEATH BENEFITS

Current legislation

In terms of the Compensation for Occupational Injuries and Diseases Act, 1993 (COIDA), a compensation fund was established. According to this Act, employers must contribute to this fund and payments are made out of this fund to

certain employees (or their dependants) if the employees die or become disabled due to an occupational injury. Payments made by the Compensation Commissioner are exempt from income tax in the hands of the recipient.

Problem statement

The families of an employee who die due to an occupational injury may be entitled to additional “top-up” benefits provided by or arranged by the employee’s employer. These benefits are currently taxable, even though they are essentially akin to COIDA benefits. While the estate may be enriched by the payment, the payment does not truly compensate for the lost earning power of the deceased.

Proposed amendment (section 10(1)(gB)(iii))

Under the proposal, all lump-sum benefit payments (excluding annuities) payable as a direct result of an occupational death of an employee will be exempt. A prerequisite of this tax-exemption is that a (tax-exempt) death benefit should also be payable in terms of COIDA (i.e. that the benefit must act as a top-up). The tax-exempt amount shall be limited to an amount of R300,000.

OIL AND GAS FISCAL STABILITY

Current legislation

The fiscal stabilisation contained in the OP26 regime acted as an incentive to invest in what was a ‘high risk’ exploration region by providing long-term security in terms of tax. Upon the initiation of an oil and gas investment, investors were given a legal guarantee that the 1977 Income Tax regime would not become more burdensome throughout that investment. However, investors could benefit from reduced rates of tax and other tax relief measures introduced subsequently.

With the expiry of the OP26 leases, certain tax incentives were renewed to maintain the incentive to invest in local oil and gas. This renewal came in the form of the Tenth Schedule of the Income Tax Act, thereby creating transparency and certainty for oil and gas exploration or production. The Tenth Schedule also contains a fiscal stability clause.

Problem statement

While the concept of fiscal stability is not in dispute, close examination of the initial version of the fiscal stability contracts have revealed a number of minor issues of concern to both Government and the taxpayer alike. These issues (though anticipated) must be remedied before the first fiscal stability contracts can be signed.

Proposed amendment: (Tenth Schedule)

A. Paragraph 1 of the Tenth Schedule (definitions)

The definition of "oil and gas right" contains an incorrect reference. Exploration and production rights fall within the definition of section 1 of the MPRDA (regardless of whether the right is wholly new or a conversion of a prior right). The definition of "refining" also needs to be corrected to better reflect the reality of the process.

B. Paragraph 8(1) of the Tenth Schedule (entering into fiscal stability)

The proposal clarifies a number of small issues when concluding fiscal stability. First, the Minister of Finance will conclude these agreements on a geographic right-by-right basis per taxpayer. Second, the Minister of Finance need not wait for an exploration or production right to be issued by the Minister of Minerals and Energy. The Minister can enter into a conditional agreement to be effective as at the date an exploration or production right is granted. However, this fiscal stability agreement will be null and void if the exploration or production right is not granted within six months after the fiscal stability agreement was concluded.

C. Paragraph 8(2) of the Tenth Schedule (assigning fiscal stability)

The proposal allows for limited rights of fiscal stability transfer.

Taxpayers holding a fiscal stability agreement in terms of an exploration right can freely assign the fiscal stability benefits if the underlying exploration right is transferred. This freedom of assignment in respect of exploration rights should assist smaller oil and gas exploration companies who actively engage exploration but who sell mineral rights to larger players once the production stage is reached.

Taxpayers holding a fiscal stability agreement in terms of a production right have limited freedom to assign stability benefits if the underlying production right is transferred. In particular, the assignment of fiscal stability rights is limited to intra-group transfers (i.e. movements within the same economic group).

D. Paragraph 8(3) of the Tenth Schedule (change in interests)

Taxpayers often change their percentage interests in a single oil and gas right over time. These changes reflect changes in tolerance of risk and the need for cash. Multiple players with interests in a single geographical oil and gas right swap interests among themselves as part of their practical dealings. The proposal accordingly allows the fiscal stability clause to remain fully in effect in respect of a single taxpayer even if the taxpayer's proportional interest in a right changes over time (the fiscal stability coverage includes the initial interest as well as any additions or subtractions).

E. Paragraph 8(4) of the Tenth Schedule (termination)

The wording to the termination rules clarify that the elective termination by a taxpayer must not be partial. The termination must cover the entire fiscal stability rights as they related to the underlying geographical interest. The termination will also take effect at the beginning of the following year of assessment after termination notice.

F. Paragraph 8(5) of the Tenth Schedule (allocations relating to two sets of taxation)

Some taxpayer may ultimately face a situation where some of their geographical oil and gas rights are benefiting from the Tenth Schedule while others are under a different tax regime. This paragraph provides the Minister of Finance with the authority to allocate income and expense between the two on a proportional basis.

G. Paragraph 8(6) of the Tenth Schedule (assigning fiscal stability)

This paragraph adds an explicit breach of agreement clause. If the Tenth Schedule is not applied to the benefit of a taxpayer as agreed, the taxpayer is entitled to compensation or a change in law restoring the taxpayer to the original terms of the agreement.

H. Paragraph 8(7) of the Tenth Schedule (assigning fiscal stability)

This paragraph clarifies two points. Firstly, fiscal stability is available only in terms of exploration and production rights (not related permits). Secondly, the technical wording of the provision is clarified to state that all exploration rights, renewals thereof and production rights stemming from a former exploration right (or renewal thereof) are deemed to be one in the same right in the hands of an oil and gas company. Thus, if a taxpayer enters into an exploration right, fiscal stability benefits continue for all subsequent renewals as well as conversion to the first production right.

I. Repeal of Schedule 3 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006

Schedule 3 of the Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 created an interim measure to ensure that holders of OP 26 did not have their tax incentives expire before the new Tenth Schedule was in place. With the enactment of the Tenth Schedule in late 2006, Schedule 3 can be fully repealed as obsolete.

DRAFT

CUSTOMS AND EXCISE

1. Customs and Excise definitions

Current legislation

The Customs and Excise Act, 1964 currently incorrectly classifies excise duties on imported goods as customs duties. Also, the current definition of excise duties incorrectly restricts the imposition of such duties to goods manufactured locally. It would appear that the reasons for these incorrect classifications are largely historical.

Problem statement

The incorrect inclusion of excise duties within the custom duty definition, and the resulting incorrect restriction of the imposition of excise duties to locally manufactured goods, has unintended consequences both in terms of revenue estimation and international comparisons of tax revenues. International best practice dictates that excise duties on imports be classified as excise revenues.

Proposed amendment

The proposed amendments accordingly separate excise duties on imports from the customs duties definition. The proposed amendment will require system changes by SARS and the effective date of implementation therefore will be subject Ministerial approval.

2. Improved control over counterfeit goods

Current legislation

Current legislation does not provide the authorities with sufficient teeth to act against the illegal trade in counterfeit goods.

Problem statement

These proposals are intended to provide legal certainty and address the confusion relating to conflicting provisions in the Counterfeit Goods Act and Customs and Excise Act.

Proposed amendment

SARS will act as a filter for all counterfeit goods while such goods are under customs control. Customs officers will be responsible for the detention and control of possible counterfeit goods. Once this detention has interrupted the

movement of the goods, the intellectual property right holder will be required to apply to court for an order declaring the detained goods to be counterfeit goods.

The proposals are in line with the World Customs Organisation's (WCO) model provisions for national legislation to implement effective border measures by Customs authorities, consistent with the TRIPS agreement. The proposed amendment is further in line with the provisions of section 113(8) of the Customs and Excise Act, 1964, where goods suspected of being imported in contravention with any other law in South Africa are detained and then handed over to another authority etc for further action. In the draft proposed legislation, the goods are hand4ed over for safe-keeping to the Counterfeit Goods Depot Operator as contemplated in the Counterfeit Goods Act, 1997, and further steps must be taken by the holder of the intellectual property right to ensure that the goods are not subsequently released into home consumption.

DRAFT

CLAUSE BY CLAUSE EXPLANATION

CLAUSE 1

Transfer Duty: Amendment of section 3 of the Transfer Duty Act, 1949

The proposed amendment serves to expand the current wording of section 3 so as to include electronic payments of transfer duty made through the SARS' e-Filing system.

CLAUSE 2

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

Subclause (a): The proposed amendment is consequential to the proposed amendment in clause 49, which proposes to change the definition "company formation transaction" to "asset for share transaction".

Subclause (b): The proposed insertion of section 9(15B) of the Transfer Duty Act is to provide an exemption from duty on property sold in instances where the property forms part of a rental pool as contemplated in section 52(2) of the VAT Act. This exemption from duty is limited to instances where the purchaser elects in writing for that property to remain in the rental pool scheme (i.e. the ownership of the property will change but for VAT purposes, the rental pool will continue to utilise the property for purposes of making taxable supplies in the course or furtherance of that rental pool's enterprise).

CLAUSE 3

Transfer Duty: Amendment of section 14 of the Transfer Duty Act, 1949

Subclause (a): The proposed amendment serves to expand the current wording of section 14 so as to include the electronic submission of transfer duty declarations through the SARS e-Filing system.

Subclause (b): As payments are now also received electronically, the reference to acknowledgement of payment "by the use of a machine" is no longer relevant. The proposed amendment deletes this phrase.

CLAUSE 4

Stamp Duty: Amendment of section 4C of the Pension Funds Act, 1956

The proposed amendment is consequential upon the repeal of the provision dealing with marketable securities from the Stamp Duties Act, No. 77 of 1968.

However it is not necessary to provide for any exemption in the proposed Securities Transfer Tax Bill to any person who holds any assets on behalf of a pension fund referred to in section 4A of the Pension Funds Act, or has on behalf of any such pension fund invested any assets in any stock, debentures, securities or financial instruments. This applies where that person—

(a) transfers those assets into the name of such pension fund;

(b) takes such steps as may be necessary to ensure that on such stock, debentures, securities or financial instruments issued in his name and in any relevant register such endorsements are made as may be necessary to show that the ownership in such stock, debentures, securities or financial instruments vests in such pension fund; and

(c) if requested thereto by such pension fund, transfers to such fund the stock, debentures, securities or financial instruments vested in it,

as these transactions would not give rise to a change in beneficial ownership under the proposed Securities Transfer Tax Bill

CLAUSE 5

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

Subclause (1)(a): See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

Subclause (1)(b) to *(j)*: See notes on **BROADENING TAXABLE DIVIDEND DEFINITION**

Subclause (1)(k) and *(l)*: The proposed amendments delete obsolete provisions

Subclause (1)(m) to *(o):* See notes on **BROADENING THE TAXABLE DIVIDEND DEFINITION**

Subcluase (2): The proposed amendments in subclause (1)(c) to (e) come into operation on 1 January 2009.

Subclause (3): The proposed amendments in subclause (1)(b) and (f) to (o) come into operation on 1 October 2007.

CLAUSE 6

Income Tax: Amendment of section 5 of the Income Tax Act, 1962

The proposed amendment is consequential to the retirement reform amendments enacted in the Taxation Laws Amendment Act, 2007.

CLAUSE 7

Income Tax: Amendment of section 6quat of the Income Tax Act, 1962

Taxpayers may utilise section 6*quat* rebates (i.e. tax credits) to offset foreign taxes paid. The purpose of these credits is to prevent double taxation. However, tax credits are available only to the extent foreign taxes arise on foreign source income, not against domestic source income. Countries are only prepared to surrender primary jurisdiction if the underlying activity (i.e. source) arises outside its border. South Africa is no different in this regard.

It has come to Government's attention that a number of countries are incorrectly claiming source jurisdiction to services occurring within South Africa and accordingly claim that withholding tax is required. While South Africa is not prepared to give section 6*quat* rebates for South African source activities, South Africa is prepared to treat these foreign taxes as a deductible expense, just like any other expense incurred for the production of income. This provision of deductions is not out of line with international practice.

In particular, foreign taxes proved to be payable will be deductible like other trade or business expenses. However, these expenses cannot exceed the underlying income giving rise to the foreign tax.

CLAUSE 8

Income Tax: Amendment of section 8 of the Income Tax Act, 1962

The word 'capital' in the expression 'capital deduction or allowance' is incorrect and it is proposed that the word be deleted.

CLAUSE 9

Income Tax: Amendment of section 8B of the Income Tax Act, 1962

See notes on **CAPITAL VERSUS ORDINARY SHARES**

CLAUSE 10

Income Tax: Amendment of section 8C of the Income Tax Act, 1962

Subclause (1)(a): The section has been amended as a result of the introduction of section 9C which provides that the disposal of shares after holding them for a period of 3 years is on capital account. The amendment proposes that the provisions of section 8C take precedence over section 9C.

Subclause (1)(b) to *(c):* Subsection (3) sets out when an equity instrument is deemed to vest. In the case of disposals contemplated in subsections (2)(a)(i) and (2)(b)(i) the gain or loss has to be determined having regard to the consideration for the equity instrument and the amount received or accrued for the disposal of that equity instrument. The amount received or accrued in respect of the disposal must be determined when the disposal occurs which is not clear from the present wording. It is proposed that a specific provision be inserted to clarify the position.

Subclause (1)(d) to *(e)*: The definition of "consideration" effectively defines the amount that must be taken into account as the amount paid to acquire an equity instrument. In the case of equity instruments acquired in the circumstances set out in subsections (5)(a) and (b) the actual amount paid by the person for the equity instrument is ignored and is replaced by the amount which would have been paid by the taxpayer, who originally owned the equity instrument or performed the services as a result of which the equity instrument was given to the other person, to acquire the equity instrument. Presently the wording also includes equity instrument mentioned in subsection (5)(c) which makes its application too wide. It is proposed that the wording of the section be clarified.

Subclause (1)(f): Schemes have been introduced which seek to circumvent the operation of section 8C by providing that on termination of the period of the option the underlying equity instruments are disposed of and the proceeds paid to employees. The amendment proposed is intended to counter this practice.

Subclause (1)(g): The restriction was imposed as an additional measure to counter deferred delivery schemes in terms of which delivery of the equity instrument is not given to the taxpayer until the consideration is paid and the consideration can in terms of the scheme only be paid in the future. The present wording of the restriction effectively undermines the purpose of the restriction and it is proposed that the wording be amended accordingly.

Subclause (2): The proposed amendments in subclause (1) come into operation on the date of introduction of the Revenue Laws Amendment Bill, 2007.

CLAUSE 11

Income Tax: Amendment of section 9B of the Income Tax Act, 1962

See notes on **CAPITAL VERSUS ORDINARY SHARES**

CLAUSE 12

Income Tax: Amendment of section 9C of the Income Tax Act, 1962

See notes on **CAPITAL VERSUS ORDINARY SHARES**

CLAUSE 13

Income Tax: Amendment of section 9D of the Income Tax Act, 1962

Subclause (1)(a): The proposed amendment inserts a word that was inadvertently omitted.

Subclause (1)(b) and *(e):* Special rules apply when a foreign company becomes or ceases to be a controlled foreign company. The proposed amendment clarifies that the valuation rules apply based on the day before the foreign company becomes or ceases to be a controlled foreign company (not on the date). This change is consistent with paragraph 13(g) of the 8th Schedule.

Subclause (1)(c) and *(d):* See notes on **LONG TERM INSURERS AND CONTROLLED FOREIGN COMPANIES**

Subclause (1)(f): The proposed amendment also extend the exemption involving foreign currency gains and losses arising from transactions between controlled foreign companies that are part of the same group of companies (as defined in section 1). Under current law, interest and related financial instruments between these group members are not subject to any section 9D inclusion. At issue is the currency hedging with outside parties to neutralise financial instrument transactions between these group members. The proposed amendment accordingly disregards exchange differences from derivatives if the underlying transaction is exempt due to the offshore intra-group rule. This change is consistent with section 24I(11).

Subclause (2): The proposed amendments in subclause (1) come into operation on the date of introduction of the Revenue Laws Amendment Bill, 2007.

CLAUSE 14

Income Tax: Amendment of section 10 of the Income Tax Act, 1962

Subclause (a): The proposed amendment is a technical correction for minor wording changes.

Subclause (b) to *(d):* See notes on **EXEMPTION OF OCCUPATIONAL DEATH BENEFITS**

Subclause (e) to *(j)*: Difficulties are being experienced with regard to the application of section 10(1)(o)(ii) to share incentive arrangements and situations where remuneration is received in a year of assessment and the services in respect of that remuneration were rendered over a period longer than that year. In particular, the problem with share option gains and section 10(1)(o)(ii) is that the period to which the remuneration relates is almost always spread over a vesting period (typically 3 – 5 years). Accordingly, even though the services between grant and vesting that give rise to the gain made have been rendered outside of the Republic, only that portion of the gain that relates to services in a qualifying 12 month period ending or commencing in that year of assessment when the remuneration accrues (when the options vest) can be exempt in terms of section 10(1)(o)(ii). Situations can arise where the major portion of the services rendered in respect of a share option gain are rendered outside the Republic but as the employee has returned to the Republic when the gain accrues, no potion of the accrual is exempt.

The proposed amendments make it clear that, to the extent that the conditions of section 10(1)(o)(ii) were met, namely, the 183 day and 60 day tests are met in any twelve month period ending or commencing during any year of assessment during which those services were rendered, during the current year of assessment of previous years, the income earned outside the Republic will be exempt. Furthermore it is proposed that the ambit of the exemption be limited to specific types of remuneration for services rendered and not to all the types of income included in the definition of 'remuneration' in paragraph 1 of the Fourth Schedule to the Income Tax Act. As the requirements of the subsection are that the remuneration must be for services rendered while outside the Republic, amounts, for example, referred to in paragraph *(d)* of the definition of 'gross income' will not fall within the exemption as they are not paid for services rendered.

Subclause (k): The proposed amendment deletes an obsolete provision.

CLAUSE 15

Income Tax: Amendment of section 11 of the Income Tax Act, 1962

Subclause (1)(a): See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

Subclause (1)(b): The proposed amendment corrects a textual error

Subclause (1)(c): See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

Subclause (1)(d): See notes on **DEPRECIATION OF ROLLING STOCK**

Subclause (1)(e) to *(g):* Capital losses are clogged under paragraph 39 of the 8th Schedule. The purpose of these proposed rules is to prevent artificial acceleration of losses through the sale of depreciated assets to parties who are economically connected to one another (so there is no real economic loss). The proposed amendments similarly deny section 11(o) losses to prevent the same artificial acceleration. The proposed amendments further update certain cross references.

Subclause (2): The proposed amendment in subclause (1)(b) comes into operation on 2 November 2006.

CLAUSE 16

Income Tax: Amendment of section 11C of the Income Tax Act, 1962

The proposed amendment repeals the election to deduct foreign withholding taxes in light of the more general deduction provisions added to section 6*quat*.

CLAUSE 17

Income Tax: Amendment of section 11D of the Income Tax Act, 1962

Subclause (1)(a): This proposed amendment is consequential to the proposed deletion in subclause (1)(b).

Subclause (1)(b): **SEE NOTES ON CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

Subclause (1)(c): Section 11D provides for the deduction of 150 per cent of qualifying R and D expenditure incurred by a taxpayer. Subsection (5B) was introduced for purposes of limiting this deduction to 100 per cent if the expenditure was incurred to defray R and D expenditure incurred by a connected

person in relation to the taxpayer. The amendment proposed by this subclause deletes this limitation.

Subclause (2): The proposed amendments in subclause (1) come into operation on 2 November 2006.

CLAUSE 18

Income Tax: Insertion of section 11E into the Income Tax Act, 1962

See notes on **AMALGAMATION OF SPORTING BODIES**

CLAUSE 19

Income Tax: Amendment of section 12B of the Income Tax Act, 1962

See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

CLAUSE 20

Income Tax: Amendment of section 12C of the Income Tax Act, 1962

See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

CLAUSE 21

Income Tax: Amendment of section 12D of the Income Tax Act, 1962

See notes on **DEPRECIATION OF ROLLING STOCK**

CLAUSE 22

Income Tax: Insertion of section 12DA of the Income Tax Act, 1962

See notes on **DEPRECIATION OF ROLLING STOCK**

CLAUSE 23

Income Tax: Amendment of section 12E of the Income Tax Act, 1962

See notes on **TAX RELIEF FOR CO-OPERATIVE BANKS**

CLAUSE 24

Income Tax: Amendment of section 12F of the Income Tax Act, 1962

See notes on **DEPRECIATION OF PORT ASSETS**

CLAUSE 25

Income Tax: Amendment of section 12G of the Income Tax Act, 1962

See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

CLAUSE 26

Income Tax: Insertion of section 13quin of the Income Tax Act, 1962

See notes on **DEPRECIATION OF COMMERCIAL BUILDINGS**

CLAUSE 27

Income Tax: Amendment of section 15 of the Income Tax Act, 1962

See notes on **DEPRECIATION OF ROLLING STOCK AND COMMERCIAL BUILDINGS**

CLAUSE 28

Income Tax: Amendment of section 18 of the Income Tax Act, 1962

A taxpayer can deduct medical expenses of immediate family members from taxable income if these expenses exceed 7,5 per cent of that member's taxable income. These expenses are difficult to verify, but a streamlined verification process potentially exists for medical scheme members and their medical scheme beneficiaries. In these cases, SARS can use the medical scheme certificate to verify these expenses, except that a technical problem exists as medical schemes issues certificates in respect of all medical scheme beneficiaries (wider family) (not only for immediate family members (nucleus family) who are the potential subject of deductions).

In order to streamline the administration and audit process, it is proposed that the reference to immediate family for medical scheme members be extended to include all medical scheme beneficiaries. This should simplify administration for medical scheme members and their beneficiaries.

CLAUSE 29

Income Tax: Amendment of section 20 of the Income Tax Act, 1962

Section 20(1)(*a*)(ii) provides for the reduction of the balance of assessed loss of a person who benefits from a compromise made with or concession granted by his or her creditors. The balance of that person's assessed loss must be reduced by the amount or value of any benefit received by or accruing to that person—

- resulting from a concession granted by or compromise made with his or her creditors,
- in terms of which his or her liabilities that arose in the ordinary course of trade, have been reduced or extinguished.

It has been argued that this provision applies only if the concession is granted by or the compromise is made with the general body of creditors and not merely by or with one or some of them. It has also been argued that liabilities that are incurred prior to the commencement of trade (e.g. for funding the erection of a factory) do not arise in the ordinary course of that trade and that a concession or compromise in respect of those liabilities need not be taken into account in terms of s 20(1)(a)(ii). Another issue relates to the question whether the liability must be linked to expenditure in respect of which a deduction or allowance was allowed.

The proposed amendments are aimed at clarifying the position in this regard.

CLAUSE 30

Income Tax: Amendment of section 23A of the Income Tax Act, 1962

See notes on **DEPRECIATION OF ROLLING STOCK**

CLAUSE 31

Income Tax: Amendment of section 23D of the Income Tax Act, 1962

See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

CLAUSE 32

Income Tax: Amendment of section 23G of the Income Tax Act, 1962

See notes on **DEPRECIATION OF ROLLING STOCK AND COMMERCIAL BUILDINGS**

CLAUSE 33

Income Tax: Amendment of section 23H of the Income Tax Act, 1962

Subclause (1)(a): The proposed amendment provides that section 11D will now be subject to section 23H. The effect is that qualifying R and D expenditure which is allowable in terms of section 11D(1) will be allowed as a deduction only to the extent that the underlying R and D activities have been executed.

Subclause (1)(b):The proposed amendment is consequential to the amendment in subclause (1)(a).

Subclause (1)(c): Section 23H apportions expenditure incurred by a taxpayer for services over the period during which the services are to be rendered. However, if the period of the services is not determinable there can be no apportionment. The proposed amendment provides for the expenditure to be apportioned over the period during which the services are likely to be rendered.

Subclause (1)(d): In general, section 23H apportionment does not apply if the benefit connected to the expenditure will be enjoyed by the taxpayer within six months after the end of the year during which the expenditure was incurred. The proposed amendment provides that this exception will not apply in respect of qualifying R and D expenditure under section 11D(1).

CLAUSE 34

Income Tax: Insertion of section 23I of the Income Tax Act, 1962

See notes on **CROSS-BORDER INTELLECTUAL PROPERTY ARBITRAGE**

CLAUSE 35

Income Tax: Amendment of section 23J of the Income Tax Act, 1962

See notes on **CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY**

CLAUSE 36

Income Tax: Amendment of section 24B of the Income Tax Act, 1962

See notes on **SHARE CROSS ISSUES**

CLAUSE 37

Income Tax: Amendment of section 24I of the Income Tax Act, 1962

Similar to the changes proposed for section 9D(9)(*f*), this proposed amendment extends the relief for foreign currency derivatives to cover derivatives arising out of items already receiving relief. In effect, the taxation of the derivative will match the taxation of the underlying gain or loss.

CLAUSE 38

Income Tax: Amendment of section 28 of the Income Tax Act, 1962

The proposed amendments provide that the rules for the taxation of short-term insurers will be adjusted to reflect current practice. Firstly, the allowances for reserves will be directly linked to the liabilities contemplated in section 32(a)(1)(a) and (d) of the Short-term Insurance Act, 1998 (Act No. 53 of 1998). In effect, the calculations performed under that Act as accepted by the Financial Services Board will operate as the starting point for liability calculation. The Commissioner can then adjust the amount as already allowed by current law.

The proposed changes also clarify the relationship between the rules under section 28 and the rest of the Income Tax Act. Section 28 generally applies in lieu of section 11(a) in respect of liabilities incurred stemming from reinsurance premiums and any claims in respect of that business. The denial of deductions for reserve funds under section 23(e) is similarly disregarded.

CLAUSE 39

Income Tax: Amendment of section 30 of the Income Tax, 1962

Subclause (a): The provisions regulating the use of funds upon the dissolution of a domestic public benefit organisation ("PBO") are proposed to be adjusted slightly to ensure that former PBO funds are used for the similar purposes after the dissolution. Transfers will only be permitted in the case of dissolution transfers to section 10(1)(cA) institutions, boards or bodies if those institutions, boards or bodies have the same sole or principal object as the former PBO.

Subclause (b) to *(d):* It is further proposed that the rules for terminating local activities of foreign PBOs will be adjusted so that they are more practical from an administrative enforcement and compliance perspective. As a general matter, foreign PBOs with nominal activities can withdraw their local activities as desired. However, if more than 15 per cent of that foreign PBO's receipts and accruals stem from South African activities, the dissolution rules for domestic foreign PBOs will fully apply to that foreign PBO.

CLAUSE 40

Income Tax: Amendment of section 31 of the Income Tax Act, 1962

Subclause (a): See notes on **CROSS BORDER INTELLECTUAL PROPERTY TRANSFER PRICING**

Subclause (b) to *(d)*: The argument has been made that the current formulation of the transfer pricing provisions does not cater for cases where an argument between residents becomes a cross-border agreement due to a change of residence of one of the participants. The proposed amendments are aimed at ensuring that cross-border suppliers between connected persons are fully subject to the transfer pricing provisions.

CLAUSE 41

Income Tax: Amendment of section 35 of the Income Tax Act, 1962

Intellectual property payments to foreign persons are generally subject to section 35 withholding at 12 per cent per annum, subject to limited exceptions. These exceptions are being modernised so that they are more in sync with the exceptions contained in section 10(1)(*h*) for taxable interest earned by foreign persons. In essence, payments should not be subject to withholding on payments to foreign persons with substantial presence within South Africa. Hence it is proposed that intellectual property payments to a South African permanent establishment of a foreign person will not be subject to withholding. The exception for payments to persons within South Africa for more than 183 days will not be replicated in the intellectual property withholding regime because this cannot be readily determined from the perspective of a withholding payer.

CLAUSE 42

Income Tax: Amendment of section 36 of the Income Tax Act, 1962

The proposed amendment is consequential to the proposed amendment of the definition of ‘depreciable asset’ in clause 5(1)(a).

CLAUSE 43

Income Tax: Amendment of section 37A of the Income Tax Act, 1962

The proposed amendment places mining rehabilitation entities on par with Public Benefit Organisations with respect to impermissible distributions of property.

CLAUSE 44

Income Tax: Insertion of section 37B of the Income Tax Act, 1962

See notes on **ENVIRONMENTAL ASSETS AND ACTIVITIES**

CLAUSE 45

Income Tax: Amendment of section 37C of the Income Tax Act, 1962

The proposed amendment repeals an obsolete provision.

CLAUSE 46

Income Tax: Amendment of section 37D of the Income Tax Act, 1962

The proposed amendment repeals an obsolete provision.

CLAUSE 47

Income Tax: Amendment of heading to Part III of the Income Tax Act, 1962

The proposed amendment is consequential to the repeal of share-for-share transaction relief in section 43.

CLAUSE 48

Income Tax: Amendment of section 41 of the Income Tax Act, 1962

Subclause (1)(a): See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

Subclause (1)(b): See notes on **REMOVAL OF THE FINANCIAL INSTRUMENT LIMITATION**

Subclause (1)(c): See notes on **INTRA-GROUP TRANSACTIONS**

Subclause (1)(d) to *(e):* See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

Subclause (1)(f): See notes on **PROHIBITIONS AGAINST TRANSFERS TO WHOLLY OR PARTIALLY EXEMPT TRANSFEREES**

Subclause (1)(g): The proposed amendment corrects a prior textual error.

Subclause (1)(h): At the present time taxpayers can freely utilise the Part III reorganisation rules without receiving written advanced approval from SARS.

Section 41(5) gave the Minister the power to require advance approval by regulation if desired. Experience with the reorganisation rules indicates that the requirement of advance approval would be too unwieldy and that the optional advanced ruling procedure is sufficient. This Ministerial power is accordingly proposed to be deleted.

Subclause (1)(i) to *(j):* See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

Subclause (2): Subject to subclause (3), the proposed amendments in subclause (1) come into operation on 1 January 2008.

Subclause (3): The proposed amendment in subclause (1)(c) comes into operation on 1 July 2008.

CLAUSE 49

Income Tax: Amendment of section 42 of the Income Tax Act, 1962

Subclause (1)(a) to *(b):* See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

Subclause (1)(c): See notes on **COLLECTIVE INVESTMENT SCHEMES**

Subclause (1)(d) to *(e):* See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

Subclause (1)(f): See notes on **CAPITAL VERSUS ORDINARY SHARES**
Subclause (1)(g) to *(t):* See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

Subclause (1)(u): See notes on **REMOVAL OF FINANCIAL INSTRUMENT LIMITATIONS**

Subclause (2): The proposed amendments in subclause (2) come into operation on 1 January 2008.

CLAUSE 50

Income Tax: Amendment of section 43 of the Income Tax Act, 1962

See notes on **REPEAL OF SHARE FOR SHARE RELIEF**

CLAUSE 51

Income Tax: Amendment of section 44 of the Income Tax Act, 1962

Subclause (1)(a): See notes on REMOVAL OF FINANCIAL INSTRUMENT LIMITATIONS

Subclause (1)(b): See notes on **PROHIBITIONS AGAINST TRANSFERS TO WHOLLY OR PARTIALLY EXEMPT TRANSFEREES**

Subclause (2): The proposed amendments in subclause (1) come into operation on 1 January 2008.

CLAUSE 52

Income Tax: Amendment of section 45 of the Income Tax Act, 1962

See notes on **INTRA-GROUP TRANSACTIONS, CONNECTED PERSON TRANSFERS OF DEPRECIABLE PROPERTY AND REMOVAL OF FINANCIAL INSTRUMENT LIMITATIONS**

CLAUSE 53

Income Tax: Amendment of section 46 of the Income Tax Act, 1962

Subclause (1)(a): Under current law, tax-free rollovers involving the unbundling of subsidiaries are permitted only for intra-group transfers and for unbundlings to listed shareholders. Unbundlings outside this context (e.g. in closely held situations) are ineligible for rollover relief because unbundlings can easily be used in this outside context as a mechanism to circumvent the Secondary Tax on Companies (as opposed to facilitating economic restructurings). However, a small amendment will be made so that unbundlings will apply if the unbundling company becomes listed within 12 months of the unbundling. This proposed change allows a wholly-owned subsidiary of a listed company to be freely unbundled (a frequent non-avoidance form of unbundling in a listed context).

Subclause (1)(b) and *(c):* See notes on **COLLECTIVE INVESTMENT SCHEMES**

Subclause (1)(d): See notes on **CAPITAL VERSUS ORDINARY SHARES**

Subclause (1)(e): See notes on **REMOVAL OF THE FINANCIAL INSTRUMENT LIMITATIONS**

Subclause (2): The proposed amendments in subclause (1) come into operation on 1 January 2008.

CLAUSE 54

Income Tax: Amendment of section 47 of the Income Tax Act, 1962

Subclause (1)(a): See notes on **INTRA-GROUP TRANSACTIONS**

Subclause (1)(b) to *(c):* See notes on **REMOVAL OF THE FINANCIAL INSTRUMENT LIMITATIONS**

Subclause (2): The proposed amendments in subclause (1) come into operation on 1 January 2008.

CLAUSE 55

Income Tax: Amendment of section 64B of the Income Tax Act, 1962

Subclause (1)(a): The proposed amendment corrects the dividend cycle rules for determining the Secondary tax on Companies for long-term insurance companies. The first cycle for a long-term insurer will not be limited to the six month period prior to the dividend.

Subclause (1)(b) to *(c):* The proposed amendment updates cross references in light of prior year amendments.

Subclause (1)(d): See notes on **SIMPLIFYING STC INTRA-GROUP RELIEF**

Subclause (1)(e) to *(i):* See notes on **BROADENING THE TAX DIVIDEND DEFINITION**

Subclause (1)(j) to *(m):* See notes on **SIMPLIFYING STC INTRA-GROUP RELIEF**

Subclause (2): The proposed amendments in subclause (1) come into operation on 1 October 2007.

CLAUSE 56

Income Tax: Amendment of section 64C of the Income Tax Act, 1962

See notes on **SIMPLIFYING STC INTRA-GROUP RELIEF**

CLAUSE 57

Income Tax: Amendment of paragraph 2 of the Second Schedule to the Income Tax Act, 1962

This proposed amendment caters for pre-retirement lump sum payments arising from maintenance orders and payments on housing guarantees.

CLAUSE 58

Income Tax: Amendment of paragraph 1 of the Fourth Schedule to the Income Tax Act, 1962

Subclause (1): The proposed amendment is a technical correction to correct the grammar by the inclusion of the word “or” in both the definitions of ‘personal service company’ and ‘personal service trust’.

Subclause (2): The proposed amendment in subclause (1) comes into operation on 1 March 2007.

CLAUSE 59

Income Tax: Amendment of paragraph 11A of the Fourth Schedule to the Income Tax Act, 1962

Paragraph 11A deals with the withholding or deduction of employees’ tax from remuneration in the form of gains contemplated in sections 8A, 8B and 8C which is deemed to become payable to employees. It deems that the person who granted the right to acquire the marketable security or from whom the employee acquired the equity instrument or qualifying equity share, to have paid remuneration equal to the amount of the gain to the employee.

In the majority of cases rights to acquire marketable securities, qualifying equity shares and equity instruments are granted by or acquired by employees from trusts established by employers to provide these benefits. As these trusts only provide benefits in the form of gains they do not pay the employees cash remuneration and as a result the employees’ tax liability is not paid during the year of assessment when the gain arises. The same position occurs where the employees are employed by a subsidiary of an international company and the shares are granted or awarded by a body outside the Republic.

It is proposed that in the circumstances where—

- a gain arises in the hands of an employee in a year of assessment;
- the entity granting the right to acquire a marketable security or from whom the employee acquired the equity instrument or qualifying equity share is an

associated institution as defined in paragraph 1 of the Seventh Schedule in relation to an employer of the employee;
- the associated institution granting the benefit does not pay remuneration from which the employees' tax on the gain can be withheld;

the associated institution and the employer must withhold an amount from the remuneration payable to the employee equal to the employees' tax payable in respect of that gain and shall be jointly and severally liable for that employees' tax.

Consequential amendments are proposed for the other subclauses contained in the paragraph.

CLAUSE 60

Income Tax: Amendment of paragraph 9 of the Seventh Schedule to the Income Tax Act, 1962

Paragraph 9(7) of the 7th Schedule has been misinterpreted as it does not refer to the usual place of residence in the Republic. Therefore, any form of accommodation provided by the local SA employer to expatriates assigned to SA (who are indeed away from their usual place of residence abroad) could be seen as not supposed to be included as a fringe benefit in terms of the 7th Schedule;

It is proposed that the wording of paragraph 9(7) of the 7th Schedule be amended to refer to "usual place of residence in the Republic" with an exclusion for expatriates who are ordinarily resident outside of SA (e.g. UK) in the nature of a 183 day-rule.

Hence should the non-resident be present in SA for a period longer than 183 days in any year of assessment, the benefit of the residential accommodation would be valued in accordance with paragraph 9 and included as a fringe benefit in terms of paragraph *(i)* of the definition of gross income.

CLAUSE 61

Income Tax: Amendment of paragraph 10 of the Seventh Schedule to the Income Tax Act, 1962

The proposed amendment is consequential to the amendment to paragraph 9 of the Seventh Schedule.

CLAUSE 62

Income Tax: Amendment of paragraph 12B of the Seventh Schedule to the Income Tax Act, 1962

Until 2006, all direct employer-provided medical assistance was fully taxable as a fringe benefit. In 2006, certain exemptions were added to cater for employer-provided medical care in recognition of the fact that certain employers view direct medical provision as a core function, especially for lower-income employees. While the changes in 2006 were viewed as a great step forward, it has come to Government's attention that the exemption did not cover medical services and medicines required of an employer by law. It is accordingly proposed that the exemption be expanded to cover these circumstances.

CLAUSE 63

Income Tax: Amendment of paragraph 19 of the Eighth Schedule to the Income Tax Act, 1962

See notes on **ANTI-DISTRIBUTION STRIPPING**

CLAUSE 64

Income Tax: Amendment of paragraph 20 of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): Paragraph 20(1)*(h)*(ii) determines the base cost of an asset that has been subject to fringe benefits tax under paragraph *(i)* of the definition of 'gross income' read with the Seventh Schedule. It provides that the amount to be added to the base cost of the employee's asset is the value that was included in the employee's gross income In this way double taxation is prevented in that the amount that was included in gross income will not again be subjected to CGT.

In terms of paragraph 16(1)*(b)* of the Seventh Schedule an amount will also be included in an employee's gross income if the employer confers the benefit on some other person, whether directly or indirectly. This could happen, for example, if the employer transferred an asset to the employee's family trust or a relative. Under the present wording of paragraph 20(1)*(h)*(ii)*(bb)* there is no mechanism by which the other person can achieve a step-up in base cost as this is only granted to an employee acquiring the asset. In order to eliminate economic double taxation, it is proposed that paragraph 20(1)*(h)*(ii)*(bb)* be amended to enable the other person to obtain the required increase in base cost.

Subclause (b): The proposed amendment corrects a formatting error.

CLAUSE 65

Income Tax: Amendment of paragraph 42 of the Eighth Schedule to the Income Tax Act, 1962

See notes on **SHARE BUYBACKS OF LISTED SHARES**.

CLAUSE 66

Income Tax: Insertion of paragraph 42A of the Eighth Schedule to the Income Tax Act, 1962

See notes on **SHARE BUYBACKS OF LISTED SHARES**.

CLAUSE 67

Income Tax: Amendment of paragraph 43 of the Eighth Schedule to the Income Tax Act, 1962

The capital gain or loss currency rules of paragraph 43 refer directly to section 25D in terms of calculating currency translation. This cross-reference is causing unnecessary confusion. The proposed amendment directly refers to the underlying rule (without reference to section 25D) as a matter of clarification.

CLAUSE 68

Income Tax: Amendment of paragraph 65 of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment is consequential to the amendment to the definition of 'depreciable asset' in clause 5(a).

CLAUSE 69

Income Tax: Amendment of paragraph 66 of the Eighth Schedule to the Income Tax Act, 1962

See notes on **DEPRECIATION OF ROLLING STOCK**

CLAUSE 70

Income Tax: Amendment of paragraph 76 of the Eighth Schedule to the Income Tax Act, 1962

See notes on **ANTI-DISTRIBUTION STRIPPING**.

CLAUSE 71

Income Tax: Insertion of paragraph 76A of the Eighth Schedule to the Income Tax Act, 1962

See notes on **ANTI-DISTRIBUTION STRIPPING**.

CLAUSE 72

Income Tax: Repeal of paragraph 79 of the Eighth Schedule to the Income Tax Act, 1962

See notes on **ANTI-DISTRIBUTION STRIPPING**

CLAUSE 73

Income Tax: Amendment of paragraph 1 of the Tenth Schedule to the Income Tax Act, 1962

See notes on **OIL AND GAS FISCAL STABILITY**

CLAUSE 74

Income Tax: Amendment of paragraph 8 of the Tenth Schedule to the Income Tax Act, 1962

See notes on **OIL AND GAS FISCAL STABILITY**

CLAUSE 75

Customs and Excise: Amendment of section 1 of the Customs and Excise Act, 1964

See notes on **CUSTOMS AND EXCISE DEFINITIONS**

CLAUSE 76

Customs and Excise: Amendment of section 4 of the Customs and Excise Act, 1964

Subclause (1)(a): This section prohibits an officer from being financially interested in certain activities in respect of goods to which the Act relates. The proposed amendment is essentially a technical correction which includes exportation, environmental levy goods and Road Accident Fund levy goods in the activities and goods mentioned in the section. The section is also restructured.

Subclauses (1)(b) to *(d)*: The various amendments of section 4(3) and section 4(3A) correct the references to the Statistician General and the Statistics Act, Act No. 6 of 1999 and the reference to the South African Police Service Act, 1995 (Act No. 68 of 1995).

The amendments contained in sub-clauses (1)(*a)* to *(d)* will come into operation on the date of promulgation of this Act.

Subclause (1)(e): This paragraph empowers the Controller or an officer to substitute the detention or a part thereof by the detention of any or all of the goods in accordance with the counterfeit legislation provided for in Chapter XB.

This will come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

CLAUSE 77

Customs and Excise: Amendment of section 10 of the Customs and Excise Act, 1964

The commercial cargo clearing facility at the proposed Ressano/Garcia one stop border will be situated within the territory of Mozambique. The amendment of section 10(2) by inclusion of a reference to section 50A will allow goods to be deemed imported into the Republic although still in the territory of Mozambique.

CLAUSE 78

Customs and Excise: Amendment of section 21A of the Customs and Excise Act, 1964

The expression “Service enterprise” is deleted as it is not referred to elsewhere in the section.

The provisions enable that any expression in respect of any activity inside or outside an IDZ or a CCA may be assigned a meaning in any Schedule or rule of the Act.

CLAUSE 79

Customs and Excise: Amendment of section 43 of the Customs and Excise Act, 1964

The amendment proposed in sub-clause 1 is consequential to the insertion of Chapter XB in respect of counterfeit goods so as to adapt the provisions of section 43 in so far as it relates to the disposal of counterfeit goods.

This will come into operation on a date to be fixed by the President by proclamation in the *Gazette*.

CLAUSE 80

Customs and Excise: Amendment of section 44 of the Customs and Excise Act, 1964

Subclause (1)(a): This amendment is made as a consequence of the changes to the definitions of "customs duty" and "excise duty" in section 1.

This will only come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

Subclause (1)(b): The subsection presently relates to the liability for duty and proof of due entry where goods are brought into the Republic from a country with which an agreement has been concluded under section 51. Customs union agreements are now concluded under section 49 and the amendment to the subsection is accordingly proposed. The reference to fuel levy goods is deleted as the movement of fuel levy goods between the Republic and other Member States of SACU is now regulated in terms of other provisions of this Act.

This shall come into operation on the date of promulgation of this Act.

CLAUSE 81

Customs and Excise: Amendment of section 46 of the Customs and Excise Act, 1964

Amendment of the subsection is proposed so as to require a person entering any imported goods to produce a declaration of origin if the imported goods are liable to a provisional payment in terms of section 57A or an anti-dumping duty imposed under section 56 or a countervailing duty as imposed under section 56A or a safeguard measure imposed under section 57, and further, where imported goods are subject to any restriction in terms of any other law when imported from a specified country or specified countries. Such a declaration is required in terms of the proposed amendment where the goods are imported from a country or countries other than the country or countries or a supplier in respect of which such a payment, duty or restriction is prescribed. This amendment is necessary for the control of imports in respect of which such duties or restrictions are prescribed.

The Commissioner is enabled to make rules prescribing forms and other matters for the purposes of the subsection.

CLAUSE 82

Customs and Excise: Amendment of section 47 of the Customs and Excise Act, 1964

The present provisions regarding determination disputes only relate to the appeal procedure in Part A of Chapter XA, but the procedures in Part B and Part C may also apply.

The amendments to section 47(9) are accordingly proposed so as to include a reference to any procedure contemplated in Chapter XA.

CLAUSE 83

Customs and Excise: Amendment of section 47B of the Customs and Excise Act, 1964

Subclause (a): Section 47B(2)*(c)* provides that the operator or the agent of an aircraft must collect and pay over to the Commissioner the air passenger tax for which a chargeable passenger is liable in respect of international travel from the Republic.

The Minister of Finance announced in his 2007 Budget Review that changes will be made to legislation to clarify that operators will be liable as withholding agents for the tax with a right to reclaim any tax liability from passengers.

The proposed amendment to subsection 47B(2)*(c)* provides that operators will be entitled to collect air passenger tax from chargeable passengers at the time when a ticket is issued to the passenger or prior to the embarkation and departure of the passenger on an international flight.

The section further provides that operators will have the right to reclaim any unpaid tax from chargeable passengers in respect of any tax due by such passenger which the operator has already paid over to the Commissioner on his or her prescribed tax account.

Subclause (b): Section 47B(2)(e) is amended as customs union agreements are now provided for in section 49 and are published in Schedule No. 10 (as was done with the SACU Agreement).

CLAUSE 84

Customs and Excise: Amendment of section 52 of the Customs and Excise Act, 1964

Section 52(a) is amended as customs union agreements are now provided for in section 49 and are published in Schedule No. 10 (as was done with the SACU Agreement).

CLAUSE 85

Customs and Excise: Amendment of section 54B of the Customs and Excise Act, 1964

Section 54B(2) is amended as customs union agreements are now provided for in section 49 and are published in Schedule No. 10 (as was done with the SACU Agreement).

CLAUSE 86

Customs and Excise: Amendment of section 65 of the Customs and Excise Act, 1964

Subclauses (1)(c) to *(f)*: Section 65(4) and (5) is amended for the same reason as section 47(9).

This shall come into operation on the date of promulgation of this Act.

Subclauses (1)(a) to *(b)* and *(g)*: These amendments to the heading of section 65 and to subsections (3) and (7) are consequential to the changes made to the definitions of “customs duty” and “excise duty” in section 1.

This shall come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

Subclauses (1)(h) and *(i)*: The amendment to subsection (8)*(a)* arises from the classification of the duty payable in terms of section A of Part 2 of Schedule No. 1 on imported goods as excise duty.

The reference to item 412.18 of Schedule No. 4 is deleted as the item has been deleted in that Schedule. Subsection (8)*(b)* specifically relates to matters concerning item 412.18 of Schedule No. 4 and is deleted as a consequence thereof.

This shall come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

CLAUSE 87

Customs and Excise: Amendment of section 69 of the Customs and Excise Act, 1964

Subclauses (1)(a) to *(d):* The proposed amendments are effected as a consequence to the changes to the definitions to “customs duty” and “excise duty” in section 1.

This shall come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

Subclauses (e) to *(h)* are amended for the same reason as section 47(9) and will come into operation on the date of promulgation of this Act.

CLAUSE 88

Customs and Excise: Amendment of section 75 of the Customs and Excise Act, 1964

Subclause (a): Amendments are made to section 75(1)*(a)* to *(d)* as a result of the classification of duty levied on imported goods under Section A and Section B of Schedule No. 2 as reflected in the amended definitions of “customs duty” and “excise duty”.

This shall come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

Subclause (b) to *(o)*: Amendments are made to take out references to Schedule No. 5 as no provision was made in any item of Schedule No. 5 for refunds (on imported distillate fuel) similar to those specified in item 670.04 for locally-produced fuel and to rectify references to the correct items of Schedule No. 6.

This shall come into operation on the date of promulgation of this Act.

CLAUSE 89

Customs and Excise: Amendment of section 77C of the Customs and Excise Act, 1964

Section 77C(1) is amended to combine existing provisions of subsections (1) and (3) as all the requirements for submission of an appeal are prescribed fully by rule.

CLAUSE 90

Customs and Excise: Amendment of section 77G of the Customs and Excise Act, 1964

Section 77G is amended as a decision may be appealed against and may also be dealt with in terms of any other procedure to which Chapter XA relates.

CLAUSE 91

Customs and Excise: Insertion of chapter XB of the Customs and Excise Act, 1964

SEE NOTES ON IMPROVED CONTROL OVER COUNTERFEIT GOODS

CLAUSE 92

Customs and Excise: Amendment of section 78 of the Customs and Excise Act, 1964

Section 78 is renumbered to make provision for the counterfeit legislation to be included before Chapter XI.

This shall come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

CLAUSE 93

Customs and Excise: Amendment of section 79 of the Customs and Excise Act, 1964

Section 79 is renumbered to make provision for the counterfeit legislation to be included before Chapter XI.

This shall come into operation on a date to be fixed by the President by proclamation in the *Gazette.*

CLAUSE 94

Customs and Excise: Amendment of section 86A of the Customs and Excise Act, 1964

Section 86A is amended as a consequence of the renumbering of section 78. This will, however, only come into operation at the same time as when the counterfeit goods legislation of Chapter XB comes into operation.

CLAUSE 95

Customs and Excise: Amendment of section 92 of the Customs and Excise Act, 1964

Section 92(1) is amended to achieve uniformity with sections 105 and 114. In the past, fines were collected by the Department of Justice and paid over to the Controller, but this practice is no longer followed and the reference to "fine" is therefore deleted as fines are not recovered under the provisions of the Customs and Excise Act, 1964.

The proviso is also deleted as awards are no longer paid from such monies. "Fine" would otherwise also have been deleted for the same reason as in the substantive portion.

CLAUSE 96

Customs and Excise: Amendment of section 94 of the Customs and Excise Act, 1964

Section 94*(a)* is amended to achieve uniformity with sections 105 and 114. In the past, fines were collected by the Department of Justice and paid over to the Controller, but this practice is no longer followed and the reference to "fine" is therefore deleted as fines are not recovered under the provisions of the Customs and Excise Act, 1964.

CLAUSE 97

Customs and Excise: Amendment of section 95 of the Customs and Excise Act, 1964

The commercial cargo clearing facility at the proposed Ressano/Garcia one stop border will be situated within the territory of Mozambique. The amendment of section 95(1A) by inclusion of a reference to section 50A will deem an offence committed at the commercial cargo facility as having been committed at any place in the Republic where the accused happened to be.

CLAUSE 98

Customs and Excise: Amendment of section 111 of the Customs and Excise Act, 1964

Section 111 is amended to clarify that where a vehicle manufactured in South Africa is re-imported after exportation also requires a certificate issued by an officer as contemplated in subsection (1) as it must be verified whether the duty and VAT due have been paid.

CLAUSE 99

Customs and Excise: Repeal of section 113A of the Customs and Excise Act, 1964

Section 113A is repealed as a consequence of the insertion of the counterfeit goods legislation in Chapter XB.

This shall come into operation on a date fixed by the President by proclamation in the *Gazette.*

CLAUSE 100

Customs and Excise: Amendment of section 114 of the Customs and Excise Act, 1964

Section 114 is amended to achieve uniformity with section 105. In the past, fines were collected by the Department of Justice and paid over to the Controller, but this practice is no longer followed and the reference to “fine” is therefore deleted as fines are not recovered under the provisions of the Customs and Excise Act, 1964.

CLAUSE 101

Customs and Excise: Amendment of section 114A of the Customs and Excise Act, 1964

Section 114A is amended to achieve uniformity with sections 105 and 114. In the past, fines were collected by the Department of Justice and paid over to the Controller, but this practice is no longer followed and the reference to “fine” is therefore deleted as fines are not recovered under the provisions of the Customs and Excise Act, 1964.

CLAUSE 102

Customs and Excise: Amendment of section 114B of the Customs and Excise Act, 1964

Section 114B is amended to achieve uniformity with sections 105, 114 and 114A. In the past, fines were collected by the Department of Justice and paid over to the Controller, but this practice is no longer followed and the reference to “fine” is therefore deleted as fines are not recovered under the provisions of the Customs and Excise Act, 1964.

CLAUSE 103

Customs and Excise: Amendment of section 120 of the Customs and Excise Act, 1964

Subclause (1)(a): Section 120 is amended to add section 49 as customs union agreements and other international agreements which require to be administered under customs legislation are now provided for under that section.

This will come into operation on the date of promulgation of this Act.

Subclause (1)(b): Section 120(3) is amended in consequence of the renumbering of section 78. This will, however, only come into operation at the same time as the counterfeit goods legislation of Chapter XB comes into operation.

CLAUSE 104

Stamp Duties: Amendment of section 1 of the Stamp Duties Act, 1968

Subclause (a): The proposed amendment seeks to delete all provisions relating to marketable securities as those provisions will be catered for in the Securities Transfer Tax Act, which will come into effect on 1 July 2008.

Subclause (b): The proposed amendment seeks to insert a definition of "**Republic**" into the Stamp Duties Act, although it has been deleted during 1988, it is necessary to define the Republic as there are references to "Republic" in Stamp Duties Act.

CLAUSE 105

Stamp Duties: Amendment of section 7 of the Stamp Duties Act, 1968

The proposed amendment seeks to delete all provisions relating to marketable securities as those provisions will be catered for in the Securities Transfer Tax Act, which will come into effect on 1 July 2008.

CLAUSE 106

Stamp Duties: Amendment of section 8 of the Stamp Duties Act, 1968

The proposed amendment seeks to delete all provisions relating to marketable securities as those provisions will be catered for in the Securities Transfer Tax Act, which will come into effect on 1 July 2008.

CLAUSE 107

Stamp Duties: Amendment of section 23 of the Stamp Duties Act, 1968

The proposed amendment seeks to delete all provisions relating to marketable securities as those provisions will be catered for in the Securities Transfer Tax Act, which will come into effect on 1 July 2008.

CLAUSE 108

Stamp Duties: Amendment of section 28C of the Stamp Duties Act, 1968

The proposed amendment seeks to delete all provisions relating to marketable securities as those provisions will be catered for in the Securities Transfer Tax Act, which will come into effect on 1 July 2008.

CLAUSE 109

Stamp Duties: Amendment of item 15 of Schedule 1 to the Stamp Duties Act, 1968

The proposed amendment seeks to delete all provisions relating to marketable securities as those provisions will be catered for in the Securities Transfer Tax Act, which will come into effect on 1 July 2008.

CLAUSE 110

Value-Added Tax: Amendment of section 1 of the Value-Added Tax Act, 1991

Subclauses (a) and *(b):* Presently, the Export Incentive Scheme in Regulation GN 2761 regulates indirect exports as contemplated in paragraph (d) to the definition of "exported" in section 1 of the VAT Act. It is proposed that the requirements, which have to be met in order for the direct and indirect export of goods to fall within the definition of exported, be prescribed by Regulation.

Subclause (c): The proposed amendment is intended to provide clarity as to what consitutes a "foreign donor funded project" for VAT purposes. A foreign donor funded project is a project formed as a result of an international donor funding agreement to which the Government of the Republic is a party to and the Minister has approved by Notice in the Gazette that such funding must not be subject to tax.

Subclause (d): The reason for allowing a 'notional input tax' deduction to a vendor acquiring second-hand goods from non-vendors (including vendors who were denied input tax on acquisition of these goods) is to "unblock" the VAT

which the non-vendor paid and could not claim as input tax on acquisition of the goods.

It is proposed that second-hand goods sold by a persons/ diplomatic/consular mission, as contemplated in section 68 of the VAT Act, to vendors should not result in a vendor being entitled to claim a notional input tax where such person/diplomat/consular mission was entitled to a VAT refund as contemplated in section 68 of the VAT Act. This is due to the fact that no element of VAT is actually borne or trapped in the hands of the persons/diplomatic/consular mission. Accordingly, the price charged by a foreign diplomat or consular mission to a second-hand dealer will not include any element of VAT.

The definition of 'resident of the Republic' in section 1 of the VAT Act, means a 'resident' as defined in the Income Tax Act, 1962 (Act No. 58 of 1962) ('IT Act') and in most cases, foreign diplomats or consular missions do not fall within the definition of 'resident' in section 1 of the IT Act, as they are either specifically or implicitly excluded where the Government of the Republic and the foreign diplomat's country have entered into an agreement for the avoidance of double taxation. However, a foreign diplomat could potentially fall within the definition of 'resident' in the IT Act on the basis of the 'physical presence' test. Accordingly, the proposed amendment also ensures that the defined term 'resident' used within the definition of 'input tax' effectively excludes foreign diplomats or consular missions.

CLAUSE 111

Value-Added Tax: Amendment of section 6 of the Value-Added Tax Act, 1991

The proposed amendment is of a textual nature as the head of Statistics South Africa is now referred to as the Statistician-General.

CLAUSE 112

Value-Added Tax: Amendment of section 8 of the Value-Added Tax Act, 1991

Subclause (a): The proposed amendment is of a textual nature and inserts the number of the National Credit Act, 2005. The proposed amendment is effective from 1 June 2007.

Subclause (b): The proposed amendment seeks to clarify that the excess amount received in respect of a standard rated supply is deemed to be consideration in terms of section 8(27) of the VAT Act

CLAUSE 113

Value-Added Tax: Amendment of section 9 of the Value-Added Tax Act, 1991

The proposed amendment is of a textual nature and inserts the number of the National Credit Act, 2005. The proposed amendment is effective from 1 June 2007.

CLAUSE 114

Value-Added Tax: Amendment of section 11 of the Value-Added Tax Act, 1991

Subclauses (a) to *(c):* The amendment is consequential upon the amendment to the definition of "exported" in section 1 of the VAT Act.

Subclauses (d): The amendment is consequential upon the amendment to the definition of "foreign donor funded project" in section 1 of the VAT Act.

Subclause (e): The winnings paid by racing operators to horse owners are currently zero-rated in terms of section 72 of the VAT Act. The proposed amendment is to provide a zero-rating provision for the payment of winnings by racing operators to horse owners.

CLAUSE 115

Value-Added Tax: Amendment of section 16 of the Value-Added Tax Act, 1991

Subclauses (a) to *(c):* A vendor is entitled to certain deductions in terms of section 16(3) of the VAT Act which are not subject to the documentary requirements contemplated in section 16(2) of the VAT Act. The proposed amendment is to provide the Commissioner with discretionary powers in order to prescribe acceptable documentary proof that a vendor must be in possession of before making such deductions. This amendment will not affect deductions of "input tax" as section 16(2) set outs the documentary requirements.

Subclause (d): The proposed deletion of the proviso in section 16(2) of the VAT Act is to eliminate the duplication of the proviso which is provided for in section 16(3) of the VAT Act.

Subclause (e): Where goods or services were supplied to a vendor during a tax period and the vendor was not in possession of e.g. a tax invoice, the vendor is not entitled to claim the input tax during that tax period. If the tax invoice is obtained in a subsequent tax period, the vendor can claim input tax in terms of

section 16(3)(*g*). The proposed amendment to section 16(3)(*g*) is intended to allow a vendor to claim input tax or a deduction where the documentary requirements of section 16(2) are subsequently met.

Subclause (f): The proposed amendment to proviso (i)(ee) prescribes the calculation of the five year on any deduction not previously claimed. In calculating the five year prescription period for claiming deductions, regard must not be had to the prescribed documentary requirements. For example: winnings as contemplated in section 16(3)(d) are paid in tax period 1. The vendor does, however, not yet have the prescribed documents to substantiate the deduction. In tax period 2 the vendor is in possession of the prescribed documents. The five year prescription period is calculated from the end of tax period 1.

The proposed insertion of proviso (ii) in section 16(3) of the VAT Act is intended to clarify that any subsequent deduction of input tax or any other deduction which was not previously claimed by a vendor and such deduction was not permissible in terms of a practice generally prevailing prior to that deduction, that such deduction is limited to six months prior to the tax period in which the deduction is made. The proposed amendment aligns the proviso in Section 16(3) to the proviso in section 44(3)(a) of the VAT Act which was intended to cater for the limitation of the deduction of input tax or any other deduction.

The calculation of the six month period can be illustrated as follows: a vendor intends to claim input tax in the November 2007 tax period (i.e. a Category B tax period), on supplies which were not previously claimed. However, it was a practice generally prevailing that input tax on such supplies was not permissible. Accordingly, the vendor is entitled to claim input tax on all supplies for a period of six months prior to the November 2007 tax period. Therefore, the vendor can deduct input tax on all supplies that were incurred during the tax period ending June 2007. The vendor, being registered on Category B, would be entitled to claim input tax on all supplies incurred in the May and June 2007 tax period.

CLAUSE 116

Value-Added Tax: Amendment of section 17 of the Value-Added Tax Act, 1991

The proposed amendment is consequential upon the amendment to the definition of “foreign donor funded project” in section 1 of the VAT Act.

CLAUSE 117

Value-Added Tax: Amendment of section 28 of the Value-Added Tax Act, 1991

Subclause (a): The proposed amendment to subparagraph (ii) is to clarify that where the payment of the tax is effected by means a debit order, such payment will only be effected on the last business day of the month. However, the VAT 201 return must be submitted by the twenty-fifth day of the month or if the 25th day falls on a Saturday, Sunday or Holiday, the last the business day before the 25th day of the month.

The internet banking payment and returns submitted via e-filing must be made by the last business day before the 25th day of the month.

Payment method	**Returns**	**Payment**
Cash	25th	25th
Cheque	25th	25th
Postal Order	25th	25th
Payment at any of the 4 mayor banks	25th	25th
VAT 201 (a) debit order	25th	Last business day
E-filing of return <u>and</u> payment via SARS e-filing	Last business day	Last business day
Electronic transfers (including Internet banking)	25th	25th

It is important to note that the return and/or payment must be received on or before the abovementioned dates for the particular payment method selected. In the event that such day falls on a Saturday, Sunday or public holiday (i.e. not a business day), the return and/or the payment must be received on the last business day before that date.

CLAUSE 118

Value-Added Tax: Amendment of section 33 of the Value-Added Tax Act, 1991

Subclause (a) and *(b):* The proposed amendment is consequential upon the amendment to section 32 of the VAT Act, which was included in clause 15 of the Taxation Laws Second Amendment Act, No. 9 of 2007.

CLAUSE 119

Value-Added Tax: Amendment of section 33A of the Value-Added Tax Act, 1991

Subclause (a) and *(b):* The proposed amendment is consequential upon the amendment to section 32 of the VAT Act, which was included in clause 15 of the Taxation Laws Second Amendment Act, No. 9 of 2007

CLAUSE 120

Value-Added Tax: Amendment of section 55 of the Value-Added Tax Act, 1991

The proposed amendment is consequential upon the amendment proposed to sections 16(2A), 16(3)(*a*)(iv) and 16(3)(*b*)(ii) of the VAT Act (see clause 115). In terms of section 55(1) of the VAT Act, a vendor must keep, *inter alia*, such books of account and documentary proof that may enable the vendor to observe the requirements of the VAT Act and satisfy the Commissioner that the vendor has met such requirements. The result of the proposed amendment is that a vendor is required to keep the documents prescribed by the Commissioner in terms of section 16(2A) of the VAT Act, for the prescribed period.

CLAUSE 121

Value-Added Tax: Amendment of schedule 1 of the Value-Added Tax Act, 1991

The proposed amendment will entitle vendors to import goods used or consumed for agricultural, pastoral or other farming purposes to be exempt from value-added tax on the importation of those goods, subject to the provisions of paragraph 2 of Part A of Schedule 2 to the VAT Act.

CLAUSE 122

Value-Added Tax: Amendment of schedule 2 of the Value-Added Tax Act, 1991

The local supply of dried maize for human consumption and animal feed is currently zero-rated in terms of 11(1)(g) and 11(1)(j) of the VAT Act and the importation of dried maize for human consumption is exempt from VAT in terms of paragraph 7 of Schedule 1 to the VAT Act. It follows that the purpose of the maize ultimately determines the VAT treatment. This however creates a problem when one is unsure as to the exact purpose of the maize at the time of purchase or importation as this will determine the rate of VAT to be imposed. To overcome the problem of the VAT treatment being dependent on the purpose of the dried

maize, an amendment is proposed to zero rate the supply of dried maize locally and provide for an exemption of VAT on importation of dried maize into the Republic.

CLAUSE 123

Uncertificated Securities Tax: Amendment of section 6 of the Uncertificated Securities Tax Act, 1998

This amendment is consequential to the renaming in the Income Tax Act of a company formation transaction to an asset-for-share transaction and the repeal of section 43 of that Act. (share-for-share transactions).

CLAUSE 124

Skills Development Levy: Amendment of section 4 of the Skills Development Levy Act, 1999

The proposed amendment will give effect to the proposal in the 2006 Budget Review aimed at placing Public Benefit Organisations on par with other employers regarding the payment of the skills development levy.

CLAUSE 125

Transfer Duty and Stamp Duty: Amendment of section 99 of the Collective Investment Schemes Control Act, 2002

The proposed amendment seeks to delete the provisions which grant an exemption from the payment of transfer duty and stamp duty in respect of any endorsement or entry made in terms of section 99(5) of the Collective Investment Schemes Control Act and in respect of the issue of a substituting participatory interest or the transfer of assets as a result of any amalgamation, cession, transfer or take-over by the scheme or portfolio in terms of that section. The company reorganization rules in the Income Tax Act, 1962, will be amended to provide an exemption for those transactions.

CLAUSE 126

Income Tax: Repeal of Third Schedule to the Small Business Tax Amnesty and Amendment of the Taxation Laws Act, 2006

This amendment is consequential to the enactment of the Tenth Schedule to the Income Tax Act.

CLAUSE 127

Income Tax: Amendment of section 3 of the Taxation Laws Amendment Act, 2007

The effective date is changed by means of this proposed amendment.

CLAUSE 128

Income Tax: Amendment of section 15 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 129

Income Tax: Amendment of section 54 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 130

Income Tax: Amendment of section 56 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 131

Income Tax: Amendment of section 64 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 132

Income Tax: Amendment of section 67 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 133

FIFAS World Cup 2010: Amendment of section 112 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 134

Diamond Export Levy: Amendment of section 115 of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 135

Income Tax: Amendment of paragraph 4 of Appendix I of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 136

Diamond Export Levy: Amendment of paragraph 1 of Appendix III of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 137

Diamond Export Levy: Insertion of paragraph 1A of Appendix III of the Taxation Laws Amendment Act, 2007

This proposed amendment effects a technical correction.

CLAUSE 138

Value Added Tax: Special zero-rating in respect of goods or services supplied by 2007 ICC 20 20 WC (South Africa)

The payments made by the ICC to the 2007 ICC 20 20 WC (South Africa) in respect of a supply of goods or services by ICC 20 20 WC (South Africa) to the ICC for purposes of staging the ICC's 2007 Twenty 20 over World Championship are proposed to be subject to VAT at the rate of zero percent.

CLAUSE 139

Income Tax: Special rules relating to amalgamation of professional and amateur sporting bodies

See note on **AMALGAMATION OF SPORTING BODIES**

CLAUSE 140

Short title and commencement:

This clause provides for the name of the Act and the commencement date thereof.