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Dear Sirs

Comments on the Taxation Laws Amendment Bill 2008

Need for proper consultation

We are concerned as a threshold matter with the fact that the time frame in which we are expected to properly comment on the Bill is somewhat unrealistic. Public comment should be an important part in the finalization of legislation, but it seems to us that, given the time granted by National Treasury, obtaining proper public comment and consultation cannot be a primary objective, since obtaining detailed and considered responses to draft legislation is simply not feasible in the time period allowed for comment.

Coupled with this is the very frustrating situation which has now existed for several years. Detailed legislation is drafted without due consultation or due consideration being given to all the possible consequences. In addition, due to hasty drafting under tight time pressures, the legislation drafted is full of imperfections (by Treasury's own admission). This then results in a need for follow up legislation to address the perceived imperfections, which again is rushed out with insufficient time for consultation and which as a result brings with it its own set of problems which then have to be addressed in yet another round of amending legislation. Bills drafted to correct prior legislation are in some cases actually longer than the piece of legislation which they are intended to correct! This has the potential to become a never ending cycle.

Please note that we are very much in sympathy with the need to put a stop to tax abusive transactions. Our concern is not around the fact that changes are being proposed, if needed to counteract abuse, but around the fact that not enough time is given for due consultation on those changes. More consultation would lead to carefully considered solutions which would achieve Treasury's and SARS' objectives without harming non-abusive transactions. For example, National Treasury needs to understand the type of non abusive transactions which are potentially harmed by the proposals they have made in order to refine and re-focus those proposals. In the time allowed for comment, however, it has simply not been possible to put together detailed documentation on these transactions for Treasury's consideration. A longer period of consultation would enable this to happen.

Need for period of consolidation

South African businesses need certainty and consistency in the planning of their tax affairs. Extremely frequent and wide ranging changes to the tax law, often implemented with retrospective effect are totally counter- productive to this and are a significant deterrent to foreign investors who want certainty regarding their anticipated tax liabilities before committing to an investment. When compared against international benchmarks it is very clear that in major trading nations such as the UK, the US, Canada, Australia and many others, the introduction of tax legislation is handled in a very different and much more considered fashion. In the UK, as an example, there is a consultation process in progress to discuss the introduction of a participation exemption for foreign dividends and certain aspects of its CFC rules. This process of dialogue between the UK Treasury and industry will have lasted well over two years by the time the proposed legislation is enacted.

Use of GAAR and Reportable Arrangements

By Treasury's and SARS' own admission in the Media Statement accompanying the TLAB 2008, certain of the transactions described (which have triggered certain of the proposed amendments) relate to structures which clearly constitute impermissible tax avoidance. In such cases, since South Africa now has a "tightened up" GAAR, we would encourage the authorities to make use of this and not automatically respond to instances of blatant abuse by seeking to introduce rushed and hence potentially problematic specific anti avoidance measures. Because of the shortage of time spent in considering the full ramifications of such measures, they inevitably have an impact far beyond that which was intended and end up significantly disadvantaging commercial, non abusive transactions. We comment further below on the proposed changes to section 41 and section 45 which in our view fall into this category.

In order to monitor any potential transactions which are considered abusive, the provisions of section 76A or sections 80M to 80T when they are brought into effect should be broadened to include such transactions. In this way, SARS would be aware early of transactions which are taking place and could ensure appropriate remedial action is taken.

In the week since the draft legislation appeared, we have had to contact a large number of clients and advise them to put on hold a variety of completely non-abusive transactions which are likely to be severely negatively affected if these proposals are enacted in their current form, because the (presumably unintended) impact of these proposals is to create an environment in which many tax neutral reorganisations within South African groups are no longer feasible. South African

legislation is without any doubt going backwards and not forwards in this area, compared with international norms.

We outline below our comments on the specific proposals

1. Section 23K (section 20 of TLAB)

While sympathetic to SARS that an unbundling should not necessarily result in a step up in base cost of the unbundled shares, in our opinion the proposed section 23K is not targeted at the real mischief. Any asset coming into the SA tax base for the first time e.g. the shares in the SA company held by the foreign parent which in the example are now being transferred to a SA shareholder, should be allowed to come in at market value. This is in line with SARS' own practice in the CFC rules (when a company becomes a CFC) and in the provisions relating to companies moving their tax residence to SA. It is also in line with international practice.

Quite apart from the unfairness of a provision that seeks to attach a low base cost to any such assets (especially in the context of a situation where Treasury is encouraging the formation of SA holding companies to facilitate the formation of a "group of companies" for the purposes of the corporate rules) it is very difficult to arrive at a reasonable solution for what the base cost of those assets should be if they were held by the foreign party before October 2001, nor is it necessary unless the shares represent an interest in immovable property. The proposed amendment simply provides that the base cost will be limited to the cost of the equity share to the seller (irrespective of when the share was acquired) less any deductions which that seller may have been allowed in respect of that share. If implemented in this form, in many cases the base cost will be negligible if the shares have been held for a long time and it is highly unlikely that any foreign parent will be willing to transfer its existing SA subsidiaries to a new SA holding company. This will impose tax on the disposal of these shares which would not otherwise have been payable if they were disposed of by the non resident.

To help address the mischief with which SARS is concerned we recommend that the legislation rather provide that if an unbundled share is disposed of within 18 months after the unbundling, to a buyer outside the group of companies of which the unbundled company is a member, then the base cost of the unbundled share will be equal to the base cost which that unbundled share had in the hands of the unbundling company immediately before the unbundling occurred. This could be dealt with in a proviso to section 46 rather than in a totally new section (it is not clear from the wording of the proposed section how it interacts with other sections which are in conflict with it e.g. section 24B).

On a minor point relating to the wording of the proposed amendment, we note that the reference to amounts received on the disposal of a share constituting "income" in the hands of the connected person, is inappropriate (since the proceeds are likely to have been capital rather than revenue in nature) and the reference should rather be to amounts which "were not subject to tax" in the hands of that person.

2. Section 41 – "group of companies" (section 23(d) of TLAB)

2.1. The requirement to be registered as external companies seems reasonable and practical in the case of companies which have a presence in SA. (Indeed, all such companies probably should be so registered). However, not all dual resident companies have sufficient presence in SA to enable them to register as external companies in terms of the Companies Act (e.g. pure holding companies which do not hold themselves out to the public as having a place of business here). To enable such companies to register, a change may well be required to the Companies Act. If no such change is made, then arguably in the case of companies incorporated in a treaty country, the denial of relief in the absence of external company registration – if such registration is not a legal possibility for those companies- remains discriminatory under the treaty provisions. Registration also brings with it exchange control complications since external companies are regarded as SA residents for exchange control purposes. Again, this is not a problem for companies with local branches but will be difficult to deal with in the context of pure holding companies with no local assets other than their South African shareholdings.

We therefore recommend that dual resident holding companies with no business presence in SA (other than Board meetings of directors from time to time) should be able to qualify as members of a group of companies as defined in section 41, even though they will be prevented (under the current wording of the Companies Act) from registering as external companies in SA since they are not holding themselves out to the public as doing business here.

2.2. The exclusion, possibly with immediate effect, of any foreign incorporated and foreign tax resident company from the definition of group of companies means that it is no longer possible for a CFC of a South African company to use section 45 to distribute or sell its shares in another CFC to its SA parent company on a tax neutral basis. (Our CFC rules will tax any gain made by the seller CFC). Other sections in the corporate rules also cannot be used (section 42 theoretically could be, but in practice can not work because it would result in a loop structure). This seems very inequitable. It should be in SARS' interest for holding structures to be flattened in this way i.e. for foreign subsidiaries to be held directly from SA rather than indirectly though a chain of foreign companies. Since the CFC being transferred remains at all times within the SA tax net, there seems no logical reason why a tax neutral transfer should not be available.

In this context, we seriously question why CFCs should be excluded from the definition of group of companies in section 41. Such companies by virtue of being CFCs are fully within the SA tax net. Any tax due in relation to a CFC's income can and must be collected by SARS from the CFC's SA parent and not from the CFC itself (hence tax administration cannot be a reason for excluding such companies from being members of a group of companies for the purposes of the corporate rules.) Our proposal is that CFCs continue to be included in the section 41 definition of "group of companies".

2.3. The announcement in the Media Statement that the changes to the definition of group of companies will be immediate i.e. as from 21 February 2008 is completely unacceptable as it disrupts vested rights. By their very nature, corporate reorganisations take time and generally once embarked on, cannot simply be halted without great disruption and

potential cost. Transactions which are already in progress and in which the parties involved were relying on tax neutrality have overnight been turned into taxable transactions. In many cases, the tax costs are enormous even though no real economic gains are being made.

3. Section 45 (section 26 of TLAB)

The proposed amendment to the definition of "intra-group transaction" is aimed at prohibiting tax avoidance as set out in the transaction on page 3 of the Media statement on Company Restructuring Measures (dated 21 February 2008). In our view, the mentioned transaction would fall within the current anti-avoidance legislation and it remains debatable if specific legislation is required to stop transactions of this nature. In any event, the proposed change will have far reaching unintended consequences.

We are concerned about the uncertainty created by the effective date of the proposed amendment. The Bill has an effective date of years of assessment ending on or after 1 January 2009, but the media release talks about the "immediate closure of tax avoidance". We have received a number of confirmations from various sources (including National Treasury) stating that the effective date for the change to the definition was inadvertently left out and that it will be effective for all intra-group disposals on or after 21 February 2008. There are numerous intra-group transactions currently in process that are either subject to suspensive conditions or that are in the final stages of implementation (with effective dates post 21 February 2008) that must now be put on hold due to the uncertainty regarding the effective date.

If implemented as currently worded, section 45 will in substance be ineffective and the scope of the corporate rules severely eroded. This will create immense inflexibility. For years, provisions of various kinds have existed in SA tax legislation which have effectively allowed group members to transfer assets between themselves at tax values, irrespective of the form of consideration for those assets. If the proposed amendments are enacted, this ability will largely be removed, making South Africa one of a very few countries in the world which does not provide tax neutral treatment for this type of transaction.

Since the mischief concerning SARS appears from the example in the Media Statement to be the risk of an effective sale to a third party without triggering tax on the inbuilt gains in the shares\assets transferred, we recommend that this mischief rather be addressed by providing that when assets are sold on loan account, the loan account will only have a base cost equal to its face value for so long as it is retained within the group of companies of the transferor company. This will enable the loan account to be repaid to the original transferor without recouping the tax deferred under the section 45 transaction. Should the transferor distribute or sell the loan note outside the group, however, within e.g. 18 months from the date of the section 45 transaction which gave rise to the note, the note will then have a base cost equal to the base cost of the assets which it transferred (or an appropriate proportion of that base cost, if a portion of the loan has been repaid before the loan is ceded) and hence the tax deferred under the original transaction will be triggered.

4. Section 47 (section 28 of the TLAB)

The date of introduction of the provision clarifying that the part disposal rules in paragraph 76 and 76A should be disregarded should logically be 1 October 2007.

5. Other sections

5.1. Section 64B(5)(f) (sec 29(1)(a) of TLAB) -There does not appear to be any reason why dividends which flow from a controlling group company to a controlled group company should be excluded from the intra-group relief. Intra-group relief should be available whether dividends flow up, down or across the group. The existing exclusion from the exemption regarding the dividend to be taken into account in the determination of the profits of that shareholder should be adequate to address any concerns in this regard.

5. 2 4th Schedule paragraph 11B(4) (sec 38 of TLAB) – The potential refund of SITE amounts to employees who have not been employed for a full year is welcomed. It is suggested that the legislation makes clear whether the refund should be made by the Commissioner or the employer. (Refer Meyerowitz paragraph 38.65, Silke paragraph 20.39). We submit that the Act should allow the Commissioner to make the refund.

5.3. Schedule 7, paragraph 9 (section 40 TLAB)
The paragraph (7B) exclusion of the nil value for a period of two years where the employee spends more than 30 days in South Africa prior to being seconded to South Africa, would appear to lead to an inequitable situation between employees fundamentally having the same secondment process except for the 30 day 'trigger'. It is suggested that if this is a concern, the date of arrival be backdated by any period in South Africa in the 12 months prior to the secondment.

5.4. Taxation Laws Second Amendment Act
The Taxation Laws Second Amendment Act removes the requirements for reporting certain information in the annual tax return. These references have been removed to facilitate e-filing. A further section that requires amendment is section 10(2) to the Act that requires all amounts falling within the exemptions provided for in paragraphs 10(1)(h) and (k) to be set out by the taxpayer in the return rendered by him.

Yours faithfully

Anne Bennett (for Deloitte Tax)

Director