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The Honourable: The Minister of Finance
The Chairman: Standing Committee on Finance - Parliament

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Dear Sirs

COMMENT ON THE DRAFT TAXATION LAWS AMENDMENT BILL AND TAXATION LAWS SECOND AMENDMENT BILL

We have pleasure in setting out our comments hereunder in relation to the above. As requested, our comments are in order of the draft Explanatory Memorandum, and are therefore not in order of priority.

LEARNERSHIP ALLOWANCE SIMPLIFICATION

1 Paragraph (b) of the definition of "employer" in section 12H(1) is incorrect grammatically. The words "are parties" should read "is a party".

EMPLOYER-PROVIDED POST-RETIREMENT MEDICAL AID

2 As indicated in the Explanatory Memorandum, one of the reasons why the taking out of these policies has become widespread is the removal of the liability from the balance sheet, which liability is otherwise required by GAAP.

3 But the problem does not end with employees who have already retired. There is also a significant problem in relation to employees who are nearing retirement age, in circumstances where it may not be possible to amend the retirement schemes and/or employment packages to cost to company arrangements.

4 Consequently, it is also fairly common for employers to make contributions under policies for employees nearing retirement. Where a payment is made to a retirement fund for this

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purpose, it is possible to deal with this under section 11(l) of the Income Tax Act No. 58 of 1962 ("**the Income Tax Act**"), but the law does not cater for a contribution under a policy.

5 In our view, it is not sufficient merely to deal with retired employees. Whether or not, as a policy decision, contributions for employees nearing retirement should be allowed in the year of payment or should be spread over a number of years, is something that can be decided upon and legislated for. But we do not believe that this aspect should simply be ignored.

6 Failing the introduction of specific legislation in this regard, the SARS should, concurrently with the promulgation of the legislation, issue a binding general ruling covering the deductibility of such payments and the period over which they should be written off, in terms of sections 11(a) and 23H of the Income Tax Act.

7 Furthermore, the requirement in the legislation that the employer must divest himself in full of the post-retirement medical aid obligation is too onerous as possible methods to address the commercial issues in relation to obligations include the retention of a residual obligation, by the employer should the annuity policy not be able to guarantee the full amount. In other words, a shortfall may arise in the policy and the employer undertakes to make good such shortfall. In such a solution the lump sum is paid over to the insurer who acquires assets to fund its future obligations in terms of the policy and the employer has no recourse against the insurer for funds already paid away. Whether or not the obligation to cover future obligations is transferred in full to the insurer has no bearing on the deductibility thereof, as this has no impact on whether or not the policy is an investment policy or a true insurance policy. It is submitted that the facts in *Rhodesian Railways v COT* 14 SATC 311 are sufficiently distinguishable from the scenario where employers attempt to transfer their post-retirement obligations in part by acquiring an annuity policy from a third party insurer. Given the non-applicability of this case to the facts at hand, and thus there being no reserve fund or investment policy, there is no reason to require that the obligation be transferred in full as this is not a requirement of the general deduction formula.

ENERGY EFFICIENCY

8 The reference in section 12L(3) to subsection (1) should be a reference to subsection (2).

DIVIDENDS TAX: WITHHOLDING REFINEMENTS

Distributions in specie

9 This is a comment on clause 55(1)(b) of the Bill which adds subsection (3)(a) to section 64E of the Income Tax Act.

10 From a tax perspective, the purpose of this provision would be to ensure that the fiscus receives the same amount of dividends tax that it would have received had the company sold the shares in question and distributed the net proceeds as a dividend.

11 Had that happened, the amount of the dividend would not have been equal to the value of the shares distributed, but would instead be the amount of the profit realised on the disposal of the shares less the tax payable on that profit (at the rate of 28% if the shares were held as trading stock and at the effective rate of 14% if the shares were held as capital assets). In our view the provision should recognise this situation.

12 Given that a distribution of shares triggers CGT (paragraph 75 of the Eighth Schedule) or full tax (section 22(8) of the Income Tax Act), the amount of the deemed dividend should be based on the figure contemplated in subsection (3)(a), but reduced by the amount of normal tax payable by the company by reason or in consequence of that distribution.

Dividends tax exemptions

13 The amendments to section 64F of the Income Tax Act do not include an exemption from withholding tax arising from the introduction of paragraph 51A of the Eighth Schedule to the Income Tax Act, dealing with the termination of domestic residence companies.

14 An appropriate exemption was added in respect of STC, but given that the CGT exemption is intended to last until 31 December 2011, an exemption from the dividends tax is also required (unless it is anticipated that the dividends tax will not commence before 1 January 2012).

DIVIDENDS TAX: DEEMED DIVIDENDS

Section 64O

15 In the definition of "financial assistance" reference is made to "the payment of a guarantee". We think that a better description is "payment under a guarantee".

16 Subsection (2)(a) has the potential for double tax. If a loan is made, say, to a shareholder, this will trigger the tax. If then a dividend is declared to that shareholder which has the effect of extinguishing the loan by set-off, this will be an actual dividend, which triggers the tax a second time. Surely this cannot be the intention.

17 A similar situation arises if the loan is repaid in cash and then the cash is distributed as an actual dividend. (It should be noted that section 64C of the Income Tax Act catered for this situation by deeming the repayment of the loan to be a dividend received, thereby triggering an STC credit. Clearly this is not a solution here, but equally the present situation is untenable.)

18 Subsection (2)(b) is understandable in the case where the South African company, to which section 31 applies, is a subsidiary of a foreign holding company. But if section 31 is applied to a South African company in relation to its foreign subsidiary (or a fellow subsidiary where both have the same South African holding company), it is illogical that this should trigger a withholding tax on a deemed dividend to shareholders, ie the profits are moving "downwards" and not "upwards".

19 This problem of a deemed "downward" dividend is recognised in the exclusion contained in the proposal section 64P(d) of the Income Tax Act, in that financial assistance provided to a CFC will not be deemed to be a dividend. But this should apply even where, say, goods are sold at less than an arm's length price to a CFC – after all it is the same principle.

20 For the sake of precision and clarity, subsection (2)(d) should be made subject to any relevant double tax agreement. The fact is that a holder of a hybrid debt instrument would be well within its rights to assert that it is still receiving interest, which ought to be the subject of the interest article under the treaty, and not a dividend subject to the dividends article.

21 It is stated in the Explanatory Memorandum that the purpose behind the words "and is not a shareholder" in subsection (3)(c) is that there should be no treaty relief because the company cannot hold shares in itself.

22 With respect, this is not the issue. One should instead ask what would happen if, just prior to the company ceasing to be a resident, it declared all of its realised and unrealised profits to its shareholder/s. If the tax rate would have been, say, 5% (because, say, its sole shareholder is in a treaty country), then that is the amount that ought to be payable on the deemed dividend,

ie there is no reason why the fiscus should receive more by way of an exit charge than it would have received had an actual dividend been declared.

23 In subsection (4)(c) it must be remembered that the cessation of residence will also trigger CGT. Once again, had the company actually sold all of its assets and distributed the proceeds as a dividend, the amount available for distribution as a dividend would have been the net proceeds less CGT. Surely the deemed dividend on cessation of residence should take into account the CGT that will also be payable.

24 In subsection (5)(c) there could be an argument that no dividend is deemed to be payable as the company has ceased to be a resident. Rather the dividend should be deemed to have been paid on the day prior to cessation of residence.

Section 64P

25 The use of a two-leg test in subsection (c) dilutes the benefit of a safe harbour contained in paragraph (i), because one still needs to make the factual enquiry of what the rate would be to a member of the general public. This is made even more difficult if the company is not in the habit of granting financial assistance to members of the general public. Given that it is a safe harbour, the sole test should be that as in (i).

26 A situation could arise where a loan is made by a company in circumstances where it has no realised or unrealised reserves, for example, the company is a dormant company and has made the loan entirely out of share capital and/or a loan to the company. It would be entirely inequitable and illogical for such a loan to be deemed to be a dividend merely because, say, no interest was charged.

27 Accordingly, in our view, there should be a similar exemption as contained in section 64C(4)(c) of the Income Tax Act, namely, where the loan exceeds the amount which could otherwise have been declared as a dividend.

28 Similarly, no exemption has been made for a share granted to an employee share trust, as is contained in section 64C(4)(i) of the Income Tax Act. In this regard it should be noted that, in the vast majority of cases, the trust and the company are connected persons, because the company is the default beneficiary of the trust, ie once the trust is terminated because all of its shares have been sold to employees, any profit is paid back to the company.

29 It follows, therefore, that all such loans will be deemed to be a dividend, which is entirely impractical and, what is more, does not amount to an avoidance which section 64O seeks to prevent.

Section 64Q

30 Subsection (2)(a) is impractical, because these loans are often not pre-planned some time in advance, which would enable the parties to submit the written declaration. Sometimes funds are laid out on the spur of the moment or another person retains the proceeds on disposal of an asset, and so on. It would be more practical if the written declaration could be submitted within a reasonable period after the loan has been paid.

31 Subsection (2)(b) is unnecessary, and, in fact, its inclusion gives rise to an incorrect impression. In our submission a loan to any South African company could not give rise to the dividends tax. The reasons for this are as follows:

31.1 Section 64O(2) states that, for the purposes of section 64E(1), a company is deemed to have paid a dividend where, for example, it grants financial assistance.

31.2 Because this is for the purpose of section 64E, one needs to apply the rule as if an actual dividend had been declared, in which case the dividend would have been exempt from tax under section 64F(2)(a) of the Income Tax Act.

31.3 In fact, if the loan is made to any South African resident company, on that reasoning, the dividend would be exempt from tax, and therefore the loan should not be deemed to be a dividend which triggers tax. But by specifically excluding a loan to a group company, one gives the impression that a loan to a non-group company triggers the tax.

32 If we are incorrect, and section 64O(2) does no more than deem a dividend to be paid without also incorporating by reference the exemption provisions, then we would query why a loan only to a group company is exempt from withholding tax on a deemed dividend. The purpose of having deemed dividends which trigger the tax is to prevent a situation where profits are effectively transferred to or for the benefit of a shareholder without the dividend tax being payable. But if the dividend had actually been declared and it would have been free of dividends tax, why should, say, a loan to the relevant person trigger a tax when an actual dividend would not?

33 Consequently, in our submission, any deemed dividend should be exempt from the tax if an actual dividend would have been so exempt.

Section 64R

34 The reference is subsection (1)(a) to "a transfer of shares by that company" is very confusing. The normal meaning of that expression is, for example, that company A holds shares in company B and then transfers the B shares to another person.

35 If what is intended is an issue by the company of its own shares, then that is what should be stated.

LIQUIDATING, WINDING UP OR DEREGISTRATION OF EXCLUSIVE RESIDENCE COMPANIES

36 The Explanatory Memorandum correctly refers back to the concession when CGT was introduced, whereby residences could be "unbundled" out of companies on a tax-free basis. At that stage, residences could also be moved out of trusts on a tax-free basis. Unfortunately, what the legislation did not deal with at that stage was where the residence was owned by a company which, in turn, was owned by a trust.

37 The logic behind the concession this year is the annual fee that will have to be paid by all companies, thereby creating a new cost. While this is undoubtedly true, we have our doubts as to whether this can be such a compelling basis for the concession. There are already costs associated with maintaining a company, such as an audit fee, fees for submission of tax returns, and the like. And homes that are held in companies tend to be more expensive homes (the purpose originally being to avoid transfer duty), so that the owners thereof are unlikely to be people who have to count every cent. And, in any event, while the transfer will be free of transfer duty, there will be conveyancing costs, and possibly bond transfer costs, and it is likely to be many years before the saving in the annual company duty will exceed these costs.

38 That is not to say that the concession is not welcomed – it certainly is. But we believe that the concession should not stop with companies. It should, as in 2002, extend to trusts as well; and, what is more, it should enable residential homes owned by companies, which themselves

are owned by trusts, also to distribute the immovable property to a beneficiary without any fiscal cost.

CONVERSION OF THE CONTROLLED FOREIGN COMPANY (CFC) RULING EXEMPTIONS

Definition of "foreign business establishment"

39 The adoption of objective tests to allow more than one CFC within a country to share resources, and yet each have a foreign business establishment, as opposed having to seek a ruling, is warmly welcomed. But there a number of serious potential defects that require attention.

40 The criterion that the fixed place of business must be used for a period of not less than one year continues to create uncertainty, and the issue has not been clarified even though the definition has gone through several re-writes.

41 The question remains: at what point in time must one test the one-year period? If one signs a lease for five years, then for the first four years one need not worry (presumably). But if the financial year-end arrives and there are only, say, nine months left of the lease and the lease has not yet been renewed by year-end, does this mean that, going into the final financial year, the CFC does not have a foreign business establishment? Moreover, the current definition is somewhat broader and more flexible in that it refers to the structure which is used "or will continue to be used" for not less than a year.

42 Now the proposed provision merely refers to the fixed place that "is used" or "is conducted" for at least one year. The use of the present tense is somewhat confusing, given that the measurement of a year can only be made by looking backwards or forwards, but one cannot measure a year looking at the present, ie one can say that it has been used for at least a year, or will be used, or is likely to be used, for another year, but what does it mean to say that it ***is*** used for a year?

43 The requirement that the premises are used for the "continuous" carrying on of the business is also problematic. The word "continuous" means without cessation. In other words, on a literal interpretation, to qualify, the business must be carried on twenty-four hours per day, 365 days per year. Clearly this is not intended. On the other hand, not every business does carry on even from 9 to 5, five days per week. Some types of business might only need attention for a few hours a day. The requirement that it be continuous is too burdensome (not to mention impossible). It is noted that the Explanatory Memorandum has a lower threshold in that it refers to the business being carried on continuously or regularly (it uses this or a similar expression twice), but the draft legislation itself only uses the word "continuous".

44 To qualify as a foreign business establishment each of the tests in paragraphs (a) to (e) of the definition must be met, ie they are cumulative. It is unclear, however, what "proper facilities" in paragraph (d) means. Paragraph (a) requires suitable premises, paragraph (b) suitable management and staff, and paragraph (c) suitable equipment. Cumulatively these constitute proper facilities, so what more is required in paragraph (d), remembering that that test must be met in addition to the first three?

45 The requirement that the fixed place of business must be located in the country for a sole or main purpose other than the avoidance of tax in another country is unnecessarily burdensome and an unnecessary infringement of the freedom of a company to operate efficiently. One can understand such a requirement to protect the South African tax base, but we see no reason why the legislature should assume the responsibility of protecting other country's tax base (where reciprocal protection is generally not offered).

46 The major problem is that it is the ***location*** that is being tested here, and not the business itself. The current definition requires that the foreign business establishment must have been ***used*** for a business purpose other than avoidance of tax, but here it is the ***choice of location*** that must have a non-tax purpose.

47 Assume that a group of companies requires a management and treasury operation, or even an assembly operation. It has a choice to locate its entire operation, which undoubtedly constitutes a proper business, in, say, the UK, where it will be subject to full rates of tax, or in Jersey, where it will not be subject to tax at all. There can be no doubt that the operation itself has been established solely (not even mainly) for commercial purposes. At yet the choice of Jersey over the UK, simply because it is more tax efficient than the UK, is sufficient to deny the foreign business establishment exemption in South Africa. This is, to say the least, bizarre.

48 An even more stark example could be the situation where a company might establish a factory in South Africa, but instead establishes the factory in Lesotho or Swaziland, because it is offered a tax holiday for a period as an incentive. Now the profits of that Lesotho or Swazi subsidiary will be taxed in South Africa. Surely this cannot be intended.

49 It is the establishment and carrying on of the business that must not be tax-motivated, and not its location.

50 Given that the definition of a foreign business establishment is broadly similar to the definition of a permanent establishment in the OECD Model agreement, it is somewhat surprising that the activities in paragraphs (b) to (e) of the current definition have been dropped from the new definition.

51 It is impractical to require that the company whose facilities, etc, are being shared by other companies must be incorporated in the country. The fact is that, while not unknown, it is most unusual that one company in the group is the sole owner or lessee of the premises, the sole employer and the sole owner or lessee of the equipment, which it then uses itself or allows other companies to use. Invariably there are different companies with different employees who do work across the group, or own equipment which are used by other companies in the group. Insisting on the owner of the facility/the employer must be incorporated in the country is not only impractical, but could result in a denial of the concession to existing groups.

52 In any event, we are not quite sure why incorporation is all that relevant. It is merely stated that this is a requirement in the Explanatory Memorandum, but no reason is given therefor. Section 9D(1) already defines a country or residence, and we would have thought that the more important criterion is that each of the CFCs sharing facilities ought to have the same country of residence, but incorporation as a criterion seems very technical and without logic. (It should also be noted that, particularly in Europe, it is very common for companies to operate cross-border, and any restriction, such as incorporation, would amount to a breach of the freedom of establishment, and possibly the freedom of movement of capital, rules under the EU Treaty. Our laws must recognise these realities if our companies are doing business there.)

53 Finally, we cannot understand why the resource-sharing concession is limited to companies in the group as defined for tax purposes. Look at the situation the other way around: Assume that an existing foreign investor is investing further into South Africa and is establishing a new CFC here which required BEE participation and management participation, with the result that its investment in the new CFC is held as to less than 70%. If our proposed law applied in the investor's country, that new venture would be denied foreign business establishment status.

54 Surely the key test is that all the companies are under common control, which requires that the parent can exercise a majority of the voting rights, or even have more than 50% of the participation rights, but why should the concession be limited to at least a 70% holding? In fact, the greater the minority participation, the more likely it will be that the inter-company charges will be decided on after hard bargaining.

The new proviso to subsection (2)(a) – high tax exemption

55 We fail to understand why the requirement in provisos (i) and (ii) is incorporation. Once again, we point out what we stated in 52 above, namely, that incorporation is not an important criterion in international business, and particularly in the EU. What is far more important is residence, and it is common to find in international groups companies incorporated in one country but resident (and tax-paying) in another. To design one's laws which ignore this reality creates unnecessary limitations and restrictions on the way business is done. As stated, section 9D(1) already defines a country of residence in relation to a CFC, and we cannot understand why residence is not the criterion here as well. We have difficulty in seeing what additional control or comfort the fiscus obtains by referring to incorporation rather than residence.

56 If it is required that some registration under the company law of the country is required, incorporation is not necessarily the sole method. Registration, or deemed incorporation, should also be allowed (*cf* the definition of "company" in section 1 of the Income Tax Act which refers to deemed incorporation as well as a body corporate formed or established). For example, many countries have laws similar to that contained in section 323 of our Companies Act, in terms of which a foreign company can register as an external company with the Registrar of Companies; or even provisions to re-domiciliate, in terms of which they give up their registration in one country and assume the registration in another (similar to section 335 of our Companies Act).

57 It is noted that all three provisos must be met. In our view, however, proviso (iii) is unnecessary, and is unnecessarily burdensome, for the following reasons:

57.1 The motivation for the high tax exemption is to facilitate the disregarding of CFC income if little South African tax is at stake – see the Explanatory Memorandum. The unspoken implication is that, but for the exemption, both the taxpayer and the SARS would have to comply with unnecessary administrative procedures which, at the end of the day, yield very little to the fiscus.

57.2 If proviso (iii) applies, it certainly relieves the SARS of the administrative burden, but it does nothing for the taxpayer. The reason is that, in order to establish whether or not the proviso applies, the entire calculation must still be made, and so the taxpayer has gained very little, if anything. It might have been different if the choice was between either proviso (ii) or (iii), but given that both have to be complied with, very little in the procedures of companies with CFCs in this position will change.

57.3 Moreover, we think it is necessary to consider whether there is any real risk in dropping proviso (iii). How many countries around the world have a nominal or statutory rate of tax on income of at least 20%, but have concessions in respect of portfolio income which results in an effective tax rate of much less? We cannot think of any. Certainly there are companies in Europe such as the Netherlands, Belgium, etc, which have participation exemptions and the like, but not for portfolio investments. On the other hand, the so-called low tax jurisdictions (tax havens) do not have tax rates as high as 20%.

57.4 In any event, there can be circumstances where it is simply impossible for both provisos (ii) and (iii) to be met. Assume that a country has a statutory tax rate of, say,

20%, and its tax system is very similar to that of South Africa's, ie it taxes interest and foreign dividends, but maybe not domestic dividends, will tax exchange gains, has a CGT, taxes share gains if not capital, allows reasonable expenses, and so on. In such a case the effective tax rate is likely to be very close, or equal to, 20%. If those profits had been taxed in South Africa, the effective rate would have been equal or close to 28%. 75% thereof would have been 21%. If the tax rate in the foreign country is 20%, it can never reach 21%! In such circumstances proviso (iii) effectively renders the whole exemption to be nugatory.

Amendment to section 9D(10)

58 The effective date of the new foreign business establishment definition will be foreign tax years ending during years of assessment ending on or after the date of introduction of the Bill to Parliament. Thus, for example, for a group with a June year-end, the foreign business establishment exemption will apply for the year ending 30 June 2010.

59 The current concession, which is to obtain a ruling under section 9D(10)(a)(i), applies for tax years, in this example, which ended on 30 June 2007, 2008 and 2009. But, as we understand it, there are a number of ruling applications outstanding.

60 Making the effective date of the amendment 2010 means that the ruling process for 2008 and 2009 must continue, with all the administrative burdens and difficulties that go with them, in order to decide, on a fact-intensive basis, whether or not the exemption is warranted. In large measure this seems to be self-defeating.

61 We would recommend the following:

61.1 If an application has already been lodged but not finalised, the new rules should apply retroactively to 2008, so that the ruling application can be withdrawn.

61.2 If the ruling has already been given, the applicant can choose whether to apply the ruling or rely on the new exemption.

PORTABLE SPOUSAL DEDUCTION

62 Once again, the principle of enacting this concession is greatly welcomed, but we fear that the manner in which the legislation has been drafted will make its use extremely limited, and even discriminatory.

63 As the Explanatory Memorandum points out, the purpose of the amendment is to avoid the need to have complex structures and compliance costs, while still enabling married couples to have, between them, the R7 million deduction. But it is only in a minority of cases that this concession will be available, having regard to the way the legislation is worded.

64 The principal problem is that, in terms of section 4A(2) of the Estate Duty Act, the first-dying spouse must have bequeathed ***all*** of his or her property to the surviving spouse. While this is not unknown, it is not all that usual.

65 Very often the bulk, by far, of the estate will be bequeathed to the surviving spouse, but the testator will still make certain relatively minor bequests to others, such as: Bequests of jewellery and personal effects to children; bequests of family heirlooms or mementos to children or grandchildren; some modest cash bequests to children or grandchildren or even long-serving domestic servants; or charitable bequests, and so on (and even though charitable bequests themselves are deductible under section 4(h) of the Estate Duty Act, the very fact that a charitable bequest is made will deny the use of the portable spousal exemption).

66 In our view, without detracting from the objective of the amendment, and without creating any risk or cost to the fisc, the following procedure should apply:

66.1 Each person's deceased estate should be entitled to a deduction under subsection (1) of section 4A equal to the lesser of –

66.1.1 R3,5 million, and

66.1.2 an amount equal to the net value of the estate before deducting the amount in 66.1.1 above.

66.2 The estate of the second-dying spouse will then be entitled, under subsection (2), to a further deduction of an amount equal to the excess of R3,5 million over the amount of the deduction under subsection (1) available to the estate of the first-dying spouse: Provided that the deduction under subsection (2) may not exceed the value of property which accrued to the second-dying spouse from the estate of the first-dying spouse under section 4(q) of the Estate Duty Act.

IMPACT OF VALUE-ADDED TAX ON RE-ORGANISATIONS

Section 8(25) of the VAT Act

67 We cannot agree with the removal of section 42 of the Income Tax Act from the concession available under section 8(25) of the VAT Act.

68 According to the Explanatory Memorandum this is because section 42 mainly deals with single asset transfers.

69 In our experience, nothing could be further from the truth. Our experience is that section 42 is used more for transfers of businesses as going concerns than for single assets. There are two main reasons why section 42 is used for this purpose. The first is that it is used where a group does not exist, for example, where there is a BEE transaction together with management participation, and the minority interest is greater than 30%; or sometimes businesses merge in situations where section 44 of the Income Tax Act is not suitable, and each transfers its business into a Newco where the sellers end up holding, say, 50% each of Newco. The second reason is that groups sometimes prefer to use section 42 as opposed to section 45 of the Income Tax Act, as then they then do not have to worry about a possible degrouping charge within the next six years.

70 In our experience, removing the section 8(25) concession could cause significant disruption and cost, particularly where a seller or purchaser is partially VAT-exempt.

71 Moreover, section 42 itself clearly contemplates that the section can be used for a sale of a business as a going concern – see section 42(8)(b) of the Income Tax Act. If the section itself contemplates it, how can the concession in the VAT Act be removed on the basis that this is not common?

72 In any event, even if there is a single asset transfer, there is no reason to deny the concession and impose cash flow burdens on the parties. For example, assume a large immovable property worth R100 million is being transferred using section 42. Why should the seller have to charge are R14 million VAT and then the purchaser has to wait until a refund is obtained (remembering that there will most certainly be an audit)?

Amendment to section 20 of the VAT Act (see clause 35 of the Taxation Laws Second Amendment Bill)

73 The concession envisaged is very welcome as it deals with a practical problem that always accompanies any group rationalisation where a business is transferred.

74 What we cannot understand is why it is limited to section 44 of the Income Tax Act. Exactly the same considerations apply when a business as a going concern is transferred under section 42, 45 and 47 of the Income Tax Act.

SECOND PROVISIONAL TAX PAYMENT

75 We note the proposed amendments to paragraphs 19 and 20 of the Fourth Schedule to the Income Tax Act, and we are pleased to note that an attempt will be made to approach the issue on a more practical basis, though precisely how the difficulties will be alleviated will depend upon the bases as notified in the *Gazette*.

76 What concerns us, however, is that the concession appears to be geared towards "less sophisticated taxpayers". As the Explanatory Memorandum states, the amendment "will assist a large number of smaller taxpayers while continuing to require larger taxpayers to prepare accurate estimates."

77 While smaller taxpayers certainly face the problem, larger corporates face different problems, which are no less intractable in their environments. Even though they might have sophisticated management accounting systems, there are numerous adjustments that have to be made to the management accounts, and the accounting information in general, to arrive at taxable income, especially when taking into account the many complex provisions in the Income Tax Act, such as, for example, calculating interest under section 24J; determining foreign exchange gains and losses under section 24I; calculating CFC income (and what is exempt and not exempt); calculating capital gains where the asset was acquired before 1 October 2001; reversing accounting depreciation and claiming depreciation under the Act; and so on. Even large corporates, with sophisticated management accounts which produce their numbers within a month of a month-end, could have significant difficulty in producing estimates by year-end within a 20% accuracy.

78 This, of course, leaves them with relying on the Commissioner's discretion to waive penalties under paragraph 20(2) of the Fourth Schedule to the Income Tax Act. Unfortunately, the penalty is raised automatically by the computer, which means that each time the taxpayer will have to lodge objection. Clearly this is undesirable from both the taxpayers' and the SARS's points of view.

79 Moreover, with the fall in corporate profits resulting from the recession, it seems that, for the present at any rate, the amendment is unlikely to result in any significant greater inflows to the fiscus by means of the second provisional payment.

80 In our view, the new paragraph 19(1A) should apply to all taxpayers, including large corporates, in a manner which can go some way towards fulfilling the objective of the 80% rule, but at the same time not overburdening the administration because of the risk of penalties.

AMENDMENT TO PARAGRAPH 74 OF THE EIGHT SCHEDULE TO THE INCOME TAX ACT

81 On the same basis as set out in 33 and 34 above, we question the use of the word "transfer" in the new definition of "distribution", and enquire whether the word "issue" is not more appropriate.

Should you wish to discuss further any matter raised herein, please do not hesitate to contact the writer.

Yours faithfully

Werksmans Incorporating Jan S. de Villiers