Dear Madam

ANNEXURE C: REQUESTING PROPOSALS FOR MISCELLANEOUS / TECHNICAL TAX AMENDMENTS FOR THE 2010/2011 BUDGET CYCLE

We refer to the call for comment on the above-mentioned. Set out below please find the SAICA National Tax Committee’s submission regarding policy comments.

Income Tax - Individuals, Employment and Savings

1. Section 8C gains – Ascertaining employees’ tax

1.1. The legal nature of the problem

Gains made in respect of the vesting of equity instruments as provided for in sections 8A and 8C of the Income Tax Act No. 58 of 1962 (“the Act”) are included in a taxpayer’s taxable income. These gains are specifically included in the definition of remuneration for purposes of the Fourth Schedule to the Act.

Paragraph 11A(4) of the Fourth Schedule to the Act requires employers to ascertain from the Commissioner the amount of employees’ tax to be withheld from gains made as a consequence of sections 8A and 8C. The SARS EMP10 Guide for Employers in respect of Employees’ Tax further requires an employer to apply for a tax directive by completing an IRP3A form for each individual, per transaction.

In addition, the revised IRP5 tax certificate specifications implemented for the reporting period ending February / August 2010 require a mandatory tax directive number when an employer discloses a section 8A or 8C gain on a tax certificate for an individual. Failure to
include the tax directive number will result in failure to submit the IRP5 certificates successfully.

If a mandatory field is not completed on an IRP5 certificate for a single employee, the entire submission for that employer can be refused by SARS. A penalty of 10% of the total amount of employees’ tax paid during the year of assessment can be levied on the employer for failure to submit this reconciliation within the time period allowed.

We submit that this potential penalty that can be applied to the employer, as described above, is not commensurate to the offence committed. The requirement for a tax directive application and tax directive number is provided for by a SARS internal process and restricted further by system limits, and not one that is provided for in law.

It is submitted that paragraph 11A of the Fourth Schedule to the Act does not require the Commissioner to make a determination for each individual gain nor requires the issue of a directive for each transaction effected / vesting for an employee / former employee on a marketable security or equity instrument.

**Our proposal is to amend the legislation as follows:**

The applicable marginal rate of 40% should be applied to gains made upon vesting of equity instruments as envisaged by sections 8A and 8C and the need for the application of tax directives removed.

**1.2. Factual description of the relevant transaction**

As stated above, participants in a share scheme incur a taxable benefit in terms of section 8C of the Act when the restrictions imposed on equity instruments are lifted. The time period imposed on these restrictions are referred to as Vesting. The Vesting period applied in a scheme is usually determined by the rules, varies from scheme to scheme and is lifted in segments over the intended retention period.

In many instances, the vesting of these rights at the end of the Vesting Period merely implies that the restrictions are lifted and that tax is due on the benefit. It does not necessarily mean that the employee will “cash out” the benefit as he/she would still have to exercise their right to the instrument/s before the cash payment is effected or shares are transferred.

In the instance where the equity instruments vests without the participant exercising their rights / shares, there will be no cash payment due to the employee. Only the employees’ tax payment is due to SARS.

The employer would, therefore, be unable to withhold any money that is due to SARS by that employee as a result of the vesting of the gain.
A delay in the issue of the directive due to, for example an outstanding tax return by the individual, will not delay any payment to the individual but merely the payment of the employees’ tax due to SARS. The stated purpose of the directive is therefore not achieved.

1.3. **Description of what the transaction seeks to achieve**

To simplify the employees’ tax compliance in relation to section 8A and 8C gains.

1.4. **Nature of the businesses impacted by the problem**

All employers who operate share schemes that fall within the scope of sections 8A and 8C.

1.5. **The relevant urgency of the matter at hand.**

This matter is urgent especially in light of the Business Requirement Specification for the PAYE reconciliation 2010 was released during 2009, containing the new validation rules to be applied to IRP5 certificates by SARS with effect from 1 March 2009.

2. **Insurance in respect of offshore business travel**

2.1. **The legal nature of the problem**

Employees are often required to travel offshore for business purposes and more often than not, are required to be insured for death or disability. Employers often take up short term insurance policies from offshore insurers. Upon the happening of an insured event, the offshore insurance company pays the employee directly to cover the costs associated with the happening of the event outside South Africa.

Paragraph 53 of the Eighth Schedule excludes capital gains and losses in the hands of a natural person (or special trust) determined in respect of the disposal of personal use assets. Short term insurance policies are not deemed to be personal use assets but only to the extent to which the policies relates to any asset which is not a personal use asset. This paragraph applies only to short term policies as defined in the Short Term Insurance Act, i.e. provided by South African registered insurance companies.

This means that payments to an employee in terms of short term insurance policy with an offshore insurer will not be exempt.

**Our proposal is to amend the legislation as follows:**

We propose that the Eighth Schedule be amended to also refer to short term insurance policies issued by Insurance companies registered as such under the laws of a country other than South Africa.
2.2. **Factual description of the relevant transaction**

Employees are often required to travel offshore for business purposes and more often than not, are required to be insured for death or disability. Employers often take up short term insurance policies from offshore insurers. Upon the happening of an insured event, the offshore insurance company pays the employee directly to cover the costs associated with the happening of the event outside South Africa.

2.3. **Description of what the transaction seeks to achieve**

To enable employers to provide adequate insurance to employees who are required to travel overseas, without suffering adverse tax consequences.

2.4. **Nature of the businesses impacted by the problem**

All employers who send employees overseas for business purposes are affected.

2.5. **The relevant urgency of the matter at hand**

This matter is urgent and can be easily rectified.

3. **Capital Gain, Paragraph 67**

3.1. **The legal nature of the problem**

Paragraph 67 allows for the roll-over of any capital gain that arises where assets are transferred to a spouse. It only applies if ownership is acquired intestate or by testamentary succession or as a result of a redistribution agreement. It also applies where the assets are transferred in consequence of a divorce order or an agreement for the division of assets.

3.2. **Detailed factual description of the relevant transaction**

In terms of section 3 of the Matrimonial Property Act, at the dissolution of a marriage subject to the accrual system, by divorce or by the death of one or both of the spouses, the spouse whose estate shows no accrual or a smaller accrual than the estate of the other spouse, or his/her estate if he/she is deceased, acquires a claim against the other spouse.

In terms of the Maintenance of Surviving Spouses Act, if a marriage is dissolved by death the survivor shall have a claim against the estate of the deceased spouse for the provision of his reasonable maintenance needs until his/her death or remarriage in so far as he/she is not able to provide therefore from his own means and earnings.

Both these claims do not amount to the spouse obtaining ownership as required by paragraph 67. These claims are required in terms of the relevant other Acts.
3.3. **Description of what the transaction seeks to achieve**

The transaction seeks to prevent the spouse from having to realise assets to pay for the resulting capital gains, but as the above two scenarios are not included in the law, the spouse will be forced to realise the assets and award the cash after tax to the spouse entitled to either the accrual claim or the maintenance claim.

We propose that the forced sale of the assets in the two situations described above also be excluded in terms of paragraph 67.

3.4. **Nature of the businesses impacted by the problem**

This provision impacts on all taxpayers that have to dispose of property to meet an accrual claim or a claim for the maintenance of the surviving spouse.

3.5. **The relevant urgency of the matter at hand.**

This should be addressed as a matter of urgency.

4. **Proposed amendment to par 57 of the 8th Schedule to the Act**

4.1. **The legal nature of the problem**

A person must disregard R750 000 of any capital gain made on the disposal of small business assets (par 57). The purpose of this paragraph is to provide relief to small business persons who have invested their resources in their businesses. A ‘small business’ is defined as a business where the market value of all its assets does not exceed R5 million as at the date of disposal of its assets or interests (par 57).

The problem is that par 57 requires a natural person to have held the ‘active business asset’ or interest in company (at least 10%) for at least five years. Meaning that a natural person could have in his own name carried on the business for more than 5 years, but might have owned some of the individual business assets for less than 5 years, and the capital gain on the assets owned for less than five years would not qualify for the par 57 exclusion. If a small business is conducted in a company, par 57 only requires the natural person to have held the interest in the company for more than 5 years, although the individual assets within the company, attributed directly to the capital gain on the disposal of the interest in the company, could have been held for less than 5 years.

4.2. **Detailed factual description of the relevant transaction**

Due to the working of the 8th Schedule certain assets, that are by nature usually held for less than 5 years, such as normal trading stock or livestock for farmers, also have capital gains tax
consequences on disposal (usually in case of death of a taxpayer). This has the result that the capital gain relating to these assets held for less than 5 years by the natural person in his/her personal name, would not qualify for the par 57 exclusion. The anomaly is that if the small business was conducted in a company, and the taxpayer upon death held a qualifying interest in such company, the whole capital gain relating to the disposal of the interest in the company (largely made up of for example the trading stock within the company) would have qualified for the par 57 exclusion.

The current wording of par 57 therefore encourages taxpayers to conduct small business in a company as opposed to conducting it in their own name. It is therefore proposed that the wording in par 57 be amended to ensure that natural persons conducting small businesses in their own name’s, would qualify for the par 57 exclusion although they might have owned some of the assets for less than 5 years, but on condition that they have carried on the trade for more than 5 years.

4.3. Description of what the transaction seeks to achieve
See (ii) above.

4.4. Nature of the businesses impacted by the problem
Small business conducted by natural persons.

4.5. The relevant urgency of the matter at hand.
Medium priority – natural person small business owners have already experienced hardship in the regard.

5. Provisional tax basic amount – 16% uplift

5.1. The legal nature of the problem,
Par 19(d) of the 4th Schedule requires the ‘basic amount’ for provisional tax to be increased in certain circumstances:

“Provided that, if an estimate under item (a) or (b) must be made in respect of a period that ends more than one year after the end of the latest preceding year of assessment in relation to such estimate, the basic amount determined in terms of sub-item (i) and (ii) shall be increased by an amount equal to eight per cent per annum of that amount, from the end of such year to the end of the year of assessment in respect of which the estimate is made.”

The result of the above wording is that the ‘basic amount’ is increased by 0%, 16%, 24%, 32% etc.
5.2. **Detailed factual description of the relevant transaction**

For the 2010 filing season, all provisional taxpayers with a February year-end, for the first provisional tax payment of 2011 (2011/01) had their basic amount increased by 16%, although it was impossible for the taxpayers to have already filed their 2010 annual Income Tax returns.

In light of the above problem, it is therefore suggested that the Act be amended to ensure that in a ‘normal scenario’, for example where a taxpayer has only been assessed on the 2009 tax year then when submitting his 2011/01 provisional tax return, the basic amount only be increased by 8%.

In other words, the annual increments should be 0%, 8%, 16%, 24%, etc. Thus the solution would be that the *proviso* to para 19(1)(d) should be amended as follows: "...8% per annum…from the end of such year to the **BEGINNING** of the year of assessment in respect of which the estimate is made”.

The above issue was raised with SARS and we were accordingly advised to request for legislative correction through National Treasury.

5.3. **Description of what the transaction seeks to achieve**

See (ii) above.

5.4. **Nature of the businesses impacted by the problem and**

All provisional taxpayers.

5.5. **The relevant urgency of the matter at hand.**

Very urgent. This needs to be corrected before the next provisional tax year.

6. **Calculation of provisional tax liability – First Period**

6.1. **The legal nature of the problem**

*Relevant paragraphs in the Fourth Schedule: para 17(3), 19(1)(b), 19(1)(c), 19(3), 23*

In essence, these paragraphs require that the following steps should be followed in determining the provisional tax payment liability for the first provisional tax period:

- estimate the total taxable income for the **entire** year (which in any event may not be less than the ‘basic amount’ (as defined), unless the Commissioner permits otherwise);
- calculate tax on that estimated taxable income; and
• reduce the calculated tax liability by half in order to determine the provisional tax amount that should be paid for the first period.

**Note:** As a remedy, SARS may increase the provisional taxpayer’s estimate of taxable income. If SARS does so, then the increased estimate is final and conclusive (i.e. the taxpayer cannot object or appeal against SARS decision).

### 6.2. Detailed factual description of the problem

Where a business earns income evenly throughout the year, the current provisional tax legislation will yield a fair result in terms of which the correct tax liability will be paid in respect of the first provisional tax period.

However, where income is not earned evenly throughout the year, situations may arise where the application of these provisions lead to inequitable results for provisional taxpayers. Specifically, in a situation where a provisional taxpayer is expected to make an overall profit (and hence taxable income) for the entire year but makes a loss in the first six months of the financial year, that taxpayer will, in terms of the current legislation, still be liable for provisional tax on the income that will only be earned in the future.

#### Example

Company A makes a loss of R2 million during the first 6 months of its financial year. However, it anticipates that it will make R6 million profit during the second 6 months of the financial year, bringing the total taxable income for the year to R4 million.

Assume further that the basic amount (as defined) is R4 million and that profits are the same as taxable income.

According to the strict interpretation of the current provisional tax legislation requirements, then Company A will be required to make a first provisional tax payment calculated as follows:

- Total estimated taxable income for the current year: R4.00 million
- Tax @ 28%: R1.12 million
- Provisional tax liability for first provisional tax period: R0.56 million

It is submitted that it is inequitable to require Company A to pay provisional tax on profits that it will only make in the second half of its financial year, especially as this will put it into unnecessary cash flow pressure.

Though, in practice, it may be argued that Company A may base its provisional tax calculation on a lower tax estimate (i.e. nil in this case) such a practice is not supported by the law in its current form (it must not be lower than the ‘basic amount’ unless SARS approves).
Furthermore, if Company A attempts to use a nil taxable income estimate for the first period, there are two other two practical problems that it will face with SARS:

- firstly, it is not guaranteed that SARS will approve the use of such a lower estimate of taxable income as such approval is entirely at the discretion of SARS; and
- secondly, SARS may, if not satisfied with the justification of the lower tax estimate, increase the estimate of the taxable income for provisional tax purposes and such revised amount is final and conclusive even if SARS acts unreasonably.

It is submitted that this problem will continue unless the legislation is amended to make it clear that the first provisional tax calculation should, in addition to the basic amount, also be limited to the actual taxable income for the first period.

Furthermore, it submitted that paragraph 19(3) should also be amended to provide that any increase in the estimate that SARS makes for the first provisional tax period, should be subject to objection and appeal (not final and conclusive as is currently), in order to provide a balancing mechanism for provisional taxpayers in case SARS acts unreasonably to increase estimates of taxable income for the first provisional tax period.

6.3. Transactions it seeks to achieve

The provisional tax system is intended as an advance tax payment system to be offset against the normal tax liability at the end of the year.

It is submitted that it was not intended that the provisional tax paid in the first period should be in respect of taxable income that will be earned in the second provisional tax period.

6.4. Nature of businesses affected

- Seasonal businesses which make most of their income during the second half of their financial year.
- Business that normally make losses during the first six months but make an overall profit at the end of the financial year.

6.5. Relevant urgency

Very urgent as, in practice, there are taxpayers who have to borrow funds to pay first period provisional tax liabilities in respect of taxable income which they would only earn during the second half of their financial years.

7. Skills Development Levies on share gains made by former employees

7.1. The legal nature of the problem
Restricted equity instruments, in the form of share incentive schemes, are generally set up by employers to provide employees with long term incentives, linked to the overall performance of the company. Generally, awards given under such schemes only become available (vest) to the employee in tranches over a certain period, such as a third of the rights / options on each of the third, fourth and fifth anniversary of the award.

It is also common practice that, in the event that the employee resigns, he / she would lose the portion of the award that has not yet vested at that point in time. However, in the event that an employee is retrenched or retires, the employee will, in all probability, retain his/ her rights or options awarded regardless of the vesting periods. This benefit is not calculated and included in the retirement or retrenchment package due to the restricted nature of the options or rights.

In these circumstances a retired employee or a person that is no longer an active employee on the monthly payroll system, would receive a taxable gain under such a share scheme only when these restrictions are lifted or the person exercises his/her rights under the scheme.

The question is how the taxable gains made by former employees are to be treated for purposes of calculating the Skills Development Levy (“SDL”) due in terms of the Skills Development Levies Act No. 9 of 1999 (“the Levies Act”).

The Levies Act
The stated purpose of the Skills Development Act No. 97 of 1998 is, in short, to develop the skills of the South African workforce and to increase the level of investment in education and training in the labour market by employers.

Every employer is required to pay SDL at a rate of 1% of the “leviable amount”, as defined in the Levies Act, for its employees towards the purpose set out above. The levy is paid on a monthly basis to the South African Revenue Service (“SARS”) together with the employee’s tax submission.

The leviable amount, as stated in section 3(4) of the Levies Act means “the total amount of remuneration, paid or payable, or deemed to be paid or payable, by an employer to its employees during any month, as determined in accordance with the provisions of the Fourth Schedule to the Income Tax Act for the purposes of determining the employer’s liability for any employees’ tax in terms of that Schedule”.

Excluded from the above remuneration for the calculation of the leviable amount are:

- payments made to labour brokers,
- pension / retirement fund payments, living annuities, termination of employment gratuities (paragraphs (a), (d), (e) or (eA) of the definition of “gross income” in section 1 of the Tax Act)
- amounts due to learners on registered learnerships and
- remuneration payable to directors of private companies.
The Act also provides for specific exclusions from SDL for employers whose total remuneration for the tax year will not exceed R500,000, Public Benefit Organisations and municipal entities.

An employee and employer is defined in the Levies Act as an employee and employer for the purposes of the Fourth Schedule to the Tax Act. It is, thus, clear that one has to look to the Tax Act to understand the calculation of the leviable amount and, specifically, whether or not share gains earned by former employees are to be included in this calculation.

**The Tax Act**

The Fourth Schedule to the Act provides for the withholding of employee’s tax from remuneration that is paid / payable by an employer to an employee. It is clear that there has to be three triggers for the Fourth Schedule to the Tax Act to be applied, namely there has to be an employee, employer and remuneration. In short, an employee is defined as any person that receives remuneration and an employer as any person that pays or is liable to pay any person remuneration. The definition of the term “remuneration” specifically includes any share gains made under sections 8A, 8B and 8C of the Tax Act. It is notable that this definition of “remuneration” also specifically includes pension, retiring allowances and superannuation allowances, whilst gratuity payments, pension, etc is specifically excluded from the SDL leviable amount in terms of section 3 of the Levies Act.

Ordinarily, restricted equity instruments are managed and held in special purpose vehicles, until they have vested in the recipient. These special purpose vehicles are usually trusts, i.e. separate legal entities. Historically, it was argued that the gain was made by an individual from an option or right held by another entity (not the employer). As such, the amount would not be subject to the withholding of employees’ tax as there is no employee / employer relationship. This argument led to the introduction of paragraph 11A of the Fourth Schedule to the Tax Act which deems gains made under such share schemes to be an amount of remuneration which is payable to that employee by the person who granted the right. As such, if this other entity is an associated institution (an entity managed or controlled by the same persons or a fund established solely for providing benefits for employees or former employees) the employer and this other entity are jointly and severable liable for the employee’s tax due.

**Application of the Acts in calculating the monthly SDL**

It is clear that gains derived by current employees from participation in share schemes should be included in the balance of remuneration for employees’ tax purposes, whether they are held and/or administered by a share trust or a separate legal entity established for the benefit of employees or not. This is as a result of the specific inclusion in the Fourth Schedule to the Tax Act.

In this instance, where the employee has been retrenched or has retired and is allowed to retain his/her rights in terms of the scheme “administered” by his/her former employer, it is
questionable if an employee-employer relationship exists at the time that the taxable event occurs in terms of sections 8A, 8B or 8C. In this regard the question is not whether such a relationship exists between the recipient and the share trust or other legal entity, but rather between the ex-employee and the awarding employer at that point in time. We would argue that there is no employee-employer relationship at the time that the taxable event occurs, after the employees’ termination of employment.

In addition, it is submitted that permission for the retrenched or retired employee to retain the rights granted to him/her under the share scheme is directly linked to their retrenchment or retirement benefit. If the employee had resigned from the employer’s employment he/she would, ordinarily forfeit his/her rights. As such, it can be argued that the benefit should be included under paragraph (d) of the gross definition in section 1 of the Tax Act. The benefit cannot be included in the retrenchment / retirement packaged due to its restricted nature. Therefore, the benefit granted to the ex-employee in these circumstances is deferred.

As the Levies Act specifically excludes pension/retirement fund payments, living annuities and termination of employment gratuities as defined in paragraph (d) in the gross income definition of section 1 of the Tax Act. Such taxable gains, albeit included for employees’ tax considerations in the Tax Act, should be excluded from the SDL leviable amount.

The SDL Act specifies that its purpose is to develop the skills of the South African workforce. Current employees that enjoy the benefit of the gains made under share schemes are, undoubtedly, subject to employees’ tax and the employer subject to SDL levies on those gains. In this instance, it could be argued that there is no employee / employer relationship with these former employees and, hence, such taxable gains could fall outside the ambit of the Levies Act. It is unfortunate that, by using the mechanism of the Fourth Schedule to the Tax Act, more specifically the anti-avoidance measure aimed at preventing the evasion of employees’ tax contained in paragraph 11A of the Fourth Schedule and the fact that the taxable event on these gains are delayed until vesting or exercise, these gains appear to be included in the SDL leviable amount. It is also not clear if the exemption excluding retirement or retrenchment benefits in the Levies Act would apply in these instances.

Registered employers for SDL purposes would have to bear the cost of the 1% SDL levy on these awards post the termination of the employee’s employ with the organisation. This seems to be as a result of the lack of clarity, or an oversight due to the close alignment of the calculation of the two levies.

Our proposal is to amend the legislation as follows:

- The Skills Development Levies Act be amended to exclude benefits received by former employees or, similar to the way the Unemployment Insurance Act operates, exclude payments made to employees who work less than a certain number of hours during a particular month.
7.2. **Factual description of the transaction**

See above.

7.3. **Description of what the transaction seeks to achieve**

To simplify the Skill’s Development levy compliance in relation to section 8C gains made by retired or retrenched employees.

7.4. **Nature of the businesses impacted by the problem**

All employers who operate shares schemes which falls within the scope of sections 8A and 8C and who allow retrenched or retired employees to retain their rights or options awarded regardless of the vesting periods.

7.5. **The relevant urgency of the matter at hand.**

This matter is urgent and can be easily rectified.

8. **Income tax: capital gains tax payable on foreign participation schemes invested in bonds. Anomaly between determination of capital gains or capital losses in respect of disposal of investments in foreign bonds and investments in interests in foreign participation schemes which solely invest in bonds.**

8.1. **Background**

The bond market (also known as the debt, credit or fixed income market) is a financial market where participants buy and sell debt securities, usually in the form of bonds.

Bond market participants are similar to participants in most financial markets and are essentially either buyers (debt issuer) of funds or sellers (institution) of funds and often both. Participants include institutional investors, governments, traders and, to a limited extent, individuals.

An analysis of the profile of investors in bonds conducted in the United States of America showed that no more than 10% of the bond market is directly held by individuals. This is ascribed to the specificity of individual bond issues, and the lack of liquidity in many smaller issues. Consequently, the majority of bonds are held by institutions like pension funds, banks and mutual funds. Most individuals participate in the bond market through bond funds, close-end funds and participatory investment schemes in bonds which are operated and managed by investment companies.

8.2. **The legal nature of the problem**
Individuals who invest directly in foreign bonds and who hold these foreign bonds as capital assets are required to determine any capital gain or capital loss on the disposal of the foreign bonds in terms of paragraphs 43(1) or (2) of the Eighth Schedule to the Act, read with the provisions contained in Part XIII of the Eighth Schedule to the Act.

Paragraph 43(1) will apply where the currency of acquisition and disposal of the foreign bond is the same. The effect of the application of paragraph 43(1) is that the capital gain or capital loss on the disposal of the foreign bonds is determined in the foreign currency concerned and that capital gain or capital loss is then translated into the Rand equivalent by using either the average exchange rate applicable in the year in which the asset is disposed of or the spot rate applicable on the date of disposal of the asset. The individual therefore need not account for the gain or loss associated with the fluctuations in the exchange rate from the date the foreign bond was acquired to the date of disposal of that foreign bond.

Paragraph 43(2) will apply if the currency of acquisition is not the same as the currency of disposal. The effect of the application of paragraph 43(2) is that the base cost of the foreign bond would have to be converted into the currency of disposal by reference to the exchange rate which applied between the currency of acquisition and the currency of disposal at the time of acquisition. The capital gain or capital loss is then determined in the currency of disposal and that capital gain or capital loss is then converted into Rands as per paragraph 43(1) above. The effect of the provisions of paragraph 43(2) is that the foreign currency gain or loss that arose between the currency of acquisition and the currency of disposal will be subject to capital gains tax but the currency gain or loss in Rand terms associated with the asset will not be taken into account in the determination of any capital gain or capital loss.

Paragraph 43(1) and (2) is subject to paragraph 43(4) which applies to the disposal of a "foreign equity instrument" as defined in section 1 of the Act. A "foreign equity instrument" includes, amongst others, "any participatory interest in an arrangement or scheme contemplated in paragraph (e)(ii) of the definition of “company” in section 1", i.e. any foreign collective investment scheme being an "arrangement or scheme carried on outside the Republic in pursuance of which members of the public (…), are invited or permitted to invest in a portfolio of a collective investment scheme, …". The term "portfolio" is not defined in the Act but is generally accepted to mean "a range of investments held by a person or organisation". Foreign collective investment schemes would by definition include a foreign collective investment scheme in bonds as, sans a definition of "portfolio" which excludes "bonds", such foreign collective investment scheme would fall within the definition of "foreign equity instrument".

However, as the provisions paragraph 43(4) applies to these investments, the capital gains tax consequences for an individual holding a participatory interest in these foreign collective investment schemes in bonds, are significantly different from that of an individual who directly invests in foreign bonds.
When paragraph 43(4) applies the capital gain or loss on the disposal of a foreign equity instrument or South African-source asset must be determined by translating the proceeds into Rands at the average exchange rate for the year of assessment in which the asset was disposed of or at the spot rate on the date of disposal of the asset, and the expenditure incurred in Rands at the average exchange rate for the year of assessment during which the expenditure was incurred or at the spot rate on the date on which the expenditure was incurred.

This has the effect that the Rand-based currency gain or loss between the date on which the expenditure was incurred and the year of assessment in which the asset is disposed of, is taken into account. Bearing in mind that it is highly unlikely that individuals will invest directly in foreign bonds and that the majority of individuals will invest in bonds by way of participatory interests in collective investment schemes in bonds, it is not clear why the capital gain or capital loss realised from the disposal of these indirect investments in these foreign bonds should be treated any differently from a direct investment in the same bonds.

8.3. Proposed solution

Paragraph 43(4) should be amended to exclude capital gains or capital losses related to the disposal of participatory interests in foreign collective investment schemes which are mandated to only invest in bonds.

This amendment should be effective from 22 December 2003 and apply in respect of disposals of participatory interests in foreign collective investment schemes which are mandated to only invest in bonds on or after that date. (Sub-paragraph (4) in its current form (as amended) came into effect on 22 December 2003).

9. Extension of definition of "disability" contained in section 18 of the Act, to include dread diseases which may, if not treated and managed properly result in "disabilities"

9.1. Legal nature of the problem

The current definition of "disability" contained in section 18 of the Act, does not include dread diseases, such as diabetes. The management of these conditions are expensive, if done properly and consequently patients with insufficient financial means or who do not have adequate medical aid cover do not management their conditions properly. It is noted that the majority of the tax jurisdictions include dread diseases where special dispensation is given to disability related expenditure. The exclusion in the South African context is therefore unclear and even possibly unfounded.

Failure to manage these conditions properly may eventually result in the patients becoming disabled or suffering from conditions which qualify as "disabilities" as defined in section 18 of the Act. The costs of treating these conditions exceed the costs of the products needed to manage and treat the dread diseases are less than the costs of treating the "disabilities".
9.2. **Proposed solution**

The definition of "disability" contained in section 18 of the Act should be extended to include dread diseases.

In addition, annexure 1 the discussion paper on proposed list of qualifying physical impairment and disability expenses under section 18(1)(d) of the Act, and proposed criteria for diagnosis of a disability need to be expanded to include the following items:

- Insulin;
- Needles and syringes required for the administration of insulin;
- Blood Glucose Meters;
- Glucose Test strips;
- Lancing devices;
- Lances;
- Ketone test strips;
- Infusion pumps;
- Glucogon.

10. **Suggested amendments to certain definitions contained in section 1 of the Act, section 9(1)(g) of the Act, section 11 of the Act, the Second Schedule to the Act, and the Eighth Schedule to the Act**

10.1. **Background to comments**

The Monetary policy of South Africa has changed dramatically from 1970-2000. The period in question saw major changes internationally even as South Africa evolved from a deepening inward orientation in the 1970s and 1980s to a gradual reversal and outward orientation during the 1990s.

South Africa emerged from an era of trade and cultural isolation into a world that was rapidly integrating in terms of trade, technological innovation, globally driven production and distribution processes during the 1990s.

The most significant international change in monetary policy throughout these three decades was that market-oriented policies were adopted while direct controls, such as certain exchange controls, were relaxed.

A direct consequence of the monetary policies applied prior to the 1990s was that South African businesses were effectively forced to keep their investment funds within the country's borders and only had limited opportunities to expand their business operations into foreign jurisdictions. The gradual relaxation of exchange controls since 1994 has meant that South African businesses are now able to invest freely – within certain limits - in foreign
jurisdictions and consequently optimise their risk and return as a result of their exposure to the vast international markets instead of only local markets.

A necessary concomitant of the expansion of South African businesses into the international arena is that South African resident employees have also now become more mobile as their South African employers expand their operations into foreign jurisdictions. It is no longer uncommon to find South Africans being transferred for extended periods to work at foreign operations of their South African employer, or to be specifically employed to assume employment at a foreign operation of their prospective South African employer. Such transfers or employment contracts are also not reserved for young/junior employees. Senior employees/executives, some of them close to retirement, are also transferred to foreign operations on a regular basis. Some of these employees may even retire before their return to South Africa, upon their return to South Africa or soon thereafter. Some of these employees may even decide not to return to South Africa.

As a result of the changes in government in South Africa since 1994, South Africa is no longer subject to trade sanctions and accordingly it is no longer a "no-go" location for foreign businesses to commence operations. This is evident from the increased foreign investment in South Africa since 1994. It is also not uncommon for foreign multi-nationals to locate their Africa/Southern African regional office in South Africa. Foreign businesses are now transferring their non-South African resident employees to South Africa. Some of these non-South African resident employees may actually retire whilst based in South Africa and decide to stay here after their retirement.

Most multi-national businesses (including South African multi-nationals) have "internationalised" their operations to such an extent that their employees are deployed all over the world in positions where their particular skills are required without consideration of the nationality or residence (tax or otherwise) of the employees.

Most of the foreign multi-national businesses are able to offer membership of highly competitive multi-national retirement funds to their employees irrespective of where they are resident. The trend is for these multi-nationals to often have group retirement funds that provide retirement benefits to retired employees all over the world. Country-specific retirement funds are seen to be limiting and viewed as a "stumbling block" or inhibiter where employees are transferred on a regular basis to different foreign jurisdictions. Prospective employees also seem to prefer membership of a "global" retirement fund as opposed to a country-specific retirement fund, which affects the ability of multi-nationals to attract suitably qualified employees on a global basis.

South African multi-nationals are restricted in terms of the current tax legislation and foreign exchange controls (we understand that a South African multi-national would have to allocate a portion of its foreign investment allowance should it want to set up a retirement fund offshore). This causes South African multi-nationals to be at a disadvantage relative to their foreign counterparts in respect of this employee-benefit offering.
10.2. The legal nature of the problem

The changes made to date to the taxation of the lump-sum benefits is in our view nothing more than a review of the current provisions contained in the Act. If a major overhaul of the taxation of retirement benefits was intended as indicated by the Minister Finance, Trevor Manual, in his budget speech in 2006, then the changes made to date has not quite reached that objective.

Whilst the Act and various other Acts administered by the South African Revenue Service ("SARS") have been amended to recognise South Africa's renewed participation in the international arena (for example the introduction of the residence basis for income tax), this is unfortunately not the case as regards contributions to retirement fund or benefits from such funds. The current provisions dealing with the taxation of lump-sums and retirement benefits also ignores the increased participation of South African businesses in the international arena and the mobility of employees on a global basis.

What follows is a comparison of the differences between the taxation of a lump-sum where a South African resident is a member of a foreign retirement fund compared to the taxation of the same lump sum where the South African resident is a member of an approved retirement fund.

<table>
<thead>
<tr>
<th>Description</th>
<th>Foreign fund</th>
<th>Pension fund or provident fund</th>
</tr>
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<tbody>
<tr>
<td>South African resident</td>
<td></td>
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</tr>
<tr>
<td>South African based employee</td>
<td>Lump sum payment arguably tax-free for income tax purposes if payment of benefits not linked to specified events related to employment status of employee (based on a very broad interpretation of the exclusion contained in paragraph (d)(i) of the &quot;gross income&quot; definition) Alternatively, the lump sum payment is taxed IN FULL.</td>
<td>Portion of lump sum payment may be tax-free based on specified formulas. Taxable portion taxed at employee's average tax rate. However, the provisions DO NOT take into account any services rendered outside South Africa. Lump sum payment not subject to CGT</td>
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<td><strong>Expatriate employee working for another legal entity in foreign jurisdiction</strong></td>
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</tr>
<tr>
<td><strong>Non-South African resident</strong></td>
<td>Lump sum payment arguably tax-free for income tax purposes if payment of benefits not linked to specified events related to employment status of employee. Alternatively, the lump sum payment is taxed to the extent that the Portion of lump sum payment may be tax-free based on specified formulas. Taxable portion taxed at employee's average tax rate. The provisions take into account any services rendered outside South Africa. Lump sum payment not subject to CGT.</td>
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</table>

The definition of a "pension fund" or "provident fund" is crucial to determine the application of the provisions of the Act to amounts received/accrued from (in this instance lump-sums) a pension fund or provident fund (hereinafter collectively referred to as "retirement funds"). In essence any lump-sum payment received from a retirement fund by an employer will only qualify for the proposed tax treatment of the lump-sum if the retirement fund is approved by the SARS. It therefore follows that these provisions will not apply to foreign retirement funds,
as these are generally not approved by SARS. What is needed is that the definitions of a "pension fund" and a "provident fund" be expanded to also include foreign retirement funds.

There are a number of tax implications that arise with regards to retirement funds for the expatriate employee at various stages of his/her career. These relate to the ability of the expatriate employee to claim deductions for any contributions made to a retirement fund, as well as the taxation of any benefits derived on retirement from such retirement funds.

What follows is a more detailed analysis of the current tax consequences in respect of lump-sum receipts from a retirement fund for a South African resident who at various stages through his or her career rendered services outside of South Africa as an expatriate employee.

South African retirement fund
The tax treatment of lump-sum payments from retirement funds are summarised as follows: Lump-sum payments from retirement funds are taxable in the hands of the retiring or deceased employee to the extent that the lump-sum payments exceed the tax-free portion of the lump-sum payments. The tax-free portions of the lump-sum payments are determined in terms of the Second Schedule to the Act. A number of factors influence the quantum of the tax-free amount.

The taxable portion of the lump-sum payments is taxed at a rate determined with reference to the relevant tax table in the tax year the employee retires.

The lump-sum payments from retirement funds are not subject to capital gains tax ("CGT") in the hands of the employee.

The current provisions of the Act provide that the taxable portion of any lump-sum payments from retirement funds that relate to services rendered outside South Africa will not be deemed to be from a South African source and will accordingly not be taxable in South Africa. This is due to the fact that paragraph (e) of the definition of “gross income” in section 1 of the Act, which includes the taxable portions of lump-sum payments in gross income, provides that the provisions of section 9(1)(g) shall mutatis mutandis apply in relation to the determination of the taxable portion of lump-sum payments. The extent to which services were rendered by an employee both in and outside South Africa must accordingly be taken into account.

Where the South African resident employee rendered services in and outside South Africa, the provisions of section 9(1)(g) of the Act do not apply to the taxable portion of any lump-sum payments received from a retirement fund. A South African resident will only be able to enjoy a similar tax benefit if section 10 of the Act, which deals with exemptions, makes provision for an equivalent exemption. The exemption provided for in section 10(1)(gC) of the Act relates only to pensions and not to lump-sum payments. A South African resident will therefore always be subject to tax on the full taxable portion of the lump-sum from retirement funds.
Foreign retirement fund
The tax treatment of lump-sum payments from any foreign retirement fund are summarised below. The position of lump-sum payments from foreign retirement funds is only considered in respect of South African tax residents.

Paragraph (d) of the definition of "gross income" (section 1 of the Act) provides that "any amount, including any voluntary reward, received or accrued in respect of the relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment or of any appointment (…) to any office or employment: Provided that –

(i) the provisions of this paragraph shall not apply to any lump-sum award from any pension fund, provident fund or retirement annuity fund;
(ii) any such amount which becomes payable in consequence of or following upon the death of any person shall be deemed to be an amount which accrued to such person immediately prior to his death;"

Paragraph (d) accordingly causes an amount that relates to the relinquishment, termination, loss, repudiation, cancellation or variation of any office or employment to be included in "gross income" for income tax purposes and as a result the amount is, subject to what follows, taxable in the hands of the recipient.

Paragraph (e) of the said definition in turn includes in a taxpayer’s "gross income" only the taxable portions of the lump-sum payments that are determined in terms of the Second Schedule to the Act. The taxable portions of the lump-sum payments determined in terms of that Schedule are accordingly taxable. However, paragraph (e) provides that the provisions of section 9(1)(g) of the Act apply mutatis mutandis in respect of any taxable amount determined in terms of the Second Schedule to the Act. Practically, this means that lump-sum awards that fall to be taxed under paragraph (e) may be subject to apportionment on the basis of services rendered inside and outside South Africa. It is noted that the provisions of the Second Schedule to the Act only apply in respect of pension funds or provident funds as defined in the Act. The provisions accordingly do not apply to lump-sum payments from pension or provident funds that do not fall within the said definitions i.e. non-South African pension or provident funds.

It is further noted that the full value of lump-sum payments from any retirement fund would have been subject to income tax in the hands of the South African employee but for the exclusion of such payments in terms of paragraph (d)(i) of the definition of "gross income" in section 1 of the Act.

If the narrow meaning of the terms "pension fund" or "provident fund" is used, the exclusion in terms of paragraph (d)(i) of the definition of "gross income" in section 1 of the Act will not apply to lump-sum payments from foreign retirement funds. The South African resident will accordingly be taxable on the full value of the lump sum payment received. The taxable portion of the lump-sum payment that relates to services rendered outside South African
accordingly also not be exempt from tax due to the lack of an exemption in section 10 of the Act. The South African resident will accordingly be taxable on the total lump-sum payment received.

The intention of the legislature as regards the income tax position of lump- sum payments from foreign retirement funds is, in our view, based on the issues noted above, unclear.

It is noted that the uncertainty regarding the income tax position of lump-sum payments received from foreign retirement funds is in sharp contrast to the provisions dealing with CGT where any lump-sum payments from any foreign retirement fund are exempt from CGT.

The tax treatment of any lump-sum payment from a South African retirement fund to a non-South African resident are summarised as follows:

As regards the position where the non-South African expatriate has rendered services in and outside South Africa, it is noted that the provisions of section 9(1)(g) of the Act applies to any lump-sum payments received by the non-resident from pension and provident funds as defined for purposes of the Act.

This is due to the fact that paragraph (e) of the definition of "gross income" in section 1 of the Act which includes the taxable portions of lump-sum payments in "gross income" provides that the provisions of section 9(1)(g) shall mutatis mutandis apply when the taxable portions of lump-sum payments are determined. The extent to which services were rendered by an employee both in and outside South Africa must accordingly be taken into account.

The taxable portion of the lump-sum payments that relate to services rendered outside South Africa will therefore not to be deemed to be from a South African source and accordingly will also not be taxable in South Africa.

10.3. Proposed solution

We are of the opinion that the amendments introduced to date do not address a number of significant anomalies between the taxation of lump-sums received from South African retirement funds and foreign retirement funds by South African residents.

The anomalies are regrettably not limited to the taxation of lump-sum payments. Anomalies are also found in respect of the deductions of contributions made both in the hands of the employers and in the hands of the members (individuals), the taxation of the annuities and capital gains tax.

We are aware of a number of South African multi-national groups that currently experience difficulties when negotiating offers of employment with skilled individuals as a direct result of their reluctance/inability to offer competitive and/or global retirement benefits. Failing to address these anomalies will cause South African multi-national groups to continue to be at a
disadvantage to their foreign competitors who are able to offer competitive and/or global retirement benefits.

Further, any reform of the taxation on retirement benefits will be incomplete if these anomalies are not dealt with.

11. Amendments to section 9(1)(g) of the Act

11.1. Background

The expansion to specifically include a "lump-sum benefit contemplated in the Second Schedule" is welcomed. Although we have argued that a lump-sum is nothing more than the upfront payment of any pension or annuity granted to a person, the inclusion of the lump-sum benefit now ensures that there is no doubt as regards the application of section 9(1)(g) of the Act to these lump sum benefits.

11.2. The legal nature of the problem

Clarification is required regarding the determination of "period during which the services rendered". In this regard we refer to determination of the tax-free portion of a lump-sum in the circumstances provided for in section 9(1)(g) of the Act in circumstances for example where the taxpayer at some time during his/her career transferred his/her fund credit from a pension fund to a provident fund. There are currently two views regarding the determination of the period during which the services were rendered which should be applied. Supporters of one view argues that the tax-free portion of the lump-sum should be determined with reference to period of membership of the provident fund and not with reference to taxpayer's years of service in respect of which he/she is now receiving the lump-sum payment whereas supporters of the other view argue that in these circumstances the period during which the services rendered relates to the taxpayers total career and not merely the period related to his/her membership of the provident fund.

Whilst it is clear from the provisions of section 9(1)(g) of the Act, the calculation of the non-resident portion is totally dependent on the years of service rendered in respect of which the pension or annuity is granted and no reference is made at all to the period of membership of the particular retirement fund, the jury seems to be out on whether it can be said that the lump sum to which the taxpayer has become entitled to has been granted "in respect of services" rendered by him, and if so, whether it is only in relation to the services rendered by the taxpayer whilst a member of the provident fund, or the total services rendered by him to his employer.

It is apparent that the present provisions of section 9(1)(g) of the Act, read with paragraph 2(a) of the Second Schedule to the Act, give rise to considerable uncertainty in application. Where previously the tax-free portion of a lump sum derived on retirement was determined by
reference to formula A, and formula A was determined by reference to the number of years of employment taken into account for purposes of determining the amount of benefits payable to the taxpayer under the rules of the retirement fund, this is no longer the case. As a consequence of the benefit of taking years of employment (service) into account for purposes of formula A, that the revenue authorities allowed a provident fund in these circumstances to carry over the employee's service period under the pension fund on conversion. Having determined the tax-free portion of the lump sum, section 9(1)(g) of the Act would then have been applied to determine the portion of the taxable amount of the lump-sum that was regarded as being derived from a source in South Africa.

Had formula A not been replaced by the graduated tax rate regime (thereby rendering the years of service rendered by the taxpayer redundant for purposes of determining the tax payable in respect of a lump-sum), there would have been no doubt that the period of service referred to in formula A and section 9(1)(g) of the Act was the same years of service, namely, in the stated situation, those relating to membership of the pension fund and provident fund. It is only now that years of service rendered under a pension and provident fund in the case of conversion are no longer relevant for purposes of determining the tax-free portion of the lump-sum, that an argument that only the period relating to the membership of the last retirement fund, in this instance the provident fund should be used has arisen.

Unfortunately, in the absence of any authoritative pronouncements concerning this conundrum, whether by text book writers or the revenue authorities, we are of the opinion that this aspect be addressed in the proposed legislation.

11.3. Proposed solution

Provisions need to be incorporated into the Act to clarify the position.

**Income Tax- Domestic Business**

12. **Section 12H – cut off date of 1 October 2011**

12.1. The legal nature of the problem

Section 12H of the Act has only recently been amended (Taxation Laws Amended Bill 2009) to provide additional incentive to employers to enter into registered learnerships with employees. However, in terms of the current wording contained in section 12H, the section would only apply to registered learnerships entered into before 1 October 2011, although the amended section 12H only applies for years of assessment ending on or after 1 January 2010. Surely the cut-off date of 1 October 2011 is insufficient to provide incentive to employers to enter into registered learnership agreements with employees.

12.2. Detailed factual description of the relevant transaction
It is suggested that the cut-off date of 1 October 2011 for registered learnership agreements be extended.

12.3. **Description of what the transaction seeks to achieve**

See (ii) above.

12.4. **Nature of the businesses impacted by the problem**

All employers that enter into registered learnership agreements with employees.

12.5. **The relevant urgency of the matter at hand**

Very urgent.

13. **Section 12H – Practical Problem where there is a time delay in registration of the learnership agreement**

13.1. **The legal nature of the problem**

We refer to the substitution of section 12H of the Act as substituted by section 23 of the Taxation Laws Amendment Act No. 17 of 2009 (“TLAA 2009”).

Although the new learnership allowance is more generous than before, a practical problem arises where there is a delay between the commencement of a learnership agreement and the actual registration of that learnership by the SETA.

13.2. **Detailed factual description of the relevant transaction**

For example, a practitioner may sign a learnership agreement with a commencement date of 1 January 2010 but that agreement might only be registered by the SETA a few weeks later. If the strict wording of section 12H is applied, this delay in registration will result in financial loss to the employer as the allowances and the counting of the completed twelve-month periods will only be triggered once the learnership is registered. The loss to the employer is illustrated in the following example:

Assume the employer referred to above has a February year-end and he enters into a three-year training contract. The employer’s learnership allowances will be calculated as follows:

- Year of assessment ending 28 February 2010: The employer may not claim a commencement allowance as the learnership agreement had not yet been registered by the SETA on 28 February 2010, even though the learnership affectively started on 1 January 2010. Had the learnership been registered immediately, i.e. on 1 January
2010, the employer would have been entitled to a tax deduction of R5 000 (R30 000 x 2/12) in this year.

- Years of assessment ending 28 February 2011 and 2012: The employer may claim a commencement allowance of R30 000 in each year as a registered learnership agreement is in place for the whole year.
- Year of assessment ending 28 February 2013: The employer may claim a commencement allowance of R25 000 (R30 000 x 10/12, as the learnership was in existence for ten months of the year - from 1 March to 31 December 2012) and a completion allowance of R60 000 (R30 000 x 2, as there are two completed periods of twelve months between the registration of the learnership on 1 March 2010 and its conclusion on 31 December 2012). Had the learnership agreement been registered immediately on 1 January 2010, this completion allowance would have amounted to R90 000 (R30 000 x 3 as there would have been three completed twelve-month periods within the duration of the agreement).

The delay in the registration of the learnership agreement in the above example results in the employer losing out on tax allowances totalling R35 000 (R5 000 commencement allowance lost in the 2010 tax year and R30 000 completion allowance lost in the 2013 tax year).

We are of the view that an amendment to the provision may be necessary to allow learnerships to qualify for the allowance over their full duration where a delay in registration is unavoidable due to administrative processes.

13.3. **Description of what the transaction seeks to achieve**

Refer (ii) above.

13.4. **Nature of the businesses impacted by the problem**

All employers that enter into registered learnership agreements with employees.

13.5. **The relevant urgency of the matter at hand**

Very urgent.

14. **Section 12J**

These comments are motivated by the desire to promote certain amendments of section 12J of the Act in order to encourage investment in small business and help meet the very important objectives for which it was originally promulgated.

14.1. **Section 12J(2) – Exclusion of certain investment vehicles**

14.1.1 **Legal nature of the problem**
According to the Explanatory Memorandum, “the VCC is intended to be a marketing vehicle that will attract retail investors. It has the benefit of bringing together small investors as well as concentrating investment expertise in favour of the small business sector.” Section 12J(2) however currently restricts the availability of the deduction to “a natural person, a listed company or a controlled group company in relation to a listed company”.

14.1.2 Proposed solution

The existing exclusion of private companies, partnerships and trusts and other legal entities from the ambit of the deduction, as reflected in Section 12J(2), should be removed.

14.1.3 Nature of the businesses impacted by the problem

The restriction imposed by Section 12(J)(2) excludes the availability of the deduction to private companies (large and small), trusts and partnerships. This has two implications:

- Well-heeled individuals, who typically form the bedrock of the “angel investor” community often use private companies, trusts and partnerships as their investment vehicles of choice. The exclusion of these structures from claiming the deduction has the unfortunately impact of excluding precisely these vehicles from the ambit of the deduction, thus inhibiting the involvement of these companies (who are often the best source of equity funding for small business) from VCC activities.

- Many middle-sized, private companies have expressed an interest in making equity investments in small business via VCC vehicles as part of their compliance with the BB-BEE Scorecard. Their ability to obtain the Section 12J benefit is however currently impeded by the exclusion.

- Many large corporations have established Section 21 Companies or Foundations (structured as Trusts), to manage corporate social investment programmes on behalf of the corporations. These vehicles are increasingly involved in the establishment and implementation of Enterprise Development Programmes and several have indicated a desire to provide equity investment to small business as part of their programmes. Their ability to obtain the Section 12J benefit is however currently impeded by the exclusion.

It is common cause that equity investment for small business is virtually unobtainable and remains an urgent need. In this context, the existence of the exclusion contained in Section 12(J)(2) which undermines the participation of “angel investors”, mid-range private companies and Section 21 Companies/Trusts in the provision of equity funding to small business is counter-productive.

14.1.4 The relevant urgency of the matter at hand
The impact of the current recession on small business has been substantial. In many cases, existing small businesses need to be recapitalized in order to restructure. Alternatively, many small businesses require new infusions of capital for the resumption and expansion of their operating activities. The provision of this capital is critical to the renewed growth of the small business sector and the associated expansion of job creation activity by the sector.

14.2. Section 12J(3) – Capping of deduction value

14.2.1 Legal nature of the problem

Section 12J(3) places a cap on the value of the deduction for natural persons (both on an annual and an aggregate basis). This provision thus restricts the benefit of investment into small business via VCC vehicles for this class of investor and in so doing in effect limits the value of investment that this class of investor is likely to make. No similar restriction if imposed on listed entities.

14.2.2 Proposed solution

The existing cap on individual investment, both on an annual and aggregate basis, should be removed.

14.2.3 Nature of the businesses impacted by the problem

Angel investors provide the bedrock of equity investment available in many developed countries. It is not clear why section 12J(3) places a restriction in the current environment that effectively undermines the involvement of individuals in economic transformation activity (via investment in small business), whilst no similar restriction is imposed on listed companies.

14.2.4 The relevant urgency of the matter at hand

It is common cause that equity investment for small business is urgently required to support the small business sector. The establishment of several angel funding networks is currently impeded by this restriction.

14.3. Section 12J(6A) – Minimum aggregate asset requirements

14.3.1 Legal nature of the problem

Section 12J(6A) provides that the Commissioner must withdraw approval for the VCC if “the expenditure incurred by the company in that period to acquire qualifying shares –

i) ...
ii) *In any qualifying company other than a junior mining company, was at least R30 million.*

14.3.2 Proposed solution

The existing minimum capitalization over 3-years should be reduced to R10 million and the time period for investment should be increased to at least 5 years. This will provide sufficient time for the establishment of a range of smaller investment vehicles which will be necessary to develop and prove the market.

14.3.3 Nature of the businesses impacted by the problem

It is not clear why the threshold of R30 million has been imposed and no clear rationale appears from the Explanatory Memorandum. Several instances have been identified in which smaller but nevertheless significant sums may be made available as equity investment. Very often fund management activities for these vehicles would either be subsidized or provided at a reduced cost. The establishment of these smaller funds is often undertaken on a pilot basis in order to scale up support over the medium-term.

14.3.4 The relevant urgency of the matter

The blanket requirement of a minimum of R30 million as a 3-year capitalization, with the threat of approval withdrawal unfortunately has the unintended consequence of blocking the establishment of these small, alternative funding vehicles.

14.4. Section 12J(6A)(a)(ii) – Qualifying companies and impermissible trades

14.4.1 Legal nature of the problem

Section 12J(6A)(a)(ii) provides that the expenditure incurred by the company must be in a “qualifying company”. Section 12J(1) defines “qualifying company” as any company that is not carrying out an “impermissible trade”. “Impermissible trade” is in turn defined to include a range of activities including “any trade carried on as a franchisee”. The rationale for the exclusion of franchisee activities from the ambit of equity investment is not clear from the Explanatory Memorandum.

14.4.2 Proposed solution

It is proposed that the restriction on franchisee contained in Section 12J(1)(f) be removed from the definition if “impermissible trade”.

14.4.3 Nature of the businesses impacted by the problem
The operation of small business enterprises under the umbrella of franchise support is a very useful vehicle for small business development. It is widely recognized that South Africa suffers from a lagging entrepreneurial culture and the dearth of entrepreneurial skills and experience. Franchising is accordingly an important vehicle for small business development. Franchisees typically require a mix of funding to commence business activities, including equity funding.

14.4.4 The relevant urgency of the matter at hand

Franchising is an important vehicle for small business development. The exclusion of franchisees from the ambit of operation of a “qualifying company” presents an unnecessary block to the provision of small business equity funding to this sector.

15. The taxation of financial instruments - section 24J

15.1. The legal nature of the problem

Sections 24J, K and L of the Act, which regulate the taxation of “income instruments”, interest rate agreements and option contracts were implemented many years ago and do not make reference to the additional types of financial instruments available in the market today, such as derivatives.

Consequently, there is uncertainty as to the requisite tax treatment of such financial instruments.

15.2. Detailed factual description of the relevant transaction

Section 24K of the Act requires that the interest in terms of interest rate agreements is accrued on a day to day basis during the period in which it is calculated.

Section 24L of the Act requires that the option premium is incurred on a day to day basis during the term of the option contract, except if the taxpayer holds option contracts as trading stock.

Section 24J of the Act requires that interest on income instruments is accrued on a yield to maturity basis, except where a taxpayer is dealing in instruments, interest rate agreements, or option contracts. In such circumstances, the taxpayer may upon application to the Commissioner elect to have such instruments taxed on a market value basis, provided that such market value is determined in accordance with commercially accepted practice and is consistently applied in respect of all such agreements.

The accounting standards generally require that instruments are held at fair value in certain circumstances, which results in the profit and losses on such instruments being reported at market value. The taxation treatment of such instruments may only be applied on a ‘market
value’ basis upon application to the Commissioner in the circumstances provided. As a result, there are numerous adjustments which are required by taxpayers in order to adjust the market value of such instruments back to an accrual basis. The back office systems utilized to record and track such instruments are rarely capable of providing the details required for such adjustments, since they have been upgraded to remain in line with the latest accounting developments, i.e. market value, and unfortunately the taxation of such instruments has not been revisited in line with the constant accounting developments.

15.3. Description of what the amendment seeks to achieve

There needs to be certainty for taxpayers regarding the taxation of financial instruments. Therefore, these sections of the Act need to be reviewed and amended to include all of the financial instruments, including derivatives, in accordance with the latest accepted accounting practice.

15.4. Nature of the businesses impacted by the problem

The entire financial services industry is impacted by this problem.

15.5. The relevant urgency of the matter at hand

Given that SARS has recently embarked upon a review of these instruments, it is imperative that National Treasury be part of this review and that the necessary legislative amendments are tabled for debate in order to afford taxpayers in the financial industry the opportunity to participate in the development of amendments to the Act aimed at providing certainty on the appropriate treatment of all financial instruments.

16. Section 42 of the Act

16.1. The legal nature of the problem

Para (b) of the definition of asset for share in section 42 of the Act states that as a result of a qualifying asset for share transaction ‘that company acquires from that asset from that person-

(i) as trading stock, where that person holds it as trading stock;
(ii) as a capital asset, where that person holds it as a capital asset; or
(iii) as trading stock, where that person holds it as a capital asset and that company and that person do not form part of the same group of companies’

We are advised by the Explanatory Memorandum that part (iii) means that where the person and the company are not part of a group, as defined, and the person held it as a capital asset, that company may choose to hold it as trading stock. However, it may also be read strictly to
mean that where the person and the company are not part of a group and it was held as capital, it must be acquired as trading stock.

16.2. Proposed solution

In order to bring the wording in line with SARS stated intention, it is proposed that the wording of (iii) be amended to state:

‘(iii) as trading stock, where elected as such, where that person holds it as a capital asset and that company and that person do not form part of the same group of companies’

17. Clarification required regarding the meaning of the term "circumstances beyond the control of the taxpayer" contained in section 89quat(3) of the Act.

17.1. Background

Prior to the amendment to section 89quat(3) of the Act, contained in the Taxation Laws Amendment Bill currently tabled in Parliament, the Commissioner was able to remit all or part of any interest due by a taxpayer as a consequence of having underpaid provisional tax if the Commissioner was satisfied that the taxpayer had on reasonable grounds contended that the amount in respect of which the tax was underpaid should not have been included or that the deduction, allowance, etc should have been allowed.

Section 89quat(3) of the Act will be amended with effect from 1 November 2010 to only allow the Commissioner to remit all or part of any interest due by a taxpayer as a consequence of having underpaid provisional tax if the underpayment was due to "circumstances beyond the control of the taxpayer".

17.2. The legal nature of the problem

It is not clear when circumstances will be considered to meet the requirement of "circumstances beyond the control of the taxpayer". Examples offered included "hospitalisation of the taxpayer", "transfer affected via the internet not being recorded" etc.

However, there are more significant circumstances which, in our view, would also qualify as "circumstances beyond the control of the taxpayer". Such circumstances would include the claiming of a deduction for income tax purposes where that deduction is supported by and is claimed in accordance with:

- The tax treatment of the amounts followed by the industry in which the taxpayer operates;
- Judgements delivered in the Supreme Court and High Courts of South Africa where the tax treatment of the specific nature of amounts matter were decided and those judgements have not been overruled;
The said judgements were delivered some time ago;

The taxpayers have been assessed on the basis applicable to the industry and accepted by the Courts in the past; and

The taxpayers have a legitimate expectation that the tax treatment of the amounts concerned is accepted by SARS.

We are aware of a number of taxpayers currently subjected to audits by SARS where the situation noted above apply, i.e. SARS is either currently attempting to or has issued revised assessments against taxpayers where amounts claimed as deductions in line with current accepted practice and in accordance with judgments delivered in favour of taxpayers. We note that there has not been any amendments to the Act in these cases since the judgements were delivered.

We are of the opinion that these situations also qualify as "circumstances beyond the control of the taxpayer".

In addition, as the taxpayer paid the amount of tax due in accordance with the practice prevailing at the time, it cannot be said that the tax allegedly underpaid is a debt due to the State and hence that interest should accrue to the State until such time as due and legal process has been followed in terms of which it is determined that the taxpayer incorrectly relied on the practice prevailing. The tax underpaid only becomes a debt due to the State at the time that decision is made and not from the date of the voluntary third provisional payment.

17.3 Proposed Solution

The meaning of the term "circumstances beyond the control of the taxpayer" contained Section 89quat(3) of the Act, need to be clarified

18. Re-introduction of "reasonable grounds" in circumstances where additional assessments are raised

18.1. Background

Prior to the amendment to Section 89quat(3) of the Act, contained in the Taxation Laws Amendment Bill currently tabled in Parliament, the Commissioner was able to remit all or part of any interest due by a taxpayer as a consequence of having underpaid provisional tax if the Commissioner was satisfied that the taxpayer had on reasonable grounds contended that the amount in respect of which the tax was underpaid should not have been included or that the deduction, allowance, etc should have been allowed.

Section 89quat(3) of the Act will be amended with effect from 1 November 2010 to only allow the Commissioner to remit all or part of any interest due by a taxpayer as a consequence
of having underpaid provisional tax if the underpayment was due to "circumstances beyond the control of the taxpayer".

18.2. The legal nature of the problem

It is not clear when circumstances will be considered to meet the requirement of "circumstances beyond the control of the taxpayer". Examples offered included "hospitalisation of the taxpayer", "transfer affected via the internet not being recorded" etc.

However, there are more significant circumstances which, in our view, would also qualify as "circumstances beyond the control of the taxpayer". Such circumstances would include the claiming of a deduction for income tax purposes where that deduction is supported by and is claimed in accordance with the tax treatment of the amounts followed by the industry in which the taxpayer operates or where the taxpayer has sought the advice of professional tax advisors who advised them that the deduction is allowable or income is not of a revenue nature.

The taxpayer paid any provisional tax on that basis within the time limit allowed in the Act and submitted the tax returns on the basis of industry practice or in accordance with the advice sought. The return was submitted within the time limits allowed by SARS (in the case of a company 12 months from the end of the relevant tax year). The taxpayer is also assessed on that basis however is subjected to an audit by SARS before the end of the prescription period, which is 3 years from the date of the original date of assessment or 3 ½ years from the date of the payment of the voluntary third provisional tax payment. SARS disagrees with the treatment of the particular income or expense item and issues an additional assessment which has a new date of assessment, i.e. the date of the issue of the additional assessment which is 3 years later than the original date of assessment.

The taxpayer objects and appeals against the decision reached and decides to take to the matter to Court. This process alone takes another 10 years, i.e. a total of 13 years since the original assessment – which in not unlikely – before the issue is resolved.

The situation arises that the taxpayer has to pay interest from the date the voluntary third provisional tax payment to the date of the decision reached by the Court which could be as much as 13 ½ years from the date of payment of the voluntary third provisional tax payment.

In addition, as the taxpayer paid the amount of tax due in accordance with the practice prevailing at the time, it cannot be said that the tax allegedly underpaid is a debt due to the State and hence that interest should accrue to the State until such time as due and legal process has been followed in terms of which it is determined that the taxpayer incorrectly relied on the practice prevailing. The tax underpaid only becomes a debt due to the State at the time that decision is made and not from the date of the voluntary third provisional payment.
18.3. Proposed solution

Section 89quat(3) of the Act should re-introduce the provision that the Commissioner may remit all or part of any interest due by a taxpayer as a consequence of having underpaid provisional tax if the Commissioner was satisfied that the taxpayer had on reasonable grounds contended that the amount in respect of which the tax was underpaid should not have been included or that the deduction, allowance, etc should have been allowed.

19. Section 23J of the Act

19.1. The legal nature of the problem

Clause 38 of the Revenue Laws Amendment Act, No 35 of 2007 (“RLAA”), inserted section 23J into the Act. Since it was not otherwise provided for, clause 126 of the RLAA deemed section 23J to have come into operation as from the commencement of years of assessment ending on or after 1 January 2008.

In essence, section 23J limits the cost or value of a depreciable asset, which was acquired from a connected person, for the purposes of this section and any deduction or allowance claimed in respect thereof to an amount determined in accordance with subsection 23J(2).

Section 23J reads as follows:

‘23J. Limitation of allowances granted in respect of assets previously held by connected persons.- (1) Where a depreciable asset acquired by a taxpayer was held within a period of two years preceding the acquisition by a person who was a connected person in relation to that taxpayer at any time during that period, the cost or value of the depreciable asset for the purposes of this section and any deduction or allowance claimed by the taxpayer in respect of that asset shall not exceed an amount determined in accordance with subsection (2).

(2) The amount to be determined for purposes of subsection (1) is the sum of—

(a) the cost of the depreciable asset for purposes of any deductions allowable in respect of that asset to the most recent person contemplated in subsection (1) that previously held that asset (hereinafter referred to as the ‘connected person’), less the sum of—

(i) all deductions which have been allowed to the connected person in respect of the asset; and

(ii) all deductions that are deemed to have been allowed to the connected person in respect of the asset in terms of section 11(e)(ix), 12B(4B), 12C(4A), 12D(3A), 12DA(4), 12F(3A), 13(1A), 13bis(3A), 13ter(6A), 13quin(3) or 37B(4);

(b) any amount contemplated in paragraph (n) of the definition of ‘gross income’ in section 1 that is required to be included in the income of the connected person that arises as a result of the disposal of the asset by the connected person; and
It is unclear as to whether the provisions of section 23J applies in respect of:

- assets acquired on or after the commencement of years of assessment ending on or after 1 January 2008; or
- allowances claimed in respect of years of assessment ending on or after 1 January 2008.

This must be clarified.

19.2. Detailed factual description of the relevant transaction

Below, we provide a practical example of the disparate conclusions resulting from these alternate interpretations of the effective date of section 23J.

We assume the background facts to be as follows:

- The taxpayers is a company, whose year of assessment ends on the first day January;
- On 1 January 2007 the taxpayer acquired a building that has never been used from a connected person (also a company) for R1 000 000;
- The connected person, in turn, acquired the building for a cost price of R600 000;
- The connected person did not claim any allowances in respect of the building;
- The connected person realised a capital gain of R400 000 on the disposal of the building to the taxpayer; and
- The taxpayer uses the building in a process of manufacture and is, thus, entitled to claim an allowance in respect of the building, as provided for in section 13.

Should the provisions of section 23J only apply in respect of assets acquired on or after the commencement of years of assessment ending on or after 1 January 2008, the taxpayer will be entitled to claim an allowance of R50 000 (i.e. R1 000 000 x 5%) in respect of both the 2007 and 2008 years of assessment (and, in fact, all subsequent years of assessment).

However, should the provisions of section 23J apply in respect of all allowances claimed in respect of years of assessment ending on or after 1 January 2008, the taxpayer will be entitled to claim an allowance of R50 000 (i.e. R1 000 000 x 5%) in respect of the 2007 year of assessment, whereas the allowance in respect of the 2008 year of assessment (and subsequent years) will be limited to R40 000 (i.e. [R600 000 + (R400 000) x 50%] x 5%).

19.3. Description of what the transaction seeks to achieve
Taxpayers are seeking certainty in respect of the method to be applied when determining allowances claimed on depreciable assets, which were acquired from connected persons.

Section 23J of the Act should, therefore, be amended to expressly state the intention of the legislator.

19.4. **Nature of the business impacted by the problem**

The existing ambiguity leads to uncertainty and the potential exposure for taxpayers to a liability for penalties and interest or, conversely, the overpayment of tax, where allowances are determined incorrectly.

19.5. **The relevant urgency of the matter at hand**

The matter is urgent as it affects the determination of all allowances claimed in respect of years of assessment ending on or after 1 January 2008 on depreciable assets acquired from connected persons.

20. **Section 30 of the Act**

20.1. **The legal nature of the problem**

In terms of the current wording of section 18A, specifically section 18A(1)(a)(i)(aa), it appears that only entities that conduct public benefit activities listed in Part II of the Ninth Schedule within South Africa would qualify to apply for section 18A status. Based on this, it would appear that donations made to public benefit organisations (“PBOs”) that conduct activities outside South Africa, i.e. organisations providing disaster relief to countries other than South Africa, would not be deductible in terms of section 18A(1).

This is despite the fact that the requirement to qualify as a PBO at least 85 per cent of organisations’ activities had to be carried out for the benefit of persons in the Republic has been removed.

20.2. **Detailed factual description of the relevant transaction**

The current legislation does not take into account that South African taxpayers may want to donate to organisations that collate all the funds and assist with the distribution of such funds in countries other than South Africa. Further, it limits the capacity of South African civil society organisations to liaise with and distribute resources to civil society networks outside South Africa, after receiving donations from local donors.

For example, where an entity fully complies with the section 30 requirements and wishes to facilitate public benefit activities listed in Part II, such as alleviation of poverty or disaster relief, but wants to utilise the funds it raised by distributing such funds to Haiti, it appears that
because the actual activities are not performed in South Africa, donors to such entity will not be able to deduct donations made from their taxable income.

20.3. **Description of what the transaction seeks to achieve**

The activities seek to provide relief to persons or international organisations and allow the donors a deduction under section 18A(1)(a)(i)(aa) to encourage South African donations to international humanitarian projects, specifically Haiti in this instance.

20.4. **Nature of the business impacted by the problem**

South African entities and individuals making donations to local entities wishing to assist with international humanitarian crises will be unable to deduct such donations under the current wording of section 18A(1)(a)(i)(aa). Further to our example above, this has the effect that South Africans wishing to aid Haiti via a South African entity will be unable to deduct such donations under section 18A.

20.5. **The relevant urgency of the matter at hand**

The matter is very urgent as the lack of income tax deduction discourages South Africans from donating and thus assisting financially with the humanitarian catastrophe following the earthquake taking place in Haiti.

**Income Tax- International Tax**

21. **Amendment to section 1 of the Act, substitution of definition of "foreign dividend". Exclusion of participation exemption for "foreign dividends" as a consequence of the substitution of the definition with a new definition of "foreign dividend" contained in section 1 of the Act**

21.1. **Background**

Prior to the proposed substitution of the definition of "foreign dividend" contained in section 1 of the Act, contained in the Taxation Laws Amendment Bill currently tabled in Parliament, a foreign dividend was defined as any dividend received by or which accrued to any person from a foreign company as defined in section 9D, i.e. essentially any amount distributed out of the profits of the foreign company to the extent that it does not constitute a capital distribution. A foreign dividend therefore need not be recognised as a "dividend" in the jurisdiction from where the dividend is declared. These distributions qualified for the participation exemption contained in section 10(1)(k)(ii) of the Act.

21.2. **Legal nature of the problem**
The proposed definition of "foreign dividend" essentially requires that the "foreign dividend" must be recognised as a "dividend" in the jurisdiction from where the dividend is declared. This creates problems where an entity incorporated in a foreign jurisdiction is recognised as a "company" in terms of the definition of "company" contained in section 1 of the Act distributes amounts out of profits to the members/participants of that legal entity but the distribution does not comprise a "dividend" in terms of the laws of the foreign jurisdiction. Examples of these entities will include co-operatives incorporated in foreign jurisdictions.

It is not clear what the nature of these profit or non-capital distributions will be for South African income tax purposes.

21.3. Proposed solution

The definition of the term "foreign dividend" contained Section 1 of the Act, need to be extended to include non-capital distributions made by foreign entities such as co-operatives.

22. Section 6quat limitation of foreign tax rebates based on ‘deemed’ source of income

22.1. The legal nature of the problem

Section 6quat of the Act provides as follows –

(1) Subject to the provisions of subsection (2), a rebate determined in accordance with this section shall be deducted from the normal tax payable by any resident in whose taxable income there is included –

(a) Any income received by or accrued to such resident from any source outside the Republic (other than any foreign dividend contemplated in paragraph (d) which is –

(i) Not deemed to be from a source within the Republic …

This section effectively allows a South African resident to claim a foreign tax rebate in respect of the sum of any taxes on income proved to be payable to any sphere of government of any country other than the Republic (without any right of recovery in terms of any entitlement to carry back losses arising during any year of assessment to any year of assessment¹).

However, where the foreign income has been earned from a source deemed to be within South Africa, then the South African resident is prohibited from claiming a foreign tax rebate, and is only allowed to claim a tax deduction instead (in terms of section 6quat (1C) of the Act).

¹ Section 6quat(1A) of the Act
There are many instances where South African residents are performing services to companies in Africa, which are members of SADC, which are necessarily performed from South Africa since the skills required to do so are located here. The fees charged for such services are arm’s length, either due to the third party nature of the relationship between the parties or in accordance with section 31 of the Act. Where withholding has been imposed on these fees by the recipient country, such withholding is not claimable by the South African resident in terms of section 6quat of the Act, unless the Double Taxation Agreement (“DTA”) between South Africa and the jurisdiction in question places the source of such fees in the other country. Consequently, the South African resident suffers double taxation on these fees, despite the fact that a tax deduction is allowed in respect thereof, where South Africa does not have a functional DTA with the country in question.

This disallowance of a foreign tax rebate is penal and unnecessary, especially in light of the spirit of uniting the African continent and the furtherance of initiatives such as NEPAD. In addition, it is not acceptable for South African taxpayers to be prejudiced simply because South Africa has not entered into DTAs with certain countries in Africa, which is something over which they have no control.

22.2. Detailed factual description of the relevant transaction

Section 6quat of the Act has far reaching consequences for many South African taxpayers which perform services in Africa.

For example, a Bank offers back office support services to one of its subsidiaries in Africa, since the subsidiary in question does not have skills in its own market to do so. Regardless of the fact that such services are performed from South Africa from a cost and efficiency perspective, the African country imposes withholding on the fees paid. If there is no functional DTA between the two countries, the South African bank is only entitled to deduct such withholding instead of claiming a tax rebate.

If the value of the services is R500, and the withholding imposed is R10 –

The South African bank will be taxed on R500, even though only R490 is actually received. If the cost of funding is R400, then its taxable income will be R100, with SA tax being R28. Instead of being able to claim the R10 and only paying the difference of R18 to SARS, the SA bank will only be allowed to deduct the R10, i.e. taxable income of R90, on which it will be liable for R25.20. The additional cash tax to be paid is R7.20. The total tax paid on this transaction will be R35.20 (R10 and R25.20), which is an effective tax rate of 35.2%, instead of 28%.

22.3. Description of what the amendment seeks to achieve
We propose that subsection (i) of section 6quat(1)(a) be deleted. Consequently, services may be performed for operations in Africa in a tax efficient manner.

22.4. Nature of the businesses impacted by the problem

Section 6quat of the Act is available to all residents deriving foreign source income. Therefore, current limitation applies to any resident performing services to an operation in Africa (or elsewhere in the world).

22.5. The relevant urgency of the matter at hand

This issue has been in existence for some time. However, as South Africa becomes increasingly the ‘gateway’ to Africa, it is likely that additional services will be provided by South African corporate taxpayers, and the tax suffered on the provision of such services will be unduly punitive and consequently may inhibit growth in Africa in the foreseeable future.

23. Section 24I(10) of the Act

23.1. The legal nature of the problem

Section 24I(10) of the Act defers the taxation of exchange differences on exchange items, and any forward exchange contracts or foreign currency option contracts, between connected South African residents and their controlled foreign companies (“CFCs”).

This section has the ability to create enormous temporary differences in a taxpayer’s tax return. In addition, since the section relates to forex transactions, a taxpayer is unduly prejudiced when estimating its provisional taxation since the forex rates used in an estimate may differ materially to the final rates at its year end. This is an anomaly which is wholly outside of the taxpayer’s control, and ordinarily results in a taxpayer making a very conservative estimate and overpaying provisional tax in order to avoid related penalties and interest.

23.2. Detailed factual description of the relevant transaction

This section requires that an affected taxpayer single out one leg of a transaction, which is commercially viewed as a ‘whole’. For example, if a Bank enters into a forex loan transaction with a CFC, it will simultaneously hedge that transaction in order to ensure that there is no risk in the transaction. The Bank’s accounting records will only show the net movement of this loan and hedge. However, section 24I(10) of the Act requires that the Bank ‘strip out’ the forex movement on the leg with the CFC and defer the taxation thereof until maturity date of the transaction, whereas the hedge transaction will be taxed throughout the life of such hedge. The result may be a material ‘add back’ or deduction in the taxpayer’s tax return, which has no resemblance to the commercial reality of the trade.
Whilst the CFC’s net income, as defined in section 9D of the Act, also took the provisions of section 241(10) of the Act into account, this section was possibly justifiable from SARS perspective in order to create parity between the South African resident and its CFCs. However, the recent amendment to the foreign business establishment definition (and attendant exemption) in section 9D of the Act, together with the introduction of the “high tax” proviso to section 9D(2A) of the Act, which were both effective 1 January 2008 has altered the perceived parity created by section 241(10) since CFCs in many instances are no longer required to take this provision into account (since they will submit nil returns for the purposes of section 9D of the Act).

23.3. Description of what the amendment seeks to achieve

It is proposed that section 241(10) of the Act be deleted. We have considered limiting its application to instances where the resident imputes the ‘net income’ of its CFC. However, the imputation may not apply annually, depending on the circumstances of the CFC. In addition, the amount of uncertainty that this section creates when estimating provisional taxes warrants its deletion.

23.4. Nature of the businesses impacted by the problem

All South African multinational organizations are impacted by the application of section 241(10) of the Act.

23.5. The relevant urgency of the matter at hand

This matter is relatively urgent, since it negatively impacts on a taxpayer’s ability to accurately estimate its provisional tax, and leads to unnecessary temporary differences.

Other Taxes – Transfer Duty

24. Transfer Duty: exemption from transfer duty not extended to unbundling transactions. Anomaly between transfer of "property", as defined in section 1 of the Transfer Duty Act, No 40 of 1949, in terms of sections 42, 44, 45 and 47 of the Income Tax Act, and the transfer of "property" in terms of section 46 of the Income Tax Act

24.1. Background

Section 41 to 47 of the Income Tax Act, deals with the re-organisation of business operations and companies where the ownership of the business operations and companies do not change in any material way. The effect of these provisions is that the business operations and companies can be re-organised without any significant tax liabilities arising. These transactions are collectively referred to as the "corporate rules."
Section 9 of the Transfer Duty Act, No 40 of 1949 ("the Transfer Duty Act") contained a number of exemptions from transfer duty where ownership of "property", as defined in section 1 of the Transfer Duty Act, could be transferred from one person to another as a consequence of utilising the corporate rules, except for unbundling transactions entered into in terms of section 46 of the Act.

24.2. The legal nature of the problem

The definition of "property" contained in section 1 of the Transfer Duty Act was amended with effect from 1 September 2009 to include "a share in a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980)". The purpose of this amendment was to bring the transfer of ownership of a share in a share block company into the transfer duty net.

The provisions of section 46 of the Act do not preclude a share block company from entering into an unbundling transaction. Before the amendment to the definition of "property" to include a share in a share block company for transfer duty purposes, the transfer of ownership of a share in a share block company was subject to securities transfer tax ("STT") in terms of the Securities Transfer Tax Act, No 25 of 2007 ("the STT Act"). Section 8(1)(a)(iv) of STT Act provided for the exemption of any STT on the transfer of ownership of a share if the share was transferred in terms of an unbundling transaction referred to in section 46 of the Act.

The inclusion of shares in share block companies in the definition of "property" for transfer duty purposes however now results in transfer duty liability where the ownership of the shares in a share block company is transferred as a consequence of a section 46 of the Act unbundling transaction as the Transfer Duty Act does not provide for the exemption from transfer duty of any "property" disposed of in terms of an unbundling transaction entered into in terms of section 46 of the Act.

We note that before the inclusion of a share in a share block company in the definition of "property" for Transfer Duty Act purpose, the only transfer of ownership of shares which attracted transfer duty was share or member's interest in a company which has a direct or indirect interest in "residential property" as defined in the Transfer Duty Act. There are however a large number of share block companies which hold property that does not comprise "residential property" as defined in the Transfer Duty Act, but property that would generally be referred to as commercial property, for example hotels, business premise etc.

We are of the opinion that this is an unintended consequence of the amendment to the definition of "property" as defined in section 1 of the Transfer Duty Act that the transfer of ownership of a share in a share block company where the property owned by that share block company comprises commercial property should be precluded from enjoying the exemption on transfer of ownership in terms of an unbundling transaction in terms of section 46 of the Act where it enjoyed such an exemption in terms of the STT Act.
24.3. Proposed solution

Section 9(1)(l) of the Transfer Duty Act, which deals with exemptions, must be amended to include the transfer of ownership of a share in a share block company in terms of an unbundling transaction contemplated in section 46 of the Act where the property owned by the share block company does not comprise "residential property" as defined in section 1 of the Transfer Duty Act.

This amendment should be effective from 1 September 2009 and apply in respect of the acquisition of any share in a share block company on or after that date, i.e. the same date the amendment to the definition of "property" became effective.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully

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