30 March 2007

Legal and Policy Division
South African Revenue Service
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BY E-MAIL: policycomments@sars.gov.za

Dear Sirs

CALL FOR COMMENT: CIRCUMSTANCES UNDER WHICH THE DISPOSAL OF LISTED SHARES ARE DEEMED TO BE ON CAPITAL ACCOUNT

The draft interpretation note refers to section 9B of the Income Tax Act No. 58 of 1962 ("the Act") as it currently stands. The Minister of Finance announced in the 2007 Budget speech that the proceeds on the sale of all shares held for more than three years will be treated as capital and thus subject to capital gains tax rather than income tax.

As amendment to section 9B of the Act would be required to change the holding period from five years to three, we are of the opinion that this interpretation note would not reflect the proposed legislation as the proposed changes are to take effect from 1 October 2007. This amendment was also not addressed in the Draft Taxation Laws Amendment Bill, 2007.

Clarity is required as to why a new draft interpretation note is being issued on the old legislation.

The proposal contained in the Budget also does not indicate whether it is restricted only to the disposal of listed shares. This means that it may also, unlike the existing safe haven provision, apply to the disposal of shares in unlisted companies. It is unclear whether the effect of the proposal would be to treat the proceeds, on the disposal of shares held for less than three years, as automatically being revenue irrespective of the specific facts and circumstances of the taxpayer. It is also not clear whether the treatment will be automatic or whether it will require an election as is the case presently and further whether such election is to be made on a case by case basis or would be binding on all qualifying disposals.
1. **Aspects not covered in the interpretation note**

   1.1. Section 9B of the Act does not refer to section 8C(1)(a) of the Act which states “Notwithstanding section 9B…”. In our view, we recommend that a reference to this should be made in the interpretation note as it is an important exception to the rule.

   1.2. Should the Act be amended to change the qualifying period to three years as was proposed in this year’s Budget Speech, we believe that section 8B(1) of the Act should be amended accordingly to reflect three years instead of five years.

2. **Paragraph 4.1 – Affected shares**

   It would be useful if a list of the exchanges defined in section 1 of the Securities Service Act No. 36 of 2004 and licenced in terms of section 10 of the Income Tax Act No. 58 of 1962 (the Act) is given as part of the interpretation note.

3. **Paragraph 4.2 – Disposal of affected shares**

   3.1. Section 9B(1)(b) of the Act is explained in paragraph 4.2 (b) of the draft interpretation note. Consideration should be given to include practical examples in the interpretation note dealing with this provision.

   3.2. Consideration should be given to adding a detailed example to the draft interpretation note, illustrating the capital gains tax effect when a section 9B of the Act election has been made, to assist the taxpayer with such a calculation.

4. **Paragraph 4.3 - Election**

   The paragraph refers to the capital gain consequences, but it is believed that it should do more than that. The statement “…but will trigger capital gains tax…” is not entirely correct. Firstly, we do not have a separate “capital gains tax” and secondly, the capital gain will only be subject to tax if it results in a taxable capital gain and once included in taxable income exceeds the tax threshold. A taxpayer with an assessed loss (exceeding the taxable capital gain) will not have to pay any tax on the resulting gain.

5. **Paragraph 4.5 – Recoupment of expenditure and losses**

   5.1. The third sentence in Example 1 is unclear. It states “In this all deductions …”, we propose that the wording be amended to read: “As a result of this,…”.

   5.2. Clarity is required as the example is unclear in the treatment of the expenses relating to Year 6. As Year 6 is the first year that Z could elect section 9B of the Act, the election would probably only be made on submission of the return and the deductions might well have been allowed in the year of disposal (Year 5, before the decision). The expenses are not of a capital nature, but may be denied under section 23(e) of the Act.
6. **Paragraph 4.7 – Treatment of trading stock**

6.1. The draft interpretation note focuses on taxpayers, who hold shares as trading stock. However, some shareholders, who hold shares on capital account, may wish to utilise the election provided for in section 9B of the Act, in order to obtain certainty regarding the tax treatment of amounts that will be realised on the disposal of the shares. We are concerned that SARS may argue that the mere fact that a taxpayer has elected that any amount that is realised on the disposal of an affected share be deemed to be of a capital nature, is indicative of the fact that the shareholder considers the shares to be held on revenue account.

6.2. The example does not illustrate the section 9B of the Act adjustment adequately. The total add back in terms of section 9B(6) of the Act is R200 000 (the original cost) or the R150 000 plus the R50 000. The inclusion is incorrectly reflected as “taxable income”, when it should refer to “income”. This example could be further extended to explain the capital gain consequence of the taxpayer’s election.

Please do not hesitate to contact me should further information be required.

Yours faithfully

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