REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

INCOME TAX BILL, 1992

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INTRODUCTION

The Bill fixes the rates of normal tax payable by individuals and companies, and introduces amendments to the Income Tax Act, 1962 (Act No. 58 of 1962), hereinafter referred to as the principal Act. The provisions with regard to Mining Taxation are dealt with in a separate explanation at the beginning of this Memorandum.

MINING TAXATION

On 1 January 1992 the new Minerals Act, 1991, came into operation. One of the important objectives of this Act was to consolidate and rationalise most of the various mineral laws into one Act. Due to the fact that the various mineral laws were amended and repealed under the Minerals Act, 1991, it is necessary to make certain consequential amendments to the principal Act.

Clause 2(a): The definition of an "assisted gold mine" was inserted in the principal Act in order to identify those mines which would qualify for the specific lower taxation rate formulae as well as for assistance under the Gold Mines Assistance Act, 1968.

The last-mentioned Act was, however, repealed by the Gold Mines Assistance Repeal Act, 1987. As the special dispensation in respect of mines of this nature has expired, the definition in question is deleted by the amendment introduced by this clause.

Clause 2(b): The amendment introduced by this clause is consequential upon the deletion of section 36(7D) of the principal Act.

Clause 2(c): Presently paragraph *(l*A*)* of the definition of "gross income" in section 1 of the principal Act specifies that amounts payable under section 30(3) of the Mining Rights Act, 1967 (being amounts payable by the State to or in favour of the holder of a right to natural oil), shall be included in gross income. Due to the repeal of the Mining Rights Act, 1967, and since no provision has been made for similar payments under the Minerals Act, 1991, the provisions of paragraph *(l*A*)* are deleted.

Clause 2(g): This amendment is of a textual nature.

Clause 7: This amendment is consequential upon the repeal of the Mining Rights Act, 1967, and by reason of the Minerals Act, 1991, coming into operation. Although existing mining leases will continue to exist for a period of two years from the date of implementation of the Minerals Act, 1991, no provision has been made by the last-mentioned Act for the granting of further mining leases. The last-mentioned Act does, however, provide that a person should be in possession of a mining authorisation, as defined in that Act, before being entitled to mine for or dispose of a mineral in respect of which he is the mineral right holder, or has obtained written

permission from such mineral right holder to mine for and dispose of such mineral for his own account.

Clause 16: This amendment is of a consequential nature. Refer to the explanation in respect of *clause 7* above.

Clause 24: Although this clause makes a number of amendments to the provisions of section 36 of the principal Act, no new principles are introduced and the amendments comprise briefly the following:

(1) The deletion of provisions which have become obsolete; and

(2) the introduction of certain consequential amendments as a result of the repeal of the Mining Rights Act of 1967. In this regard, see also the explanation provided in respect of *clause 7*. Without doubt, the most important consequential amendment resulting from the repeal of the Mining Rights Act, 1967, is the calculation of the unredeemed balance of the capital expenditure of a specific mine in order to calculate the capital allowance in respect of such mine. This method was previously prescribed in section 26(3) and (4) of the Mining Rights Act, 1967. Due to the repeal of that Act, it became necessary to provide for guidelines in respect of the determination of such an unredeemed balance in the principal Act.

Clause 25: This amendment is of a textual nature.

Clause 27(d): This amendment is consequential upon the repeal of the Mining Rights Act, 1967, by the Minerals Act, 1991.

Rates

The lower uniform formula for gold mines is adjusted by paragraph 1(c) of the Schedule to the Bill in order to bring it into line with the rate in respect of companies.

In terms of the proviso to paragraph 1(e) of the abovementioned Schedule, the surcharge in respect of mining companies (other than gold mining companies) is reduced from 6 per cent to 3 per cent.

CLAUSE 1 AND THE SCHEDULE

Rates of normal tax

Rates of normal tax are enacted by clause 1 and the Schedule to the Bill.

Individuals

The rates for persons other than companies apply in respect of the year of assessment ending on 28 February 1993 or 30 June 1993 and are provided for in paragraph 1 of the Schedule.

The rates are as follows:

Married persons: a progressive rate ranging between 17 per cent on the lowest income segment (amounts less than R5 000) and 43 per cent which is reached on the income segment above R80 000.

Unmarried persons: a progressive rate ranging between 17 per cent on the lowest income segment (amounts less than R5 000) and 43 per cent which is reached on the income segment above R56 000.

Married women: a progressive rate ranging between 17 per cent on the lowest income segment (amounts less than R5 000) and 40 per cent which is reached on the income segment above R50 000.

Companies

The rates for companies apply in respect of years of assessment, i.e. the financial year of the company concerned, ending during the 12-month period from 1 April 1992 to 31 March 1993, and are provided for in paragraphs 1(b) to (f) inclusive, of the Schedule.

Those rates are as follows:

(a) Taxable income derived otherwise than from mining: 48 cents per R1 (paragraph 1(b) of the Schedule).

(b) Taxable income derived from gold mining: an amount determined in accordance with the formula provided for in paragraph 1(c) of the Schedule.

(c) Taxable income in the form of "recoupments" of capital expenditure accruing to companies which are or have been gold mining companies: the average rate of tax, determined as provided, or 35 cents per R1, whichever is the higher (paragraph 1(d) of the Schedule).

(d) Taxable income from mining operations (other than mining for gold): 48 cents per R1 (paragraph 1(e) of the Schedule). To the tax calculated above a surcharge equal to 3 per cent of such tax is added (see proviso to subparagraph (e)). A further levy, by way of additional normal tax, is provided for in respect of taxable income from oil mining in terms of section 5(2A) of the principal Act.

(e) Taxable income derived from long-term insurance business: 43 cents per R1 (paragraph 1(f) of the Schedule).

CLAUSE 2

Definitions: Amendment of section 1 of the principal Act

Subclauses (a), (b) and (c): See the separate explanation in respect of MINING TAXATION.

Subclause (d): The amendment introduced in terms of this subclause, amends the definition of "local authority" by deleting certain provisions which have become obsolete, and by including water boards, regional services councils and joint services boards within the ambit of the definition.

Subclause (e): By reason of the fact that Namibia has, since independence, become a sovereign state, it is necessary to effect certain consequential amendments to the principal Act. The amendment introduced by this subclause, as well as various others, give effect thereto.

Subclause (f): The amendment introduced by this subclause is of a textual nature and should be read together with the amendment introduced by *subclause (i)*.

Subclause (g): The amendment is of a textual nature. Also refer to the separate explanation in respect of MINING TAXATION.

Subclause (h): Refer to the explanation in respect of subclause (e) above.

Subclause (i): This amendment is consequential upon the amendment introduced by *subclause (f)*.

CLAUSE 3

Administration: Amendment of section 3 of the principal Act

At present, section 3(2) of the principal Act specifies that the Commissioner may not withdraw or amend a decision made by an officer under his control where a discretionary power has been exercised under the provisions of the principal Act, after the expiration of two years from the date of written notification of such a decision, if all the material facts were known to the said officer.

In accordance with the amendment introduced by this clause, the period is extended from two to three years in order to bring it into line with the limitation of three years placed upon the issuing of additional assessments under the provisions of section 79 of the principal Act.

CLAUSE 4

Rebates: Amendment of section 6 of the principal Act

Subclauses (a), (b) and (c): The primary rebates allowed to taxpayers, are amended as follows:

Married persons: increased from R2 000 tot R2 225

Unmarried persons: increased from R1 625 tot R1 950

Married women: increased from R800 to R900

Subclause (d): The additional rebate in respect of persons over the age of 65 years is increased from R2 100 to R2 500.

CLAUSE 5

Income of spouses: Amendment of section 7 of the principal Act

With the exception of cases contemplated in section 7(2) of the principal Act, the general tax rule now stipulates that each spouse is separately taxable on his or her income. Uncertainty has however arisen about the correct taxation treatment of income (especially passive income such as investment and rental income) in the hands of spouses married in community of property.

By reason of the fact that spouses who are married in community of property each have an undivided half share in the joint estate, the question arose whether the income of such spouses accrues to the joint estate and is therefore taxable in equal shares in the hands of the spouses, or whether such income accrues to each spouse individually and personally for taxation purposes before it forms part of the joint estate. In order to remove any uncertainty in this regard but also, for practical reasons, to simplify the administration of the Act, certain specific provisions have been introduced under this clause in order to regulate the matter.

The effect of these provisions is as follows:

1. The proposed section 7(2A)(a) provides, as a general rule, that income derived from a trade, shall be taxable in full in the hands

of the spouse carrying on such trade. Where the spouses, however, carry on a trade jointly, the income accrues to the spouses in the profit-sharing ratio agreed by them. The anti-avoidance provisions contained in section 7(2)(b) are, however, still applicable to prevent the channelling of excessive remuneration to a spouse. Where no such agreement exists in respect of the joint trade, the income accrues to the spouses in the proportion to which each spouse would reasonably be entitled, having regard to the nature of the trade, the extent of each spouse's participation therein and other relevant factors.

2. The proposed section 7(2A)(b) provides that rental income derived from the letting of fixed property and also all income derived otherwise than from a trade, shall be taxable in equal shares in the hands of the spouses. The effect of this provision is therefore that investment income, such as interest, will be taxable in equal shares in the hands of the spouses. The relevant section also governs situations where a donor or a testator donates or bequeaths an asset to a spouse on condition that such asset shall not form part of the joint estate. If the donor or testator furthermore provides that the fruits (income) produced by the asset shall also not form part of the joint estate, the income will be taxed in the hands of the spouse who is the owner of the asset. Where the donor or testator did not stipulate to whom the income should accrue, it will accrue to the joint estate and be taxed in equal shares in the hands of the spouses.

3. The proposed section 7(2B) provides that where any income is taxed in the hands of a spouse, any deduction or allowance relating to that income will be allowed to the spouse. The normal rules will, however, continue to apply in respect of expenditure which is deductible for tax purposes but does not specifically relate to any particular income. In the case of medical expenses, for instance, the expenditure will still be deductible in the hands of the spouse who paid the medical expenses, notwithstanding the fact that the expenditure was discharged from funds belonging to the joint estate.

   Likewise, in the case of contributions to a pension fund or retirement annuity fund, the contributions are deductible in the hands of the member of the fund, subject to the transferability of contributions by a woman to her husband in respect of contributions to a retirement annuity fund (see also *clause 11*).

4. The proposed section 7(2C) provides that for the purposes of determining which spouse carried on the trade:

   4.1 any benefits payable by a pension fund, provident fund, benefit fund or a retirement annuity fund are deemed to be income derived from a trade in the hands of the spouse who is a member or past member of the fund;

   4.2 annuity amounts as defined in section 10A of the principal Act, are deemed to be income derived from a trade in the hands of the spouse to whom the annuity amount is payable (although these annuities should more correctly be treated as investment income, they are treated in this manner because employees tax is deducted and an employees tax certificate is issued in the name of the annuitant);

   4.3 any income derived from the grant of the right of use of a patent, design or trademark, shall be deemed to be income

derived from a trade in the hands of the spouse who is the registered holder of that patent, design or trademark;

4.4 any income derived from the grant of the right of use of a copyright, shall be deemed to be income derived from a trade in the hands of the spouse who is the author of the work which is the subject of the copyright, or the owner of such a copyright by reason of assignment, testamentary disposition or operation of law, whichever the case may be; and

4.5 any income derived from the grant of the right of use of any other property similar to a patent, design, trademark or copyright, shall be deemed to be income in the hands of the spouse who is the holder of such other property.

5. The implementation provisions provide that to the extent that such income was derived from a trade, the provisions shall be applicable from the commencement of years of assessment ended or ending on or after 28 February 1991. In so far as it relates to rental from a fixed property, in cases where the rental was taxed in only one of the spouse's hands, the spouses shall be allowed to apply in writing until not later than 31 December 1992, for an apportionment of the rental income for tax purposes. It is important to note that written applications of this nature should be signed by both spouses.

   To the extent that such income was derived otherwise than from a trade, the provisions shall be applicable as from the commencement of years of assessment ended or ending on or after 29 February 1992.

CLAUSE 6

Recoupments: Amendment of section 8 of the principal Act

Subclauses (a) and (b): Removal of certain discretionary powers of the Commissioner.

Subclause (c): The amendment introduced in terms of this clause deletes the provisions of section 8(2) and (3) as these provisions have become obsolete.

Subclause (d): The amendment introduced by this clause should be read with the amendment introduced by *clause 15*. At present section 8(4)(g) of the principal Act provides that recoupments of allowances made under the principal Act in respect of any aircraft which is replaced by a further aircraft, will under certain circumstances not be taxed. Such recoupments are, however, to be deducted from the cost of the further aircraft for the purpose of calculating the allowances under section 14*bis* of the principal Act in respect of such further aircraft.

The effect of this amendment is that such recoupments may not in future be deducted from the cost of the further aircraft, where the amount is recouped as a result of a loss, sale or disposal of an aircraft which takes place on or after 1 August 1992.

CLAUSE 7

Amounts deemed to have accrued from sources within the Republic: Amendment of section 9 of the principal Act

Refer to separate explanation on MINING TAXATION.

CLAUSE 8

Investment income of foreign investment companies: Amendment of section 9A of the principal Act

Subclause (1)(a): The amendment is of a consequential nature and is retroactive as from 16 March 1988, which is the date on which non-residents tax on interest was abolished.

Subclause (1)(b): Removal of a discretionary power of the Commissioner.

CLAUSE 9

Distinction between capital and income: Amendment of section 9B of the principal Act

At present section 9B of the principal Act provides that an amount received by or accrued to or in favour of a taxpayer as a result of the disposal of a listed share which was held by him for at least 10 years, is deemed to be of a capital nature and thus not subject to taxation if the taxpayer elects that the provisions of the relevant section should apply to him.

The effect of the amendments introduced by this clause is that:

(1) the period of continuous ownership is reduced from 10 years to 5 years;

(2) where the taxpayer is a registered insurer, and has acquired a share in accordance with the transfer of insurance business as contemplated in section 25A of the Insurance Act, 1943, from another insurer who carried on long-term and short-term insurance business, then both such insurers will be deemed to be one and the same insurer. The effect of this amendment is that the duration of ownership of such a share in the name of both insurers is regarded cumulatively, for the purposes and application of section 9B;

(3) as a result of the reduction in the period of ownership referred to in (1) above, a taxpayer is afforded the opportunity to revoke an election already exercised in respect of an affected share which was disposed of by him before 18 March 1992, and to exercise a new election in respect of the first affected share disposed of by him on or after that date.

In so far as (1) and (3) above are concerned, the proposed provisions come into operation on or after 18 March 1992 and shall apply in respect of an affected share disposed of on or after that date.

Regarding (2) above, the proposed provisions come into operation on 14 March 1990 and shall apply in respect of any affected share disposed of on or after that date.

CLAUSE 10

Exemptions: Amendment of section 10 of the principal Act

Subclause (1)(a) and (b): These amendments are of a consequential nature and are necessitated as a result of Namibia's independence.

Subclause (1)(c): Removal of the Commissioner's discretionary power.

Subclause (1)(d): The effect of the amendment introduced by this subclause is to extend the scope of the provisions of section 10(1)(cB) so as to allow a trust to enjoy the exemption granted under the provisions of that section, if such trust complies with all the requirements of the section.

Subclause (1)(e): Removal of the Commissioner's discretionary powers.

Subclause (1)(f): The effect of the amendment introduced by this subclause is to extend the scope of the provisions of section 10(1)(cF) so as to allow a trust to enjoy the exemption granted under the provisions of that section, if such trust complies with all the requirements of the section.

Subclause (1)(g) and (h): Removal of the Commissioner's discretionary powers.

Subclause (1)(i): Section 10(1)(cG) of the principal Act grants an exemption to foreign ship operators if their country of residence grants similar relief to South African ship operators. This provision is intended to cover the situation where there is no double taxation agreement between the two countries.

The amendment introduced by this subclause extends the scope of the provisions of section 10(1)(cG) to allow similar treatment to owners or charterers of aircraft. The operation of the amendment is retrospective from 1 November 1991.

Subclause (1)(j): The amendment introduced by this subclause is of a textual nature.

Subclause (1)(k): At present section 10(1)(cC) of the principal Act exempts the income of a housing utility company from taxation under the circumstances contemplated by that section. Bodies of this nature are, however, only exempt where the principal object of such a company is to build new dwelling houses or to purchase newly built dwelling houses for occupation by employees of an employer or by members of the general public.

Under this subclause two additional paragraphs are inserted in section 10(1) of the principal Act to exempt from tax certain bodies which have been incorporated or are to be incorporated in order to address the housing shortage amongst low-income communities.

The new paragraph (cI) which is introduced by this clause deals mainly with housing utility associations. Despite there being similarities between the contents of paragraph (cI) and the existing paragraph (cC), there are also differences. In one respect the extent of the new paragraph (cI) is much wider because the activities it allows are not limited to the erection of new dwelling houses, but also include the development and improvement of land. On the other hand the provisions are restrictive in the sense that they are specifically applicable to persons of low-income communities. According to the introduction of paragraph (cI), the persons who may qualify for the exemption are section 21 companies, trusts or associations of persons, as approved by the Commissioner.

In subparagraph (i) the sole objects of such a company, trust or association (hereinafter referred to as a housing utility association) are defined, the most important of which is contained in item (aa), namely to acquire, hold, develop or improve land in order to enable members of

certain communities to acquire and occupy land. For the purposes of the paragraph in question, such a community is defined as a community of which all the members, or the majority of them, are persons who earn less than R1 000 per month.

Items (bb) and (cc) of subparagraph (i) also allow the housing utility association which is involved in the provision of land or accommodation to become involved in supplementary projects which are aimed at assisting the members of such a community by:

(1) the making of grants or the furnishing of material, labour or advice; and

(2) the provision of necessary community facilities and the establishment and carrying on of necessary community programmes aimed at the furtherance of community life, job creation and the health and welfare of members of such a community.

Item (dd) of subparagraph (i) provides for those situations where a separate company in a housing utility group is responsible for the financial administration of the group or for the rendering of financial, administrative, managerial, landholding or other assistance or services to such group. The carrying on of such additional activities is, however, limited to the holding company or a subsidiary company or a fellow subsidiary company of the company which actually provides the housing.

Subparagraphs (ii) to (vii) contain provisions aimed at the prevention of the abuse of the tax exemption in question by providing that:

(1) the sole object or objects of the housing utility association should be actively pursued;

(2) the housing utility association may not knowingly become or allow to become a party to any transaction, operation or scheme of which the sole or main purpose is the reduction, postponement or avoidance of taxation;

(3) the housing utility association does not carry on any business other than business which is directly connected with its objects;

(4) the housing utility association be controlled by persons some of whom are independent of the housing utility association, whilst the possibility of community involvement is not excluded. As a further control measure, at least one of the directors, trustees or members of the housing utility association has to be a person nominated by the Minister responsible for housing affairs;

(5) the housing utility association will upon its deregistration, winding-up or liquidation be obliged to give transfer of its surplus assets to a similar body which is also exempt from taxation under paragraph (cI); and

(6) the housing utility association may not distribute any of its profits to any person and is required to utilise its funds solely for the objects for which it has been established or for investment in instruments and institutions as prescribed.

One of the major stumbling blocks in the provision of housing for the low-income communities seen in the context of an increasing urban population, is the fact that conventional home loan finance is not

readily available to members of such communities. In order to address this problem, various special home loan finance bodies which have available the required skills, have come to the fore and are willing to run the risk of providing home loan finance to such communities on a non-profit basis.

The effect of the insertion of paragraph (cJ) in the principal Act, is to exempt from tax such bodies which include a company, trust or other association of persons.

Subparagraph (i)(aa) of the new paragraph (cJ) determines the sole or principal object of such a body. In the first instance it allows such a body to raise funds by way of:

(1) donations;

(2) loans from exempt persons, any government, any external company and any public company;

(3) the issue of commercial paper or debentures to financial institutions; or

(4) deposits from persons from communities as contemplated in the proposed paragraph (cI)(i)(aa) as a pre-condition for or for securing the grant of a loan to such a person.

Subparagraph (i)(bb) to (ee) on the other hand prescribes the objects for which the funds raised should be applied, namely:

(1) to lend or grant money to any housing utility association contemplated in paragraph (cC) or (cI) — (item (bb));

(2) to lend money directly to or provide other financial assistance to the members of communities as contemplated in the proposed paragraph (cI)(i)(aa) — (item (cc));

(3) item (dd) enables the provision of funds to banks or other financial institutions on condition that those institutions make the monies available to members of the communities as contemplated in the proposed paragraph (cI)(i)(aa) by way of loans;

(4) item (ee) deals with financing agencies, for example the Home Loan Guarantee Company (an association incorporated under section 21 of the Companies Act, 1973) which provides guarantees to a consortium of short-term insurers in order to enable such insurers to provide loan guarantee policies to conventional home loan institutions, which policies provide cover against possible losses in respect of home loans provided by the last-mentioned institutions to members of the low-income communities.

Subparagraphs (ii) to (vii) likewise contain provisions aimed at prevention of the abuse of the tax exemption by providing that:

(1) the special home loan finance body shall actively pursue its sole or principal object;

(2) the special home loan finance body shall not carry on any business other than business which is directly related to its objects;

(3) the body is required to utilise its funds solely for the objects for which it has been established or for investment in instruments or institutions as prescribed;

(4) the body is not permitted to distribute any of its profits to any person, unless such a person is exempt from tax under paragraph (cC) or (f) or the proposed paragraphs (cI) and (cJ);

(5) the body will upon its deregistration, liquidation or winding-up be obliged to give or transfer its surplus assets to a similar body which is exempt from tax under paragraph (cC) or (f) or the proposed paragraphs (cI) and (cJ);

(6) 25 per cent of the persons controlling the body are independent persons. As a further control measure at least one of the directors, trustees or members of the body, as the case may be, is a person nominated by the Minister responsible for housing affairs.

The exemptions are effective as from the commencement of years of assessment ended or ending on or after 28 February 1991.

Subclause (1)(l) and (m): Removal of the Commissioner's discretionary power.

Subclause (1)(n): This subclause introduces a new paragraph (hA) into section 10(1) of the principal Act, which grants exemption from tax on any interest accruing to individuals who are not ordinarily resident in the Republic, and to companies which are neither managed nor controlled in the Republic. In the case of emigrants, the exemption is subject to the further condition that they also do not carry on business in the Republic.

The expression "Republic", as used for the purposes of this exemption, includes neighbouring countries within the common monetary area.

In terms of *subclause (2)(c)*, the exemption applies to interest accruing on or after 3 June 1992.

Subclause (1)(o): Removal of the Commissioner's discretionary power.

Subclause (1)(p): This subclause introduces an exemption in respect of a *bona fide* bursary or scholarship which is granted to a person to enable or assist him to study at a recognised educational or research institution. The proviso to the new paragraph (p) however limits the exemption as follows:

(1) Where the bursary is granted to an employee due to services rendered *and* the grant is linked to a reduction or forfeiture of any remuneration to which the employee is entitled or may become entitled, the exemption will not apply. Any *bona fide* bursary which is granted to an employee where there is no associated reduction or forfeiture in remuneration, will therefore not be taxable.

(2) Where a bursary or scholarship is granted to a relative (for example a child) of the employee, the exemption will not apply if the bursary has been granted as a result of the employee's services and the employee's annual remuneration exceeds R36 000. In addition, the exemption is limited to the first R1 200 of the bursary. It remains a requirement that there may be no associated reduction or forfeiture of the employee's remuneration.

Subclause (1)(q): Removal of the Commissioner's discretionary power.

Subclause (1)(r): In accordance with the exemption introduced by this subclause, two further bodies are exempt from tax in terms of section 10(1)(t) of the principal Act, of which the first is the South

African Bibliographic and Information Network (SABINET), a company registered under section 21 of the Companies Act, 1973, as an association incorporated not for gain and which is at present mainly dependent on State subsidies. The association came into being as a result of a necessity by specialised libraries to have a central information point where it could be ascertained what specialised information is available at which library in the country and to make such documented information more accessible. The principal object of SABINET is also described as the promotion of the bibliographic and information network of Southern Africa.

The second body which is exempt is Gezicor (Proprietary) Limited (GEZICOR). GEZICOR was formed with the purpose of providing electricity as cheaply and economically as possible to the inhabitants of Gazankulu. ESKOM holds 50 per cent of the shares in the company while the Gazankulu Government (as nominee for the Gazankulu Electricity Trust) holds the balance of the shares.

Subclause (1)(s): Paragraphs *(v)* and (*v*A) of section 10 were introduced in order to grant exemptions in respect of interest, on loans to or deposits in a South African building society through a local branch or agency, to persons resident in the territory (paragraph *(v)*) and outside the Republic and territory (paragraph (*v*A)).

At the time these paragraphs were introduced, section 9(2) deemed any interest received by or accrued to any person from a South African building society to be income from a South African source. In the meantime this section was amended so as to apply only to South African residents and therefore made the existence of section 10(1)*(v)* and (*v*A) superfluous.

These paragraphs are therefore deleted.

Subclause (1)(t): The amendments introduced by this subclause remove certain discretionary powers held by the Commissioner and bring about certain textual amendments to section 10(1)(w) of the principal Act.

Subclause (1)(u): This amendment is of a textual nature.

Subclause (1)(v): In terms of the amendment introduced by this subclause, the allowances and incentives which are payable in accordance with the Regional Industrial Development Programme (RIDP) and which came into operation on 1 May 1991, are exempt from tax.

CLAUSE 11

Deductions: Amendment of section 11 of the principal Act

Section 11(n) of the principal Act permits the deduction of contributions to retirement annuity funds by a *taxpayer*. Up to the 1991 tax year, a husband was still a taxpayer in respect of certain income of his wife, and it followed that he could deduct contributions made to such a fund by his wife. With effect from the 1992 tax year, however, each spouse is a separate taxpayer and may therefore claim only his or her own contributions.

Following representations made by the insurance industry, it has been decided to propose, as is done by this clause, that where a wife became a member of a retirement annuity fund before 1 March 1992, her husband will be permitted to claim a deduction of her contributions until the 1997 year of assessment.

CLAUSES 12, 13 AND 14

Allowances to manufacturers and industrialists in economic development areas: Repeal of sections 11ter, 11quat and 11quin of the principal Act

As the application of sections 11*ter*, 11*quat* and 11*quin* have become redundant, they are being repealed in terms of clauses 12, 13 and 14.

CLAUSE 15

Deductions in respect of aircraft: Amendment of section 14bis of the principal Act

Section 14*bis* of the principal Act provides for an allowance equal to 40 per cent of the adjustable cost of an aircraft under the conditions prescribed in that section in the year of assessment during which the contract for the acquisition of the aircraft was concluded.

The amendments introduced by this clause are directed mainly at changing the qualifying date in respect of the allowance from the year of assessment during which the contract was concluded to the year of assessment during which the aircraft is brought into use. The amendment comes into operation in respect of contracts which are concluded on or after 1 August 1992.

Although, as explained in relation to *clause 6(d)*, recoupments in respect of aircraft which are disposed of after 1 August 1992 may no longer be carried forward for offset against the cost of replacement aircraft, provision must still be made for recoupments which took place before that date. For this reason, the allowance to be granted in respect of aircraft acquired after 1 August remains based on the "adjustable cost", i.e. the actual cost after deduction of recoupments on previous aircraft.

As far as the determination of the cost of an aircraft is concerned, two anti-avoidance measures have been introduced.

Subsection (4) provides that the cost may not exceed the cash cost which would have been payable under a sale at arm's length. This measure is intended primarily to prevent the capitalisation of finance charges into the cost.

Subsection (5) is intended to prevent the movement of an aircraft within a group of companies at an inflated price so as to enjoy a further write-off. It provides that where an aircraft is disposed of between connected persons, the write-off to the new owner will be restricted to the lesser of the cost to the previous owner or the market value at the time of the disposal.

CLAUSE 16

Deductions from income derived from mining: Amendment of section 15 of the principal Act

The amendment introduced by this clause removes a discretionary power of the Commissioner and brings about a consequential amendment as a result of the Minerals Act, 1991, coming into operation.

CLAUSE 17

Expenditure incurred by a lessor of land let for farming purposes, in respect of soil erosion works: Amendment of section 17A of the principal Act

This amendment is of a textual nature.

CLAUSE 18

Deduction in respect of medical expenses: Amendment of section 18 of the principal Act

Section 18 of the principal Act at present provides that a taxpayer may claim a deduction in respect of expenditure which he necessarily incurred and paid in consequence of any physical disability suffered by him, his spouse, his child or stepchild in respect of which he is entitled to a rebate.

The deduction is however, in the case of persons under the age of 65 years, limited to so much of the expenditure as exceeds the greater of R1 000 or 5 per cent of the taxpayer's taxable income. In addition, the exemption that physically disabled persons enjoyed under section 6(1)(wA) of the Sales Tax Act, 1978, in respect of goods or services relating to aids or devices used by them as a result of their disability, has fallen away with the conversion to a value-added tax system.

The proposed provisions introduced by this clause thus have the effect of easing the above-mentioned limitations imposed on the deduction a handicapped person, as defined, may make. Such a handicapped person who is under the age of 65 years, will in future be entitled to a deduction equal to so much of the sum of all expenditure incurred by him under section 18(1)(a), (b), (c) and (d) as exceeds R500.

Under the proposed section 18(3) of the principal Act, a definition of a handicapped person has been introduced which includes a blind person, a deaf person, a person who as a result of a permanent disability requires a wheelchair, calliper or crutch in order to move from one place to another and a person who requires an artificial limb.

CLAUSE 19

Sponsorship allowance: Amendment of section 18B of the principal Act

The amendment introduced by this clause gives effect to the joint statement on 14 February 1992 by the Ministers of Finance and of National Education and Environment Affairs that the sponsorship allowance under section 18B of the principal Act was to be discontinued. The allowance will be available only to the sponsors of events which had by that date already been approved by the Minister of Finance.

CLAUSE 20

Deductions not allowed in the determination of taxable income: Amendment of section 23 of the principal Act

Subclause (a): At present section 23(d) of the principal Act prohibits the deduction of any tax imposed on income and any interest in terms of section 89, 89*bis* and 89*quat* of that Act, which is payable on such tax.

In terms of the amendment introduced by this subclause, the scope of the provisions is extended to prohibit the deduction of any—

(1) tax, duty, levy, interest or penalty imposed in terms of the principal Act;

(2) additional tax which is imposed in terms of section 60 of the Value-Added Tax Act, 1991; and

(3) interest or penalties payable in respect of the late payment of any tax, duty or levy imposed in terms of any Act which is administered by the Commissioner, the Regional Services Councils Act, 1985, and the KwaZulu and Natal Joint Services Act, 1990.

Subclause (b): Section 23(g) of the principal Act prohibits the deduction of any amount of expenditure which was not wholly and exclusively laid out for the purposes of trade. Nevertheless, it has been the long-standing practice of Inland Revenue, which has in the past been accepted by the courts, to allow an apportionment of expenditure which is incurred partly for purposes of trade and partly for purposes other than trade.

The Appellate Division of the Supreme Court has, however, recently held that the provisions of section 23(g) must be strictly applied, and no deduction may be granted where expenditure is incurred for a dual purpose. The amendment introduced by this subclause is intended to restore the previous practice of allowing an apportionment of such expenditure.

Subclause (c): The amendment introduced in terms of this subclause should be read together with the amendment introduced in terms of *clause 10(1)(p)*. This amendment is introduced as an anti-avoidance measure and has the effect that if a bursary or scholarship is granted by an employer or an associated institution, to an employee of such employer, or to a relative of such employee, and in consequence of the grant of such bursary or scholarship the remuneration to which the employee was entitled or might in the future have become entitled was in any manner whatsoever reduced or forfeited, a deduction in respect of the cost to such employer or his associated institution in respect of the grant of such a bursary or scholarship, is prohibited.

CLAUSE 21

Reduction of cost of certain assets: Amendment of section 23C of the principal Act

At present section 23C of the principal Act provides that where, for the purposes of the application of the principal Act, the cost of acquisition of an asset or the cost of services rendered to a taxpayer is to be taken into consideration and value-added tax (VAT) was imposed in respect of the supply to or the importation by the taxpayer of such asset or service and he is entitled to input tax in respect of such VAT, the VAT shall be excluded from the cost of the asset or the amount of the expenditure. Situations may however arise where no VAT was for example levied on the acquisition of an asset, but the taxpayer acquiring the asset may still be entitled to a notional input tax.

The amendment introduced by this clause rectifies the deficiency that exists and now provides that where the taxpayer is a vendor as defined in the Value-Added Tax Act, 1991, and he is entitled to an input tax, then the amount of the input tax shall be excluded from the cost of the asset or the amount of the expenditure.

In terms of the proviso which has been added to the section, where an input tax credit is allowable in respect of a lease, each lease payment must be reduced by a proportionate share of the input tax. Thus, if the lease provides for, say, 12 equal monthly payments, each payment will be reduced by one-twelfth of the input tax.

CLAUSE 22

Income of beneficiaries and trusts: Amendment of section 25B of the principal Act

This amendment is of a textual nature and must be read with the amendment introduced by *clauses 2(f)* and *(i)*.

CLAUSE 23

Determination of taxable income of co-operative societies and companies: Amendment of section 27 of the principal Act

The amendment introduced by this clause is of a consequential nature by reason of the repeal of sections 11*ter*, 11*quat* and 11*quin* of the principal Act.

CLAUSE 24

Deduction of capital expenditure of mines: Amendment of section 36 of the principal Act

See separate explanation on MINING TAXATION.

CLAUSE 25

Calculation of capital expenditure on change of ownership of mining property: Amendment of section 37 of the principal Act

The amendment introduced by this clause is of a textual nature.

CLAUSE 26

Beneficiation processes: Amendment of section 37E of the principal Act

Section 37E was introduced into the principal Act last year to provide for an accelerated write-off of certain buildings, plant and machinery and pre-production interest associated with beneficiation processes carried on for export purposes. At the time of the introduction of the legislation, certain matters relating to the implementation of this concession had not been finally decided, and a committee (to be appointed by the Ministers of Finance and of Trade and Industry) was vested with various discretionary powers as to how the provision would apply. The outstanding matters have since been resolved, and the section has been re-drafted to give effect to the latest decisions. In the process, several of the committee's discretionary powers have been removed.

Subclause (1)(a) amends the definition of a "beneficiation process" in certain material respects.

Firstly, whereas a locally mined base mineral or locally produced intermediate product had to be used in the process as input, any raw material or intermediate product may now be used, whether locally produced or imported.

Secondly, whereas the process previously had to result in a "substantial" addition of value, it is now specified that at least 35 per cent must be added to the value of the raw material or intermediate product input. In

terms of a formula introduced into the definition, the value added is to be calculated by expressing the ex-factory selling price of the output, after deduction of the cost of input raw materials and intermediate products and electricity consumed in the process, as a percentage of the ex-factory selling price. Electricity is excluded from the value added calculation because it is regarded for this purpose as an already beneficiated product.

Thirdly, the committee's discretion to approve a process even though the general requirement would not be met that at least 60 per cent by value of the output product would be exported, has been removed. The committee will henceforth have to be satisfied in every case that a minimum of 60 per cent by value will be exported.

Finally, it is now provided that where the taxpayer intends importing capital goods to be used in the process, he must make use of such foreign term credits as may be available to him for the purpose of financing the acquisition.

Subclause (1)(b) corrects a provision which erroneously linked the section to the commencement date of the Value-Added Tax Act. The commencement date is now specified as 12 September 1991, being the date upon which the State President actually implemented the original provision.

Subclause (1)(c) effects a technical adjustment to the definition of "intermediate product", so as to make it appropriate where an intermediate product constitutes either the taxpayer's input or his output. The previous definition applied only to an intermediate product which constituted the taxpayer's output.

Subclause (1)(e) lays down certain guidelines to be considered by the committee, namely—

(a) the encouragement of downstream industries,

(b) the cost of the concession to the State,

(c) the preference to be granted to local products and skills, and

(d) the effect on smaller local enterprises.

No minimum standards or levels are prescribed: the committee is merely required to have regard to these factors in its overall evaluation of the proposed process.

Subclause (1)(f) deletes the discretion previously given to the committee to permit a write-off of more than the actual cost of plant and machinery to be acquired (i.e. a form of investment allowance), or to permit the write-off over a shorter period.

Subclause (1)(g): Subsection (5) of section 37E provides that where the committee has, in terms of its discretion discussed in relation to subclause (f) above, granted an investment allowance, and the taxpayer subsequently recoups a portion of the write-off allowed, he is deemed also to have recouped a proportionate share of the investment allowance. In view of the removal of that discretion, and the fact that the committee has in no case granted an investment allowance, this provision is deleted.

Subclause (2) makes the amendments applicable as from 18 March 1992, the date upon which the Minister of Finance announced the proposed changes in his Budget Speech.

CLAUSE 27

Non-resident shareholders tax: Amendment of section 42 of the principal Act

Subclause (a): Non-resident shareholders tax (NRST) is, as the name implies, intended to be imposed on dividends paid to shareholders who are not residents of the Republic. In the case of companies, the tax is imposed under section 42(1)(iii) of the principal Act if the shareholder is not a "South African company", which expression is defined to mean a company established under South African law.

South Africa has concluded double taxation agreements with several other countries. It is a standard provision of such agreements that a State may not impose any tax in such a way that it has a more burdensome effect on nationals of the other State than it has on its own nationals. What this means is that tax may be imposed with reference to the place of residence of the recipient of income, but not with reference to his nationality.

In a recent case brought by the foreign parent company of a South African subsidiary, the court held that by imposing NRST on a company registered under foreign law, South Africa had in fact contravened the non-discrimination clause of the agreement. To rectify the position, this subclause proposes an amendment in terms of which NRST will be imposed by reference to the place of management of a shareholder company, rather than by reference to the place of incorporation.

Subclause (b): This amendment is consequential upon the independence of Namibia.

Subclause (c): This amendment is consequential upon the amendment introduced by *subclause (a)*.

Subclause (d): See separate explanation on MINING TAXATION.

Subclause (e): Removal of a discretionary power of the Commissioner.

Subclauses (f) and (g): These amendments are consequential upon the amendment introduced by *subclause (a)*.

CLAUSE 28

Donations tax: Amendment of section 56 of the principal Act

This clause amends section 56(1)(h) of the principal Act so as to grant an exemption from donations tax in respect of donations made by, or to, a body which is exempt from income tax under section 10(1)(cI) or (cJ) of the Act. The latter exemptions were introduced by *clause 10(1)(k)* of the Bill, and are dealt with in the explanation of that clause.

CLAUSE 29

Levy on financial services: Substitution of section 64A of the principal Act

Section 64A was inserted into the principal Act last year to impose a levy on the interest income of persons rendering financial services which were exempt from value-added tax. Pending further discussions with interested parties, certain detail matters were left to be determined by the Minister of Finance by notice in the *Gazette*, which was done on 15 October 1991.

The section is now substituted in its entirety in accordance with final

decisions taken, and the notice in the *Gazette* is at the same time withdrawn (by *clause 38*).

As now drafted, the section identifies two distinct categories of institution liable for the levy.

Persons in the first such category, comprising deposit-taking institutions and mutual building societies, are liable for the levy on what is defined in subsection (1) as their "leviable amount". This expression in effect means 50 per cent of the minimum amount of capital and/or reserves required to be maintained by the institution in terms of its relevant controlling legislation, as determined on a quarterly basis.

The second category, listed in subsection (3), comprises duly registered long-term assurers, pension funds, friendly societies and unit trust schemes. These institutions are liable for the levy, on a quarterly basis, on interest accrued. The accrual of interest is determined in accordance with generally accepted accounting practice.

"Interest" is defined in subsection (1) to include all forms of interest and finance charges, commissions or fees received in respect of guarantees, acceptances or endorsements of financial instruments, and profits (less losses) derived from futures, options and trading in financial assets.

"Financial assets" are defined to include marketable securities, bills of exchange and other interest-bearing instruments, as well any other instruments of a type ordinarily traded by financial institutions. Excluded from the definition, however, are shares and units in a unit trust.

An exemption is provided in subsection (4) in respect of—

(1) certain funds which are at present obliged to invest their funds almost exclusively in interest-bearing instruments, and whose liability for the levy would accordingly be unacceptably high;

(2) small pension funds or friendly societies whose quarterly interest income does not exceed R125 000; and

(3) interest derived by pension funds from certain other institutions which are themselves liable for the levy, so as to prevent a double imposition of the levy.

Subsection (5) provides that the levy is to be paid within 21 days after the end of each calendar quarter, while subsection (6) imposes interest on late payments.

CLAUSE 30

Penalty on default: Amendment of section 75 of the principal Act

At present section 75(1)(f) provides that a taxpayer shall retain all records relating to his trade and in which details were recorded from which his returns for assessment were prepared, for a period of five years from the date of the last entry therein. In terms of the amendment introduced by this clause the period of five years now only commences from the date on which the return, relevant to the last entry in the record, was received.

CLAUSE 31

Prevention of or relief from double taxation in the Republic and South West Africa: Repeal of section 109 of the principal Act

By reason of the independence of Namibia this provision became redundant and is hereby repealed. Any further agreement with Namibia would be negotiated in terms of section 108 of the principal Act.

CLAUSE 32

Lump sum benefits: Amendment of paragraph 6 of the Second Schedule to the principal Act

Withdrawal benefits from pension, provident and retirement annuity funds are, as a general rule, taxable. However, paragraph 6 of the Second Schedule in effect exempts from tax certain withdrawal benefits which are transferred into new funds. In the case of retirement annuity funds, a benefit may be transferred tax-free into another retirement annuity fund only if the benefit arises on the winding up of the first fund. This clause inserts a new subparagraph (cA) into the said paragraph 6, to enable any withdrawal benefit from a retirement annuity fund to be transferred free of tax into another such fund.

CLAUSE 33

Definitions: Amendment of paragraph 1 of the Fourth Schedule to the principal Act

Subclause (a) amends the definition of "remuneration" so as to exclude advances paid to directors of companies, while *subclause (c)* excludes from the definition remuneration paid to directors of private companies, unless the Commissioner in any case otherwise directs.

Subclause (b): Paragraph (c) of the definition of "remuneration" includes (and thus makes subject to the deduction of PAYE) 25 per cent of a travel allowance, but not a travel allowance referred to in section 8(1)(b)(iii) of the principal Act. The latter allowance is one which is based on the actual distance travelled by the recipient, is paid at not more than a rate determined by the Minister of Finance, and is also paid in respect of a maximum distance of 6 000 kilometres. The effect of the amendment introduced by this subclause is that a travel allowance will be exempt from the deduction of PAYE if it is based on actual distance travelled and does not exceed the appropriate rate per kilometre, but irrespective of the number of kilometres in respect of which it is paid.

CLAUSE 34

Standard Income Tax on Employees (SITE): Amendment of paragraph 11B of the Fourth Schedule to the principal Act

Under the SITE system, a taxpayer whose taxable income consists only of one or more sources of net remuneration which are subject only to SITE (i.e. none of them is payable at a rate exceeding R50 000 per annum), is subject to tax only to the extent of the SITE deducted from each such source. He is not subject to assessment on his combined income.

Taxpayers have sought to exploit this concession by arranging for their retirement benefits from a single retirement annuity fund to be used to purchase several smaller annuities with different assurers, thereby gaining the benefit of an artificially low overall rate of tax. As the law stands at present, the fund of which the taxpayer was a member is in such cases required to aggregate the annuities for purposes of a single SITE calculation. It has become clear, however, that the funds are unable to meet this requirement.

In the circumstances, it has become necessary to propose in terms of this clause that annuities payable by retirement annuity funds be excluded from the SITE system. Such annuities will, with effect from 1 March 1993, be subject to the deduction of PAYE only, and the recipient will be required to submit a return of income for assessment.

CLAUSE 35

Fringe benefits: Amendment of paragraph 1 of the Seventh Schedule to the principal Act

An interest-free or low-interest loan granted by an employer to an employee gives rise to a taxable benefit in the hands of the employee. The benefit is determined as the difference between interest calculated on the loan at the "official rate of interest", and the interest actually payable by the employee.

The amendment introduced by this clause reduces the official rate of interest from 19 per cent per annum to 17 per cent per annum, with effect from 1 August 1992.

CLAUSE 36

Fringe benefits: Amendment of paragraph 7 of the Seventh Schedule to the principal Act

The taxable value of the private use of a company car is calculated at 1,2 per cent per month of the "determined value" of the vehicle. The definition of "determined value" in paragraph 7(1) of the Seventh Schedule lays down various rules for fixing this value, depending on the manner in which the employer acquired the car. The amendment introduced by this clause provides that where the employer holds the car under a lease as contemplated in the definition of an "instalment credit agreement" as defined in the Value-Added Tax Act, the determined value will be the cash value envisaged in the latter definition, but excluding value-added tax.

CLAUSE 37

Fringe benefits: Amendment of paragraph 13 of the Seventh Schedule to the principal Act

Where an employer pays any debt due by his employee, the employee is in terms of paragraph 13 of the Seventh Schedule taxable on the amount so paid.

Many employers are prepared to grant bursaries to students on the condition that the student will, after completion of his studies, work for the employer for an agreed period, failing which the employee becomes liable to repay the bursary. It frequently happens that an employee in these circumstances receives a job offer from another employer before the expiry of this agreed period. The new employer may well agree to pay whatever is then due by the empoyee to his old employer, on condition that the employee undertakes to work for the new employer for an agreed period. This payment gives rise to a taxable fringe benefit in the hands of the employee.

In fact, however, the employee, by binding himself to work for the new employer, derives no benefit from this transaction, other than, perhaps, an increased salary which is in any event fully taxable.

The amendment introduced by this clause exempts from tax in the

hands of the employee a payment made in these circumstances, provided that the employee is contracted to work for the new employer for period at least as long as the unexpired portion of his contract period with the old employer.

CLAUSE 39

Commencement of certain amendments

This clause provides that the amendments introduced by this Bill will apply, except where otherwise stated in the amendment itself, as from the commencement of years of assessment ended or ending on or after 1 January 1993.

CLAUSE 40

This clause provides the short title of the Bill.

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