REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

INCOME TAX BILL, 1994

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INTRODUCTION

The Bill fixes the rates of normal tax payable by individuals and companies (both in the Republic as well as the former Republic of Venda) and introduces amendments to the Income Tax Act, 1962 (Act No. 58 of 1962), hereinafter referred to as the principal Act, as well as an amendment to the Income Tax Act, 1984 of the former Republic of Ciskei. Several substantive provisions relating to the harmonisation of the tax systems of the former Republic of Venda as well as those of the former self-governing territories with the tax system of the Republic, are also provided for. Certain interim measures for the harmonisation of the former Republics of Transkei, Bophuthatswana and Ciskei are also provided for. The provisions with regard to foreign exchange transactions are dealt with in a separate explanation at the beginning of this Memorandum.

FOREIGN EXCHANGE TRANSACTIONS

The provisions of section 24I were introduced into the principal Act during 1993. The object of the provisions was to treat, for tax purposes, all gains made and losses incurred in respect of foreign exchange transactions in a manner which takes into account as far as possible, the principles of fairness, simplicity, economic reality, current tax principles and generally accepted accounting practice.

Clause 18 introduces proposed amendments to such provisions.

Subclause (1)(a): Some taxpayers take out cover by way of a forward exchange contract to serve as a hedge for future obligations in foreign exchange in respect of which the amounts can be determined with certainty. Although agreements from which the obligations stem, have already been entered into, a loan, advance or debt has not yet arisen and the accompanying interest not yet incurred. An undesirable situation therefore arises in respect of such a forward exchange contract in that the prescribed market-related forward rate which is available for the remaining period of such forward exchange contract, must be used for the translation of such forward exchange contract. As a result thereof, an exchange difference arises in respect of the forward exchange contract without a compensating underlying loan, advance or debt in place.

It is proposed that a definition of an "affected forward exchange contract" be introduced into the principal Act in order to create the possibility of utilising the forward rate at the translation date. The proposal is, however, limited to forward exchange contracts which have been entered into to serve as a hedge for liabilities which have not yet arisen at year-end, but for which an agreement has already been entered into in respect of which a liability will arise at a later stage. In addition, the loan, advance or debt must eventually be utilised for purposes contemplated in section 24I(7)(a) of the principal Act. Although interest determined in respect of the loan is regarded as part of the loan in respect of which it is determined, paragraph (b) is inserted for

purposes of clarity. The effect of the proposal will be that no exchange differences will arise at the translation of an affected forward exchange contract.

Subclause (1)(b): It has been maintained that it is not clear in terms of the current legislation whether exchange differences in respect of cash balances in foreign currency (which includes unused travellers' cheques in foreign currency) should be determined. In order to remove any uncertainty in this regard it is proposed that the definition of "exchange item" be extended by including cash balances in foreign currency which is held by a person, or is held by any other person on behalf of such person, in paragraph (b) of that definition.

Subclause (1)(c): If a forward exchange contract complies with the definition of "affected forward exchange contract", as proposed in *subclause (1)(a)*, such forward exchange contract must be translated at the forward rate. The result thereof is that no exchange difference arises at the translation thereof.

Subclause (1)(d): In terms of the proposed amendment the Commissioner is authorised to approve alternative ruling exchange rates for use instead of any one of the rates referred to in the definition of "ruling exchange rate". The amendment accommodates taxpayers who, for accounting purposes, use exchange rates which do not agree fully with the ruling exchange rates as defined in section 24I of the principal Act, but which are based or determined on a basis which is acceptable to the Commissioner. The alternative ruling exchange rates must be exchange rates which are determined and applied in terms of generally accepted accounting practice.

Subclause (1)(e): At the recording of a transaction for accounting purposes, there may be cases where the loan, advance or debt is recorded at the forward rate, but where the accompanying asset, liability, income or expenditure is recorded at the spot rate. This subclause addresses the treatment of a premium or discount in such situations and requires that it is to be spread on a day-to-day basis over the period of the forward exchange contract and is to be included in or deducted from a taxpayer's income on such a basis.

The amendment to section 24I(5) was necessitated as a result of the amendment to the definition of ruling exchange rate in subsection (1). The alternative rate approved by the Commissioner may be used instead of the spot rate on transaction date, spot rate on translation date or forward rate, as may be required in terms of subsection (5).

Subclause (1)(f): It is maintained that the provisions of section 24I(7) provide for the carry-back of exchange differences in respect of the relevant loan to a previous year of assessment during which the relevant asset was brought into use.

The proposed amendment is aimed at removing any uncertainty in this regard by providing that exchange differences in respect of such a loan which arose before the relevant assets are brought into use, be deferred only to the year of assessment during which the said assets are so brought into use.

Subclause (1)(g): Companies often make loans or advances to or receive loans or advances from other companies in a group of companies, such loans or advances being of a capital nature. Where the loan or advance is denominated in a foreign currency, section 24I requires that an exchange difference in respect of the loan or advance be included in or deducted from income. However, where such a loan or advance is not hedged by a matching forward exchange contract, no compensating exchange difference arises against the exchange difference arising on such loan or advance. In terms of the proposed amendment, a relief measure is introduced to soften the impact of taxation in respect of unrealised profits and losses, where such profits or

losses arise as a result of loans or advances which a company has granted to or obtained from another company which is a connected person in relation to such company. Such loans must be of a capital nature and be similar to an equity investment. Consequently that portion of the loan which is covered by a forward exchange contract will not qualify for the spreading of exchange differences. Unrealised gains on the loans which arose from the commencement of section 24I and unrealised losses which arise during years of assessment ending after 31 December 1995, will qualify for the spreading of the exchange differences.

The spreading is brought about by annually including or deducting, as the case may be, 10 per cent only of the deferred amount of an exchange difference in or from a company's income. The deferred amount is compiled by determining the sum of unrealised exchange differences which arise during a current year of assessment in relation to a qualifying exchange item and the qualifying unrealised exchange differences, which arose in previous years, in relation to such an exchange item, reduced by such portions which have already been taken into account in income. The spreading consequently takes place according to the reducing balance method.

Provision is made for two situations where the total deferred amount of exchange differences as at the end of the preceding year of assessment, which has not yet been taken into account for tax purposes, must be reduced, namely:

- where there is a reduction in the amount of the uncovered portion of a loan or advance in the foreign currency from the end of the preceding year of assessment to the end of the current year of assessment. The reduction of the deferred amount is made in the same ratio as the reduction in the amount of the uncovered loan expressed in the foreign currency. The reduction includes a repayment or settlement of a loan, as well as the hedging of the total amount or a portion of the loan; and

- where, during a year of assessment, an exchange item no longer complies with the requirements of a qualifying exchange item, in other words the loan is no longer between companies which are connected persons or the exchange item is no longer of a capital nature, the deferred amount will be reduced by 100 per cent.

Any reduction in the deferred balance will be included in or deducted from the taxpayer's income in full during the relevant year of assessment.

Where a qualifying exchange item is realised during a year of assessment by reason of the fact that it is converted into a qualifying exchange item denominated in any other foreign currency, any exchange difference arising as a result of such conversion, shall be deemed to be a deferred amount in relation to the old qualifying exchange item. In addition the foreign currency amount of the old qualifying exchange item is, shall for the purposes of section 24I(7A)(d), be deemed not to be reduced as a result of such conversion. After the conversion, the old and the new qualifying exchange items are deemed to be one and the same. The amount of the exchange item at the end of the preceding year must be restated in the currency of the translated loan or advance by using the exchange rate at which the conversion took place. The restatement is necessary in order to determine the reduction of the deferred amount as at the end of the preceding year of assessment, where there was a repayment or settlement of the loan or advance during the current year of assessment or where the loan is converted, whether wholly or partially, during such current year of assessment.

EXAMPLE

A taxpayer lends $300 000 to a foreign subsidiary on 30 June 1994 in order to extend the trade of the subsidiary. The subsidiary's trade ceases and the loan is repaid on 1 April 1996. The taxpayer's tax year ends on 30 September.

SPOT RATES FOR PURPOSES OF THE EXAMPLE

DATE	RATE
30 June 1994	4.100
30 September 1994	4.150
30 September 1995	4.350
1 April 1996	4.300

RESULT

Year of assessment	Calculations	Exchange difference	Tax inclusion/ (deduction)	Amount deferred
30/9/94	(4.10 – 4.15) x 300 000 (15 000 – (15 000 × 0.1))	15 000	 1 500	13 500
30/9/95	(4.15 – 4.35) × 300 000 (73 500 – (73 500 × 0.1))	60 000	 7 350	 66 150
30/9/96	(4.35 – 4.30) × 300 000 (66 150 × 1.0)	(15 000)	(15 000) 66 150	 0

CLAUSE 1 AND THE SCHEDULE

Rates of normal tax

Rates of normal tax are enacted by *clause 1* and the Schedule to the Bill and such rates are applicable in the Republic of South Africa as well as the former Republic of Venda.

Individuals

The rates for persons other than companies apply in respect of the year of assessment ending on 28 February 1995 or 30 June 1995 and are provided for in paragraph 1(a) of the Schedule. These rates remain unaltered from last year.

The rates are as follows:

Married persons: a progressive rate ranging between 17 per cent on the lowest income segment (amounts up to 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 up to 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 up to R5 000) and 40

per cent which is reached on the income segment above R50 000.

In addition to these rates of tax, paragraph 1(f) of the Schedule introduces a transition levy which forms part of normal tax. The transition levy payable is calculated at the rate of 3.33 per cent of the amount by which the taxable income of the taxpayer exceeds R50 000 in the case of a person other than a married woman, and R175 000 in the case of a married woman, in respect of the 1995 year of assessment.

Certain amounts are, however, not subject to the transition levy and must, therefore be excluded from taxable income when determining the transition levy. These are the taxable portions of lump sum benefits from approved pension, provident and retirement annuity funds as determined in accordance with the provisions of the Second Schedule to the principal Act, as well as bonuses, gratuities or compensation on termination of services as contemplated in section 7A(4A) of the principal Act. See also *clause 5(a) and (b).*

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 1994 to 31 March 1995, and are provided for in paragraphs 1(b) to (e) inclusive, of the Schedule.

Those rates are as follows:

(a) Taxable income derived otherwise than from gold mining and long-term insurance business: 35 cents per R1, but in the case of a company which mines for gold and which is exempt from secondary tax on companies in terms of an option exercised by it, 48 cents per R1 of its non-gold mining taxable income (paragraph 1(b) of the Schedule).

(b) Taxable income derived by a company from gold mining: an amount determined in accordance with one of the following formulae:

(i) where such company is not exempt from secondary tax on companies: $y = 43 - \frac{215}{x}$; or

(ii) where such company is exempt from secondary tax on companiesy $= 58 - \frac{290}{x}$,

as provided for in paragraph (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 derived from long-term insurance business where such taxable income has been determined under the provisions of section 28 of the principal Act: 43 cents per R1 (paragraph 1(e)(i) of the Schedule).

(e) Taxable income derived from long-term insurance business where such taxable income has been determined under the provisions of section 29 of the principal Act: 30 cents per R1 in respect of the insurer's individual policyholder fund and 35 cents per R1 in respect of its company policyholder fund and corporate fund (paragraph 1(e)(ii) of the Schedule).

In addition to these rates of tax, paragraph 1(g) of the Schedule introduces a transition levy which forms part of normal tax. The transition levy payable is calculated at the rate of 5 per cent of the amount by which the company's taxable income, before the set-off of any assessed losses brought forward from previous years, exceeds R50 000. The levy will apply in respect of taxable income as determined above in respect of years of assessment ending during the period of 12 months ending on 31 March 1995. See also *clause 39*.

CLAUSE 2

Definitions: Amendment of section 1 of the principal Act

Subclause (1)(a): The definition of "connected person" was introduced last year. In order to restrict the wide scope of the definition it is proposed to firstly limit the provisions of paragraph (d)(iv) to a person other than a company and secondly to amend the provisions of paragraph (d)(v).

It is proposed that insofar as the definition establishes the connection between two companies, the scope be limited to cases where one company has control over another company. Such cases are already catered for in the provisions of paragraphs (i), (ii) and (iii) of the definition which deal with the relationship between holding companies, subsidiaries and fellow subsidiaries and the provisions of paragraph (d)(v) are therefore amended to exclude fellow subsidiaries.

The second part of the amendment of paragraph (d)(v), however, provides for an exception to the rule in that where none of the shareholding companies control the relevant company (i.e. the voting rights are held on an equal basis by each shareholder) such shareholding companies will be considered to be connected persons if each of them holds at least 20 per cent of the equity share capital of the relevant company. For example, assume Companies A and B both hold 50 per cent of the equity share capital and voting rights of Company C. Neither Company A nor B has control over Company C because they are equal shareholders. They are therefore not considered to be "subsidiaries" and fall outside the scope of paragraph (d)(ii), but between Company A and Company C or Company B and Company C, the relationship is sufficiently close to warrant the inclusion thereof in the "connected person" concept. The amendment in terms of *subclause (1)(a)* will ensure this inclusion.

These proposed amendments will come into operation from the date of promulgation of the Bill.

Subclause (1)(b): This subclause substitutes the definition of "retirement-funding employment". At present only 35 per cent of a travelling allowance is to be taken into account when determining the "remuneration" factor of "retirement-funding employment". The proposed amendment provides that the full amount of a travelling allowance is to be taken into account when determining tax the deductible pension fund contributions, but only if the rules of the pension fund provide that the allowance is to be taken into account in the determination of the employee's contributions to such a fund. Such allowances will, therefore, not qualify to be taken into consideration when determining the deduction from income in respect of retirement annuity fund contributions.

CLAUSE 3

Exercise of powers and performance of duties: Amendment of section 3 of the principal Act

A wide range of discretionary powers have been granted to the Commissioner in various sections in the principal Act. Over the last few years many of these discretionary powers have been removed. Unless

specifically provided for, the decisions made when exercising such remaining discretionary powers, are not subject to the objection and appeal procedures. Certain of the sections containing such powers have now been identified and the proposed amendment makes the objection and appeal procedures available to the taxpayer. These sections are, section 8(4)(e), section 10(1)(cH), (cI), (cJ), (cK), (*i*A), (j), and (nB), section 11(e), (f), (g), (gA), (j), (t), (u) and (w), section 12C, section 13(1), section 14(1), section 15, section 16A, section 22(1), (3), and (5), section 24(2), section 24C, section 24D, section 27(2), section 31, section 35(2), section 42(2), paragraphs 7, 9, 13, 13A, 14, 19 and 20 of the First Schedule, paragraph 4 of the Second Schedule and paragraphs 3 and 6 of the Seventh Schedule.

The proposed amendment will come into operation from the date of promulgation of the Bill and will apply to any decision communicated to the taxpayer or person concerned on or after such date.

CLAUSE 4

Preservation of secrecy: Amendment of section 4 of the principal Act

This amendment is consequential upon the repeal of the Exchequer and Audit Act, 1975, and the introduction of similar provisions in the replacement Act.

CLAUSE 5

Levy of normal tax: Amendment of section 5 of the principal Act

Clause 5(a) and (b): The proposed amendments are, firstly, consequential in that a reference to the Sixth Schedule (which was repealed last year) is deleted and, secondly, it provides for the exclusion of the transition levy from the application of the formula contained in section 5(10) of the principal Act. The transition levy is therefore added after the formula tax has been determined. See also *clause 1*.

Example: A married person retires during the 1995 tax year and has the following taxable income:

Taxable portion of pension fund payout on retirement:	R10 000
Other taxable income:	R80 000
Total taxable income:	R90 000
In the formula: "A" will be tax on R80 000	R24 700
"B"	R90 000
"C"	R10 000

The tax before transition levy will be $\frac{24\,700}{(90\,000 - 10\,000)} \times 90\,000$

= R27 787.50

Add: Transition levy on *R80 000 - R50 000 at 3.33%	= R 999.00
Total normal tax	R28 786.50

* The proviso to paragraph 1(f) of the Schedule excludes the taxable portion of the pension fund payout (R10 000) from the levy.

Certain references to obsolete taxes and reductions have also been deleted.

Clause 5(c): The proposed amendment is consequential in that a reference to the Sixth Schedule (which was repealed last year) is deleted.

CLAUSE 6

Certain amounts to be included in income or taxable income: Amendment of section 8 of the principal Act

Subclause (1)(a) is consequential upon the introduction of the new Constitution of the Republic of South Africa, 1993.

Subclause (1)(b): The proposed amendment takes into account that members of Parliament no longer receive an allowance to meet the expenses described in section 8(1)(d) of the principal Act, but instead have a portion of their salaries allocated to meet such expenses. Such amount shall be determined from time to time by the Minister by notice in the *Gazette*. Such portion is therefore deemed to be an allowance contemplated in section 8(1)(d) of the principal Act.

Secondly, this subclause introduces a method of apportionment in respect of the limit contained in section 8(1)(d)(iv) and the amount determined under the new section 8(1)(f), in that such amounts are reduced in relation to the period for which the office is held during any year of assessment. For example, if a member of Parliament has been in office for only 9 months of the year of assessment, the R2 500 limit for hospitality expenditure will be reduced to R1 875.

Subclause (2): The commencement date of *subclause (1)* is 27 April 1994.

CLAUSE 7

Circumstances in which amounts are deemed to have accrued from sources within the Republic: Amendment of section 9 of the principal Act

Section 9(1)(g) of the principal Act deems certain pensions to have accrued to a person from a source within the Republic, if the services for which the pension is paid, were actually performed within the Republic. Under certain circumstances salaries and emoluments are deemed to be from a source within the Republic although the services giving rise to such salaries and emoluments are actually performed outside the Republic. However, the services themselves are not deemed to be performed in the Republic and arguments have been advanced that pensions flowing from such services are not taxable in the Republic. This amendment, therefore, deems such services to have been performed within the Republic for purposes of determining whether the pension is taxable in the Republic.

The proposed amendment is deemed to have come into operation in respect of services performed on or after 1 January 1995.

CLAUSE 8

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

This proposed amendment is consequential upon the deletion last year of paragraph (eA) of the definition of "gross income" in section 1 of the principal Act.

CLAUSE 9

Exemptions: Amendment of section 10 of the principal Act

Subclause (1)(a) withdraws the exemption from normal tax of the salary and emoluments of the State President. The President elected in terms of the new Constitution will therefore be liable for tax on his salary and emoluments.

Subclause (1)(b) provides that the exemption granted in respect of a pension payable to an ex-State President (elected under the previous Constitution) or his spouse, will not apply to a pension paid to an ex-President elected in terms of the new Constitution, or his spouse. The existing right to an exemption has, however, been retained for persons already enjoying an exemption in terms of section 10(1)(c)(ii) of the principal Act.

Subclauses (c) and (d) propose amendments to section 10(1)(cC) and (cI), respectively. At present both sections provide that one of the directors of the companies envisaged in such sections, must be a person nominated by a Minister responsible for housing matters. This nomination must now be made at the provincial level of government and in terms of the proposed amendment the provincial member of the Executive Council is given the authority to do so.

Subclause (1)(e): This subclause introduces a new paragraph into section 10(1) of the principal Act. Some local authorities are contemplating separating their fresh produce markets from their other functions as local authorities and transferring such activities to a non profit-making company. Such activities are presently exempt from tax by reason of the fact that they are carried on directly by the local authorities. Such a company must, however, comply with certain conditions, before the Commissioner will approve an exemption in terms of the new provisions. These conditions are briefly:

(a) the company must be a company registered in terms of section 21 of the Companies Act, 1973 (Act No. 61 of 1973);

(b) the sole or principal object of the company must be to promote or facilitate the distribution of agricultural and related commodities;

(c) such sole or principal object must be actively pursued;

(d) the company is not involved in any tax avoidance schemes;

(e) it does not carry on any other type of business;

(f) at least one of the members is a local authority; and

(g) on deregistration, winding-up or liquidation, the remaining assets are transferred to a similar company which is so exempt or to a local authority.

If these conditions are not met during a year of assessment —

(a) the Commissioner may withdraw his approval with effect from the commencement of that year of assessment;

(b) where the approval has been withdrawn, the assets must be transferred to a similar company which is exempt or to a local authority within two months;

(c) if this is not done, the accumulated revenues will be taxed in the hands of the company.

Finally where the company is not satisfied with the Commissioner's decision, it has the right to objection and appeal.

Subclause (1)(f) withdraws the exemption granted to the South African Bibliographic and Information Network (SABINET) with effect from the commencement of the 1995 year of assessment.

Subclause (1)(g): In his Budget Speech on 22 June 1994 the Minister announced the withdrawal of the tax exemption in respect of subsidies paid under the General Export Incentive Scheme (GEIS) in respect of export sales made on or after 1 March 1995. This amendment therefore provides for the withdrawal of the exemption in respect of GEIS, but retains the exemption in respect of certain other schemes which are approved by the Minister of Trade and Industry in concurrence with the Minister of Finance.

CLAUSE 10

General deductions allowed in determination of taxable income: Amendment of section 11 of the principal Act

Subclause (a) and (b): These amendments are consequential upon the introduction of section 14*bis*(1)(c) last year.

Subclause (c): This amendment deletes obsolete provisions.

CLAUSE 11

Deduction in respect of certain machinery, plant, implements, utensils and articles: Amendment of section 12C of the principal Act

The proposed amendment allows for a deduction of relocation expenses incurred in the moving of an asset contemplated in sections 12B and 12C of the principal Act, from one location to another. Such deduction will follow the tax life of the asset, i.e. where an asset (contemplated in section 12C) has been written off completely, the relocation expenses will be written off in the year in which they are incurred and if the asset was taken into use two years prior to being relocated, the relocation expenses will be written off over the remaining period of three years.

CLAUSE 12

Deduction in respect of buildings used by hotel keepers: Amendment of section 13bis of the principal Act

Clause 13(a): This amendment is consequential upon the repeal of the Hotels Act, 1965.

Clause 13(b) deletes certain obsolete provisions with regard to the investment allowance previously granted to hotelkeepers.

Clause 13(c): The amendment is consequential upon the deletion of section 13*bis*(7), (7A), (7B) and (8).

CLAUSE 13

Deduction of expenses incurred by dentists, medical practitioners, engineers and scientists on post-graduate studies: Repeal of section 16 of the principal Act

Repeal of obsolete provisions.

CLAUSE 14

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

Repeal of obsolete provisions.

CLAUSE 15

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

Subclause (a): An amendment to section 23(b) of the principal Act was introduced last year, which had the effect that where a taxpayer's trade constituted any employment or office, no deduction of expenses in respect of a home study is allowable, unless the taxpayer's income from such employment or office consists mainly of commission or other variable payments based on his work performance *and* his duties are not performed mainly in an office provided by his employer. The amendment proposed by this clause extends the provisions to allow a deduction in respect of persons who, although receiving only a salary and therefore no variable payments, work mainly from an office at home. The deduction is, however, allowable only in cases where the duties are performed mainly in the office at his home.

Subclause (b): The amendment is consequential upon the deletion of section 11(uA) of the principal Act.

CLAUSE 16

Prohibition of double deduction: Amendment of section 23B of the principal Act

Section 23B of the principal Act prohibits the allowance of any double deductions or allowances except in instances where the principal Act expressly allows it. It has, however, been submitted that where the principal Act provides for a specific deduction or allowance in terms of any provision other than the general deduction formula in terms of section 11(a) or (b), but such specific provision imposes a limit on the amount of such deduction or allowance, the excess not so claimable under such specific provision may be claimed in terms of the general deduction formula. This certainly was never the intention of the legislature and has not been allowed in practice. However, to put the matter beyond any doubt, the amendment proposed in terms of this clause has the effect that such excess will not be allowable in terms of section 11(a) or (b). It is furthermore proposed that the amendment should come into operation as from the commencement of years of assessment ending on or after 1 January 1990.

CLAUSE 17

Acquisition of trading stock: Insertion of section 23F in the principal Act

Section 22(1) of the principal Act provides that the amount that is to be taken into account by a trader in the determination of his taxable income, is trading stock *held and not disposed of* by him at the end of a year of assessment. It has, however, come to light that certain taxpayers who have purchased trading stock in certain circumstances claim the purchase price of such trading stock as an expense in terms of section 11(a) or (b) of the principal Act, but do not include such trading stock not disposed of, at the end of the year of assessment in the value of their trading stock for tax purposes. Such taxpayers contend that an unconditional liability has been established in respect of the payment of the purchase price in such circumstances and therefore entitles them to claim the purchase price as an expense. In addition, it is argued that such trading stock is not held by the taxpayer at year-end for various reasons, such as the fact that the trading stock has not yet been manufactured by the seller or that ownership in such stock has not yet passed to the purchaser.

This has given rise to an unacceptable state of affairs and in terms of the proposed amendment a deduction in terms of section 11(a) or (b) in respect of expenditure incurred for the purchase of trading stock is deferred until the first year of assessment in which any of the following events occur —

- such trading stock is disposed of by the taxpayer;
- such trading stock falls to be included in the taxpayer's income in terms of section 22(1) of the principal Act; or
- it is shown by the taxpayer that such trading stock was destroyed or lost and will neither be disposed of nor held by him.

CLAUSE 18

Gains or losses on foreign exchange transactions: Amendment of section 24I of the principal Act

Refer to separate explanation of FOREIGN EXCHANGE TRANSACTIONS.

CLAUSE 19

Determination of taxable income derived from insurance business: Amendment of section 28 of the principal Act

With the introduction of section 29 into the principal Act in 1993, long-term insurers are now required to maintain their investments in four funds, one of which is the untaxed policyholder fund. Although the income from such a fund is exempt for purposes of section 29, the provisions of section 28 still require that a portion of the income be included in taxable income. This resulted in practical problems being experienced by insurers in determining what portion of the income is subject to the provisions of section 28. The amendment proposed by this clause therefore excludes income derived from such funds fully from the taxable income determination in terms of the lastmentioned section.

CLAUSE 20

Persons carrying on business which extends beyond the Republic: Repeal of section 30 of the principal Act

Where a person's business, other than insurance business and in certain other special circumstances, extends to a country outside South Africa, the provisions of section 30 require that such person's taxable income or assessed loss be apportioned and prescribes a specific formula for that purpose. The proviso to the section, however, provides that where satisfactory accounts can be furnished, the actual taxable income from sources within the Republic must be determined and assessed.

The fact that the abovementioned formula is a fixed formula and is based on the taxpayer's total assets has revealed that the provisions of the section are open for manipulation, especially where the taxpayer's assets consist mainly of certain types of movable assets.

In terms of the proposed amendment the provisions of section 30 are, therefore, deleted. Where a taxpayer's business generates income from sources both inside and outside the Republic, future apportionments will have to be made in terms of the general provisions of the principal Act, supplemented by guidelines provided by case law.

CLAUSE 21

Assessment of non-residents who derive income from royalties or similar payments: Amendment of section 35 of the principal Act

At present section 35 of the principal Act provides for a withholding tax on royalties and other similar payments, at a rate which is equal to the rate of tax for companies. With the introduction of the transition levy, certain practical problems were, however, highlighted. In view of the fact that this tax is not a final tax and that the recipient of the royalty is not relieved of the responsibility of submitting an annual tax return, this amendment proposes that the rate of tax be set at 12 per cent of the royalty payment. When the recipient of the payments submits his annual tax return, he will be assessed at the rate of normal tax properly chargeable under the principal Act. This will have the effect that the recipient of a royalty will only receive the benefit of the R50 000 deduction in respect of the determination of the transition levy, on assessment.

CLAUSE 22

Determination of taxable income derived by persons (other that companies) in port or settlement of Walvis Bay: Repeal of section 37B of the principal Act

Repeal of obsolete provisions.

CLAUSE 23

Non-resident shareholders' tax: Income subject to tax: Amendment of section 42 of the principal Act

Subclause (a): The amendment is of a textual nature to the English text of the principal Act.

Subclause (b) introduces an exemption from non-resident shareholders' tax (NRST) in respect of dividends declared by a company which has its place of effective management outside the Republic. Such dividend must be declared out of dividends in respect of which NRST was paid and which have accrued to the company within the six months immediately preceding the date of declaration of such dividends.

EXAMPLE: Assume X Ltd — a company located in the United States, has two subsidiaries — Y (Pty) Ltd and Z (Pty) Ltd (company Y holding all the shares of company Z) which although receiving income from a South African source, are effectively managed outside South Africa. If Z was to declare a dividend to Y it would be subject to NRST. If Y was then to distribute a dividend out of the dividend received from Z to X within six months of the receipt of the first dividend, such second dividend would be exempt from NRST under the new provisions.

CLAUSE 24

Levy and recovery of secondary tax on companies: Amendment of section 64B of the principal Act

Subclause (1)(a) excludes long-term insurers from the provisions of paragraph (a)(i) of the definition of "dividend cycle" as specific provisions are being introduced by *subclause (1)(c)*.

Subclause (1)(b): The amendment is of a textual nature.

Subclause (1)(c) inserts a new paragraph into the definition of "dividend cycle" in relation to the first dividend declared by a long-term insurer out of profits derived during any year of assessment commencing on or after 1 July 1993 (this date being the date on which the provisions of section 29 of the principal Act came into operation) and subsequent dividends.

In relation to the first such dividend, it is the period commencing on *the later* of the day falling six months prior to the declaration of such dividend or the day following the date of declaration of the last dividend (but ignoring a dividend *in specie* or a dividend on a preference share) declared by the company prior to the declaration of the first dividend, and ending on the date upon which the said first dividend accrues to the relevant shareholder. The effect of this amendment is that where a long-term insurer has received a dividend during such period, it may be deducted as a credit in the determination of the net amount.

Subclause (1)(d) introduces the new rate of 25 per cent in respect of secondary tax on companies (STC) with effect from 22 June 1994 as announced by the Minister in his Budget Speech on the said date.

Subclause (e) excludes from the net amount of any dividend, dividends which are exempt from STC in terms of the proposed section 64B(5)(f) inserted in terms of *subclause (g)*.

Subclause (f): The amendment is of a textual nature.

Subclause (g) introduces three new paragraphs to section 64B(5), namely, (e), (f) and (g), whereby certain dividends are exempt from STC.

The new paragraph (e) exempts from STC dividends declared by a gold mining company contemplated in section 64B(12)(e), out of amounts received by or which accrued to such a company as a result of the disposal of gold mining assets.

The new paragraph (f) on the other hand exempts dividends declared by a wholly owned subsidiary to its holding company from STC. The purpose of this amendment is to provide relief from STC where corporate profits are distributed within a wholly owned group of companies from one company to its holding company. The exemption is, however, only applicable if certain further conditions are met, namely the holding company which received the dividend must be a company which has its place of effective management in the Republic and its profits must be derived solely from a source within the Republic. Furthermore, the exemption will apply on a voluntary basis and the distributing company must, in respect of each dividend declared, elect by notice in writing forwarded to the Commissioner, whether the provisions of the exemption should apply to such a dividend distributed or not.

The new paragraph (g) introduces an exemption in respect of dividends declared by a long-term insurer out of profits derived during a year of assessment commencing prior to 1 July 1993.

This exemption is introduced because long-term insurers did not enjoy the benefit of the lower rate of company tax which was introduced simultaneously with STC, as was the case with other companies. Long-term insurers were subject to special rates of tax.

Subclause (h) introduces three new subsections into section 64B, namely, (15), (16) and (17) which provide special rules for long-term insurers.

The new subsection (15) provides for the creation of the "insurers credit" to be allowed to long-term insurers who are required to determine their normal tax liability wholly or partially under the provisions of section 28 of the principal Act (i.e. the old rate of 43 per cent is applied to taxable income) and partially under the provisions of section 29 of the said Act (i.e. the lower rates of 30 per cent and 35 per cent are applied to taxable income).

The insurers' credit is determined by calculating the actual normal tax liability and deducting an amount which represents the tax which would have been payable had the provisions of section 29 been applied to the entire taxable income.

The new subsection (16) provides for the carrying forward of the insurers' credit where it exceeds the STC liability during the first and second years of assessment commencing on or after 1 July 1993.

(a) Where such credit exceeds the first year's STC liability, it is carried forward to the second year and allowed in full.

(b) Where it exceeds the second year's STC liability, it is carried forward to the third year, but is limited to the STC liability for the third year.

The new subsection (17) deems a dividend not to be paid out of a previous year's profits to the extent that there are sufficient profits in respect of a subsequent year available to fund such distribution (i.e. a last-in-first-out (LIFO) method is used). For example if an insurer has pre-1 July 1993 profits of R100 000 and post-1 July 1993 profits of R50 000, and on 1 August 1994 declares a dividend of R75 000, the amount by which the dividend exceeds the R50 000 (i.e. R25 000) will not be deemed to be a dividend declared out of pre-1 July 1993 profits and will be exempt from STC. Only the amount of R50 000 will be subject to STC.

CLAUSE 25

Secondary tax on companies: Certain amounts distributed deemed to be dividends: Amendment of section 64C of the principal Act

Subclauses (a) and (e): The expression "shareholder" used limits the application of subsections (4) and (5) to only some of the persons who fall within the definition of "recipient". This was not the intention and the expression is therefore been substituted with "recipient" which is the expression used throughout the section.

Subclauses (b) and (c): These amendments are of a textual nature.

Subclause (d): Several companies have share incentive schemes for the benefit of their employees which are operated through a trust specifically formed to deal with the acquisition of shares in the company for the resale thereof to employees. In order to finance such purchases, the company advances loans to the trust and such loan then becomes a deemed dividend for STC purposes. As these types of trusts are merely conduits for the passing of the company's shares to employees participating in such a share incentive scheme, an exemption is now provided in respect of such loans.

CLAUSE 26

Notice by Commissioner requiring returns and manner of furnishing returns: Amendment of section 66 of the principal Act

Inland Revenue has now introduced a pre-printed "business-reply" envelope which is to be used by taxpayers when submitting their annual returns. The provisions of section 66(12) of the principal Act are, therefore, obsolete and have been deleted.

CLAUSE 27

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

In order to maintain a degree of similarity between income tax and VAT record- keeping requirements, the provisions of section 75(2) of the principal Act have been extended to allow a taxpayer to keep his books and documents in a form which is acceptable to the Commissioner, instead of only allowing him to keep a microfilm copy thereof.

CLAUSE 28

Accounts and recovery procedures in respect of certain taxes: Amendment of section 89ter of the principal Act

The amendment introduced by this clause, firstly, limits the application of the definition of "tax" contained in section 89*ter* of the principal Act to subsections (1) and (2). Subsection (1A) provides for the allocation of payments received from a taxpayer and the provisions thereof should not be restricted to the limited definition of "tax" contained in subsection (3), but to the wider definition of "tax" contained in section 1 of the principal Act.

Furthermore certain consequential amendments are made to section 89*ter* as a result of the introduction of the levy on financial services and the secondary tax on companies.

CLAUSE 29

Regulations: Amendment of section 107 of the principal Act

The amendment is consequential upon the repeal of the Sixth Schedule to the principal Act last year.

CLAUSES 30 and 35

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

In terms of Government Notice No. R.57 dated 14 January 1994, the official rate of interest used for the purpose of quantifying the benefit of an interest-free loan was reduced from 15 per cent to 14 per cent with effect from 1 February 1994.

As required by paragraph 20(2) of the Seventh Schedule, that amendment is now confirmed by *clause 30*, while *clause 35* withdraws the relevant notice.

CLAUSE 31

Fringe benefits: Amendment of paragraph 5 of the Seventh Schedule to the principal Act

At present paragraph 5 of the Seventh Schedule to the principal Act provides that where an asset is presented by an employer to an employee as an award for bravery or for long service, the value to be placed thereon will be nil if the cost to the employer of the asset did not exceed R2 000. Where the cost exceeded R2 000, the full value was subject to tax.

This clause softens this approach by exempting the first R2 000 of the cost and subjecting only the balance to tax. For example, if a watch costing R2 500 is given to an employee in respect of long service, only R500 would be subject to tax.

Subclause (b): This amendment is consequential upon the amendment to paragraph 5(3) of the Seventh Schedule to the principal Act.

CLAUSE 32

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

Employees are often transferred from one company to another within the same group of companies and when doing so they retain the right of use of the vehicle which was granted to them prior to the transfer. Because the new employer acquires the vehicle at the time of transfer, the "determined value" of the vehicle is reduced by 15 per cent per annum. This clause therefore introduces a new subparagraph (1A) into paragraph 7 which provides that in

cases where the employee and vehicle are transferred to an associated institution, the determined value of the vehicle will not be reduced.

The clause also deletes the proviso to subparagraph (1) as these provisions are now included in the new subparagraph (1A).

CLAUSE 33

Fringe benefits: Amendment of paragraph 9 of the Seventh Schedule to the principal Act

The definition of "remuneration" contained in the Fourth Schedule is used for purposes of determining the cash equivalent of the value of the taxable benefit of accommodation enjoyed by an employee. Paragraph (c) of this definition includes 35 per cent of a travelling allowance. As the intention of including 35 per cent of the travelling allowance in the definition of "remuneration" was merely to subject such amount to employees' tax, the travelling allowance has been excluded for purposes of determining the cash equivalent of the value of the taxable benefit of accommodation.

The amendment is deemed to have come into operation from the commencement of the 1995 year of assessment.

CLAUSE 34

Fringe benefits: Amendment of paragraph 20 of the Seventh Schedule to the principal Act

The amendment is consequential upon the amendment effected to paragraph 5 of the Seventh Schedule. See also *clause 31.*

CLAUSE 36

Transition levy for companies who have had a change in financial year end

The transition levy which is payable by companies is determined in respect of a financial year which ends during the period of 12 months ending on 31 March 1995. It is therefore possible that where a company has changed its financial year, it may be required to submit two returns during the said period. Should this occur, the transition levy will be charged only in respect of the first year of assessment.

EXAMPLE: If a company which has a May year-end changes its year end to 28 February, it would, during the 12 months ending 31 March 1995, have to submit a 1994 return (1 June 1993 to 31 May 1994) and a 1995 return (1 June 1994 to 28 February 1995). The transition levy will be imposed in respect of the 1994 taxable income.

CLAUSE 37

Administration by Commissioner of certain laws of a former state

The amendment introduces enabling legislation for the Minister to provide that the Commissioner will administer the tax laws of the former Republics of Transkei, Bophuthatswana, Venda and Ciskei. The date from when this will take place as well as the laws which are to be so administered, will be announced in a *Gazette* at a future date.

CLAUSES 38, 39 and 40

Transition levy payable by persons deriving income from a source within the former Republics of Transkei, Bophuthatswana and Ciskei

In his Budget Speech on 22 June 1994, the Minister announced that as one of the steps in the process of the harmonisation of the tax systems of the former Republics of Transkei, Bophuthatswana, Venda and Ciskei, persons subject to tax in such former Republics shall be subject to the transition levy.

The amendments introduced in terms of these clauses provide for the levying of such transition levy in respect of the former Republics of Transkei, Bophuthatswana and Ciskei.

The only material difference between the imposition of the transition levy for such former Republics and South Africa is that by reason of the fact that such former states do not have separate rate structures for married women, there is no discrimination on the basis of gender and, it is therefore not necessary to provide a separate deduction of R175 000 as was the case in South Africa. A married woman's taxable income derived from such former states will, therefore, only be reduced by R50 000 for purposes of determining the transition levy.

It must be noted that the enabling legislation to impose the transition levy in the former Republic of Venda is included in the provisions of *clause 1*.

CLAUSE 41

Application of the principal Act

Subclause (1)(a): The former self-governing territories of Gazankulu, KwaNdebele, KaNgwane, KwaZulu, Lebowa and Qwaqwa were granted the authority to raise an income tax in respect of their citizens. Each of these territories introduced an Income Tax Harmonisation Act to enact such authority. With the reincorporation of these territories into the Republic's tax system, it is necessary to make the provisions of the principal Act applicable to the citizens of such territories. This amendment is deemed to have come into operation as from the commencement of years of assessment commencing on of after 1 March 1994. See also *clause 46* with regard to the repeal of laws.

Subclause (1)(b): The Minister announced in his Budget Speech on 22 June 1994, that any person (other than a natural person) who commences for the first time or recommences trade in any of the former Republics of Transkei, Bophuthatswana, Venda or Ciskei on or after that date, would be subject to the provisions of the principal Act. This amendment gives effect to that announcement as from 22 June 1994.

Subclause (1)(c): The former Republic of Venda retained the South African Income Tax Act as well as the annual amendments with only a few exceptions. It will, therefore, not create any hardship to any of their former taxpayers, to include them within the ambit of the principal Act. The proposed amendment gives effect thereto.

In the case of persons other than companies the amendment will come into operation as from years of assessment commencing on or after 1 March 1995 and in the case of companies from the commencement of years of assessment commencing on or after 1 April 1994.

Subclause (3) provides that where any reference is made in a law contemplated in Schedule 1 to a law which is not yet applicable in any of the abovementioned former Republics, such a law referred to shall for the purposes of the laws referred to in Schedule 1 be deemed to be applicable in the said former Republics.

CLAUSE 42

Determination of taxable income derived by persons in a former territory and the former Republic of Venda

With the reincorporation of the former territories and the former Republic of Venda into the Republic's tax system, regard must be had to anything that was done or occurred in a previous year which could have a bearing on the determination of the taxpayer's taxable income under the principal Act. For example, if a taxpayer had a library in respect of which a depreciation allowance was granted under the tax laws of a former territory or the former Republic of Venda, the tax value brought forward from the previous year would be taken into consideration when determining an allowance under the principal Act.

CLAUSE 43

Determination of value in respect of fringe benefits granted to persons whose remuneration is derived from a source within the former Republic of Venda

With the reincorporation of the former Republic of Venda into the Republic's tax system, certain phasing-in provisions in relation to the taxation of fringe benefits must be retained to eliminate undue hardship for those taxpayers affected by the reincorporation. This clause introduces the authority to apply the phasing-in provisions contained in the Income Tax Amendment Proclamation, 1993 of the former Republic of Venda, as though they are contained in the principal Act.

CLAUSE 44

Application of this Act to the former Republic of Venda

The proposed amendment gives the authority for the principal Act, and any amendments thereto, to apply to the former Republic of Venda.

CLAUSE 45

Amendment of paragraph 12 of the First Schedule to the Income Tax Act, 1984 of the Ciskei

The Income Tax Act, 1984 of the former Republic of Ciskei at present exempts certain companies from the payment of provisional tax. This proposed amendment removes the exemption so that provisional tax is now payable by such companies which will assist with the collection of the transition levy which is payable by such companies.

CLAUSE 46

Repeal of laws

The income tax laws of the former territories of Gazankulu, KwaNdebele, KaNgwane, KwaZulu, Lebowa and Qwaqwa are repealed together with the income tax laws of the former Republic of Venda.

Subclause (2) provides for the recovery of any outstanding taxes or duties in terms of certain laws repealed.

CLAUSE 47

Definitions

This clause introduces a definition of the former Republics of Transkei, Bophuthatswana, Venda and Ciskei — "former state" — as well as a definition of the former self-governing states — former territory". These terms are used throughout the substantive clauses of this Bill.

CLAUSE 48

Commencement of certain amendments

This clause provides that the amendments introduced by this Bill will apply for purposes of assessments in respect of normal tax, except where otherwise stated in the amendment itself or where the context otherwise indicates, as from the commencement of years of assessment ended or ending on or after 1 January 1994.

CLAUSE 49

This clause provides the short title of the Bill.