REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

INCOME TAX BILL, 1996

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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, as well as an amendment to the Income Tax Act, 1994 (Act No. 21 of 1994). Substantive provisions relating to the withdrawal of a Government Notice and the repeal of certain laws are also provided for.

Any reference to the Tax Commission shall mean the Tax Commission of Enquiry into certain aspects of the Tax Structure of South Africa (under the chairmanship of Prof M Katz).

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 1997 or 30 June 1997 and are provided for in paragraph 1 of the Schedule.

The rates for natural persons consist of a progressive rate ranging between 17 per cent on the lowest income segment (amounts up to R15 000) and 45 per cent which is reached on the income segment above R100 000.

The rates for persons other than natural persons, such as trusts but excluding companies, consist of a progressive rate ranging between 17 per cent on the lowest income segment (amounts up to R5 000) and 45 per cent which is reached on the income segment above R100 000.

The rates for—

- natural persons are provided for in paragraph 1(a) of the Schedule; and
- persons other than natural persons (such as trusts but excluding companies) are provided for in paragraph 1(b) of the Schedule.

Companies

The rates for companies apply in respect of years of assessment, ie the financial year of the company concerned, ending during the 12-month period from 1 April 1996 to 31 March 1997, and are provided for in paragraphs 2(a) to (e) inclusive, of the Schedule.

Those rates are as follows:

(a) Taxable income derived otherwise than from gold mining, long-term insurance business or by a foreign company through a branch or agency in the Republic: 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, 42 cents per R1 of its non-gold mining taxable income (paragraph 2(a) 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 companies: $y = 51 - \frac{255}{x}$,

as provided for in paragraph 2(b) 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 2(c) 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: 45 cents per R1 (paragraph 2(d)(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 2(d)(ii) of the Schedule).

(f) Taxable income (excluding from gold mining or long-term insurance business) derived by a company which has its place of effective management outside the Republic and which carries on trade through a branch or an agency within the Republic: 40 cents per R1 (paragraph 2(e) of the Schedule).

Companies deriving taxable income in the former Republics of Transkei, Bophuthatswana or Ciskei are also subject to the above rates of tax.

CLAUSE 2

Definitions: Amendment of section 1 of the principal Act

Subclause (1)(a): This subclause introduces a definition of "Chief Executive Officer" and is consequential upon the creation of the South African Revenue Service (SARS).

Subclause (1)(b): At present a "hotel keeper" is defined as a person who carries on the business of a hotel keeper or boarding or lodging house keeper, if the gross receipts therefrom exceed R2 000 for the year of assessment. The monetary value test of R2 000 was introduced in 1969 and due to inflation no longer serves any purpose. As the main test in determining whether a person is a hotel keeper, is whether he is *carrying on the business* of a hotel keeper, it is considered that the further monetary test is unnecessary and it is therefore proposed that it be deleted from the definition.

Subclause (1)(c) and (d): The definitions of "neighbouring country" and "South African company" in section 1 of the principal Act contain references to territories which formerly formed part of the Republic. Such references are now obsolete and it is, therefore, proposed that they be deleted.

CLAUSE 3

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

Section 4 of the principal Act provides *inter alia* that the information which is obtained by the Commissioner, may under certain circumstances be supplied to specified other persons. With the creation of SARS, information will also have to be made available to the Chief Executive Officer in the performance of his duties. The amendment proposed by *subclause (a)* introduces such provisions.

Subclause (b): Once the Chief Executive Officer has obtained certain information it is also necessary that he is subject to the same restrictions as the Commissioner with regard to divulging information which comes to his knowledge in the course of the performance of his duties. In terms of the proposed provisions, he is, therefore, prohibited from divulging information to any person, other than—

- to the taxpayer concerned;
- such taxpayer's representative;
- in the performance of his duties as Chief Executive Officer; or
- by order of a competent court.

Subclause (c): The amendment proposed by this subclause requires the Chief Executive Officer to take an oath/solemn declaration of secrecy.

Subclauses (d) and (e): These amendments are consequential upon the amendments to the secrecy provisions contained in the principal Act.

CLAUSE 4

Rebates: Amendment of section 6 of the principal Act

The primary rebate allowed to all taxpayers who are natural persons is increased from R2 625 to R2 660.

CLAUSE 5

Date of receipt or accrual of antedated salaries or pensions and of certain retirement gratuities: Amendment of section 7A of the principal Act

Section 7A of the principal Act was introduced into the principal Act in 1975 and provides (on an optional basis) for the spreading over more than one year of assessment of a retrospective salary or pension award, where the award is permanent and relates to a period which commenced before the commencement of the year of assessment during which the award became effective. These provisions at the time, replaced a proviso to paragraph (c) of the definition of "gross income" which provided for the spreading of a retirement gratuity. Such proviso was deleted with the introduction of section 7A and it was necessary to provide for the continuation of the provisions of the proviso for a limited period. Section 7A(5) ensured that the balance of any retirement gratuity which had to be spread in terms of the deleted proviso, and remained to be taxed in the 1976 and 1977 years of assessment, was included in income notwithstanding the deletion of the proviso. The provisions of section 7A(5) have therefore become obsolete and it is proposed that they be deleted.

CLAUSE 6

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

Subclause (a): In terms of the definition of a South African ship in section 14 of the principal Act, the Minister of Finance may direct that a ship be classified as a South African ship, if it is owned by a foreign company which is managed and controlled in South Africa and the sole shareholder in the company is a South African company.

Furthermore, in terms of section 14(1D), a parent company may elect that for income tax purposes it and its wholly-owned subsidiary company be deemed to be one and the same company. This has the effect that certain allowances in respect of a ship owned by the subsidiary company, may be utilised by the parent company in the determination of its taxable income.

A potential tax avoidance scheme has now come to light in that when such a parent company wishes to dispose of the ship owned by its subsidiary company, it would rather sell the *shares* in the subsidiary company and thereby the recoupment provisions in respect of the tax allowances which it has enjoyed in respect of the ship, are avoided.

In order to counter such a scheme, it is proposed that new provisions, in the form of section 8(4)(dB), be introduced into the principal Act.

The proposed provisions deem the sale or disposal of such shares to be a recoupment in terms of section 8(4)(a), of allowances previously granted in terms of sections 11(o), 12C and 14 in respect of the underlying asset of the company, namely the ship. The amount to be included in the parent company's taxable income is the lesser of—

- the total of such allowances granted in respect of a ship owned by the subsidiary at the date of sale or disposal of such shares; and
- the market value of the ship at the date of sale or disposal of the shares.

These provisions are deemed to have come into operation on 1 June 1996 and apply to any shares sold or disposed of on or after that date.

The proposed paragraph (l) as introduced in terms of *subclause (b)*, deems certain amounts to have been recovered or recouped by a taxpayer and is consequential upon the introduction of section 24J of the principal Act.

The proposed provisions envisage a situation where a person, who was allowed to deduct interest or related finance charges (including a discount or premium) which was incurred or deemed to have been incurred by him in respect of a financial arrangement during any year of assessment, transfers such financial arrangement to another person during any year of assessment and as a result of such transfer the obligation to pay any of such interest or related finance charges has been transferred to the other person.

The proposed paragraph provides that the person who so transferred his obligation to pay the interest or related finance charges will be deemed to have recovered or recouped an amount equal to the amount of the obligation transferred, in the year of transfer.

The effect of this amendment will be that the difference between the amount of any obligation in respect of interest or related finance charges which a person has been allowed as a deduction for income tax purposes and which has not been paid, and the amount he actually paid in respect of the transfer of the obligation to another person, will be deemed to have been recovered or recouped by the transferor for the purposes of section 8(4)(a). The difference will be included in the transferor's income in terms of section 8(4)(a), during the year of assessment the obligation was so transferred.

CLAUSE 7

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

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

Subclause (c): Provision has now been made in the Stamp Duties Act to define a "lending arrangement", ie where shares have been lent by any person (the lender) to any other person (the borrower) to enable the borrower to effect delivery of shares under a transaction entered into by the borrower to sell shares of the same kind. The loan of the shares is, however, conditional in the sense that shares of the same kind and of the same or equivalent quantity and quality must be returned to the lender within six months. The argument has been put forward that such a transaction is tantamount to a loan of consumption and therefore represents a disposal of the shares by the lender and an acquisition of such shares by the borrower. In order to regulate this type of transaction it is proposed that section 9B of the principal Act be amended to deem the transaction not to be a disposal in the hands of the lender and that the share lent and any replacement share, be regarded as one and the same share in the hands of the lender. The amendment will apply in respect of shares lent on or after 1 August 1996.

CLAUSE 8

Exemptions: Amendment of section 10 of the principal Act

Subclause (1)(a): Section 10(1)(cB)(ff) of the principal Act provides an exemption from income tax in respect of, *inter alia*, companies, societies and associations of persons, the sole object of which is to promote the common interests of persons carrying on a particular kind of business, profession or occupation. The intention was that such organisations should promote the common interests of their *members* only. The present wording gave rise to arguments that an organisation could be exempt from tax even if it promotes the common interests of persons, other than the members of the organisation. In order to place it beyond any doubt that such persons must themselves be members of the business, profession or occupation, a reference to members has been introduced.

Subclause (1)(b): Section 10(1)(cI)(i)(aa) of the principal Act contains references to territories which formerly formed part of the Republic. Such references are now obsolete and have therefore been deleted.

Subclause (1)(c) and (d): An exemption from normal tax is provided in section 10(1)(cK) in respect of a company which provides electricity to the electricity consumers of, *inter alia*, any former self-governing territory. With the re-incorporation of such former territories into the national territory of the Republic, the activities of such companies have been transferred to the provinces. These clauses introduce amendments which are consequential upon such transfer.

Subclause (1)(e), (f), (g) and (i): Section 10(1)(cL) was inserted into the principal Act in 1993 and provides for the exemption from normal tax of the receipts and accruals of a fund which has as its sole object the provision of funds to any company, society, association of persons or trust contemplated in section 10(1)(cF) of the Act (such bodies provide residential accommodation to certain aged or retired persons).

Section 10(1)(fA) was also introduced into the Act in 1993 to provide for the exemption from normal tax of the receipts and accruals of a fund which has as its sole object the provision of funds to any religious, charitable or educational institution contemplated in section 10(1)(f) of the Act.

As the provisions of the two sections are similar insofar as the conditions prescribed therein are concerned, it is proposed that they be amalgamated into one section which deals with funds which provide financing for either bodies contemplated in section 10(1)(cF) or section 10(1)(f) of the Act.

Section 10(1)(cL) is therefore deleted by *subclause (1)(e)* and section 10(1)(fA) is amended by *subclause (1)(f), (g) and (i)*, to incorporate the necessary cross references.

Subclause (1)(h): Section 10(1)(fA)(ii)(hh) of the principal Act contains a reference to territories which formerly formed part of the Republic. Such reference is obsolete and has therefore been deleted.

Subclause (1)(j): The Compensation for Occupational Injuries and Diseases Act, 1993 (Act No. 130 of 1993), contains provisions which exempt compensation paid in terms of that Act from normal tax. As the correct procedure with regard to permanent exemptions is that they should be contained in the principal Act, the firstmentioned Act has been amended to withdraw the exemption in that Act and to introduce such exemption into the principal Act. This amendment will come into operation on the date the amendment to the Compensation for Occupational Injuries and Diseases Act becomes effective.

Subclause (1)(k) and (l): These amendments are of a textual nature.

Subclause (1)(m): The provisions of section 10(1)(hA) of the principal Act provide that interest received by or accrued to individuals who are ordinarily resident outside the Republic and companies which are managed and controlled outside the Republic, is exempt from normal tax.

The Tax Commission drew attention to the fact that branches of foreign companies carrying on business in the Republic enjoy the benefit of this exemption. This places these branches at an advantage when compared with South African incorporated businesses, particularly when the foreign branches operate as banks.

It is accordingly proposed that with effect from 1 April 1996, the exemption be withdrawn in respect of interest which is effectively connected to a business carried on by a company which is managed and controlled outside the Republic. The proposed amendment will apply to interest received or accrued on or after the aforementioned date.

Subclause (1)(n): This subclause introduces two amendments. The first amendment is consequential upon the deletion of section 10(4).

Secondly, exemptions in respect of certain interest income are provided for in section 10(1)*(i)*(i), (ii), (vi), (xii), (xiiA) and (xiii) of the principal Act. These exemptions were, however, phased out in terms of section 10(4) of that Act with the full amount of interest becoming taxable with effect from the 1995 year of assessment. These provisions are therefore obsolete and have been deleted. See also *subclause (1)(p)*.

Included in the provisions which have been deleted, is section 10(1)*(i)*(xiv) in terms of which R200 per annum was exempt in respect of savings accounts with the Corporation for Economic Development Limited. The Corporation for Economic Development Limited was a state-aided company which has now been dissolved. Such an exemption is therefore obsolete and the provisions have thus been deleted.

Subclause (1)(o): Section 10(1)(t)(xiv) provides an exemption from normal tax for Gezicor (Pty) Ltd, a company which was formed for the sole purpose of providing electricity as cheaply and economically as possible to the inhabitants of the former self-governing territory of Gazankulu. This company was deregistered on 30 June 1993 and the exemption is, therefore, no longer necessary.

Subclause (1)(p): This amendment deletes section 10(4) of the principal Act which provided for the phasing-in of the withdrawal of the exemption of certain interest. The withdrawal of the exemption was completed in the 1995 year of assessment and these provisions are thus obsolete. See also *subclause (1)(n)*.

CLAUSE 9

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

The provisions of section 11(gA) of the principal Act provide for a deduction of an allowance in respect of expenditure actually incurred by a taxpayer in respect of the developing or acquisition of intellectual property. An allowance equal to the greater of an amount calculated by dividing such expenditure by the life of the property or one twenty-fifth, is granted. Expenditure not exceeding R200 is, however, allowed in full in the year in which it was incurred. The amount of R200 has not been increased since 1962. Having regard to the effect of inflation, it is proposed that this amount be increased to R3 000, which will have the effect that where a taxpayer incurs expenditure of R3 000 or less in respect of such property, the expenditure will be deducted in full in the year in which it is incurred.

CLAUSE 10

Deduction of expenses incurred by medical practitioners and dentists on courses or congresses outside the Republic: Amendment of section 16A of the principal Act

Section 16A of the principal Act contains a reference to territories which formerly formed part of the Republic. Such reference is now obsolete and it is proposed that the section be amended accordingly.

CLAUSE 11

Deduction of donations to universities, colleges and certain educational funds: Amendment of section 18A of the principal Act

Subclause (1)(a) to (d): Section 18A of the principal Act contained various references to territories which formerly formed part of the Republic. These references are now obsolete and it is proposed that the section be amended accordingly. Furthermore, references to repealed Acts have also been amended to refer to the replacement Acts.

Subclause (1)(e) and (f): These amendments are of a textual nature.

Subclause (1)(g) to (j): In terms of section 18A of the principal Act, donations made to various bodies, *inter alia* the Bible Society of South Africa, qualify as a deduction from the income of the donor. The Tax Commission has pointed out that preferential treatment given to particular religious organisations is discriminatory and, therefore, unconstitutional. It is, therefore, proposed that the principal Act be amended accordingly and that all donations made to the Bible Society on or after 1 October 1996, should no longer qualify as deductions in the determination of the taxable income of a donor.

CLAUSE 12

Amounts to be taken into account in respect of values of trading stocks: Amendment of section 22 of the principal Act

Subclauses (a) and (c): Provision has now been made in the Stamp Duties Act to define a "lending arrangement", ie where a marketable security has been lent by any person (the lender) to any other person (the borrower) to enable the borrower to effect delivery of a marketable security under a transaction entered into by the borrower to sell a marketable security of the same kind. The loan of the marketable security is, however, conditional in the sense that a marketable security of the same kind and of the same or equivalent quantity and quality must be returned to the lender within six

months. Arguments have been advanced that such a transaction represents a disposal of the marketable security by the lender and an acquisition of such marketable security by the borrower.

In order to provide certainty in this regard *subclause (a)* introduces a new subsection into section 22 of the principal Act whereby a marketable security which has been so lent, is deemed not to have been acquired by the borrower and the replacement marketable security is deemed not to have been acquired by the lender.

Subclause (c) deems the marketable security which has been so lent by the lender and not returned at year end to remain closing stock in his hands and excludes such marketable security from the closing stock of the borrower.

Subclause (b): Section 22(8) of the principal Act provides for the taxation of trading stock which has been applied, disposed of or distributed under certain circumstances.

The amendments to that section proposed by this clause provide for—

- the rewording of the section to assist in the interpretation thereof;
- the introduction of provisions whereby the market value of trading stock donated by a taxpayer or disposed of by him for a consideration which is less than the market value thereof, will be included in the income of the taxpayer;
- a reduction in the amount to be included in the income of the taxpayer where trading stock has been disposed of at less than market value, other than in the normal course of business, by an amount equal to the consideration which is received by or has accrued to the taxpayer in respect of trading stock so disposed of;
- the exclusion of farmers' livestock and produce (in respect of which paragraph 11 of the First Schedule applies) from these provisions (see *clause 32* for the amendment to the said paragraph); and
- the deemed incurral of expenditure in respect of the acquisition by a taxpayer of trading stock, where such trading stock has been used or consumed by him in the ordinary course of his trade and the value thereof has been included in his income.

Although the amount to be included in income in respect of trading stock which has been privately consumed by the taxpayer, is the cost to him, provision has now also been made that in instances where the cost price cannot be readily determined, the market value of such trading stock be included in income.

CLAUSE 13

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

Subclause (a): The definition of "affected forward exchange contract" was inserted in 1994 to address a situation where a taxpayer takes out cover by way of a forward exchange contract (FEC) to serve as a hedge for future obligations in a foreign currency. Although agreements from which the obligations stemmed, had already been entered into, a loan, advance or debt had not yet arisen. An undesirable situation, therefore, arose in respect of such an FEC as it had to be revalued at year end by applying a market related forward rate. As a result of such a revaluation an exchange difference would normally have arisen without a compensating exchange difference in relation to an underlying loan, advance or debt.

In order to address the situation the aforementioned definition was introduced and allows a taxpayer to utilise the forward rate specified in such an FEC at year end. The

definition at present, however, only encompasses FECs which have been entered into to hedge a loan, advance or debt for utilisation in respect of the acquisition of machinery and plant or the devising or acquisition of inventions, patents, designs, trade marks, copyrights or other similar property.

The same difficulties, however, also arise in respect of the acquisition of other assets (such as trading stock) or the financing of expenses. Similar mismatching can also arise where a loan, advance or debt will arise as a result of the sale of assets or the supply of services by a taxpayer.

It is, therefore, proposed that the ambit of the definition be extended to also encompass situations as outlined in the aforementioned paragraph.

The purpose of the amendment is furthermore to—

- bring the tax treatment and accounting treatment of foreign exchange differences as close together as possible;
- ease the burden on taxpayers with regard to the revaluation of FECs of this nature; and
- simplify the application of the provision in relation to both taxpayers and the Commissioner.

Subclause (b): Section 24I(7) provides for the deferral of taking an exchange difference, premium or other consideration into account in the determination of a taxpayer's taxable income under certain circumstances, until the year of assessment during which the underlying assets acquired through the utilisation of a loan, advance or debt, have been brought into use. Various conditions, however, must be complied with to qualify for a deferral of the exchange difference, premium or other consideration. The Act, however, does not specifically provide guidelines with regard to the treatment of such an exchange difference, premium or other consideration so deferred where the taxpayer no longer meets the conditions prescribed by section 24I(7). The proposed amendment now provides that where a taxpayer during a year of assessment fails to comply with the prescribed conditions, such exchange difference, premium or other consideration shall no longer be deferred but be taken into account in the determination of the taxpayer's taxable income during such year of assessment.

CLAUSE 14

Incurral and accrual of interest: Amendment of section 24J of the principal Act

Subclause (1)(a) and (b): At present the definitions of "adjusted gain on transfer or redemption of an instrument" and "adjusted loss on transfer or redemption of an instrument" do not encompass situations where a taxpayer has applied the alternative method of accruing interest. The proposed amendment now provides that where a taxpayer applies an alternative method in relation to an instrument and disposes of the instrument, an adjusted gain or loss on transfer or redemption of an instrument is to be determined. This will ensure that the total net cash flow relating to the instrument is deemed to be either accrued or incurred in terms of section 24J(2), (3) or (4), as the case may be. This amendment comes into operation from 16 March 1995.

Subclause (1)(c): At present the provisions of section 24J, insofar as they relate to the accrual of interest, apply only to income instruments. An income instrument is defined as an instrument the term of which will or is likely to exceed one year and was issued or acquired at a discount or premium or bears deferred interest. In terms of the proposed amendment the definition is extended to include all instruments as defined in the case of a company. This will have the effect that the accrual basis will now apply to all interest accrued or incurred in relation to all instruments of a company.

Subclause (1)(d): As announced by the Minister of Finance in his Budget Speeches on 15 March 1995 and 13 March 1996, all instruments issued on or before 15 March 1995 which are not yet within the accrual basis, are to be brought within the

scope of section 24J of the Income Tax Act. The proposed amendment gives effect to such announcements. However, the proposed amendment will be limited to the holders of instruments and apply to instruments held by them on 14 March 1996 which were issued on or before 15 March 1995.

Subclause (1)(e) provides guidelines as to how and when interest accruing in respect of instruments brought into the scope of the accrual basis, as contemplated in *subclause (1)(d)*, is to be taxed. As a first step the accrual of interest in terms of section 24J should be calculated as from the date of acquisition or issue of the instrument by the holder. Any accrued interest until 13 March 1996 and which had not yet been included in income, will be deferred until the year of assessment in which the instrument is transferred or redeemed. However, any interest in relation to such an instrument which was assessed to tax before the date of promulgation of this Bill, will not be allowed to be deferred as described above.

Subclause (1)(e) is deemed to come into operation from the date of issue of transfer of an instrument to a holder thereof on 14 March 1996, in order to determine the accrual amounts or amounts determined in accordance with an alternative method, from the acquisition date until 13 March 1996.

Example 1

A taxpayer entered into an arrangement with a moneylender in terms of which R150 000 was invested with the moneylender on 31 March 1993 for a period of 5 years. Interest of R5 000 (3,33%) is payable annually on 31 March and an amount of R115 000 (representing interest) is payable on 31 March 1998. The taxpayer's year ends on the last day of February.

CASHFLOW	
Date	R
31 March 1993	(150 000)
31 March 1994	5 000
31 March 1995	5 000
31 March 1996	5 000
31 March 1997	5 000
31 March 1998	265 000
	135 000

A yield to maturity of 14,35062%, applying an annual accrual period, is applicable to the instrument.

In terms of the proposed subsection (3A) the following amounts are to be determined:

Interest accrued from the date of acquisition until 13 March 1996 by applying section 24J

Accrual period 1	= R150 000 x 0,1435062
	= R21 526
Accrual period 2	= R166 526 x 0,1435062
	= R23 898
Accrual period 3	= (R185 424 x 0,1435062) x 348 ÷ 366
	= R25 301
Total accrual	= R21 526 + R23 898 + R25 301
	= R70 725

Interest received or accrued until 13 March 1996 without applying section 24J

Accrual period 1 – 3 = R5 000 + R5 000 + R nil

= R10 000

Difference determined on 13 March 1996

= R70 725 – R10 000

= R60 725 will be deferred until 31 March 1998

From 14 March 1996 interest which is deemed to have accrued in terms of section 24J will be included in taxable income during the relevant year of assessment. The taxable income for the 1996/7 year of assessment is:

Interest accrued from 14 March 1996 until 31 March 1996

= (R185 424 x 0,1435062) x 18 ÷ 366

= R1 308

Interest accrued from 1 April 1996 until 28 February 1997

= (R207 033 x 0,1435062) x 334 ÷ 365

= R27 187

Total accrual

= R1 308 + R27 187

= R28 495 for 1996/7 year of assessment

Subclause (1)(f): Where an adjusted loss on transfer or redemption is calculated in relation to an instrument on for example the transfer of the instrument, the loss so calculated may consist of two elements, namely—

- interest accrued in terms of section 24J, but never received by the taxpayer; and
- a portion of the original acquisition price or issue price forfeited.

The proposed proviso provides for a deduction of the interest which accrued, but which will not be received by the holder.

The converse applies to an issuer of an instrument who has incurred interest in terms of section 24J, but which interest will not be paid by him. Such portion of interest must be included in the income of the issuer during the year of assessment during which the instrument is disposed of and forms part of the "adjusted gain on redemption or transfer of an instrument".

Example 2

A taxpayer acquires government stock on 1 December 1996 for an amount of R188 317. The stock carries a coupon of 11,5% per annum payable six monthly and matures on 30 May 2000 at a nominal value of R200 000. The financial year of the taxpayer ends on 30 June. The taxpayer sells the stock on 12 August 1997 due to circumstances beyond his control for an amount of R185 776.

CASHFLOW	
Date	R
1 December 1996	(188 317)
30 May 1997	11 500
30 November 1997	11 500
30 May 1998	11 500
30 November 1998	11 500
30 May 1999	11 500
30 November 1999	11 500
30 May 2000	211 500
	92 183

A yield to maturity of 6,82740%, applying a six monthly accrual period, is applicable to the instrument in respect of the taxpayer.

Interest accrued for the year of assessment ended 30 June 1997

= (R188 317 x 6,8274%) + ((R189 674 x 6,8274%) x 31 ÷ 184)

= R12 857 + R2 182

= R15 039 taxable income

Interest accrued for the year of assessment until date of disposal on 12 August 1997

= (R189 674 x 6,8274%) x 43 ÷ 184

= R3 026 taxable income

Adjusted loss on transfer of the stock

= (R189 674 + R2 182 + R3 026) – R185 776

= R9 106 loss

Reconciliation

Cash flow

Acquisition price (1/12/1996)	(R188 317)
Coupon (30/5/1997)	R 11 500
Selling price (12/8/1997)	R185 776
Net cash receipt	R 8 959

Income tax treatment

Interest accrued (1996/7)	R 15 039
Interest accrued (1997/8)	R 3 026
Subsection (4A) deduction	(R 6 565)
Balance of adjusted loss on transfer	(R 2 541)
	R 8 959

Included in the loss is an amount of R6 565 (R194 882 – R188 317) which represents taxable income in the current and the previous year of assessment. Subsection (4A) allows this amount to be deducted from the income of the taxpayer.

The balance of the adjusted loss on transfer, amounting to R2 541 (R9 106 - R6 565), will be dealt with in terms of the ordinary provisions of the principal Act.

This amendment comes into operation from the date of the introduction of section 24J into the principal Act, namely 16 March 1995.

The proposed subsection (5A), to be introduced in terms of *subclause (1)(g)*, prevents the possibility of double deductions or double inclusions of amounts by reason of the application of the provisions of section 24J. Such situations may for instance arise as a result of the differences in the timing of the accrual and incurral of interest before and after the introduction of section 24J and by reason of the application of subsection (4A).

CLAUSE 15

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

The amendment is consequential upon the deletion of section 13*bis*(7) of the principal Act.

CLAUSE 16

Taxable income of companies carrying on long-term insurance business: Amendment of section 29 of the principal Act

Section 29 of the principal Act contains references to territories which formerly formed part of the Republic. Such references are now obsolete and it is proposed that the section be amended accordingly.

CLAUSE 17

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

The definition of "capital expenditure incurred" in section 36(11) of the principal Act deals with the determination of the amount of capital expenditure incurred during a period in respect of a mine. The definition still contains a reference to an Ordinance of the territory (ie Namibia) which is no longer necessary. This clause deletes such obsolete provisions.

CLAUSE 18

Donations tax: Exemptions: Amendment of section 56 of the principal Act

Subclause (1)(a): Section 7(7) of the principal Act was inserted in 1983 to ensure that where a taxpayer makes over to some other person his right to receive income from movable or immovable property, but retains ownership of, or an interest in that property, he will continue to be taxed on that income. The section provides further that should the taxpayer go so far as to transfer the property in question to some other person, but retains the right to regain the property at some future date, the income flowing from that property will continue to be taxed in his hands.

At the same time an exemption for donations tax purposes in terms of section 56(1)(p) was introduced. The intention of the legislature at the time was to maintain the

right to subject the income to normal tax in the donor's hands by way of section 7(7), but not to exact a further tax in the form of donations tax. This was achieved by inserting section 56(1)(p).

Section 56(1)(p), however, has the effect that transactions of the above nature are still attractive from the point of view of capital transfer taxes (donations tax combined with estate duty), as it provides a mechanism to reduce such taxes. The proposed deletion of section 56(1)(p) will rectify the situation and is applicable to any property disposed of under a donation which takes effect on or after the date of promulgation of this Bill.

Subclause (1)(b): Section 56(2)(b) of the principal Act currently provides that the first R20 000 of all donations made by a natural person during a year of assessment is exempt from donations tax. Prior to 16 March 1988 the exemption from donations tax in terms of that section was limited to a specified amount in respect of each of the donor's children and was determined on a cumulative basis. This method was amended with effect from the said date and in terms of the proviso to these provisions the donations tax in respect of a donation made by a donor to his children on or before 24 June 1988 was not to exceed the tax that would have been payable under the donations tax provisions of the Act as applicable before the amendment thereof by the Income Tax Act, 1988. Such proviso was applicable in respect of the one year only and it is proposed that it be deleted.

It is furthermore proposed that, as announced by the Minister of Finance in his Budget Speech on 13 March 1996, the amount of R20 000 be increased to R25 000 with effect from the 1997 year of assessment.

CLAUSE 19

Rate of donations tax: Amendment of section 64 of the principal Act

The Tax Commission supports the principle of a capital transfer tax which would encompass the present estate duty and donations tax. However, no detailed recommendations in this regard have been made.

When compared internationally, South Africa's rates of tax of this nature are relatively low and it is proposed that, as an interim measure, the present rate of donations tax be increased from 15 per cent to 25 per cent in respect of the value of any property disposed of under a donation which takes effect on or after 14 March 1996.

CLAUSE 20

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

When it was decided in 1991 to exempt financial services from Value-Added Tax (VAT), a "proxy tax" on financial institutions, the financial services levy, was introduced to compensate for the so-called loss of revenue arising from the exemption of financial services for VAT purposes.

In view of the fact that the majority of financial services rendered by the banking industry and unit trusts will now be subject to VAT, it is proposed that such industries be exempt from the financial services levy with effect from 1 October 1996. The amendments introduced by this clause give effect to this proposal.

CLAUSE 21

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

Subclause (1)(a): The amendment proposed by this subclause extends the scope

of the definitions so that they are applicable to both sections 64B and 64C of the principal Act.

Subclause (1)(b), (c) and (e): The Tax Commission recommended that the scope of section 64B(5)(f) of the principal Act be amended so as to allow—

- for situations where the shares of a subsidiary company in a group are held by more than one shareholder within the group of companies, which are themselves wholly owned subsidiaries; and
- for a maximum of 10 per cent of the equity share capital of a company in such a group, to be held by full-time employees or a trustee under a share incentive scheme.

These recommendations necessitated four new definitions which are introduced by *subclause (1)(b) and (c)*—

- "affected company" is a subsidiary company which is fully owned, whether directly or indirectly, by a holding company. Up to 10 per cent of its shares may, however, be held in terms of a share incentive scheme.
- "holding company" is a company which fully owns an affected company, whether directly, or indirectly through one or more intermediate companies. Provision is again made that up to 10 per cent of the shares of the affected or intermediate company may be held in terms of a share incentive scheme.
- "intermediate company" is a company which is fully owned, together with shares held in terms of a share incentive scheme—

  (a) by a holding company; or

  (b) by—

    (i) one or more intermediate companies jointly ; or

    (ii) a holding company and an intermediate company jointly.

- "share incentive scheme" is a scheme whereby no more than 10 per cent of the equity share capital of a company is —

  (a) held by the full-time employees of the company in terms of a share incentive scheme operated for their benefit;

  (b) held by a trustee for the benefit of such employees under a scheme contemplated in section 38(2)(b) of the Companies Act, 1973; or

  (c) collectively held by both such full-time employees and such a trustee.

Subclause (1)(c): This subclause introduces several amendments to section 64B(5)(f) of the principal Act.

Firstly, the provisions provide for an exemption in respect of a dividend declared by an affected company to a holding or intermediate company, thereby giving effect to the aforementioned recommendations of the Tax Commission.

Secondly, section 64B(5)(f)(ii) at present provides that the profits of the company to whom the dividend is declared are to be derived solely from a source within the Republic for an unspecified period. This rule is relaxed and the amendment provides that at least 90 per cent of the profits during the preceding three years of assessment must have been derived from a source within the Republic.

Finally, the remaining amendments all stem from the extension of the exemption to inter-company dividends.

These amendments come into operation on 1 August 1996.

Subclause (1)(d): Although the Tax Commission reported that it favours a progression towards some form of imputation system in principle, it did not recommend a change at this stage because of the complexity of administering and complying with such a system. It thus recommended the retention of secondary tax on companies (STC), but favoured a substantial reduction in the rate from its present level of 25 per cent in order to reduce the burden of the dual company tax rate and to minimise the distorting effects of STC.

In light of the above, it is proposed that the rate of STC be reduced to 12,5 per cent in respect of all dividends declared on or after 14 March 1996.

Subclause (1)(f) and (g): The amendments proposed by these subclauses are of a textual nature.

Subclause (1)(h): An aspect considered by the Tax Commission with regard to STC is the way in which STC applies to foreign companies operating branches in South Africa. At present STC is imposed on dividends declared by foreign companies, but only to the extent that the dividend is paid out of profits generated from a South African source.

STC has been criticised in this regard as it purports to give South Africa extra-territorial powers which, in practice, are difficult to enforce. This in turn gives foreign investors who operate in the Republic in a branch form and do not pay STC, an advantage over those who incorporate their business – a distorting factor that should be avoided in a tax system.

The Tax Commission recommended that the STC provisions be amended to remove STC on foreign branches and that no separate branch profits tax be introduced. After its deliberations the Joint Standing Committee on Finance supported the recommendation that STC be removed, but proposed that a final "branch profits tax" be introduced simultaneously.

The latter recommendations were accepted as South African companies operating in opposition to South African branches would object to the *de facto* advantage such branches would have if no "branch profits tax" were levied.

The amendment proposed by this subclause therefore abolishes STC on dividends declared by a foreign company out of profits (excluding profits derived from gold mining and long-term insurance business) derived through a branch or agency in the Republic.

The commencement of this proposal coincides with the introduction of normal tax in respect of taxable income derived by a foreign company through a branch or agency in the Republic, namely from years of assessment ending on or after 1 April 1996.

CLAUSE 22

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

The amendment introduced by this clause allows for loans made by an affected company to other companies in a wholly owned group of companies, to be made without such loans being deemed to be dividends for STC purposes. The definitions of "affected company", "holding company" and "intermediate company" are all applicable to this section.

Any loan made on or after 1 August 1996 will fall within this exemption.

CLAUSE 23

Additional assessments: Amendment of section 79 of the principal Act

At present STC is not subject to any prescription rules and where an error has been made by a company in respect of the payment of STC, the Commissioner may, under certain circumstances, issue assessments in respect of the non-payment of STC as from the date of implementation of STC. It is, therefore, proposed that the three-year prescription rule be extended to include STC calculations and that such amendment comes into operation from the date of introduction of STC, namely 17 March 1993.

CLAUSE 24

Interest on underpayments and overpayments of provisional tax: Amendment of section 89quat of the principal Act

These amendments are consequential upon the limitation of the Commissioner's discretionary powers where the provisions of section 103 of the principal Act have been applied. In this regard see the explanation with regard to *clause 29*. The date of commencement of these amendments corresponds with that of the amendments to section 103.

CLAUSE 25

Calculation of interest: Amendment of section 89quin of the principal Act

This clause is consequential upon the repeal of the Sixth Schedule to the principal Act.

CLAUSE 26

Recovery of taxes: Amendment of section 91 of the principal Act

Section 91(2) of the principal Act contains a reference to the Magistrates' Courts Ordinance, 1963, of the territory (Namibia). In view of the fact that South Africa no longer has any jurisdiction over Namibia, such reference is obsolete and it is proposed that the section be amended accordingly.

CLAUSE 27

Public officers of companies: Amendment of section 101 of the principal Act

Every company is required, in terms of section 101 of the principal Act, to appoint a public officer who will be responsible for the tax affairs of the company and to appoint a place for service and delivery of notices. Such company must keep the office of public officer constantly filled and *inter alia* maintain such a place of service and delivery. Any company which makes default in the above matters, is liable to a penalty of R10 per day. The last increase in the penalty took place in 1991, when the amount was increased from R2 to R10. It is proposed that such penalty be increased to R25 per day in respect of any default made on or after the date of promulgation of this Bill.

CLAUSE 28

Treatment of certain small tax claims and refunds: Amendment of section 102A of the principal Act

Section 102A of the principal Act provides that where the amount of a taxpayer's liability for normal tax for a year of assessment exceeds the amount of employees tax deducted from his remuneration, the Commissioner shall not recover such an amount if the shortfall is less than R10. It is proposed that this amount be increased to R25 in respect of such shortfalls arising on or after the date of promulgation of this Bill.

CLAUSE 29

Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income: Amendment of section 103 of the principal Act

The Tax Commission examined the anti-avoidance provisions of section 103 in depth. It specifically referred to the problems presently experienced with the abnormality test and that there is no disadvantage for taxpayers who enter into an avoidance scheme, even if it is successfully challenged by the Commissioner. The Tax Commission recommended specific wording to amend the provisions to make them more effective by the introduction of a business test.

After public hearings on the Tax Commission's Report, the Joint Standing Committee on Finance recommended that the provisions be amended. In view of widespread avoidance involving millions of rand, the Committee also recommended that the imposition of interest be considered.

In the light of the above, it is proposed that the abnormality test be amended along the lines recommended by the Tax Commission, namely that a business test be introduced.

It is further proposed that where the provisions of section 103 have been applied, the discretion granted to the Commissioner in terms of section 89*quat*(3) and (3A) whereby he may direct that interest shall not be paid, should be restricted. This has the effect that where the provisions of section 103 are successfully applied, interest will be payable in respect of so much of the tax as is attributable to the application of section 103.

It is proposed that these amendments come into operation in respect of transactions, operations or schemes entered into or carried out on or after the date of promulgation of this Bill.

CLAUSE 30

Determination of taxable income from farming: Amendment of paragraph 4 of the First Schedule to the principal Act

Deletion of obsolete provisions.

CLAUSE 31

Determination of taxable income from farming: Amendment of paragraph 5 of the First Schedule to the principal Act

Deletion of obsolete provisions.

CLAUSE 32

Livestock and produce: Amendment of paragraph 11 of the First Schedule to the principal Act

Paragraph 11 of the First Schedule to the principal Act provides for the taxation of livestock or produce which has been applied, disposed of or distributed under certain circumstances.

The provisions of this paragraph are similar to those of section 22(8) and the amendments are along similar lines to those proposed in *clause 12*. These amendments provide for—

- the rewording of the paragraph to assist in the interpretation thereof;
- the introduction of provisions whereby the market value of livestock or produce of a farmer will be included in his income where such livestock or produce have been—
  - applied by the farmer for his private or domestic use or consumption;
  - donated by the farmer; or
  - disposed of by him (other than in the normal course of his farming operations) for a consideration which is less than the market value of such livestock or produce;
- a reduction in the amount to be included in the income of the farmer where livestock or produce has been disposed of, other than in the normal course of his farming operations, for less than market value, by an amount equal to the consideration which is received by or has accrued to the farmer in respect of the livestock or produce so disposed of; and
- a deemed incurral of expenditure in respect of the acquisition by a farmer of livestock or produce, where such livestock or produce has been used or consumed by him in the ordinary course of his farming operations and the value thereof has been included in his income.

The amount to be included in income in respect of livestock or produce which has been privately consumed by the farmer is the cost to him, but provision has been made for instances where the cost price is not readily determinable, that the market value be taxed.

CLAUSE 33

Determination of taxable income from farming: Amendment of paragraph 18 of the First Schedule to the principal Act

Deletion of obsolete provisions.

CLAUSE 34

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

The definition of "remuneration" in paragraph 1 of the Fourth Schedule to the principal Act excludes an amount paid or payable in respect of services rendered by a person as a domestic or private servant or farm labourer, if such amount does not exceed R2 400 per annum. As the tax threshold for persons under 65 years is now R15 580, such an exclusion is no longer necessary and it is proposed that this exclusion be deleted.

It must, however, be noted that where such person is paid an amount in excess of the tax threshold, the employer is required to register as an employer. See also *clause 36.*

CLAUSE 35

Standard income tax on employees (SITE): Amendment of paragraph 11B of the Fourth Schedule to the principal Act

Subclause (a): The proposed amendment introduced by this subclause provides that where, at the option of the employer a branch has been separately registered, each such separate branch shall be considered to be an employer.

Subclause (b): Paragraph 11B(4A) of the Fourth Schedule to the principal Act was introduced in 1993 to assist employees who, through ignorance of the provisions of the law, failed to furnish an updated return of their personal particulars (eg marital status and number of children qualifying for a rebate) in respect of the 1991, 1992 and 1993 years of assessment. These provisions granted authorisation to the Commissioner so that he could refund SITE (which is normally not refundable) which was overpaid by such employees in respect of such years of assessment.

The view is held that sufficient time has now been allowed for employees to come forward and claim refunds and it is proposed that only requests which are received before 1 December 1996, will still qualify for a refund of SITE overpaid in respect of the 1991, 1992 and 1993 years of assessment.

CLAUSE 36

Employees tax: Amendment of paragraph 15 of the Fourth Schedule to the principal Act

The current provisions of paragraph 15 of the Fourth Schedule to the principal Act, read together with the definition of employer as contemplated in that Schedule, require that where an employer is liable to pay any employee any remuneration, the employer must register as an employer for employees tax purposes. It is proposed that these provisions be amended so as to allow an employer who has only employees in his employ who are not liable for normal tax, not to register as an employer.

The proposed amendment also deletes certain obsolete provisions.

See also *clause 34.*

CLAUSE 37

Provisional tax: Amendment of paragraph 18 of the Fourth Schedule to the principal Act

At present individuals older than 65 are exempt from the payment of provisional tax if their annual taxable income does not exceed R35 000 and consists exclusively of remuneration, interest or rent from the letting of fixed property. It is proposed that this exemption threshold be raised to R50 000 with effect from the commencement of the 1997 tax year.

CLAUSES 38 AND 39

Deletion of heading preceding paragraph 29 of the Fourth Schedule to the principal Act

Deletion of headings following paragraph 32 of the Fourth Schedule to the principal Act

These amendments are of a textual nature.

CLAUSE 40

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

In terms of Government Notice No. 1154 dated 4 August 1995, the official rate of interest used for the purpose of quantifying the benefit of an interest-free or low-interest loan was increased from 14 per cent to 16 per cent with effect from 1 September 1995.

As required by paragraph 20(2) of the Seventh Schedule, the increase is confirmed by this clause. See also *clause 43* which withdraws the relevant notice.

CLAUSE 41

Amendment of the principal Act

This amendment is of a textual nature.

CLAUSE 42

Amendment of section 9 of the Income Tax Act, 1994

Section 9 of the Income Tax Act, 1994, withdrew the exemption previously granted to the South African Bibliographic and Information Network (SABINET) with effect from 1 April 1994. SABINET is a company registered under section 21 of the Companies Act, 1973, as an association incorporated not for gain and which was, up to 1992, mainly dependent on subsidies from the State. The reason for granting an exemption was that the major portion of the company's income was derived in the form of subsidies from the State and the company was therefore seen merely as an extension of the State. In the light thereof, the withdrawal of the exemption should have been done with effect from the commencement of the year of assessment immediately following the year in which the last State subsidy was received and not from the commencement of the company's 1994 year of assessment. The amendment introduced by this clause therefore amends the relevant commencement date accordingly.

CLAUSE 43

Withdrawal of Government Notice No. 1154 dated 4 August 1995

This clause withdraws Government Notice No. 1154 dated 4 August 1995. See also *clause 40* which amends paragraph 1 of the Seventh Schedule to the principal Act as required by paragraph 20(2) of the said Schedule.

CLAUSE 44

Repeal of laws

The tax laws of the former Republic of Ciskei were repealed last year. The Income Tax Amendment Act, 1987, and the Income Tax Amendment Decree, 1993, of the former Republic of Ciskei were inadvertently omitted from the laws repealed. These laws are now repealed.

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

CLAUSE 45

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 1997.

CLAUSE 46

This clause provides the short title of the Bill.