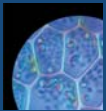


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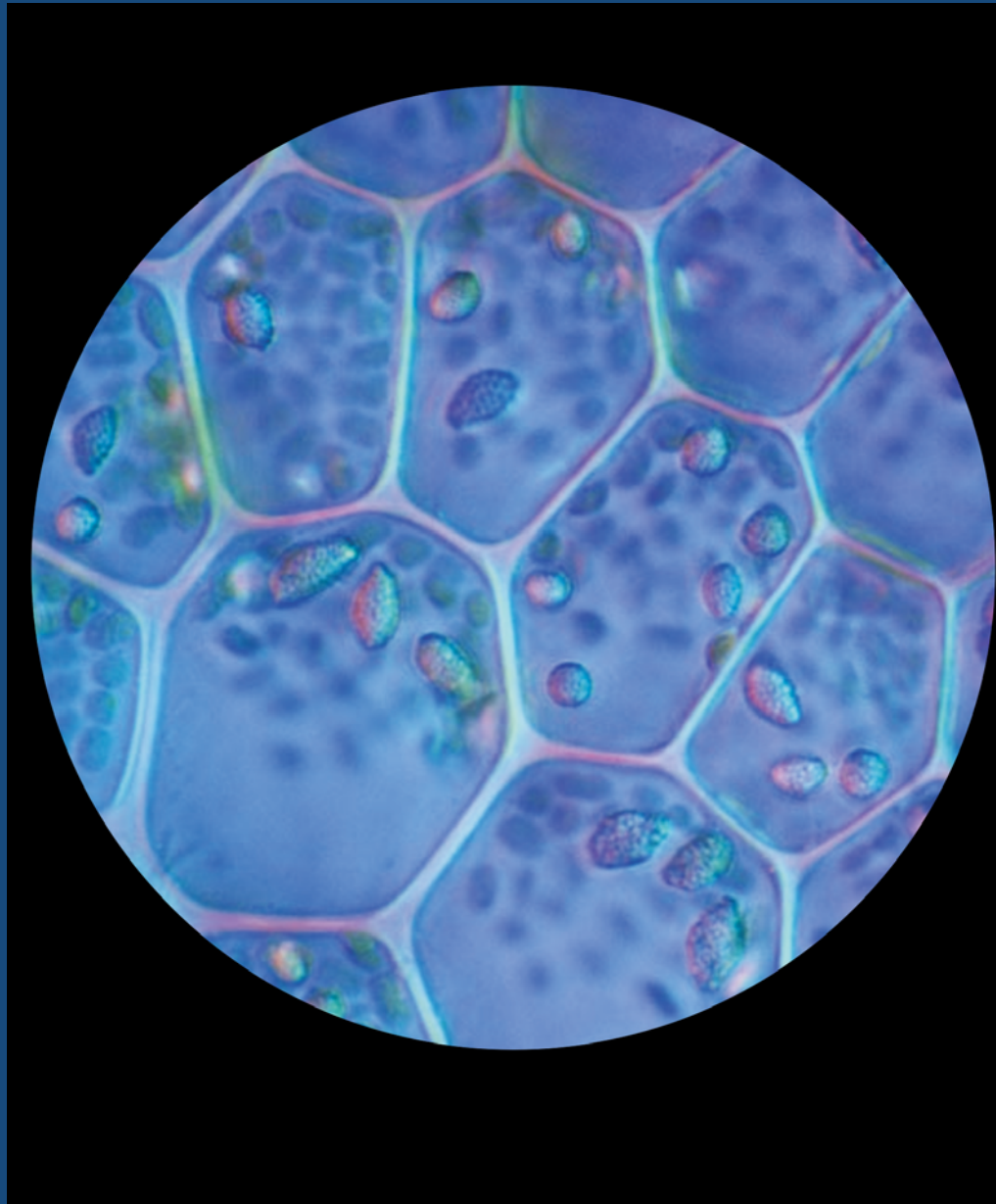
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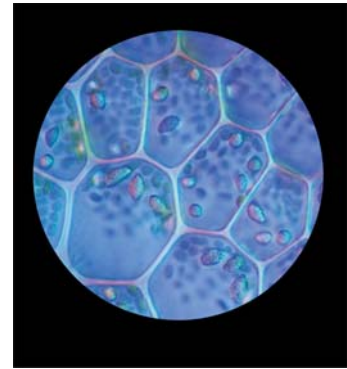


Regional offices

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A detailed picture revealed

Tax consultants and their clients have good reason to be alarmed at the implications of the draft Regulation of Tax Practitioners Bill released on 1 March 2007.



The purpose of the Bill, as stated in section 2, is “to regulate the tax practitioner profession to ensure that tax practitioners are appropriately qualified, adhere to ethical practices and are held accountable for their professional conduct”.

The Bill reveals, for the first time, a detailed picture of the envisaged regulatory regime, although the crucial “code of professional conduct” for tax practitioners is yet to be drawn up.

Obligation to register as a tax practitioner

The Bill provides that every natural person who –

- provides advice to any other person with respect to the application of any Act administered by the Commissioner of the South African Revenue Service; or
- completes or assists in completing any document to be submitted to the Commissioner by any other person in terms of such Act,

is obliged to register with the Independent Regulatory Board for Tax Practitioners (“the Board”) which is to be established in terms of the Act; (see section 24).

However, no such registration will be required in respect of a person who –

- provides advice or completes or assists in completing any document for no consideration (for example, someone who, free of charge, assists a friend or relative to complete such a document);
- provides tax advice solely in anticipation of or in the course of litigation to which the Commissioner is a party or a complainant (for example a litigation attorney who gives such advice);

- provides tax advice solely as an incidental or subordinate part of providing goods or services to another person (the ambit of this exclusion is a moot point);
- provides advice or completes or assists in completing any tax document solely to or in respect of that person’s employer by whom that person is employed on a full-time basis (this would cover tax advice and the completion of tax documents by a full-time employee for an employer on an in-house basis) or under the direct supervision of any person who is registered as a tax practitioner (this would cover an employee who does not have the requisite qualifications to be a registered tax practitioner, and who gives advice or completes tax documents under the supervision of an accredited tax practitioner).

Investigating committee and disciplinary committee

The Board is to establish two permanent committees, an investigating committee and a disciplinary committee which must include individuals with significant legal experience. The disciplinary committee must be chaired by a retired judge. (Section 20.)

Qualifications required for accreditation as a tax practitioner

The Bill foreshadows (see section 26(a)) that one of the pre-requisites for registration as an accredited tax practitioner will be that the person possesses “appropriate standards of qualifications”. At present, no such qualifications have been laid down.

The Bill also foreshadows (see section 26(c)) that “participation in continuing professional tax



education” will be required of accredited tax practitioners.

The Board is to lay down a “code of professional conduct” for accredited tax practitioners (section 29(b)).

Reportable irregularities

One of the most controversial aspects of the draft Bill is likely to be the requirement that tax practitioners must report “reportable irregularities” to the Board.

Section 31 provides that –

- (1) “If an accredited tax practitioner who acts for a person is satisfied or has reason to believe that a reportable irregularity has taken place or is taking place in respect of the tax affairs of that person, that tax practitioner must send a notice containing a request to rectify that irregularity within 30 days to that person or, if that person is an entity with a management board, to the management board.
- (2) ...
- (3) If the reportable irregularity is not rectified by that person or management board [within the 30 day period] the accredited tax practitioner must without delay –
 - (a) send a written report to the Board giving particulars of that irregularity ...
 - (b) send a copy of the report to that person or management board.”

In short, therefore, if an accredited tax practitioner “is satisfied or has reason to believe” that a reportable irregularity has occurred in the tax affairs of a client, the practitioner must call on the client to rectify that irregularity, and if this is not done within 30 days, the practitioner must report the irregularity to the Board.

A “reportable irregularity” is defined in section 1 as “any unlawful act or omission committed by any person which constitutes a contravention of any Act administered by the Commissioner or is fraudulent or amounts to theft or is otherwise dishonest”.

In terms of section 37, the Board must, “as soon as practically possible” after receiving such a report from an accredited tax practitioner, inform SARS of the details of the reportable irregularity and disclose any information relating to the taxpayer in question that has been furnished to the Board.

Offences

What constitutes “improper conduct” on the part of an accredited tax practitioner is not laid down in the Bill, and will be set out in the “code of professional conduct” which will be drawn up by the Board.

All that the Bill says in this regard is that –

“an accredited tax practitioner who knowingly or recklessly contravenes the code for tax practitioners determined by the Board is guilty of an offence”, and that a person convicted of such an offence is liable to a fine or to imprisonment for “a term not exceeding five years, or to both such fine and imprisonment”. (See section 48.)

A contravention of the duties of accredited tax practitioners, as laid down in section 28, is also to be an offence, punishable by a fine or imprisonment for up to five years, or both (section 49).

Failure to register as an accredited tax practitioner will be an offence, punishable by a fine or imprisonment for up to five years, or both (section 47).

It will also be an offence for a person who has been subpoenaed in terms of section 42(5) to testify at a disciplinary hearing or produce documents, to fail to do so, or to refuse to “answer full and satisfactorily ... all questions lawfully put concerning the subject of the hearing”, or to give a false answer to any question (section 50).

These are criminal offences, and will thus be tried in the ordinary courts.

One of the most controversial aspects of the draft Bill is likely to be the requirement that tax practitioners must report “reportable irregularities” to the Board.

Improper conduct and punishment

In addition to the criminal sanctions, outlined above, the disciplinary committee, appointed by the Board, will have power to impose punishments.

The Bill provides that the Board “must” refer a matter to the investigating committee if it suspects, on reasonable grounds, that an accredited tax practitioner has committed an act which may render him or her guilty of improper conduct; (section 39(a)).

The investigating committee must then investigate the matter, obtain evidence to determine whether the accredited tax practitioner in question should be charged and, if so, recommend to the Board the charges that should be preferred against that tax practitioner; (section 40(1)).

If, at the conclusion of a hearing, a disciplinary committee finds the accredited tax practitioner guilty of improper conduct, that committee may caution or reprimand the tax practitioner, or may impose a fine not exceeding the amount corresponding to the ratio for two or five years imprisonment prescribed by the Adjustment of Fines Act 101 of 1991, or may suspend the right to practice as an accredited tax practitioner for a specified period, or may cancel the registration of the accredited tax practitioner and remove his or her name from the register (section 43).



Recent new rules

Official rate of interest



The official rate of interest, for the purposes of paragraph 1(a) of the Seventh Schedule to the Income Tax Act, will increase to 10% per annum (from 9% per annum), with effect from 1 March 2007. The Minister of Finance, Mr

Trevor Manuel, announced the increase in *Government Gazette* no 29683 published on 1 March 2007.

This is the rate below which fringe benefits tax will apply in respect of loans to employees. It is also the safe harbour rate for loans to shareholders in establishing whether the loan is a deemed dividend subject to STC.

Tax Guide on the Deduction of Medical Expenses



In our January issue, we analysed and commented on the draft guide that had been circulated by SARS. The *Tax Guide on Deduction of Medical Expenses* has now been published in final form. A copy may be obtained from the SARS website at www.sars.gov.

Determination of daily allowance – meals and incidental costs



On 21 February 2007, the Commissioner for the South African Revenue Service published revised schedules of the amounts deemed to have been actually expended by a person, in respect of meals and incidental costs for the purposes of sec 8(1)(a)(i)(bb) of the Income Tax Act 1962. These schedules apply to years of assessment commencing 1 March 2006 and 1 March 2007 respectively.

For the year of assessment commencing 1 March 2006

The following amounts will be deemed to have been actually expended by a recipient to whom an allowance or advance had been granted or paid—

(a) where the accommodation to which that allowance or advance relates is in the Republic and that allowance or advance is paid or granted to defray—

(i) incidental costs only, an amount equal to R60-00 per day; or

(ii) the cost of meals and incidental costs, an amount equal to R196-00 per day; or

(b) where the accommodation to which that allowance or advance relates is outside the Republic and that allowance or advance is paid or granted to defray the cost of meals and incidental costs, an amount equal to US\$190 per day.

For the year of assessment commencing 1 March 2007

The following amounts will be deemed to have been actually expended by a recipient to whom an allowance or advance had been granted or paid—

(a) where the accommodation to which that allowance or advance relates is in the Republic and that allowance or advance is paid or granted to defray—

(i) incidental costs only, an amount equal to R63-50 per day; or

(ii) the cost of meals and incidental costs, an amount equal to R208-00 per day; or

(b) where the accommodation to which that allowance or advance relates is outside the Republic and that allowance or advance is paid or granted to defray the cost of meals and incidental costs, an amount equal to US\$200 per day.

Supreme Court of Appeal settles royalty debate

Taxpayers currently engaged in disputes relating to the deductibility of royalty payments should now determine whether they are able to secure a concession from SARS.

In our September 2006 issue, we commented on a judgment in the Cape Tax Court that had ruled that annual royalties incurred by the taxpayer were of a capital nature and not deductible. We expressed the view that the judgment was fundamentally flawed. On 13 March 2007, the Supreme Court of Appeal handed down its judgment in the matter of *BP Southern Africa v C:SARS* (Case No. 60/06) upholding the taxpayer's appeal against disallowance of the royalties paid.

The Supreme Court, in an unanimous decision, ruled that the conclusion reached in the Tax Court did not have due regard to the essential features of the royalty agreement. This plainly recorded that the licensee was required to make annual payment for the use – not ownership – of the licensed intellectual property and that ownership in the intellectual property at all times remained with the licensor. Further, if the agreement were to terminate, the



Taxpayer 1, SARS 0

licensee would automatically cease to have the right to use the intellectual property.

The recurrent nature of the royalty payments was strongly indicative that they related to revenue rather than capital. The recurrent cost of procuring the use of something which belongs to another is usually

recognised as being of a revenue nature. In this regard, it was held that the annual royalty fee paid was, to all intents and purposes, indistinguishable from recurrent rent paid for the use of another's property.

The Supreme Court found further that the expenditure in issue neither created nor preserved any capital asset in the hands of the taxpayer (the licensee) and for this reason, the expenditure tended to assume a revenue rather than a capital nature.

In the circumstances the appeal was allowed and the expenditure was held to be deductible.

Editor's note: This decision of the Supreme Court of Appeal brings to an end a period of uncertainty among taxpayers who manufacture or distribute products or services under licence. Taxpayers who are currently engaged in disputes or objections relating to the deductibility of royalty payments should consider carefully their contractual arrangements, and determine whether they might be able to secure a concession on this issue from SARS.

Section 9B

Draft interpretation note brings



The question whether the proceeds from the sale of shares are income or capital is often difficult to answer because of the difficulty of determining, in any given situation, whether the sale took place in the course of a trade of share-dealing or as a scheme of profit-making, or whether the sale was a mere realisation of shares held on capital account.

The detailed, eight-page explanation of section 9B, with some practical examples, will assist taxpayers and their advisers to understand the working of the section.

In the early days of income tax in South Africa, the courts took the view that the primary inquiry was into the taxpayer's "dominant intention" at the time of acquisition of the shares in question. So long as it was not the taxpayer's dominant intention to acquire the shares in order to resell them at a profit, there was no liability to income tax on the eventual disposal.

A taxpayer's secondary intention

However, more recent High Court decisions, notably *African Life 1969 (4) SA 259 (A)* and *Nussbaum 1996 (4) SA 1156 (A)*, have engaged in a far more nuanced inquiry. In both of these cases, the taxpayer was held liable to income tax on the sale of shares on the basis that (whatever the dominant intention may have been vis-à-vis the shares at the time of acquisition) there was a "secondary intention" to deal in shares and derive a profit from resale.

Because of the difficulty of predicting when a court will find a taxpayer to have had such a secondary intention, many taxpayers now prefer to arrange their affairs so as to utilise the "safe haven" provisions of section 9B, rather than risk drawn-out, expensive and ultimately unpredictable litigation in the Tax Court and the High Court.

Draft interpretation note brings welcome clarity

The draft interpretation note, issued by SARS on 6 March 2007, on the interpretation of section 9B,

in terms of which the disposal of listed shares is, in certain circumstances, deemed to be on capital account, is welcome.

The detailed, eight-page explanation of section 9B, with some practical examples, will assist taxpayers and their advisers to understand the working of the section.

The draft interpretation note includes a discussion of the way in which shares, held within a trust, including a bewind trust, are regarded for purposes of section 9B.

Particularly welcome is the explanation of the way in which, and the time within which, a taxpayer is to exercise the election available under section 9B, and the explanation of the recoupment of costs and losses previously allowed to a taxpayer in relation to affected shares, and the operation of the FIFO (first in, first out) principle in determining whether affected shares have been held for the requisite five years.

Editor's note: The Minister of Finance, in his Budget Speech on 21 February 2007, gave notice that the intention is to amend the Income Tax Act to provide that proceeds on disposals of shares that have been held for more than three years will be regarded as being amounts of a capital nature. It is, therefore, expected that some changes to the legislation and the Interpretation Note will be made in the course of this year when the amending legislation is tabled in Parliament.

Anomalies in the small business tax amnesty and the draft regulations for the waiver of tax



One of the difficulties with any tax amnesty, such as the small business tax amnesty in terms of the Small Business Tax Amnesty and Amendment of Taxation Laws Act 9 of 2006 is that, inevitably, some taxpayers, through a mere quirk of timing or other technicality, do not qualify for the amnesty though they are no more blameworthy than others who do qualify.

The hardest of hard cases in this regard is a person who, just before the small business tax amnesty was announced, had confessed to SARS that he or she had been fiddling the tax from their business, and SARS then issued an assessment for the full amount of tax that ought to have been paid, plus additional tax, interest and penalties.

Such a taxpayer would not qualify for amnesty because section 10(b) of the Small Business Amnesty Act specifically provides that amnesty does not apply to tax which became payable as a result of information given to SARS by the taxpayer himself.

Hard cases were foreseen

It was foreseen in the planning stages of the amnesty that hard cases would arise, where some people would qualify for amnesty, while others did not.

In anticipation of such hard cases, the Small Business Amnesty Act provides in section 13 that, outside of and additional to the amnesty itself, the Minister of Finance can, by regulation, empower SARS to waive the tax liability of a person who has failed to qualify for the amnesty.

But, in terms of section 13(1), such a waiver of tax via ministerial regulations is severely restricted in two respects.

Firstly, the waiver can only be in favour of a person who failed to qualify for the amnesty as a result of the particular provisions of section 10(b) or (c) of the Small Business Tax

Amnesty Act. No other ground for missing out on the amnesty will qualify a person for a waiver of tax under the ministerial regulations.

Secondly, the waiver will only be in respect of additional tax, penalties and interest, and there can be no waiver of the principal amount of tax. By contrast, where a person qualified for the amnesty, the principal amount of tax, as well as any potential liability for additional tax, penalties and interest is completely extinguished.

A third curtailment, which appears in the draft regulations but is not mandated by the Act, is that the maximum amount of additional tax, interest and penalties that can be waived under the ministerial regulations is R1 million. By contrast, there is no ceiling amount for the tax liability that can be extinguished in respect of a person who qualifies for the amnesty.

Failure to qualify for amnesty as a result of sections 10(b) or (c) of the Small Business Tax Amnesty Act

As was noted above, the ministerial regulations allow a waiver only in relation to a person who failed to qualify for the amnesty because of the provisions of section 10(b) or (c) of the Small Business Tax Amnesty Act. These two sub-sections therefore require close scrutiny.

Section 10(b) and (c) state that the tax amnesty does not apply to any tax, levy, contribution, interest, penalty or additional tax to the extent that it –

- is or becomes payable in consequence of any information which was furnished to SARS by the applicant or his representative in any return or declaration or otherwise before the submission of the amnesty application; *(the new ministerial regulations will allow a waiver of additional tax, penalties and interest – but not the principal amount of tax – in respect of a person who, no doubt unaware of the forthcoming amnesty, had confessed his transgressions*

to SARS before applying for amnesty and, consequently, did not qualify for amnesty);

- is payable by a taxpayer in terms of an assessment issued by the Commissioner before that person submitted an application for amnesty; *(the new ministerial regulations will allow SARS to waive the additional tax, interest and penalties – but not the principal amount of tax – owing and unpaid as at 31 July 2006, levied on a person who had fiddled their tax, had been caught out by SARS, and had been issued with an assessment for the tax properly payable, plus additional tax and interest).*

The ministerial regulations have remedied some inequities but introduced new inequities

The trouble with the ministerial regulations that allow SARS to waive additional tax, penalties and interest due by taxpayers who did not qualify for the amnesty, and which were intended to iron out quirks in the amnesty rules, is that the regulations give meagre relief to some persons who are deserving of generous relief, and give generous relief to people who are completely undeserving of relief.

In short, the new ministerial regulations remedy some inequities arising out of the fact that some taxpayers missed out on the small business amnesty, but introduce new inequities.

To illustrate, take the following hypothetical cases in which we assume that the tax debt in question arose from the carrying on of a business which had a gross income in 2006 not exceeding R10 million (these being prerequisites for the amnesty):

(1) Mr One had, completely dishonestly, been fiddling his tax for years prior to 2006 and had not been caught out by SARS at the time when he applied for the small business tax amnesty in August 2006. Notwithstanding his dishonesty over a long

The most striking anomaly in the amnesty rules is the denial of amnesty to a taxpayer who had voluntarily confessed to SARS, without any audit or investigation, that he had been fiddling his tax.



period, he is entitled, in terms of the amnesty rules, to apply for and receive a full amnesty. In other words, his entire tax liability for the tax years up to and including 2005 is completely extinguished, and all he needs to pay is a small amnesty levy based on the business's true taxable income in the 2006 tax year.

(2) Mr Two: Before the tax amnesty was announced, he voluntarily (and without any tax audit or investigation) confessed to SARS that he had been fiddling his tax for many years. SARS thereupon issued him with an assessment for all the tax he should have paid over those years, plus additional tax, penalties and interest. In terms of the amnesty rules, Mr Two is entitled to no amnesty relief whatsoever because amnesty is not available for tax which becomes payable as a result of information given to SARS by the taxpayer himself.

In terms of the ministerial regulations, Mr Two is entitled to a waiver of the additional tax, penalties and interest for which SARS has assessed him in respect of the tax years up to and including 2005 – provided that he had not paid these amounts as at 31 July 2006.

But the principal amount of tax, for each and every one of the years he has been fiddling his tax up to and including 2005, remains fully payable. Obviously, Mr Two is far more deserving of relief than Mr One because of Mr Two's voluntary confession and Mr One's unmitigated dishonesty, but Mr Two gets far lesser relief in that he still has to pay the full amount of tax for the income he has failed to disclose, from 2005 right back to the year dot, and he is only relieved of having to pay additional tax, interest and penalties for those years.

(3) Mr Three was assessed to tax years ago, but he ducked and dived and for years he managed to avoid actually paying the tax. SARS then issued a further assessment for additional tax, penalties and interest, amounting to hundreds of thousands of rand.

Just before the Small Business Tax Amnesty Act was passed, Mr Three paid SARS everything he owed – the principal amount of tax plus the hundreds of thousands of rand in additional tax, interest and penalties. Mr Three qualifies for no tax relief whatsoever, because the amnesty and the ministerial regulations regarding waiver of tax give no relief to someone who, as at 31 July 2006, had paid SARS what he owed.

(4) Mr Four, like Mr Three, was assessed to tax years ago, and he also ducked and dived and avoided paying. As with Mr Three, SARS issued Mr Four with an additional assessment for additional tax, penalties and interest amounting to hundreds of thousands of rand. As at 31 July 2006, Mr Four had still managed to avoid actually paying SARS what he owed. In terms of the new draft regulations, he must pay the principal amount of tax because he does not qualify for the amnesty, but the additional tax, interest and penalties owing as at 31 July 2006 will be waived up to an amount of R1 million.

Mr Four is far less deserving than Mr Three because Mr Three eventually faced up to his responsibilities and paid SARS what he owed, but the less-deserving Mr Four is relieved of having to pay hundreds of thousands of rand in additional tax, penalties and interests, while Mr Three gets no relief at all. He cannot get a refund of any of the tax, additional tax, interest or penalties that he paid.

A fundamental anomaly in the tax amnesty rules

The most striking anomaly in the amnesty rules is the denial of amnesty to a taxpayer who had voluntarily confessed to SARS, without any audit or investigation, that he had been fiddling his tax. Logic and equity suggest that the amnesty rules should treat this category of person more favourably than any other category of tax evader. Yet, anomalously, the amnesty rules single out taxpayers in this category for a denial of amnesty.

The ministerial regulations are still in draft form and may well undergo further refinement. The regulations must be submitted to Parliament for scrutiny at least 30 days before they are published, and such parliamentary scrutiny could give rise to further amendments.

In effect, the amnesty (perhaps inevitably) rewards unrepentant dishonesty, and punishes those who had confessed their transgressions. The amnesty rewards those who have successfully avoided paying tax by concealing their misdemeanours, and denies relief to those who had misbehaved and then repented and paid SARS what they owed.

Repeating the unfairness of the amnesty rules in this respect, the new ministerial regulations which allow for the waiver of tax, give meagre relief to taxpayers who had freely confessed their transgressions to SARS, relieving them only of additional tax, interest and penalties, but requiring them to pay the principal amount of tax in full.

The ministerial regulations reward those who have been assessed to additional tax, interest and penalties but have managed to avoid actually paying, while cold-shouldering those who were assessed to such amounts and paid what they owed before 31 July 2006.

A further anomaly is that, although the waiver of tax in terms of the ministerial regulations is of the tax that was payable as at 31 July 2006, if SARS has since that date and before the taxpayer submitted an application for waiver of tax (and no application for waiver can be submitted until the regulations are issued in final form, so we are still in a limbo situation) attached the assets of a taxpayer under a writ of execution, or has instituted liquidation proceedings against the taxpayer, the business debt will not be waived. In other words, a taxpayer who ducks and dives and hides from the deputy sheriff so that a writ can't be served on him will get a waiver of tax. A taxpayer who manfully stands his ground and accepts service of a writ of execution is stripped of his right to a waiver. In this respect, too, the waiver regulations reward the duckers and divers, and penalise the responsible citizen.

Since 31 July 2006, SARS will have issued writs of execution and instituted sequestration

proceedings against some taxpayers with outstanding tax debts, but not against others. The unlucky taxpayers in this lottery will forfeit their entitlement to a waiver of tax.

The regulations are still in draft form

The ministerial regulations are still in draft form and may well undergo further refinement. In terms of section 13(3) of the Act, the regulations must be submitted to Parliament for scrutiny at least 30 days before they are published, and such parliamentary scrutiny could give rise to further amendments.

However, since the Small Business Tax Amnesty Act says explicitly that the ministerial regulations can only provide for the waiver by SARS of additional tax, penalties and interest (and even then, only in respect of persons who failed to qualify for amnesty because of the particular provisions of section 10(b) and (c) of the Act) there is no possibility – unless the Act itself is amended – that the regulations can be modified to allow SARS to waive the principal amount of tax owing by a taxpayer who did not qualify for the amnesty.

The extension of the waiver to persons who did not qualify for the amnesty because of section 10(c) means, in effect, that any taxpayer who carries on a business and has been assessed for additional tax, penalties or interest for any tax year preceding the 2006 tax year, which they had not paid to SARS as at 31 July 2006 (bearing in mind that SARS is entitled to demand payment of an assessment even if the taxpayer lodges an objection), will be entitled to a waiver of these amounts in terms of the ministerial regulations. This is provided that they can avoid having their assets attached or being sequestered until those regulations are issued in final form and they can submit their application for waiver. If, before then, SARS serves a writ of attachment for the debt or if liquidation or sequestration proceedings are commenced, the taxpayer will lose the right to a waiver.

• *Editor: Ian Wilson • Written by R C (Bob) Williams • Sub-editor and layout: Carol Penny Tax Services Johannesburg*
• *Distribution: Elizabeth Ndlangamandla • Tel (011) 797-5835 • Fax (011) 209-5835 • www.pwc.com/za*

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