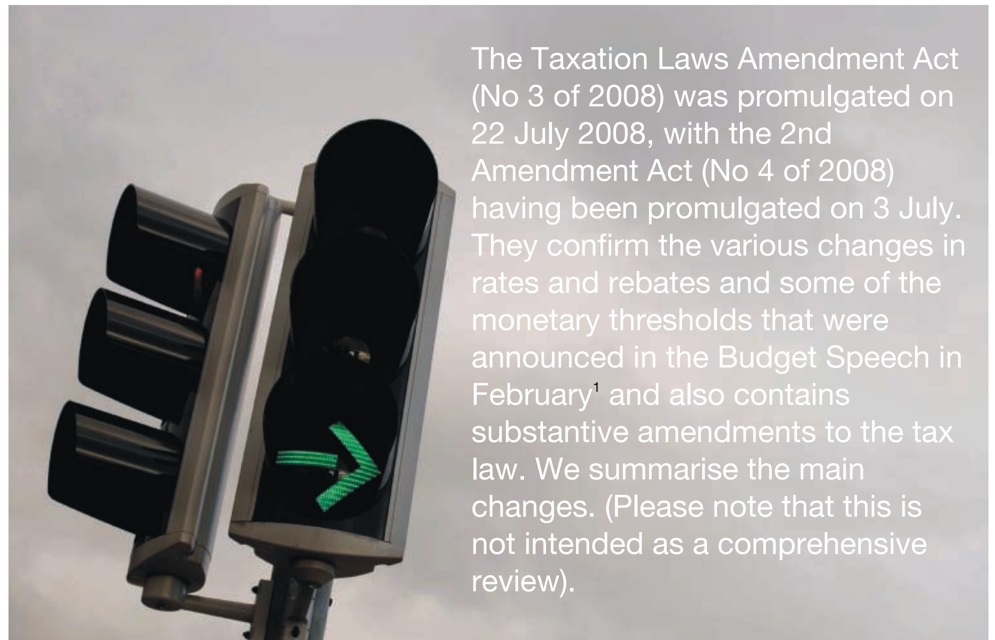
Tax Alert

22 July 2008

Taxation Laws Amendments



The Taxation Laws Amendment Act (No 3 of 2008) was promulgated on 22 July 2008, with the 2nd Amendment Act (No 4 of 2008) having been promulgated on 3 July. They confirm the various changes in rates and rebates and some of the monetary thresholds that were announced in the Budget Speech in February[1] and also contains substantive amendments to the tax law. We summarise the main changes. (Please note that this is not intended as a comprehensive review).

Most of the amendments take effect at the start of tax years ending on or after 1 January 2009 – i.e. in the case of a 28 February 2009 year-end, the changes take effect on 1 March 2008. However, certain amendments take effect on specified dates, as indicated below.

Dividends and STC (s1, s64B and s64C)

There has been significant rewording of the definition of "dividend" in s1, some of which clarify or overturn amendments made in 2007.

In terms of a re-instated paragraph (c) of the dividend definition, any reduction in company profits as a result of the reduction of share capital or the acquisition, redemption or cancellation of shares issued by the company constitutes a dividend. This represents a consolidation of past and present rules on the dividend component of capital reductions. (Effective 1 October 2007.)

An anti-avoidance provision aimed at treasury share companies (insertion of paragraph (cB)) includes as a dividend any reduction in the profits of a company as a result of the cancellation of shares that the company held in another group company.

STC (Secondary Tax on Companies) has a number of amendments

S64B(3)(b) is amended to prevent the second-level crediting of pre-residence profits distributed upon liquidation. Where a non-resident company becomes resident and is subsequently liquidated, the pre-residence profits could in past have been distributed entirely free of STC if the declaring company as well as the recipient shareholder company were liquidated. The amendment now limits the exemption to only the liquidation of the first company. (Effective 21 February 2008)

The group exclusion in s64C(4)(k) has been reworded to deal with the position where the recipient (of a deemed dividend) is not the shareholder but rather a connected person in relation to the shareholder. (Effective 1 October 2007.)

Group relief (s41 – s47)

The definition of "group of companies" in s41(1) is amended to include foreign-incorporated companies effectively managed in SA. Previously, all foreign-incorporated companies were excluded irrespective of their place of effective management.

The effective date of the new group definition is brought forward to 21 February 2008 for the purposes of the group relief rules (previously 1 January 2009). The effective date

1 *For a copy of PwC's 2008/2009 Tax Information Card which sets out tax rates, threshold adjustments and so forth please contact any of the individuals listed.*

remains 1 October 2007 for the dividend, STC, and CGT rules.

A new s41(5) gives the Commissioner power to prescribe circumstances under which the details of a transaction applying s42 to s47, must be furnished to the Commissioner. (Effective date 21 February 2008).

The definitions of “qualifying interest” as applied in s42 and s44 have been streamlined, along with the extension of the s42 definition to also cover holdings in collective investment schemes.

S42(2)(bA) is amended to reduce, from 25% down to 20%, the de minimis holding for market value base cost recognition. This provision allows listed companies to receive assets at market value (for CGT base cost purposes) as long as the transferor does not end up with more than 20% (previously 25%) of the company’s equity.

The rules on Amalgamation transactions (s44) are amended to exclude situations where assets are transferred to a collective investment scheme. However, transfers between CISs (i.e. if both the transferor and transferee are CISs) will continue to qualify.

Certain perceived tax avoidance schemes that used s45 to transfer of assets out of a group tax-free, are targeted (effective 21 February 2008):

S45(4) broadens the circumstances in which de-grouping occurs. There will now be a de-grouping charge not only if the transferor and transferor de-group from each other, but also if the transferee de-groups from any of its controlling group companies in the wider controlling group (even if the transferor and transferee remain together).

Furthermore, a new s45(4A) also triggers the de-grouping charge if the consideration given by the transferee (as quid pro quo for the asset-transfer from the transferor) is disposed of for inadequate consideration or distributed out of the group.

The automatic break-up of groups caused purely by the coming-into-operation of the new ‘group’ definition in s41(1) will not give rise to a de-grouping charge. (Effective 21 February 2008.)

Unbundling relief is extended to the unbundling of shares in a CFC in certain cases. (Effective 21 February 2008).

A new s46A, entitled “Limitation of expenditure incurred in respect of shares held in an unbundling company”, is inserted to restrict the unbundling relief in cases where a previous shareholder was not subject to tax on the disposal of the unbundling company, e.g. the previous shareholder was a

non-resident. (Effective 21 February 2008.)

S47(5) is extended to ensure that the liquidation relief addresses the new rules on capital distributions and part-disposals in para 76A of the 8th Schedule. (Effective 1 October 2007.)

The period within which the prescribed steps must be taken to liquidate (or deregister, etc) the liquidating company is extended to 18 months (previously 6 months). (Effective 1 January 2008.)

Capital gains tax – Eighth Schedule

When a CFC becomes SA-resident (and thus ceases to be a CFC), a new amendment permits a tax-free uplift in base cost for the assets that would have been CGT-exempt under the CFC rules (e.g. foreign business establishment assets). The remaining assets are effectively granted roll-over relief in that they retain their original base cost but are not deemed to be disposed of upon change-of-residence. (Effective 21 February 2008.)

The participation exemption in para 64B is amended to deny the exemption if the purchaser is a CFC that is unrelated to the seller, or if there is a deemed disposal of shares held by a CFC as a result of that CFC becoming SA-resident. (Effective 21 February 2008.) More generally, the application of the exemption in the case of capital distributions has been further clarified, and the 20% holding requirement is extended to also require voting rights (in addition to equity capital).

The rules regarding capital distributions and part-disposals are also amended to ensure that previously deferred proceeds (under para 76) will be taken into account in subsequent part-disposals (under para 76A). Furthermore, unbundling transactions are confirmed as being excluded from the para 76A part-disposal rules. (1 October 2007.)

CFCs (Controlled foreign companies – s9D)

The exclusion in respect of intra-group amounts in s9D(9)(fA) is extended to exempt inter-CFC debt-waivers)

Capital treatment for share disposals (s9C)

The definition of “qualifying share” is amended to confirm that all SA-listed shares will qualify, even if the company is non-resident. However, s9C will not apply to shares in unlisted companies that were non-resident at any time in the last three years before disposal.

S9C(3) is amended to clarify the disqualification that may apply when the shareholder and company are connected persons, i.e. if more than 50% of the company-value is attributable to fixed property, or if the company holds only the bare dominium in fixed property. (Effective 1 October 2007.)

Foreign dividends (s10(1)(k)(ii))

The exemption for dividends from dual-listed companies (bb) is relaxed by removing the requirement that at least 10% of those companies must be held by residents, i.e. the exemption applies irrespective of the percentage SA-ownership.

Research and development expenditure (s11D)

The 150% deduction is now permitted for contract-researchers where no other person is allowed the deduction. This is aimed at situations where, for example, the principal is a non-resident (and thus does not take the R&D deduction) so that the SA-resident contract-researcher is able to use the 150% incentive.

Small business corporations (s12E)

Whereas SBCs were in some cases compelled to apply a 3-year 50/30/20 depreciation in respect of certain assets, they are now permitted to choose between the 3-year write-off and the applicable s11(e) regime, i.e. they can choose the more favourable option.

Foreign exchange differences (s24I)

The taxation and/or deduction of discounts or premiums on FECs (forward exchange transactions) are simplified. Specifically, the treatment of the FEC discount/premium is no longer dependent on whether or not the FEC was a hedge in relation to a debt (etc.), nor dependent upon the accounting treatment of a hedged debt (etc). Furthermore, the premium/discount must be taken into account in full upon accrual or incurral.

Expatriate employees – Accommodation fringe benefit (Para 9 of 7th Schedule)

The exemption for free accommodation granted to a non-resident employee is extended to 2 years (previously 12 months), and an alternative recurring annual exemption is now available if the employee is only physically present in SA for less than 90 days per year.

However, neither exemption is available if the employee was physically present in SA for more than for more than 90 days (previously 30 days) in the year before arrival. Furthermore, the exemption is capped at R25,000 per month.

Retirement tax (s1, 2nd Schedule, et al)

There is some restructuring and redefinition in the taxation of retirement funds, in line with National Treasury's intention that there should be a single regulatory process governing pension, provident and retirement annuity funds. New definitions (e.g. "pension preservation fund") have been introduced, and, in general, definitions harmonised. So-called 'living annuities' are confirmed as being an annuity. Some rules around the transfer of benefits to dependents have been softened.

Public benefit organisations (s30)

The requirement that at least 85% of a PBO's activities must be for the benefit of persons in SA, is deleted. Furthermore, it is sufficient for the PBO's constitution to provide that its assets upon winding-up should pass to any other PBO, i.e. it is no longer be necessary that the receiving PBO must be a 'similar' organisation.

Employees' Tax and Provisional Tax (4th Schedule)

SITE on part-year remuneration may now be re-classified as PAYE (and thus be refundable). This seeks to address the situation where employees should ultimately be taxable at lower rates than those used for the SITE deductions, because they do not earn remuneration for the entire tax year. (Effective 1 January 2008.)

For further information, please contact:

Johannesburg Mark Badenhorst 011-797-4641 mark.badenhorst@za.pwc.com

Pretoria Bennie Botha 012-429-0292 bennie.botha@za.pwc.com

Western Cape Osman Mollagee 021-529-2061 osman.mollagee@za.pwc.com

Durban Terry McCarthy 031-250-3875 terry.p.mccarthy@za.pwc.com

Port Elizabeth Ian Olls 041-391-4474 ian.olls@za.pwc.com

East London Susan Minnie 043 707 9600 susan.minnie@za.pwc.com

Bloemfontein Gert Nel 051-503-4222 gert.nel@za.pwc.com

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