NATIONAL
TREASURY

REPUBLIC OF SOUTH AFRICA

CLAUSE BY CLAUSE EXPLANATION

TO THE

EXPLANATORY MEMORANDUM

(TLB) 2011

[13 MARCH 2012]

Clause 1

Amendment of section 1 of the Income Tax Act, 1962

Subclause (a): Collective Investment Schemes in securities and property should both be equally excluded from the trust rules (wherein all trusts are connected persons in relation to beneficiaries).

Subclause (b): The amendment merely updates a reference for collective investment schemes in property.

Subclause (c): Collective Investment Schemes in securities and property should both be equally excluded from the trust rules (wherein all beneficiaries are connected persons).

Subclause (d): The concept of "deemed source" is no longer relevant in light of the changes made to the source rules of section 9 contained within the Taxation Laws Amendment Act, 2011.

Subclause (e): The amendment eliminates overlapping gross income in respect of certain annuities. Insurance annuities for the benefit of employees and their dependents are to be dealt with solely in respect of the employer-employee payout gross income provisions of paragraph (d). Besides eliminating potential double inclusions, treatment of this gross income under paragraph (d) means that certain forms of insurance annuity income may be exempt (see section 10(1)(gG)). The amendment also deals with the overlap between gross income in respect of certain annuities for the benefit of employers (see Subclause (f) below).

Subclause (f): Insurance payouts to employers will be dealt with solely under the insurance-employer payout provisions of paragraph (m) to similarly eliminate the potential for double gross income (see Subclause (e) above). The reference to preventing overlap involving annuity payouts under (d) is being deleted as superflouous. Gross income paragraph (m) is clearly aimed at employer receipts and accruals while gross income paragraph (d) is aimed at employee receipts and accruals.

Subclauses (g) and (h): Preservation funds are allowed a one-time pre-retirement lump sum withdrawal. However, transfers to more restrictive funds (i.e. those that do not allow for any pre-retirement lump sum withdrawal other than withdrawals due to resignation). Hence, transfers to pension and provident funds do not count against this one-time withdrawal by a preservation fund. It is now proposed that transfers to retirement annuity funds similarly not count against these one-time withdrawals (because withdrawals from retirement annuity funds are simply not permitted before age 55). It is also proposed that transfers from provident preservation funds to pension or pension preservation funds should similarly not count against one-time withdrawals from provident preservation funds because pension funds and pension preservation funds are more restrictive than provident funds.

Subclause (i): The proposed amendment aligns special trusts with section 18 and aligns the qualifying age with the new age (i.e. age 18) contained within the Age of Majority Act.

Subclause (j): The proposed amendment corrects improper technical language associated with property owned during marriage.

Clause 2

Amendment of section 6quat of the Income Tax Act, 1962

Subclause (a): The amendment clarifies the interaction of section 6*quat* rebates with the recent legislative changes resulting in the re-alignment of the tax on foreign dividends. Although foreign dividends are only partially includible (so as to have the same effective rate as domestic dividends), section 6*quat* rebates will be taken into account without regard to the new partial exclusion. For instance, if a foreign dividend of R500 is distributed subject to a 15 per cent foreign withholding tax rate, the full 15 per cent rate is potentially eligible for tax rebates, even though a portion of the foreign dividend is excluded from income.

Subclause (b): The proposed amendment clarifies that the deduction for foreign taxes under section 6*quat* is elective (as opposed to electing the section 6*quin* rebate).

Clause 3

Amendment of section 6quin of the Income Tax Act, 1962

The proposed amendment clarifies the impact of foreign tax rebates claimed under section 6*quin* that re subsequently refunded, reduced or otherwise discharged in a later year of assessment. In these circumstances, the section 6*quin* rebates must be paid over to SARS in the form of additional tax. This required mechanism ensures that taxpayers do not receive an unintended benefit. The provision effectively operates like a tax credit form of recoupment (therefore, prior years of assessment need not be re-opened for this charge to apply).

Clause 4

Substitution of section 8E of the Income Tax Act, 1962

See notes on **REVISED VERSION OF THE HYBRID EQUITY AND THIRD-PARTY BACKED SHARE PROPOSALS**

Clause 5

Substitution of section 8EA of the Income Tax Act, 1962

See notes on **REVISED VERSION OF THE HYBRID EQUITY AND THIRD-PARTY BACKED SHARE PROPOSALS**

Clause 6

Amendment of section 9D of the Income Tax Act, 1962

Subclause (a): The main purpose of this amendment is to clarify how the "high foreign tax exemption" works in the cause of a foreign structure involving multi-tier controlled foreign companies. More specifically, the high tax calculation for a CFC is determined without regard to the attribution of any section 9D income from lower-tier controlled foreign companies.

Subclause (b): the proposed amendment corrects incorrect wording associated with the working capital *de minimis* exception. The exemption is intended to eliminate up to 5 per cent of certain forms of financial instrument income.

Clause 7

Amendment of section 9H of the Income Tax Act, 1962

The amendment clarifies that the exit charge of section 9H applies only to residents that are ceasing to be a resident. It should be noted that controlled foreign companies losing controlled foreign company status are subject to tax under paragraph 12 of the Eighth Schedule.

Clause 8

Amendment of section 10 of the Income Tax Act, 1962

Subclause (a): The concept of “deemed source” is no longer relevant in light of the changes made to the source rules of section 9 contained within the Taxation Laws Amendment Act, 2011.

Subclause (b): The proposed amendment eliminates the phrase “or in favour of” because this terminology creates uncertainty in the case of dividends.

Subclause (c): The proposed amendment clarifies that the ordinary revenue rule for section 8C restricted instruments applies only if the section 8C instrument arose in the context of a section 8C event (e.g. employment-related). The mere existence of a restriction would make the anti-avoidance rule overly broad because restrictions exists outside the employment context for various reasons that are not of concern.

Subclause (d): The proposed amendment eliminates the phrase “or in favour of” because this terminology creates uncertainty in the case of dividends.

Subclause (e): In 2011, the prohibition of the participation exemption for foreign dividends in the case of financial instrument holding companies was implicitly eliminated. The proposed amendment ensures that this elimination dates back to the initial prohibition (i.e. back to 1 October 2011).

Clause 9

Amendment of section 10B of the Income Tax Act, 1962

Subclause (a): The proposed amendment mainly clarifies that the same country exemption applies only to foreign dividends between foreign companies.

Subclause (b): The proposed amendments clarifies that the partial exclusion for dividends applies to all trust shareholders (not merely trust shareholders that qualify as special trusts).

Subclause (c): The term “paid” is added for the sake of consistency.

Subclause (d): The anti-avoidance rules in respect of foreign dividends are aimed at targeting foreign dividend derived from deductible payments (e.g. interest and royalties). The goal is to prevent windmill schemes where funds are shifted offshore in deductible form, followed by the repatriation of the same funds via tax-free foreign dividends. The proposed amendment clarifies that this anti-avoidance rule does not apply to trading stock transmitted offshore (because the initial deduction are matched by gross income when shifted offshore or if held to the close of the year of assessment).

Clause 10

Amendment of section 11D of the Income Tax Act, 1962

Like the additional discretionary allowance of section 12I, SARS may raise an additional assessment in respect of additional deductions for research and development if the approval for those deductions have since been withdrawn (see section 12I(14)).

Clause 11

Amendment of section 12C of the Income Tax Act, 1962

The proposed amendment deletes a reference to an obsolete subsection.

Clause 12

Amendment of section 12E of the Income Tax Act, 1962

The proposed amendment places small business co-operatives on par with small business companies as a matter of consistency with prior year amendments.

Clause 13

Amendment of section 12G of the Income Tax Act, 1962

The whole provision is being repealed as obsolete (the more recent version of this incentive is contained within section 12I).

Clause 14

Amendment of section 12O of the Income Tax Act, 1962

The proposed amendment clarifies the reporting stream required for claiming the section 12O film exemption. Special purpose corporate vehicles and collection account managers can undertake this responsibility. The amendment clarifies that the conditions of managing exploitation rights and the Ministerial notice of Gazette relate solely to collection account manager.

Clause 15

Amendment of section 18 of the Income Tax Act, 1962

The 7.5 per cent minimum for out-of-pocket expenses for persons under age 65 is based on taxable income. For this purpose, taxable income excludes pre- and post-retirement lump sum withdrawals. The proposed amendment adds the additional exclusion for severance benefits because severance benefits are taxed on par with pre- and post-retirement lump sum withdrawals.

Clause 16

Amendment of section 22 of the Income Tax Act, 1962

The proposed amendment corrects an incorrect cross reference.

Clause 17

Substitution of section 22B of the Income Tax Act, 1962

The proposed substitution has the effect of fully removing the 45-day minimum holding period for obtaining exempt dividends. The purpose of the 45-day holding period was impractical. Taxpayers often have a meaningful holding in an underlying share even though the holding is only for a short duration before disposal. The sellers of the dividend may also have realised ordinary revenue or capital gain when disposing of the dividend (meaning that tax applies at a shareholder level when viewed as an aggregate). See also the clause-by-clause notes in reference to paragraph 43A.

Clause 18

Amendment of section 23I of the Income Tax Act, 1962

The proposed amendment corrects incorrect cross-references.

Clause 19

Amendment of section 25BA of the Income Tax Act, 1962

The main focus for calculating collective investment scheme income is “accruals” as opposed to “receipts.” This focus is consistent with other parts of section 25BA. The amendment also makes a stylistic change in respect of the 12-month holding period.

Clause 20

Amendment of section 37B of the Income Tax Act, 1962

The depreciation rules for certain long-term environmental assets are being aligned with other depreciation provisions. The assets must either be owned or acquired as part of a finance “instalment credit agreement.”

Clause 21

Amendment of section 37H of the Income Tax Act, 1962

The whole tax holiday is being repealed as obsolete.

Clause 22

Amendment of section 37N of the Income Tax Act, 1962

The proposed amendment removes an obsolete cross-reference.

Clause 23

Amendment of section 42 of the Income Tax Act, 1962

The amendment restores the deemed proceeds rule in respect of section 42 debt assumptions back to its original intent. If a company assumes debt as part of a section 42 transaction, the shareholder transferring assets subject to debt effectively increases the gain upon disposal of the company shares (any focus on acquisitions as a trigger is irrelevant).

Clause 24

Amendment of section 44 of the Income Tax Act, 1962

Subclause (a): The current legislation is written in reverse to the stated intention. Longer-term debt (i.e. debt more than 18 months) or shorter-term debt (if acting as a refinancing of longer-term debt or arising in the ordinary course of business) should generally not trigger taxation (unless that debt was incurred or otherwise assumed to procure certain assets in a section 44 merger). The language relating to business undertakings is also adjusted in line with pre-existing tax principles.

Subclause (b): In any merger, the amalgamated (i.e. target) company distributes shares of the (i.e. acquiring) resultant company after receiving those shares in exchange for the surrender of the amalgamated company's assets. The proposed amendment clarifies that this distribution should not give rise to any Dividends Tax liability, even though this distribution will typically qualify as a dividend.

Clause 25

Amendment of section 45 of the Income Tax Act, 1962

The proposed amendment clarifies that the exemption in respect of debt issued within the context of a section 45 transaction is limited solely to the repayment of principal (i.e. the underlying liability).

Clause 26

Amendment of section 46 of the Income Tax Act, 1962[match closer to section 46]

Unbundlings essentially involve the distribution of share interests in strategic subsidiaries. Without relief, these distributions will typically qualify as a dividend. The proposed amendment clarifies that qualifying unbundlings are exempt from the Dividends Tax.

Clause 27

Amendment of section 47 of the Income Tax Act, 1962

In 2011, the reorganisation rules were adjusted for cross-border reorganisations, including liquidations. It was intended that these changes accommodate inbound liquidations (i.e. liquidations of controlled foreign companies into South African companies). However, the current version of the law does not technically allow this combination because the required connection between the holding company and the liquidation company is based on the section 41 group of companies. The group of company reference should have been the section 1 definition so as to better accommodate inbound liquidations.

Clause 28

Amendment of section 61 of the Income Tax Act, 1962

The proposed amendment inserts missing words for ease of reading.

Clause 29

Amendment of section 64B of the Income Tax Act, 1962

The proposed amendment clarifies concerns that certain dividends subject to the Secondary Tax on Companies will fail to give rise to transitional STC credits due to the timing of the declaration. In essence, if a dividend is subject to the Secondary Tax on Companies, the tax on those dividends should give rise to transitional STC credits. No reason exists to exclude particular portions.

Clause 30

Amendment of section 64C of the Income Tax Act, 1962

Deemed dividends under section 64C (set to terminate with the Secondary Tax on Companies) should not include amounts treated as actual dividends (determined without regard to exclusions in respect of those distributed amounts). For instance, amounts subject to the Secondary Tax on Companies as a dividend or exempt capitalisation share distributions were never intended to fall within the deemed dividend rules.

Clause 31

Amendment of section 64E of the Income Tax Act, 1962

Subclause (a): The timing rules for the new Dividends Tax will be adjusted so as to be more pragmatic. The timing trigger for dividends in respect of listed company shares will be based solely upon the date of payment. The timing trigger for dividends outside this context (i.e. dividends in respect of unlisted shares) will be based on the earlier of the date that the dividend is paid or becomes payable. This difference is based on the fact that the timing for dividends in respect of listed shares is harder to manipulate solely for tax purposes.

Subclause (b): Company loans to certain natural person shareholders and their connected persons effectively give rise to deemed dividends under the new Dividends Tax. However, the exact operation of these rules is unclear. It is proposed that deemed dividends stemming from these loans be treated as *in specie* dividends. As a result, the company making the loan is ultimately liable for the new Dividends Tax.

Clause 32

Amendment of section 64F of the Income Tax Act, 1962

The proposed amendments are designed largely to prevent potential double taxation. Hence, dividends concurrently subject to normal tax (without the benefit of an exemption) or previously subject to the Secondary Tax on Companies will be relieved from the Dividends Tax.

Collective investment schemes in securities are also relieved from the Dividends Tax regardless of whether the dividends are distributed within or without a period of 12-months. Dividends held by a collective investment scheme beyond the 12-month period are subject to normal tax so no reason exists for the Dividends Tax to apply. Dividends pushed through to unit holders are taxed at the unit holder level so these dividends should not be subject to additional tax by the collective investment scheme.

Clause 33

Amendment of section 64H of the Income Tax Act, 1962

Under the legislation as currently drafted, dividends to collective investment schemes in securities are exempt from withholding per se (as a regulated intermediary). However, it has been suggested that certain collective investment schemes hold many of their financial instruments through wholly controlled trusts in which those schemes are the sole beneficiary. The proposed amendment exempts these similar circumstances because both the scheme and the trust are operating as a single economic entity.

Clause 34

Amendment of section 64J of the Income Tax Act, 1962

Subclause (a): The amendment deletes superfluous language.

Subclause (b): Under the Second Tax on Companies, companies accruing dividends effectively receive credits when profits are received via dividends so these profits are not taxed again. This relief (informally known as "STC credits") is not required within the new Dividends Tax framework because dividends are not taxed under this new framework until the profits are fully removed domestic company solution (e.g. are held by natural persons, foreign persons or trusts). However, the new system currently allows for STC credits for a five year transitional period. This transitional period is now being reduced to three years because the new Dividends Tax has been deferred for at least two years.

Clause 35

Amendment of section 64K of the Income Tax Act, 1962

This subsection is deleted in light of the Tax Administration Act, which addresses all reporting matters.

Clause 36

Amendment of section 64L of the Income Tax Act, 1962

Consistent with other aspects of Dividends Tax withholding, both a declaration and a written undertaking is required by the payee to obtain withholding relief.

Clause 37

Amendment of section 64M of the Income Tax Act, 1962

Consistent with other aspects of Dividends Tax withholding, both a declaration and a written undertaking is required by the payee to obtain withholding relief.

Clause 38

Insertion of paragraph 12C(4) of the Seventh Schedule to the Income Tax Act, 1962

The amendment provides SARS with the power to allocate insurance contributions if the allocation does not reasonably represent a fair allocation. This power matches the allocation rules for medical aid contributions under paragraph 12A of the Seventh Schedule.

Clause 39

Amendment of paragraph 8 of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment adds a consequential cross-reference in light of the new special rules added to the participation exemption in respect of headquarter companies.

Clause 40

Amendment of paragraph 12 of the Eighth Schedule to the Income Tax Act, 1962

The amendment clarifies that the exit charge of paragraph 12 of the Eighth Schedule applies to controlled foreign companies that lose their controlled status. It should be noted that residents losing residency status are addressed under section 9H. It should also be noted that controlled foreign companies entering the headquarter regime are also subject to this provision because entrance into the headquarter company regime triggers automatic loss of controlled foreign company status.

Clause 41

Amendment of paragraph 42A of the Eighth Schedule to the Income Tax Act, 1962

The amendment updates a cross-reference in light of implementation of the new Companies Act.

Clause 42

Amendment of paragraph 43A of the Eighth Schedule to the Income Tax Act, 1962[deemed source income?]

Under current law, certain dividends could be treated as additional capital gain proceeds if sold within 45-days before disposal. The purpose of the 45-day holding period was impractical. Taxpayers often have a meaningful holding in an underlying share even though the holding is only for a short duration before disposal. The sellers of the dividend may also have realised ordinary revenue or capital gain when disposing of the dividend (so tax may not be lost at a shareholder level when all shareholders are taken into account. See also the clause-by-clause notes relating to section 22B.

Clause 43

Amendment of paragraph 64B of the Eighth Schedule to the Income Tax Act, 1962

Subclause (a): The proposed amendment is part of the clarification regarding the operation of the capital gains participation exemption in relation to headquarter companies (see subclauses (c) through (f) below).

Subclause (b): The proposed amendment eliminates an incorrect insertion of “controlled” before foreign company. Independent sales of foreign subsidiaries have long been fully eligible for the capital gains participation exemption without regard to whether those foreign subsidiaries are controlled.

Subclauses (c) through (f): As intended in 2011, the proposed amendment simplifies the application of the participation exemption in the case of disposals by headquarter companies. These disposals will be exempt merely if the disposing headquarter company holds a minimum 10 per cent shareholder interest before disposal and the shares at issue are not hybrid equity shares (i.e. are not shares with mainly debt features). The other standard requirements associated with the capital gains participation exemption do not apply.

Subclause (g): The amendment deletes obsolete terminology.

Subclause (h): The proposed amendment is part of the clarification regarding the operation of the capital gains participation exemption in relation to headquarter companies (see subclauses (c) through (f) above). The proposed amendment also corrects cross-references.

Subclauses (i) and (j): The proposed amendments update cross-references in respect of changes to the taxation of foreign dividends.

Subclause (k): The proposed amendment deletes an obsolete cross-reference (i.e. the election was removed in 2011).

Subclause (l): The proposed amendment updates a cross-reference in respect of changes to the taxation of foreign dividends.

Subclause (m): The proposed amendment reduces the minimum threshold from 20 per cent to 10 per cent in light of the other 2011 changes to the participation exemption.

Subclause (n): The proposed amendment updates cross-references to foreign capital distributions in light of changes to the domestic and foreign return of capital calculations made in 2011.

Clause 44

Substitution of paragraph 74 of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment corrects a 2011 change made to the definition of “date of distribution.” The 2011 change went too far and removed key aspects to the definition (i.e. the references to (a), (b) and (c)).

Clause 45

Amendment of paragraph 75 of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendment clarifies that assets received by shareholders via company distribution begin with a fair market value base cost.

Clause 46

Amendment of paragraph 76 of the Eighth Schedule to the Income Tax Act, 1962

Subclauses (a) and (b): The proposed amendments take into account the new definition for foreign return of capital distributions previously added with effect from 1 January 2011.

Subclause (c): The proposed amendment updates the change-over from the current capital distributions rules to coincide with the new Dividends Tax (with the old regime ending on 31 March 2011 and the new regime beginning on 1 April).

Subclause (d): The proposed amendments take into account the new definition for foreign return of capital distributions previously added with effect from 1 January 2011.

Clause 47

Amendment of paragraph 76A of the Eighth Schedule to the Income Tax Act, 1962

The proposed amendments take into account the new definition for foreign return of capital distributions previously added with effect from 1 January 2011.

Clause 48

Amendment of paragraph 78 of the Eighth Schedule to the Income Tax Act, 1962

Subclauses (a) and (c): The proposed amendments take into account the new definition for foreign return of capital distributions previously added with effect from 1 January 2011.

Subclause (b): The proposed amendment reinserts the accidental deletion of paragraph 78(2) of the Eighth Schedule that occurred within the Taxation Laws Amendment Bill, 2011.

Clause 49

Amendment of section 10 of the Income Tax Act, 1990

The proposed amendment deletes a 1990 amendment to section 10 of the Income Tax Act because this amendment has been deleted many years ago.

Clause 50

Amendment of section 8 of the Securities Transfer Tax Act, 2007

Subclause (a): The 2011 legislation specifically provided relief for brokers holding shares that act as a hedge for derivatives issued to other parties. The purpose this exemption is to provide for a two-year interim period (i.e. to protect listed market liquidity) in respect of these shares, thereby providing time for an active discussion period. The proposed amendment simply rephrases this interim exemption to provide more enhanced coverage, thereby avoiding unintended taxation.

Subclauses (b) and (c): The proposed amendment exempts disposals of headquarter company shares from the Securities Transfer Tax Act. This relief roughly coincides with the income tax relief for shareholders disposing of headquarter company shares.

Clause 51

Amendment of section 13 of the Taxation Laws Amendment Act, 2008

This 2008 amendment regarding participation rights has been superseded by subsequent amendments.

Clause 52

Amendment of section 13 of the Taxation Laws Amendment Act, 2009

The proposed amendment deletes certain 2009 amendments to section 10(1)(k)(ii) which have been superseded by amendments contained within the Taxation Laws Amendment Act, 2011.

Clause 53

Repeal of section 12 of the Taxation Laws Second Amendment Act, 2009

This provision repeals administrative provisions.

Clause 54

Amendment of section 7 of the Taxation Laws Amendment Act, 2011

The proposed amendment effectively aligns the effective date for the inclusion of foreign dividend definition (as defined with effect from 1 January 2011) in gross income.

Clause 55

Amendment of section 21 of the Taxation Laws Amendment Act, 2011

See notes on **REVISED VERSION OF THE HYBRID EQUITY AND THIRD-PARTY BACKED SHARE PROPOSALS**

Clause 56

Amendment of section 28 of the Taxation Laws Amendment Act, 2011

The proposed amendment effectively aligns the effective date for the repeal of the rules contained in section 10(1)(k)(ii) that exempt (or partially exempt) foreign dividends with the effective date of new exemption (or partial exemption) rules contained in section 10B.

Clause 57

Amendment of section 29 of the Taxation Laws Amendment Act, 2011

The proposed amendment deletes an incorrect limitation (the rule should apply to all trusts, not just special trusts).

Clause 58

Amendment of section 32 of the Taxation Laws Amendment Act, 2011

The proposed amendment defers the effective date for the new research and development provisions from 1 April 2012 to 1 October 2012.

Clause 59

Amendment of section 43 of the Taxation Laws Amendment Act, 2011

The amendment corrects the effective dates in respect of medical credits.

Clause 60

Amendment of section 49 of the Taxation Laws Amendment Act, 2011

The proposed amendment adds a sunset clause to clarify that section 23K is intended only for an interim period (i.e. until enhanced debt/equity rules and anti-excessive debt rules are enacted).

Clause 61

Amendment of section 50 of the Taxation Laws Amendment Act, 2011

The proposed amendment adds a sunset clause to clarify that section 23K is intended only for an interim period (i.e. until enhance debt/equity rules and anti-excessive debt rules are enacted).

Clause 62

Amendment of section 70 of the Taxation Laws Amendment Act, 2011

The proposed amendment corrects the effective date for the new tax cost rules associated with debt/preference shares issued as section 45 consideration.

Clause 63

Amendment of section 72 of the Taxation Laws Amendment Act, 2011

The proposed amendment corrects references on how the changes to section 47 (liquidation rollovers) will be inserted.

Clause 64

Amendment of section 116 of the Taxation Laws Amendment Act, 2011

Subclause (a): The proposed amendment corrects a cross-reference.

Subclauses (b) and (c): See the amendments to paragraph 64B of the Eighth Schedule.

Clause 65

Amendment of section 119 of the Taxation Laws Amendment Act, 2011

The proposed amendment moves the effective date for capital distributions back to 1 January 2011 to take into account the new definition of foreign return of capital (added from 1 January 2011).

Clause 66

Amendment of section 121 of the Taxation Laws Amendment Act, 2011

The proposed amendment moves the effective date for capital distributions back to 1 January 2011 to take into account the new definition of foreign return of capital (added from 1 January 2011).