
REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM

ON THE

INCOME TAX BILL, 1975

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INTRODUCTION

The Bill fixes 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 or the Income Tax Act.

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 29 February 1976, or 30 June 1976, and are provided for in paragraph 1 (a) of the Schedule. To the basic tax determined in accordance with the tables in paragraph 1 (a) of the Schedule is added a surcharge which is payable where the basic tax is R150 or more. The surcharge is 5 per cent of the basic tax but is not payable in the case of a natural person who is over 60 years of age on the last day of the year of assessment and whose taxable income for that year is R5 000 or less (see the proviso to paragraph 1 (a) of the Schedule).

The basic tax is calculated on the taxable amount, i.e. the amount remaining after deducting from taxable income the abatements provided for in section 5A of the principal Act.

Companies

The rates for companies apply in respect of years of assessment i.e. financial years, ending during the twelve-month period from 1 April 1975, to 31 March 1976, and are provided for in paragraph 1 (b) to (h), inclusive, of the Schedule. Those rates, which apply in respect of taxable income derived in South West Africa and taxable income derived in the Republic, are as follows:—

- (a) Taxable income derived otherwise than from mining—
 - (i) where derived in South West Africa: 35 cents per R1 (paragraph 1 (b) (i) of the Schedule);
 - (ii) where derived elsewhere than in South West Africa, i.e. in the Republic: 40 cents per R1 (paragraph 1 (b) (ii) of the Schedule).To the tax determined as above is added a surcharge of 2½ per cent of such tax (proviso to paragraph 1 (b)) and a loan portion of 5 per cent of such tax (paragraph 1 (h)).
- (b) Taxable income derived from gold mining—
 - (i) on any mine other than a post-1966 gold mine: an amount determined in accordance with one of the formulae provided for in paragraph 1 (c) of the Schedule plus a surcharge (which is not payable in the case of certain assisted gold mines) equal to 5 per cent of the said amount (third proviso to the said paragraph 1 (c)) and a loan portion equal to 5 per cent of the said amount (paragraph 1 (h) of the Schedule);
 - (ii) on a post-1966 gold mine: an amount determined in accordance with one of the formulae provided for in paragraph 1 (d) of the Schedule, plus a surcharge of 5 per cent of the said amount (second proviso to the said paragraph 1 (d)) and a loan portion of 5 per cent of the said amount (paragraph 1 (h) 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, as determined in accordance with paragraph 2 (2) of the Schedule, or 35 cents per R1, whichever is higher (paragraph 1 (e) of the Schedule.)
- (d) Taxable income from diamond mining: a basic tax of 45 cents per R1, plus a surcharge equal to 10 per cent of the basic tax (paragraph 1 (f) of the Schedule) plus a loan portion equal to 5 per cent of the basic tax (paragraph 1 (h) of the Schedule).
- (e) Taxable income from mining operations (other than mining for gold, diamonds or natural oil)—
 - (i) where derived in South West Africa: 35 cents per R1 (paragraph 1 (g) (i) of the Schedule);
 - (ii) where derived elsewhere than in South West Africa, i.e. in the Republic: 40 cents per R1 (paragraph 1 (g) (ii) of the Schedule).
 To the tax determined as above is added a surcharge of 2½ per cent of such tax (proviso to subparagraph (g)) and a loan portion of 5 per cent of such tax (paragraph 1 (h)).

CLAUSE 2

Accrual to the Revenue Fund of South West Africa of a Portion of the Normal Tax payable by Certain Companies

In terms of this clause a portion of the normal tax payable by companies on taxable income (other than taxable income from mining operations) derived in South West Africa will accrue for the benefit of the Revenue Fund of that territory and will be paid into that fund in the manner prescribed in section 22 (2) (c) of the South West Africa Affairs Act, 1969 (Act No. 25 of 1969). The portion so accruing will be one-seventh of the normal tax payable. This is equivalent to 5 cents for every R1 of the taxable income on which the tax is payable.

CLAUSE 3

The Loan Portion of the Normal Tax

In terms of this clause the portion of the normal tax determined in accordance with the provisions of paragraph 1 (h) of the Schedule is a loan portion of that tax and is repayable in accordance with the provisions of section 5 (2B) of the principal Act and the Fifth Schedule to that Act. The loan portion is payable only by companies.

CLAUSE 4

Definitions: Amendments to section 1 of the principal Act

Subclause (1) (a) introduces amendments to the definition of "assessment" in terms of which (a) the concept of "assessment" is limited to a determination by the Secretary by way of a notice of assessment given in a manner contemplated in section 106 (2) of the principal Act (thus excluding other informal documents, mental processes and verbal assessments), and (b) the term "assessment" will include the determination of an amount of tax chargeable under the principal Act (in addition to the determination of the amount on which tax is chargeable). The last-mentioned amendment should be read with the amendments introduced by clauses 26, 27 and 28.

Subclause (1) (b) introduces a definition of "date of assessment". This amendment is necessitated by a decision of the Income Tax Special Court in which it was held that "date of assessment" in section 79 of the principal Act

means the date of posting of the assessment notice, or possibly, the date on which the taxpayer receives the notice. In terms of departmental practice the date of assessment is regarded as being the "due date" specified in the assessment notice, which is normally a date occurring a few days after the date of posting. The amendment sanctions this practice. If a "due date" is not specified in the assessment notice (as may happen in the case of assessments in respect of taxes other than normal tax and undistributed profits tax) the date of the assessment will be the date of issue of the notice. See the amendments introduced by clauses 25 (b), 26 (1) (a), 27 and 28 (1).

Paragraphs (c) to (g), inclusive, of subclause (1) introduce amendments to the definition of "dividend". Apart from certain amendments of a textual nature, the changes proposed are as follows:—

- (1) If in the event of the reconstruction of a company a shareholder of the company is given any cash or any asset and the total value thereof exceeds the nominal value of his shares the excess is in terms of paragraph (d) of the definition of "dividend" treated as a dividend. In certain circumstances (where the second proviso to the definition is applicable) a further amount may in terms of subparagraph (ii) of the said paragraph (d) be treated as a dividend. Subparagraph (ii) is deleted by *subclause (1) (d)*. In terms of the amendment introduced by *subclause (1) (g)* the said further amount (if any) will be determined under paragraph (iii) of the second proviso to the definition.
- (2) In terms of paragraphs (g) and (h) of the definition of "dividend", the nominal value of capitalization shares awarded by any company as part of the equity share capital of the company (or a portion of such nominal value) is treated as a dividend if during the preceding 10 years the company made a partial reduction of its share capital at a time when it had amounts available for distribution to shareholders. In terms of the amendments to the said paragraphs introduced by *clause (1) (e)* the rule as to previous partial reductions of share capital is, as respects capitalization awards made on or after 1 July 1975, abolished. The nominal value of the capitalization shares awarded on or after the said date will, as in the case of capitalization shares awarded before that date which were not affected by the said rule, be deemed by the second proviso to the definition to be a profit available for distribution to shareholders and the provisions of that proviso as to a subsequent return of capital or the liquidation of the company involving distributions to shareholders will apply.
- (3) The second proviso to the definition of "dividend" provides, in effect, that where a company has transferred any amount from its reserves or undistributed profits to its share capital or share premium account the amount transferred may be deemed to be a profit available for distribution to shareholders. In the event of a subsequent return of capital or the liquidation of the company, any capital returned to shareholders is, to the extent that it does not exceed such deemed available profit, treated as a dividend. The amendments introduced by *paragraphs (f) to (g), inclusive, of subclause (1)* amplify these provisions as follows:—
 - (a) Subparagraph (ii) of the second proviso provides for an apportionment of the deemed available profits between different classes of share capital. The new subparagraphs (iiA) and (iiB) introduced by *subclause (1) (f)* make provision for cases where shares of one class are converted into shares of another class and for cases where shares are cancelled without a return of share capital.

- (b) Paragraph (iii) of the second proviso applies where share capital is returned to shareholders. This paragraph at present refers to a partial reduction of share capital. *Subclause (1) (g)* inserts therein references to a partial redemption of share capital and a reconstruction of a company.
- (4) In terms of *subclause (2) (b)*, the amendments introduced by paragraphs (c) to (g), inclusive of *subclause (1)*, are deemed to have taken effect from 6 June 1975.

CLAUSE 5

Abatements: Amendment to section 5A of the principal Act

The proposed amendment increases the abatement allowable to persons over the age of 60 years from R400 to R600.

CLAUSE 6

Antedated salaries and pensions: Insertion of new section 7A in the principal Act

The proposed new section provides (on an optional basis) for the spreading over more than one year of assessment of a retrospective salary and pension award where the award is permanent and relates to a period commencing before the commencement of the year of assessment during which the award becomes effective. See *subsections (1) and (2)* of the new section. Those provisions are similar to the provisions of paragraph (ii) of the proviso to paragraph (c) of the definition of "gross income" in section 1 of the principal Act, except that retrospective pension awards are now provided for in addition to retrospective salary awards. (Clause 4 (1) (h) proposes the deletion of the said proviso). "Pension" is defined to include only pensions payable under any law or by a pension fund or provident fund or by an employer to his former employee or the widow, child or dependant of a person who was in the employer's employ. If the retrospective payment is antedated for a period commencing two years or less before the commencement of the year of assessment in which the award is made the payment is spread over the period of the award. Otherwise it is divided into three equal amounts which will be taxable over three years of assessment, i.e. the year of assessment in which the award becomes effective and the two preceding years of assessment.

Subsection (3) provides that a bonus payable to a national serviceman on completion of a voluntary period of continuous service lasting at least 18 months is to be dealt with under *subsection (2)* as though the bonus were antedated salary or pension granted with retrospective effect.

Subsection (4) provides for the spreading of a retirement gratuity in certain circumstances. The gratuity (or so much as remains after deducting any portion thereof exempt from tax under section 10 (1) (x)) is divided into three equal amounts and one of those amounts is taxed in the year of assessment during which the gratuity accrues and the remaining amounts in the two succeeding years of assessment. The provisions of *subsection (4)* are virtually identical with the provisions of paragraph (i) of the proviso to paragraph (c) of the definition of "gross income" in section 1 (deleted by clause 4 (1) (h)).

Subsection (5) ensures that the balance of any retirement gratuity which was spread in terms of the deleted proviso to paragraph (c) of the definition of "gross income" in section 1 and remains to be taxed in the years of assessment ending on 29 February 1976 and 28 February 1977, will be included in income notwithstanding the deletion of the proviso.

CLAUSE 7

Inclusion in income: Amendments to section 8 of the principal Act

Subclause (1) (a). In terms of section 8 (2) of the principal Act, where a public company awarded capitalization shares before 1 January 1974 and within ten years from the date of the award cash or assets are given to shareholders in consequence of a partial reduction of the company's share capital or a reconstruction or liquidation of the company, an amount is included in the company's taxable income. In terms of the definitions of "dividend" in section 1 of the principal Act, where a company awards capitalization shares on or after the said date and thereafter capital is returned to the shareholders by reason of a partial reduction or redemption of share capital or the reconstruction of the company or during its winding-up, the *shareholders* may be taxable on a portion of the capital returned, on an amount which in terms of the said definition constitutes a dividend. In certain circumstances both the company and the shareholders might be liable for tax on the same amount. In terms of the amendment the company is relieved of tax to the extent that the tax would be payable on an amount which constitutes a dividend in the shareholders' hands.

Subclause (1) (b). Section 8 (4) (a) of the principal Act provides for the inclusion in a taxpayer's income of amounts recovered or recouped by him in respect of various deductions allowed under the principal Act. The amendment excludes from the operation of section 8 (4) (a) recoveries or recoupments of amounts allowed under section 15A of the principal Act in respect of the beneficiation allowance (see clause 15).

CLAUSE 8

Exemptions from normal tax: Amendments to section 10 of the principal Act

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

Subclause (1) (b). Section 10 (1) (cC) of the principal Act provides for an exemption from normal tax in favour of certain housing companies incorporated under section 21 of the Companies Act, 1973. The sole or principal object of the company must be to build dwelling houses or to purchase newly built dwelling houses or other newly built residential accommodation for the occupation of a group of employees or of members of the general public, or to assist such persons to build dwelling houses or to purchase newly built dwelling houses or other newly built residential accommodation. In terms of the amendments provision is made for the inclusion in the exemption of a company whose sole or principal object includes the building of residential accommodation other than dwelling houses. It is also provided that where the object is to assist employees or members of the general public to build or purchase dwelling houses or other residential accommodation the houses or residential accommodation must be for the occupation of the persons who are to be assisted.

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

Subclause (1) (d). In terms of section 10 (1) (x) of the principal Act certain retirement gratuities are exempt from normal tax up to a maximum amount of R9 000. In terms of the amendment the maximum amount is increased to R12 000.

CLAUSE 9

Deductions from income: Amendments to section 11 of the principal Act

The amendments proposed are as follows:

Paragraph (a). The maximum amount allowed to be deducted from the income of an employee or office holder in respect of current contributions to a pension fund not established by law or for the benefit of employees of a local authority, is to be increased from R1 250 to R1 500 per annum.

Paragraph (b). The maximum amount allowed to be deducted from income in respect of current contributions to a retirement annuity fund, is to be increased from R2 500 to R3 000 per annum.

Paragraph (c). In terms of section 11 (*t*) of the principal Act an employer who incurs expenditure in connection with the erection of dwellings for his employees or makes advances or donations for the purpose of financing the erection of such dwellings may in certain circumstances be allowed to deduct from his income up to 25 per cent of the expenditure or of the amounts advanced or donated. In terms of paragraph (ii) of the proviso to section 11 (*t*) the aggregate of the allowances under section 11 (*t*) in respect of any one dwelling is limited to R1 000. That amount is to be increased to R2 500.

CLAUSE 10

Exporters' allowance: Amendments to section 11bis of the principal Act

In terms of section 11bis (4) (*h*) of the principal Act certain discounts granted by an exporter to agents or distributors may be included in the marketing expenditure on which the exporters' allowance is calculated.

The Secretary for Inland Revenue is required to determine the extent to which the discounts have been granted instead of commissions or at an abnormally high rate in order to penetrate or maintain an export market. *Subclause (1) (b)* deletes section 11bis (4) (*h*). The deleted provisions are, however, re-enacted in the new subsection (4E) (*a*) introduced by *subclause (1) (c)*, with the following changes:—

- (a) The Secretary for Commerce will be responsible for determining the amount to be allowed.
- (b) Discounts granted to purchasers other than agents or distributors may qualify.

The decision of the Secretary for Commerce is to be final and conclusive, subject, however, to his right to withdraw the decision if it was based on false or incorrect information or is arithmetically incorrect.

CLAUSE 11

Machinery investment allowance: Amendments to section 12 of the principal Act

Subclause (1) (a). The period within which machinery or plant must be brought into use elsewhere than in an economic development area in order to qualify for the machinery investment allowance provided for in section 12 (2) of the principal Act is extended from 30 June 1978 to 30 June 1979.

Subclause (1) (b). As respects machinery or plant brought into use in an economic development area on or after 15 August 1974 and on or before 26 March 1975, the rate of the investment allowance allowable in respect thereof remains unchanged, namely a basic allowance of 25 per cent plus such further allowance, not exceeding 35 per cent, as the Minister of Finance may direct, calculated on the cost.

Subclause (1) (c). As respects machinery or plant brought into use in an economic development area on or after 27 March 1975 and on or before 30 June 1979, the investment allowance is 30 per cent basic plus such further allowance, not exceeding 35 per cent, as the Minister of Finance may direct, calculated on the cost.

Subclause (1) (d). As respects machinery or plant brought into use in an economic development area on or after 1 July 1979 the machinery investment allowance is such percentage, not exceeding 35 per cent of the cost, as the Minister of Finance may direct.

Subclause (1) (e). As respects machinery or plant brought into use elsewhere than in an economic development area on or after 15 August 1974 and on or before 26 March 1975, the rate of the investment allowance remains at 25 per cent of the cost.

Subklousule (1) (f). Met betrekking tot masjinerie of installasie wat op of na 27 Maart 1975 en op of voor 30 Junie 1979 (kyk subklousule (1) (a)) elders as in 'n ekonomiese ontwikkelingsgebied in gebruik geneem word, is die skaal van die beleggingsvermindering 30 persent van die koste.

KLOUSULE 12

Hoteltoerustingsvermindering: Wysiging aan artikel 12A van die Hoofwet.

Die wysiging is van 'n tekstuele aard.

KLOUSULE 13

Geboubeleggingsvermindering: Wysigings aan artikel 13 van die Hoofwet.

Ingevolge die voorgestelde wysigings word die basiese geboubeleggingsvermindering verhoog van 15 na 20 persent van die koste van die gebou of verbeterings wat vir die vermindering in aanmerking kom waar die oprigting van die betrokke gebou, of die betrokke verbeterings, 'n aanvang neem op of na 27 Maart 1975. Die tydperk waarin die oprigting van die gebou of die verbeterings 'n aanvang moet neem om vir die basiese vermindering in aanmerking te kom, word van 30 Junie 1978 tot 30 Junie 1979 verleng. Die tydperk wat vir die ingebruikneming van die gebou of die voltooiing van die verbeterings toegelaat word, word van 30 Junie 1979 tot 30 Junie 1980 verleng. Die bykomende vermindering waar die betrokke gebou in 'n ekonomiese ontwikkelingsgebied geleë is bly onveranderd, te wete 'n persentasie van hoogstens 25 persent van die koste van die gebou of van die verbeterings daaraan. Die posisie met betrekking tot die skale van die vermindering en die kwalifiserende tydperke word hieronder opgesom.

(a) *Geboue buite ekonomiese ontwikkelingsgebiede geleë en verbeterings daaraan—*

- (i) indien dit 'n aanvang geneem het tussen 13 Augustus 1970 en 26 Maart 1975: die skaal van die vermindering bly onveranderd, nl. 15 persent van die betrokke koste. (Kyk die wysiging ingevoer deur *subklousule (1) (a)*, gelees met artikel 13 (6A) (aA) (ii) van die Hoofwet (nie gewysig nie)); of
- (ii) indien dit 'n aanvang neem tussen 27 Maart 1975 en 30 Junie 1979: die skaal van die vermindering is 20 persent van die betrokke koste. (Kyk die wysiging ingevoer deur *subklousule (1) (b)*, gelees met die wysiging ingevoer deur *subklousule (1) (h)*).

In albei gevalle moet die gebou in gebruik geneem word of die verbeterings voltooi word nie later nie as 30 Junie 1980. (Kyk die wysiging ingevoer deur *subklousule (1) (c)*).

(b) *Geboue in ekonomiese ontwikkelingsgebiede geleë en verbeterings daaraan—*

- (i) indien dit 'n aanvang geneem het tussen 13 Augustus 1970 en 26 Maart 1975: die vermindering bestaan uit 'n basiese bedrag gelyk aan 15 persent van die betrokke koste plus 'n verdere bedrag wat bereken word teen die persentasie (maar hoogstens 25 persent) wat die Minister van Finansies gelas. (Die skaal bly onveranderd—kyk die wysiging ingevoer deur *subklousule (1) (d)*); of
- (ii) indien dit 'n aanvang neem tussen 27 Maart 1975 en 30 Junie 1979: die vermindering bestaan uit 'n basiese bedrag gelyk aan 20 persent van die betrokke koste plus 'n verdere bedrag wat bereken word teen die persentasie (maar hoogstens 25 persent) wat die Minister van Finansies gelas. (Kyk die wysiging ingevoer deur *subklousule (1) (e)*); of
- (iii) indien dit 'n aanvang neem na 30 Junie 1979: die vermindering (as daar is) is die persentasie (maar hoogstens 25 persent) van die betrokke koste wat die Minister van Finansies gelas. (Kyk *subklousule (1) (f)*).

CLAUSE 14

Hotel building investment allowance: Amendments to section 13bis of the principal Act

The amendments are of a textual nature.

CLAUSE 15

Beneficiation allowance: Insertion of section 15A in the principal Act

The proposed new section 15A provides for an allowance against income (called the beneficiation allowance) to be granted to industrialists who produce for export raw materials derived from base minerals and apply advanced beneficiation processes for the purpose of producing such raw materials. The allowance is to be calculated on the cost of new or unused machinery or plant used directly in a beneficiation process or on the cost of a building erected and brought into use wholly or mainly for the purpose of carrying on a beneficiation process therein or on the cost of improvements (other than repairs) to such a building.

Subsection (1) defines certain terms.

A "*beneficiation process*" is basically a process whereby a base mineral is refined or processed to yield an intermediate product which has a value higher than the value of the base mineral. If the intermediate product is subjected to a further process the further process may also qualify as a beneficiation process. A simple purification process or a physical process resulting merely in a change of shape is excluded. This definition should be read with the definitions of "base mineral" and "intermediate product".

A "*base mineral*" is a base mineral as defined in the Mining Rights Act, No. 20 of 1967, which has been mined in the Republic. (If the taxpayer is a company "Republic" is interpreted to include South West Africa).

An "*intermediate product*" is a substance or material which the Minister of Finance is satisfied is produced by the taxpayer concerned in order to be used by any person as a raw material.

An "*export trade*" is a trade or branch of a trade carried on wholly or mainly in order to produce an intermediate product for export. To qualify for the allowance the taxpayer concerned must carry on such a trade and the machinery, plant, building or improvements, on the cost of which the allowance is calculated, must be brought into use wholly or mainly for the purposes of that trade.

The "*prescribed period*" is the period from 27 March 1975 to 30 June 1980. The machinery or plant in question must be brought into use within that period and the erection of the building in question or the improvements in question must be commenced within that period.

Subsection (2) provides that the beneficiation allowance may be granted if the Minister of Finance, having regard to the circumstances of the case, so directs. Each application will be considered on its own merits. The allowance may, in fact, consist of separate allowances in respect of machinery or plant and in respect of a building or improvements to a building. The rate of each allowance is to be fixed by the Minister in each case, but may not exceed 20 per cent of the cost of the machinery or plant or 15 per cent of the cost of the building or the improvements to a building. The allowance in respect of machinery or plant is granted in respect of the year of assessment during which the machinery or plant is brought into use. The allowance in respect of a building is granted in

respect of the year of assessment during which the building is brought into use, but the building must be brought into use not later than 30 June 1981. The allowance in respect of improvements to a building (which does not include repairs) is granted in respect of the year of assessment during which the improvements are completed, but the improvements must be completed not later than 30 June 1981.

The beneficiation allowance is to be granted in addition to any other allowance or deduction to which the taxpayer may be entitled under the principal Act in respect of the same machinery, plant, building or improvements.

In terms of *subsection (3)* the beneficiation allowance may not be granted in respect of any machinery, plant, building or improvements used in the course of any mining operations or operations carried on in the course of mining operations unless the Minister is satisfied that the beneficiation process in question is additional to the processes normally carried on in the course of such operations or that it is introduced as part of a scheme for the creation of extensive extra capacity for export.

Any application for the allowance should be addressed to the Secretary for Industries. The allowance may be made in respect of years of assessment ending on or after 27 March 1975.

See also clause 7 (1) (d).

CLAUSE 16

Donations to universities and colleges: Amendment to section 18A of the principal Act

In terms of section 18A of the principal Act donations made by a taxpayer to universities, colleges and the National Study Loans and Bursaries Fund may, within certain limits, be deducted from his taxable income. For the purposes of the section "college" is defined as a college for advanced technical education established under an Act of Parliament. In terms of the amendment introduced by this clause the definition is expanded to include similar educational institutions established by or under other laws, e.g. a law made by a legislative assembly established under the Bantu Homelands Constitution Act, No. 21 of 1971.

CLAUSE 17

Deduction in respect of married woman's earnings: Amendment to section 20A of the principal Act

In terms of the amendment proposed by this clause the maximum annual deduction allowable under section 20A of the principal Act in respect of the earnings of a married woman is increased from R600 to R750.

CLAUSE 18

Transitional deduction: Introduction of PAYE in South West Africa: Amendment to section 21bis of the principal Act

The amendment is of a textual nature.

CLAUSE 19

Development allowance: Industrialists in decentralized areas: Amendment to section 21ter of the principal Act

In terms of section 21ter (5) (b) of the principal Act applications for the development allowance under that section must be made by 30 September 1975. The amendment introduced by this clause deletes this provision.

CLAUSE 20

Trading Stock: Amendment to section 22 of the principal Act

Section 22 of the principal Act contains rules as to the values to be taken into account for normal tax purposes in respect of trading stock held and not disposed of at the beginning and end of each year of assessment. The general rule is that the value to be taken into account is the cost price of the trading stock, less any amount by which the value has been diminished by reason of damage, deterioration, change in fashion, decrease in market value or for any other reason satisfactory to the Secretary. Subsection (5) of that section provides that a person who maintains satisfactory records may adopt the basis of valuation (called LIFO) whereby the last item of any class of trading stock purchased by any person on any date is deemed to be the first item of that class sold by such person on or after that date. In terms of the amendment the Secretary may impose conditions in the case of a person who elects the LIFO basis.

CLAUSE 21

Classification of companies as public or private: Amendment to section 38 of the principal Act

The amendment is of a textual nature.

CLAUSE 22

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

"Dividend" is defined in section 1 of the principal Act to include certain distributions by companies which are not made by way of formal declarations of dividends. The amendment introduced by this clause is designed to make it clear that where any such distribution is made the dividend is for the purposes of the non-resident shareholders' tax to be regarded as having been declared on the date on which the shareholders become entitled to the cash or the asset constituting the dividend.

CLAUSE 23

Undistributed profits tax: Amendment to section 49 of the principal Act

In the determination of the distributable income of a company for the purposes of the undistributed profits tax an allowance is made which is equal to 45 per cent of so much of the company's adjusted total net profits as does not consist of dividends: in terms of the amendments introduced by this clause the allowance is increased to 55 per cent. In the case of a public company a further allowance is made which is equal to 25 per cent of so much of its adjusted total net profits as consists of dividends: in terms of the amendments the allowance is increased to 35 per cent.

The amendments are to apply in respect of years of assessment ending on or after 27 March 1975.

CLAUSE 24

Dividends: Duties of Companies: Amendment of section 70 of the principal Act

The amendments are consequential upon amendments to the definition of "dividend" introduced by clause 4 or are of a textual nature.

CLAUSE 25

Assessments: Amendments to section 77 of the principal Act

The amendments to section 77 (3) and (5) are consequential upon the amendments to the definition of "assessment" introduced by clause 4 (1) (a) and upon the introduction of the definition of "date of assessment" by clause 4 (1) (b).

Subsection (4) of section 77 provides that an assessment notice shall be sent by post or delivered in such manner as the Secretary may consider necessary or convenient. General rules as to the manner in which notices shall be given under the principal Act are provided in section 106 of that Act and subsection (4) of section 77 is in consequence deleted. See the amendments to section 106 introduced by clause 29.

CLAUSE 26

Assessments: Amendments to section 79 of the principal Act

In terms of section 79 of the principal Act if an amount which should have been subject to tax has not been assessed to tax the Secretary for Inland Revenue is required to raise an assessment in respect of the amount. An amount subject to tax does not include the tax as such. It is proposed to amend the definition of "assessment" (see clause 4 (1) (a)) so as to include therein the determination of the tax (besides the determination of an amount on which tax is leviable (i.e. an amount subject to tax)). The proposed amendments to section 79 bring the provisions of that section into line with the said definition, as amended.

The existing proviso to section 79 (1) limits the power of the Secretary to raise additional assessments. The proviso is amended to apply also to determinations of tax.

Some of the taxes payable under the principal Act (e.g. non-resident shareholders' tax) are not payable on assessment, but are payable on declaration. In terms of section 79, however, assessments may also be raised in respect of such a tax, e.g. when the tax has not been paid on the full amount which is subject to the tax (such as a dividend). It would appear that the limitations imposed by the existing proviso to section 79 (1) do not apply in respect of such taxes payable on declaration. In terms of the amendments, however, the limitations will apply. For example, in terms of paragraph (a) (now paragraph (i)) of the existing proviso a time limit of 3 years is imposed after which the Secretary may not raise an additional assessment, except in cases of fraud, misrepresentation or non-disclosure of material facts. In terms of the new paragraph (ii) of the proviso a similar time limit is imposed in respect of an assessment of a tax payable on declaration, the time to run from the date of payment of the tax (the date of payment of the tax will be the date of the official receipt—see the proposed new subsection (2A) introduced by *subclause* (1) (b)). See also clause 28 in regard to the similar time limit in respect of claims for refunds.

A further proviso is inserted in section 79 (1) limiting the Secretary's powers to raise an assessment of undistributed profits tax on a company where the company has been assessed for normal tax purposes. In such a case the Secretary may not make an assessment in respect of undistributed profits tax after the expiration of three years from the date of the latest assessment of normal tax in respect of the same year except in a case of fraud, misrepresentation or non-disclosure of material facts.

In terms of *subclause* (2) the amendments are to take effect on the date of promulgation of the Income Tax Act, 1975, and will apply in respect of every tax levied under the principal Act, regardless of when it became payable, and in respect of every year of assessment under the principal Act.

CLAUSE 27

Objections and appeals: Amendment to section 81 of the principal Act

The amendment is consequential upon the introduction of the definition of "date of assessment" by clause 4 (1) (b). In terms of clause 4 (2) (a) the amended definition of "assessment" will for the purposes of section 81 and the

other sections in Part III of Chapter III of the principal Act not apply where the date of assessment falls before the date of promulgation of the Income Tax Act, 1975. The rules laid down in regard to objections and appeals will, therefore, apply to that part of an assessment which consists of a determination of tax as such only where the date of assessment falls on or after the said date of promulgation.

CLAUSE 28

Refunds: Amendments to section 102 of the principal Act

Section 102 of the principal Act empowers the Secretary for Inland Revenue to authorize a refund of any tax overpaid provided the claim therefor is made within 3 years after the date when the assessment was made. It was held in the case of *Stroud Riley and Co. Ltd. v. SIR* (36 SATC 143) that the 3-year time limit did not apply to a claim for a refund of non-resident shareholders' tax inasmuch as the tax was not paid on assessment. In terms of the amendment introduced to section 102 (2) by this clause it is provided that the time limit shall also apply where the tax was paid otherwise than under an assessment. In such a case the 3-year period runs immediately after the date of payment of the tax. The court decision also affects the interpretation of section 79 of the principal Act and amendments are, in consequence, introduced to that section by clause 26. The amendment introduced by this clause applies to all claims for refunds made under section 102 on or after the date of promulgation of the Income Tax Act, 1975.

CLAUSE 29

Authentication and service of documents: Substitution of section 106 of the principal Act

Section 106 (1) at present provides that any form, notice, demand or other document issued or given by the Secretary or any other officer under the principal Act shall be sufficiently authenticated if the name of the Secretary or other officer is stamped or printed thereon. In terms of the amendment to that provision the reference to such name is expanded by the inclusion of a reference to the official designation of the Secretary or other officer. In practice notices and some other documents issued under the principal Act (e.g. assessment notices) are not signed nor does the name of any official appear thereon. His official designation is, however, shown.

Section 106 (2) provides how notices under the principal Act shall be "served". In terms of the amendments that provision is expanded to include, besides any notice served, also any form, demand, document or other communication issued, given or sent. Paragraphs (c) and (d) (iii) of section 106 (2) at present provide for the service of notices by registered post. In terms of the amendments such notices and the forms, demands, documents or other communications referred to above may also be served, issued, given or sent by any other kind of post. In practice notices of assessment and other documents are usually sent by ordinary post and the amendments are designed to remove any doubt as to correctness of this procedure.

Section 106 (3) is a new provision in terms of which any form, notice, demand, document or other communication referred to in section 106 (2) and which is despatched by post is deemed to have been received by the person to whom it was addressed at the time when it would, in the ordinary course of post, have arrived at the place to which it was addressed, unless the Secretary is satisfied that it was not so received or was received at some other time.

Section 106 (4), which is also a new provision, empowers the Secretary to direct that any form, notice, demand, document or other communication (other than a notice of assessment) which has not been received by the person con-

cerned or has been received late, be withdrawn and be issued, given, sent or served anew. The Secretary must be satisfied that the person concerned has been placed at a disadvantage and that the circumstances warrant action under the said provision. Notices of assessment are excluded as adequate action in regard thereto can be taken under other provisions of the principal Act and action under section 106 (4) would be unnecessary and inappropriate.

The amendments introduced by this clause should be read with the amendment introduced by clause 25 (b) and also the amended definition of "assessment" introduced by clause 4 (1) (a).

CLAUSE 30

Rates of normal tax: Plantation farmers: Amendments to paragraph 15 of the First Schedule to the principal Act

In terms of paragraph 15 (3) of the First Schedule to the principal Act a reduced rate of normal tax is applicable in the case of a plantation farmer whose taxable income from plantation farming exceeds the annual average taxable income derived by him from that source over the preceding three years of assessment. In terms of the amendments introduced by this clause any excess plantation farming profits derived by the taxpayer (as determined under paragraph 20 (3) (g) of the First Schedule) are to be excluded from the taxpayer's taxable income and average taxable income from plantation farming for the purpose of the calculations under paragraph 15 (3). The excess farming profits are in terms of the said paragraph 20 to be taxed at a special rate (see clause 33). The provisions of paragraph 15 (3) continue to apply to the taxpayer's ordinary taxable income from plantation farming, i.e. the amount remaining after the deduction of the excess plantation farming profits.

CLAUSE 31

Plantation farmers: Amendment to paragraph 16 of the First Schedule to the principal Act

Paragraph 16 of the First Schedule to the principal Act defines "plantation" and "forest produce" for the purposes of certain provisions relating to plantation farmers.

In terms of the amendment the said definitions will also apply for the purposes of paragraph 20 of the First Schedule (introduced by clause 33).

CLAUSE 32

Rates of normal tax: Farmers: Amendments to paragraph 19 of the First Schedule to the principal Act

Farmers have the right to make an election to have their normal tax calculated according to a formula provided in paragraph 19 of the First Schedule to the principal Act. That formula provides for the farmer's average taxable income from farming to be taken into account. In terms of the amendment introduced by *subclause* (1) (b) any excess farming profits derived by the taxpayer, as determined under paragraph 20 (3) of the First Schedule (see clause 33), are to be excluded when the said average taxable income is determined for the purposes of paragraph 19. The excess farming profits are in terms of the said paragraph 20 to be taxed at a special rate. Paragraph 19 continues to apply in respect of the balance of the taxpayer's taxable income.

The amendment introduced by *subclause* (1) (c) is consequential upon the amended definition of "assessment" (see clause 4 (1) (a)) and the amendments to section 79 of the principal Act introduced by clause 26. Some of the provisions of paragraph 19 (3) have in consequence of those amendments become superfluous and are deleted. The provision to the effect that a redetermination of the annual average taxable income from farming need not be made if the redetermination involves an increase or reduction of less than R600 is, however, retained, but in a slightly different form.

CLAUSE 33

Farmers: Excess profits in consequence of sale of farms to S.A. Bantu Trust: Addition of new paragraph 20 to First Schedule to the principal Act

A farmer (other than a company) who sells his farm to the South African Bantu Trust may in consequence of the inclusion in his income of the proceeds of his livestock on the farm or the value of a plantation on the farm have an abnormally high taxable income. In terms of the new paragraph 20 added by this clause to the First Schedule to the principal Act the farmer may at his option apply to have his normal tax determined under the said paragraph.

If the provisions of paragraph 20 are applicable the normal tax payable by the farmer will be the sum of—

- (a) an amount of tax calculated on the farmer's excess farming profits (less abatements allowed under subparagraph (5)) at the rate of 9 per cent in the case of a married person or 12 per cent in the case of an unmarried person, and
- (b) an amount of tax calculated at the ordinary rates on the balance of the farmer's taxable income. (The provisions of paragraph 15 (3), as applicable to plantation farmers, and paragraph 19, as applicable to farmers who have elected average rates, will apply in relation to the balance of the taxable income—see clauses 30 and 32).

For the purposes of paragraph 20 it will be necessary to determine the farmer's abnormal farming receipts or accruals. Such abnormal receipts or accruals will, in terms of subparagraph (2), consist of amounts derived from disposals of livestock in the course of the winding-up of the farming undertaking or amounts derived from the disposal of any plantation together with the land to the S.A. Bantu Trust or from the disposal of any plantation or forest produce from such plantation in the course of the winding-up of the farming undertaking. The farmer's excess farming profits may consist of excess livestock profits or excess plantation farming profits (see subparagraph (3) (a)).

The rules for determining *excess livestock profits* are provided in subparagraph (3) (b) to (e), inclusive. The taxpayer's *livestock profits* are determined for the year of assessment in which the abnormal livestock receipts or accruals are derived and for each of the preceding years of assessment (but not exceeding five such years) during which the farming undertaking was carried on. In making these calculations only sales, purchases and the values of livestock on hand at the beginning and end of each year are taken into account and ordinary farming expenditure (such as wages, stock medicines, rent etc.) is left out of account. The average of the livestock profits so determined for the preceding years is then calculated. If the livestock profits for the year of assessment in which the abnormal sales were made exceed the average for the preceding years the excess will be the taxpayer's *abnormal livestock profits*. The abnormal livestock profits are then compared with the taxpayer's abnormal livestock receipts or accruals for the year of assessment in which the sales were made and the abnormal livestock receipts or accruals will to the extent that they do not exceed the abnormal livestock profits, be the taxpayer's *excess livestock profits* for the year in question. In terms of subparagraph (3) (f) the Secretary is empowered to depart from these rules in exceptional cases.

The rule for determining *excess plantation farming profits* is provided in subparagraph (3) (g). The taxpayer's taxable income from plantation farming is determined for the year of assessment in which the abnormal plantation farming receipts or accruals are derived and for each of the preceding three years of assessment. The annual average taxable income from plantation farming for the preceding three years is then determined. If the taxable income from plantation farming for the year in which the abnormal plantation farming income is derived exceeds the said average taxable income the amount of the excess is determined. These calculations are based on the similar calculations made under paragraph 15 (3) of the First Schedule to the principal Act, except that in determining the taxable income from plantation farming for the year of

assessment in which the abnormal plantation farming income is derived, the adjustment in respect of excess plantation farming profits provided for in clause 30 is left out of account. The abnormal plantation farming receipts or accruals for the year of assessment are then compared with the excess calculated as indicated above and such abnormal plantation farming receipts or accruals will, to the extent that they do not exceed the said excess, be the taxpayer's excess plantation farming profits for that year.

The taxpayer's *excess farming profits* for any year of assessment will be the sum of his excess livestock profits and his excess plantation farming profits for that year, but the amount of the excess farming profits may not exceed the amount of his taxable income for that year (subparagraph (3) (a)).

The balance of the taxpayer's taxable income will be the amount remaining after deducting the excess farming profits from his full taxable income (subparagraph (4)).

The abatements allowable in terms of section 5A of the principal Act against the balance of the taxpayer's taxable income will be determined with reference to such balance as though such balance were the taxpayer's taxable income. The abatements allowable against the taxpayer's excess farming profits will be calculated with reference to the taxpayer's full taxable income, but will be reduced by abatements allowed against the balance of the taxpayer's taxable income or, where the last-mentioned abatements exceed the balance of the taxpayer's taxable income, by an amount equal to the said balance (subparagraph (5)).

The concessional rate of tax provided for in the new paragraph 20 will apply only in respect of the year of assessment during which the land in question is acquired by the S.A. Bantu Trust or the first or the second year of assessment thereafter (subparagraph (1) (c)).

The application for normal tax to be calculated under paragraph 20 should be accompanied by a certificate by the Secretary for Bantu Administration and Development to the effect that the land in question was acquired by the S.A. Bantu Trust under section 10 of the Bantu Trust and Land Act, No. 18 of 1936. (See subparagraph (6)).

In terms of *subclause* (2) the provisions of the new paragraph 20 will be applicable in respect of years of assessment ending on or after 30 June 1973.

EXAMPLES IN REGARD TO THE EFFECT OF THE PROVISIONS OF CLAUSE 33

Livestock Sales

Determination of livestock profits (paragraph 20 (3) (d))

Livestock on hand at the beginning of the year	Rx	Income from the disposal of livestock	Ra
Livestock acquired during year	Ry	Livestock on hand at the end of the year	Rb
Livestock profit ((a + b) - (x + y))	Rz	Livestock loss ((x + y) - (a + b))	Rc
	—		—
	—		—

Example I

(a) *Data:*

- (i) Total disposal of livestock in year when farm is sold yields proceeds amounting to R45 000.
- (ii) At the beginning of the year the value of the farmer's livestock, at standard values, was R10 000.
- (iii) He has other farming income of R10 000 and expenses totalling R5 000.
- (iv) His average livestock profit over the previous five years was R10 000.

(b) *Without relief*

Livestock Account

Livestock on hand at beginning of year	R10 000	Livestock sales	R45 000
		Livestock on hand at end of year	Nil

Livestock purchases	Nil		
Profit on livestock	35 000		
	<u>R45 000</u>		<u>R45 000</u>
Farming expenses	R 5 000	Profit on livestock	R35 000
Taxable income	40 000	Other farming income	10 000
	<u>R45 000</u>		<u>R45 000</u>

Tax: (Married person)

On R40 000 = R16 800

If this farmer had had his normal pattern of income, it could have been expected that his taxable income would have been as follows—

Farming expenses	R 5 000	Profit on livestock	R10 000
Taxable income	15 000	Other farming income	10 000
	<u>R20 000</u>		<u>R20 000</u>

Tax on R15 000 = R2 961

(c) *Proposed relief*

Profit on livestock		R35 000
Less: Normal (average) profit on livestock		10 000
Abnormal profit on livestock		<u>R25 000</u>
Total taxable income for the year		R40 000
Abnormal profit on livestock		25 000
Balance of taxable income		<u>R15 000</u>
Tax is imposed as follows—		
Tax on abnormal profit on livestock @ 9%		R 2 250
Tax on balance of taxable income at normal appropriate rates		2 961
Tax on total taxable income of R40 000		<u>R 5 211</u>

(In this case the normal rates of tax are used in respect of the balance of the taxable income. If the farmer is taxed at equalised rates, the equalised rate would have been applicable.)

Example II

Data the same as in Example I but the farmer's other farming income amounts to R5 000 and his farming expenditure R10 000. In addition he has expenditure on improvements carried forward from the previous year of R15 000.

(a) *Without relief*

Farming expenses	R10 000	Profit on livestock	R35 000
Improvements c/f	15 000	Other farming income	5 000
Taxable income	15 000		
	<u>R40 000</u>		<u>R40 000</u>

Tax on R15 000 = R2 961

(b) *Normal pattern*

Farming expenses	R10 000	Profit on livestock	R10 000
Improvements (maximum allowed)	5 000	Other farming income	5 000
Taxable income	Nil		
	<u>R15 000</u>		<u>R15 000</u>

Improvements (balance) carried forward to following year . . . R10 000

(c) *Proposed relief*

Total taxable income		R15 000
Less: Abnormal profit on livestock (R25 000).		

In this case the deduction is limited to the taxable income . . . 15 000

Balance of taxable income Nil

As the total taxable income is ascribable to abnormal profits on livestock the full amount of R15 000 will be taxed @ 9% = R1 350.

Plantations: The principle here is broadly the same as that applicable to abnormal livestock sales.

In the determination of the taxable income from plantations the costs attaching to the establishment and maintenance of plantations are taken into account, and for purposes of determining the abnormal plantation profits such expenditure is taken into account.

The equivalent of the "livestock account" for other farmers will therefore be as follows in the case of plantation farmers—

Gross proceeds of sale of plantations and plantation produce	Rx
Less: Costs of establishment and maintenance of plantations	Ry
Current farming expenses re plantations	Rz y + z
Plantation profit	<u>x - (y + z)</u>

The excess (abnormal) plantation profit will be determined by deducting from the plantation profit for the year in which the land is sold, the average plantation profit for the preceding three years.

The excess (abnormal) profit is then taxed, as in the case of abnormal livestock profits, at 9% or 12%, while the balance is taxed in the usual way.

Example III

(a) Data:

- (i) A farmer sells his farm to the Bantu Trust together with the growing plantation thereon. The amount paid for the plantation is R400 000. His other income from plantation produce during the year is R25 000 and his maintenance expenses total R5 000.
- (ii) His average plantation profit for the three immediately preceding years was R20 000.

(b) Without relief but taxed at plantation equalised rates.

Proceeds of sale of plantation	R400 000
Income from other plantation produce	25 000
	<u>R425 000</u>
Maintenance expenses	5 000
Taxable income from plantation	<u>R420 000</u>

Rate of tax

Taxable income as above	R420 000
Less: Amount by which taxable income from plantations exceeded the average taxable income for the three preceding years (R420 000—R20 000)	400 000
Taxable income of R420 000 taxed at the rate applicable to	<u>R 20 000</u>

i.e. 24,78% of R420 000 = R104 076.

(c) Proposed relief

Taxable income from plantations	R420 000
Less: Average taxable income for three previous years	20 000
Excess plantation profits	<u>R400 000</u>

Tax payable

- (i) On normal taxable income of R20 000 at plantation equalised rates. (In this case the current plantation profit does not exceed the average of the three preceding years; it is therefore taxed at normal rates) = R 4 956
- (ii) Tax on R400 000 @ 9% = R36 000
| Total tax payable | = R40 956 |

CLAUSES 34 and 35

Lump sum benefits from pension, provident and retirement annuity funds: Amendments to paragraphs 1 and 5 of the Second Schedule to the principal Act

The Second Schedule to the principal Act provides rules for determining the amounts to be included in a person's gross income in respect of lump sum benefits derived from pension funds, provident funds and retirement annuity funds. From the gross amounts so derived certain deductions are made, some of which are, in the case of retirement and death benefits, determined in accordance with certain formulae, referred to as formula A and formula B.

Formula A, which applies in relation to a pension fund or a provident fund, takes into account the taxpayer's highest annual average salary actually earned by him during any five consecutive years of his service, but not exceeding an amount of R15 000. That amount is now increased to R20 000 (*clause 34 (a)*).

Formula B takes into account the fact that the taxpayer may be a member of more than one fund and places a limit of R30 000 on the amounts which (apart from certain contributions) may be deducted in respect of the various funds. This limit is now increased to R40 000 (*clause 34 (b)*).

Paragraph 5 (2) of the Second Schedule to the principal Act lays down that certain minimum amounts shall be deducted in certain circumstances under formula B. The minimum amounts which are as follows, are increased as indicated below:—

- (a) If the taxpayer is or was a member of a provident fund (other than a provident fund which has become a pension fund) from which any lump sum benefit was or may be derived in consequence of or following upon his retirement on or after 15 March 1961: R6 000, now increased to R8 000 (*clause 35 (a)*).
- (b) In respect of death benefits: R15 000, now increased to R20 000 (*clause 35 (b)*). If the death benefits consist of or include benefits from any pension or provident fund the deduction may be increased to an amount equal to twice so much of the taxpayer's salary earned during the twelve months ending at his death as does not exceed R15 000. That amount is also increased to R20 000 (*clause 35 (b)*).

A minimum deduction is applicable in respect of death benefits from retirement annuity funds derived where death has occurred before retirement. That minimum amount is the amount (but not exceeding the lesser of R30 000 and the value of benefits) which the taxpayer could have derived in respect of the commutation of one-third of his annuities from the funds if he had retired on the day before the date of his death. The amount of R30 000 is increased to R40 000 (*clause 35 (c)*).

CLAUSE 36

Provisional Tax: Under-estimates of taxable income: Amendment to paragraph 20 of the Fourth Schedule to the principal Act

The amendment is of a textual nature.

CLAUSE 37

Gains under or in respect of insurance policies: Amendment to paragraph 11 of the Sixth Schedule to the principal Act

In terms of the amendment provision is made for the recognition as a standard policy (i.e. one, the gains under or in respect of which, are not taxable under the Sixth Schedule to the principal Act) of a policy in which provision is made for the automatic increase of premiums and benefits at regular intervals provided the increase in premiums in any period of twelve months is fixed or ascertainable (e.g. from an index) and does not amount to more than 15 per cent of the premiums payable in the preceding period of twelve months.

CLAUSE 38

Commencement of certain amendments

For the purposes of assessments of normal tax and undistributed profits tax the amendments introduced by the Bill to the principal Act are, except where otherwise provided or the context otherwise indicates, to take effect from years of assessment ending on or after 1 January 1976.

CLAUSE 39

The Act is to apply also in South West Africa, in so far as it relates to companies.

CLAUSE 40

This clause gives the short title of the Act.

THE SCHEDULE

The provisions of the Schedule are dealt with in the portion of this Memorandum dealing with clause 1.