"On the Scales" is produced by Alexander Forbes Legal Services Department as an information service to promote a greater understanding of the issues relating to employee benefits. The issues need to be carefully weighed up in the light of the unique circumstances of each of our clients.

On the Scales

February 2006 **6/2006**

National Budget 2006

Our Finance Minister, Trevor Manuel, delivered his National Budget speech to Parliament today (15 February 2006). In his usual poetic style he stated that he placed before the nation an account of "…the mountains we have climbed and the frontiers before us". He continued in line with President Mbeki's Age of Hope theme.

Contrary to expectations, he did not announce any major restructuring plans for retirement funds. However, in a welcome move, he drastically cut Retirement Funds Tax.

The Minister has stated that the reduction in Retirement Funds Tax, to 9% from 1 March, would be followed by the publication of a discussion document by National Treasury regarding the reform of the Income Tax Act, as it relates to retirement funds (this is expected to be in the form of a follow up to the Discussion Paper on retirement fund reform that was released by Treasury in December 2004). This paper is promised in the next few months.

It was also announced that there would be a reform of the cost-disclosure, commission and governance legislation as it relates to retirement funds, and this is also expected in the reform paper. In the words of the Minister, these reforms will aim to ensure that the benefits of the lower tax rates are passed on to the retirement fund members in the form of improved returns. The Minister also promised that the new proposals would focus on the preservation of retirement benefits.

This note is intended to mainly address employee benefit issues. However, other matters of interest have also been included.

Executive Summary

Retirement Funds

- There has been a welcome reduction in Retirement Funds Tax from 18% to 9%. This is in anticipation of the retirement funds tax and legislative reform.

Social Assistance

- Old age and disability pensions are up from R780 to R820.

RSC Levies

- RSC levies will be scrapped from 30 June 2006.

Personal Tax

- Tax brackets have been adjusted to provide relief mainly for lower to middle income levels. The primary rebate is raised to R7 200, and the secondary rebate was unchanged at R4 500. The tax

threshold has been increased substantially: for under 65's it is raised to R40 000, and the R65 000 for over 65's.
- Interest exemptions have been raised to R16 000 for under 65's, and to R24 500 for over 65's.
- Tax exempt donations increase to R50 000, and the estate duty exemption increases to R2.5 million.

Individual Offshore Exchange Control Allowance
- This has increased from R750 000 to R2 million per person.

Car Allowances
- Deemed private kilometres increase and so does the monthly percentage value for that portion of the car allowance that is subject to tax.

Capital Gains Tax ("CGT")
- The CGT thresholds for taxable annual gains, primary residences and gains on death, have all been increased.

Medical Scheme Contributions and Medical Expenses
- A reminder that the new tax regime introduced in 2005 takes effect from 1 March 2006.

Transfer Duty
- The thresholds on property values on which transfer duty is payable by individuals will, with effect from 1 March 2006 be increased.
- The current flat rate of 10% for companies and trusts will reduce to a flat rate of 8%.
- Transfer duty on divorce is no longer applicable in respect of all types of marriages.

Business Taxes
- There will be a tax amnesty for small businesses operating outside of the tax system.
- The learnership tax allowance is to be extended to 2011.
- Tax changes to be considered to assist employers funding for post-retirement medical aid liabilities.

Public Benefit Organisations ("PBO's")
- Government continues to review tax rules for Public Benefit Organisations, including refining the list of tax-exempt PBO's.

Retirement Funds Tax

The only concrete change in respect of the tax regime as it applies to retirement funds was a reduction of the Tax on Retirement Funds ("RFT") rate from 18% to 9%. This tax was previously reduced from 25% (at 1 March 2004) and seems to indicate the Government's willingness to do away with this controversial tax, albeit on a gradual basis. The industry has long called for the abolition of RFT, as it penalises lower-income savers (who are unlikely to be taxed on any voluntary savings) and as it is administratively burdensome. Recent interactions between the industry and the South African Revenue Services have highlighted that uncertainty regarding how the payment of this tax is to be administered, has led to much inconsistent application.

Social Assistance

From April 2006, the old age pension and the disability grant will increase, from R780 to R820 a month. The child support grant goes up, from R180 to R190 a month.

The extension of the child support grant to qualifying children between the ages of 11 and 14 has brought the number of child support grant recipients at the end of 2005 to more than 7 million.

The South African Social Security Agency has been established to make the payments of social grants more efficient and predictable. The Agency will also work towards reducing corruption and ensuring that social grants reach those who need them most. Welfare services will remain a provincial function. Basic social service delivery will be further supported by an expansion in employment of community health workers, home and community based care-services and support for early childhood development programmes.

Regional Services Council ("RSC") Levies

The Regional Services Councils Act makes provision for the levying of two taxes. These are (1) the regional services levy, which is payroll tax, and (2) the regional establishment levy, which is turnover tax, ("REL"). Regulations to the Regional Services Councils Act specify how these levies are calculated and paid. REL is payable by a "financial enterprise" on "leviable transactions". The definition of "financial enterprise" includes long-term insurers and all forms of retirement funds.

In respect of retirement funds, REL applies in practice to non audit-exempt (privately administered) retirement funds. Audit-exempt funds (insured funds) which are underwritten by insurance policies, are not liable for REL because the underwriting insurer qualifies as a financial enterprise and is liable for the levy in respect of investments held by the insurer.

With effect from 30 June 2006, RSC levies, (both on payroll and turnover) will no longer be levied. As RSC levies will no longer be payable, the compliance obligations in respect of RSC levies will not apply.

The Minister has proposed that the RSC Levies will be replaced with a business tax on turnover. At this stage, we are unaware of the form this tax will take.

Personal Tax

Personal Tax Tables (Natural Persons)

Old: 2005/2006 Tax Year

TAXABLE INCOME (R's)	RATES OF TAX
0 - 80 000	18% of each R1
80 0001 – 130 000	R14 400 + 25% of the amount above R80 000
130 001 – 180 000	R26 900 + 30% of the amount above R130 000
180 001 – 230 000	R41 900 + 35% of the amount above R180 000
230 001 – 300 000	R59 400 + 38% of the amount above R230 000
300 001 and above	R86 000 + 40% of the amount above R300 000

New: 2006/2007 Tax Year

TAXABLE INCOME (R's)	RATES OF TAX
0 – 100 000	18% of each R1
100 001 – 160 000	R18 000 + 25% of the amount above R100 000
160 001 – 220 000	R33 000 + 30% of the amount above R160 000
220 001 – 300 000	R51 000 + 35% of the amount above R220 000
300 001 – 400 000	R79 000 + 38% of the amount above R300 000
400 001 and above	R117 000 + 40% of the amount above R400 000

Rebates

- Primary: R7 200 (previously R6 300);
- Secondary: remains R4 500.

New Tax Thresholds

- Below age 65: R40 000 (previously R35 000);
- Age 65 and over: R65 000 (previously R60 000).

Individual Offshore Exchange Control Allowance

The offshore individual allowance has been increased from its current limit of R750 000 to R2 million per person.

Interest and Dividend Income Exemption

The interest and dividend income exemption will be increased from R15 000 to R16 500 for all taxpayers under 65 years, and from R22 000 to R24 500 for taxpayers over 65 years, from 1 March 2005.

Foreign interest and dividends are only exempt for the first R2 500 (previously R2 000).

This exemption is an important benefit for taxpayers who rely on interest as their main source of income.

Motor Vehicle Allowances

Those taxpayers utilising the deemed method of claiming business travel tax deductions will be affected by the following changes. The deemed private kilometres are to be increased from 16 000 kilometres to 18 000 kilometres from 1 March 2006. The monthly percentage in respect of motor vehicle allowances subject to tax will increase from 50% to 60% from 1 March 2006.

The monthly taxable value of a company car is to be increased from 1.8% to 2.5% from 1 March 2006. This will result in an increased tax burden for taxpayers who currently utilise company cars.

Donations Tax and Estate Duty

The annual donations tax exemption is to be increased from R30 000 to R50 000 and the estate duty exemption increased from R1.5 million to R2.5 million from 1 March 2006.

Foreign Inherited Assets

Currently no rules exist for determining the base costs (for taxation purposes) of foreign located assets received as an inheritance from a foreign estate. It is proposed that such foreign assets should be given a base cost equal to market value at the date of death of the testator.

Capital Gains Tax ("CGT")

CGT, which is basically a tax levied on the disposal of capital assets, was introduced in South Africa on 1 October 2001 and is payable by all South African residents as well as by non-South African residents who make a profit or loss, when selling fixed property of a capital nature located in South Africa. Certain exclusions are afforded to taxpayers in terms of which no CGT is payable, which exclusions will, from 1 March 2006, increase as follows:

- the annual capital gain exclusion will increase from R10 000 to R12 500;
- the primary residence exclusion will increase from R1 million to R1.5 million;
- the exclusion on death will increase from R50 000 to R60 000.

What this means is that only the annual capital gain made by an individual which is greater than R12 500 will be subject to CGT. Only primary residences with a value greater than R1.5 million will similarly be subject to CGT (the amount is apportioned if the residence is jointly owned) and the exclusion of CGT on deemed disposals on death increases to R60 000.

Shares

Currently tax-payers who invest in equities as long term savings can elect to treat the proceeds on the sale of such shares as capital (rather than income), if the shares are held for more than five years. This obviously leads to the beneficial tax treatment of the proceeds. National Treasury has proposed reviewing this election in the forthcoming tax year.

Medical Scheme Contributions and Medical Expenses

The revised tax regime for medical scheme contributions takes effect on 1 March 2006. (This new regime was introduced in the 2005 budget). Currently, where companies pay the medical scheme contribution on behalf of their staff, only one third of this amount is included as a fringe benefit tax in the employee's hands.

From 1 March 2006 employees will be entitled to a tax deduction of R500 both for the principal member and the second dependant, and R300 for all other dependants on the scheme. In addition contributions to a medical scheme not ranking for a deduction against income will only be deductible to the extent that they exceed 7.5% (previously 5%) of taxable income.

Transfer duty

The thresholds on certain transfer duty brackets will be increased as follows:

- no transfer duty is payable on property values up to R500 000 (previously R190 000);
- transfer duty payable on property values exceeding R500 000 but less than R1 million remains at 5%; and
- transfer duty payable on property values exceeding R1 million (previously R320 000) remains at 8%.

The increase in the transfer duty exemption thresholds will make houses more affordable for first time and lower income buyers. No implementation date for the above proposals has been given.

Transfer duty rates for companies and trusts is reduced from a flat 10% rate to 8%.

Transfer Duty on Divorce

It is proposed that transfer duty should not be payable on divorce, in respect of all types of marriages. As it currently stands, only unions in community of property are exempt from transfer duty upon the transfer of property upon divorce.

Business Taxes

In a drive to further the development of a vibrant small business sector, there were a number of reforms relating to this segment of the business community. Firms with an annual turnover of R14 million (previously R6 million) will qualify for the graduated corporate tax regime. Businesses with a turnover of less than R300 000 (previously R250 000) will pay corporate tax of 10%.

In addition there will be a tax amnesty for small businesses who currently operate outside of the tax system. Businesses who register for tax in the amnesty period will not be liable for taxes for all years of assessment ending 31 March 2004. Businesses with a turnover of R5 million or less in the 2005 tax year will qualify to apply for this amnesty.

The tax laws relating to the payment of study bursaries and scholarships are also to be simplified to ensure that such amounts are always tax exempt in the hands of the employees who receive them (they are also deductible by the company which pays them). In order to encourage research and development, the deductibility for research and development will be increased from 100% to 150%.

Learnership Tax Allowance

In order to encourage on-the-job training and skills development, Government introduced a learnership tax allowance in 2002. This allowance, which was previously to have expired in 2006, will be extended to October 2011 in order to support the National Skills Development Strategy.

The maximum initial allowances will increase to R20 000 (previously R17 500) per year for existing employees, and to R30 000 (previously R25 000) for new employees.

Public Benefit Organisations ("PBO's")

Government continues to review tax rules for PBO's:

- the list of tax-exempt PBO's is to be refined;
- foreign PBO's are no longer allowed to operate in South Africa;
- irrespective of their legal form, the statutory tax rates for the taxable trading activities of all PBO's are to be aligned;
- the rules for permissible investments are to be relaxed.

Other

- Treasury recognises that companies who have post-retirement medical aid liabilities (which must be reflected on balance sheet), currently do not have tax effective methods of saving for this liability. Tax changes are being considered to allow for this saving to be made on a more tax efficient basis.

- Following on from the major changes that were made to the tax treatment of share options in the 2004, it is proposed that further tweaking of the revenue laws may be required to ensure consistent treatment of the myriads of share-option schemes.

- Certain collective investment schemes that attempt to 'manufacture' a non-taxable dividend in the place of taxable interest receipts have also been identified, and these loop-holes will be closed.

"Tips for Trevor"

In what has become the usual way, the general public offered tax and budgetary tips to the Minister this year.

One such tip came from Mr Makola who proposed a tax deduction on dating expenditure, saying "It's really difficult lately to find a woman without first dating her and such expenditure is sometimes beyond our budgets. We either date or forever remain bachelors…".

In the context of pensions not keeping up with the inflation rate, Mr Rademeyer pointed out to the Finance Minister that he too will grow old. The Minister responded that he had taken note and would welcome appropriate remedies!

On a more serious note, the Minister stated that the preservation of the real value of pensions should be a central principle of the retirement fund reform programme.

Should you require further information on the above, please contact your consultant