

Extended Highlights/Stop Press

"The foundation of human association is the idea that human life has equal worth and human beings are equally entitled to political, economic and social rights which allow them to choose a life they have reason to live."

Will Hutton, *The writing on the wall*, 2007. P. 204.

Minister Manuel used the principle that human life has equal value as the core principle of his 2007 Budget Speech. Government's priorities are clearly focused on accelerating growth, modernising public services and infrastructure; and reducing poverty and inequality. In order to achieve these goals it is imperative that resources be used for the purpose of recognising that all human life has equal worth.

The following represents a summary of the key points contained in the 2007 Budget.

1. Personal Income Tax

The Minister once again proposed welcome personal income tax relief. The table below illustrates the adjusted tax applicable to individual taxpayers for the 2007/2008 tax year.

Tax rates for natural persons - 2007/2008 tax year:

Taxable Income (R)	Rate of Tax
0 - 112 500	18% of each R1
112 501 - 180 000	R20 250 + 25% of the amount above R112 500
180 001 - 250 000	R37 125 + 30% of the amount above R180 000
250 001 - 350 000	R58 125 + 35% of the amount above R250 000
350 001 - 450 000	R93 125 + 38% of the amount above R350 000
450 001 and above	R131 125 + 40% of the amount above R450 000

Tax rebates:

	2006/2007 Tax Year	2007/2008 Tax Year
Primary rebate	R7 200	R7 740
Secondary rebate (applicable only to taxpayers aged 65 and over)	R4 500	R4 680

Tax thresholds:

	2006/2007 Tax Year	2007/2008 Tax Year
Below age 65	R40 000	R43 000
Age 65 and over	R65 000	R69 000



This means that a taxpayer younger than 65 and earning an income of R43 000 or less a year, or a taxpayer of 65 and older earning an income of R69 000 or less a year, will not pay any income tax in the 2007/2008 tax year.

The examples below demonstrate the tax savings for individuals (younger than 65) in terms of the proposed changes:

Taxable income	Tax payable 2006 Tax Year	Tax payable 2007 Tax Year	Tax reduction
R43 000	R540	R0	R540
R120 000	R15 800	R14 385	R1 415
R150 000	R23 300	R21 885	R1 415
R200 000	R37 800	R35 385	R2 415
R300 000	R71 800	R67 885	R3 915
R500 000	R149 800	R143 385	R6 415

These amendments to the tax tables will put more disposable income in the pockets of all taxpayers. For example, a person earning a taxable income of R300 000 for the year will have an additional R326,25 per month. This additional disposable income presents an ideal opportunity for clients to settle debts, update risk protection levels or increase investments.

In addition to the above amendments, Minister Manuel has also recognised the fact that the income-averaging formula for individual farmers is complex, and therefore a need exists for greater simplification. This need especially pertains to newly commencing farming operations. Therefore, as a first step, it is proposed to simplify the threshold within the commencing formula.

2. Interest Income and Dividend Exemption

Interest and dividend exemption levels have also been revised. The Budget Speech contained a proposal that, for the 2007/2008 tax year, the domestic interest income exemption be increased from:

R16 500 to R18 000 per year for taxpayers under the age of 65; and from R24 500 to R26 000 per year for taxpayers aged 65 years and older.

It is also proposed that the exemption of foreign interest and dividends be increased from R2 500 to R3 000.

The effect of these proposals will be that interest-bearing investments will attract no or less income tax, depending on its capital value; and such investments may thus become more attractive to investors.



Example

If a client aged 45 has an emergency fund of R250 000 invested in a fixed deposit account, earning interest at 9%, the impact of this proposal would be as follows:

Interest per year	Interest exempt 2006/2007	Interest exempt 2007/2008	Taxable interest 2006/2007	Taxable interest 2007/2008
R22 500	R16 500	R18 000	R6 000	R4 500

The increased interest exemption will thus reduce this client's taxable income by R1 500. In light of this, clients may be well advised to review their emergency fund vehicles or general interest bearing investments. The Old Mutual group is well positioned to assist clients with financial advice, domestic and international investment vehicles. This can ensure that clients take full advantage of the new exemption amounts.

3. Exchange Control

Gradual exchange control relaxation has taken place during the course of a number of years. This has allowed South African firms to diversify their investments through international as well as domestic channels.

The continued position of strength of the South African economy as well as the financial markets supports further relaxation steps, which include:

- lowering the current shareholding threshold for foreign direct investment outside of Africa from 50% to 25% to further enable South African companies to engage in strategic international partnerships;
- further developing South Africa's financial markets and increasing liquidity in the currency by permitting the Johannesburg Securities Exchange (JSE) to establish a Rand futures market.

4. Medical Aid Deduction

The income tax deduction allowed for contributions made by members to their medical schemes has been increased from:

- R500 to R530 for each of the first 2 beneficiaries; and from
- R300 to R320 for each additional beneficiary,

with effect from 1 March 2007.

This translates into the following tax implications for a family of four:

Deduction for medical scheme contributions in 2006/2007 tax year:
 $R500 + R500 + R300 + R300 = R1\ 600$

Deduction for medical scheme contributions in 2007/2008 tax year:
 $R530 + R530 + R320 + R320 = R1\ 700$.



The increased deduction will thus reduce the tax liability of the taxpaying contributing member by R100 p.m. for the tax year. This additional tax saving may result in medical aid membership becoming more affordable to clients. In addition, it is worth noting that the fundamental changes to the deduction applicable to medical scheme contributions made in the 2006 Budget have resulted in administrative and compliance difficulties. Further legislative intervention may be required to resolve such difficulties.

5. Public Benefit Organisations

In order to encourage charitable contributions, the Income Tax Act currently allows individuals and companies to deduct donations made to Public Benefit Organisations (PBOs) to a maximum of 5% of their taxable income. It is proposed that the ceiling be increased to 10% for donations by individuals and/or companies.

Example

If a company has a taxable income of R1 million in the 2006/2007 tax year and it donates R100 000 to a PBO during the course of that tax year, it would be able to deduct R50 000 for that tax year (being 5% of taxable income). Based on the proposed amendments for the 2007/08 tax year, the deduction allowed to the company will be R100 000.

This may result in increased donations and more money being available to PBOs, which could increase their investment planning needs.

In addition it is also worth noting that PBOs are subject to partial taxation. PBOs are liable for income tax on a basis of 5% of gross income or R50 000, whichever is the greater. It has been proposed that this threshold be increased to the greater of 5% of gross income or R100 000. Thus, possibly resulting in a greater tax saving for the PBO. This potential reduction in the PBO's tax liability may also lead to an investment planning need. Government has also proposed that PBOs be aligned to other employers as far as the skills development levy is concerned. The skills development levy payable by other employers will therefore also be payable by PBOs.

6. Estate Duty and Donations Tax

It has been proposed that the estate duty rebate be increased from R2.5 million to R3.5 million. This means that clients with an estate valued at less than R3.5 million will not pay any estate duty.

It has further been proposed that the annual donations tax threshold be increased from R50 000 to R100 000.

Clients are always looking for ways to reduce the value in their estates with a view to limiting estate duty. A popular way to limit estate duty is to transfer growth assets out of the estate and into an inter vivos trust. Clients can sell assets to a trust using a loan account. The loan account can then systematically be reduced on an annual basis by the client donating the maximum exempt amount (R100 000) to the trust, which in turn repays the outstanding loan. The client must be made aware of CGT implications.

A further opportunity could be to consider increasing contributions iro children's education funds utilising the increased donations tax threshold.



Clients may also be well advised to review their wills in order to assess the impact of the revised estate duty abatement amount. In view of the increased abatement a client is now able to bequeath an estate residue exceeding R3.5 million (as apposed to R2.5 million) to his or her spouse in order to limit the estate duty liability.

7. Capital Gains Tax

The annual exclusion threshold for capital gains or losses has been increased from R12 500 to R15 000. This essentially means that a client could potentially have an extra R2 500 available for reinvestment in the event of a capital disposal.

The capital gains tax threshold on death has been substantially increased from R60 000 to R120 000. This will result in a positive impact on the liquidity in a deceased estate, which may necessitate revision of the estate plan and/or will.

8. Secondary Tax on Companies

Secondary tax on companies (STC) is believed to raise the cost of equity financing which is detrimental to the country's economic growth. Reform to secondary tax on companies is therefore proposed. This reform will take place in two phases, ultimately phasing out STC and replacing it with a dividend tax.

The first phase will introduce a broader dividend tax of 10% to replace STC, currently being levied at 12.5%. This will become effective as from 1 October 2007, except for certain immediate anti-avoidance measures, which take effect on 21 February 2007.

9. Small Business Development

In its vision to promote entrepreneurship, job creation and small business growth, Government focused on the reduction of the tax compliance burden for small businesses. It is envisaged that this drive will be continued by the development during 2008 of a simplified tax regime for very small businesses.

Tax amnesty

Clients who own or operate as small businesses should be cognisant of the 31 May 2007 deadline for amnesty applications. The Finance Minister expressed the expectation that amnesty volumes will peak in the final weeks prior to the 31 May 2007 deadline.

BEE transactions

Amendments to the Income Tax Act were proposed to help BEE partners to raise financing. This proposal is aimed at preventing unjustified additional tax costs.

Environmental capital expenses

In order to correct previous environmental oversights, proposals were tabled for environmental capital structures, such as dams and tanks, presently not depreciable, to qualify for depreciation allowances.



10. Taxation of Share Investments

Tax on dividends

As previously mentioned reform to taxation of dividends will be conducted in two phases. The first phase has commenced with the conversion of Secondary Tax on Companies (STC) as mentioned above. The second phase, which is envisaged to commence in 2008, will entail the conversion of this tax to a dividend tax on shareholders. This new tax will depend on the renegotiation of a number of international tax treaties. The ultimate aim of these reform measures is to lower the cost of doing business and to align with international trends of imposing taxes at shareholder level.

Sale of long-term share investments

Investors who dispose of share investments are currently taxed on the proceeds either as income or as capital gains, depending on the circumstances of the investment and the sale. In order to ensure equitable treatment, it has been proposed that the proceeds of all shares disposed of after a three (3) year period be regarded as capital gains. The effective date of this provision is the 1st of October 2007. (It should be noted that this measure will not affect the ordinary income tax treatment of executive employee share schemes).

Stamp duties

Stamp duty is currently payable on the trade of unlisted shares, while uncertified securities tax (UST) is payable in the case of exchange-traded securities. It is proposed that the trade in securities (whether unlisted or not) be subjected to the same securities tax. Amendments are proposed to simplify exemptions and also to ensure that the tax implications of derivatives and partial disposals of securities are clarified.

These measures generally bode well for security investors, as the collective aim is to ensure that security investments become more cost efficient and taxation practices are clarified and/or streamlined.

11. Property Investment Vehicle

A review of the tax applicable to property vehicles such as collective investment schemes in property and property loan stock is planned during the course of 2007. The rationale for this step is that currently the tax treatment of such entities is fragmented since it is based on legal form instead of common purpose.

Long-term leases of fixed property are currently subject to stamp duty while transfers of fixed property are subject to transfer duty. Government has undertaken to examine the relationship between the VAT Act, Transfer Duty Act and stamp duties on long-term leases.

12. Retirement Reform

A number of important changes to retirement funds was announced as part of the wider social security reforms. These changes are aimed at creating an equitable and efficient framework for people to provide for their retirement. More retirement reform is also envisaged going forward and details of future reform will be published in a separate discussion paper. Future reforms will allow full or partial tax deductibility for retirement fund contributions (with no tax relief above a specified ceiling); provide tax exemption for investment growth in retirement funds and determine the taxability of retirement benefits. This will necessitate more uniform treatment of pension, provident and retirement annuity funds in the future.



The first step taken as part of this retirement reform process is the abolition of retirement fund tax with effect from the 1st of March 2007. Retirement funds are currently taxed at 9% on gross interest and net rental income. The abolition of this tax will result in improved net returns on retirement fund investments and thus also increased retirement fund benefits for members. This measure should also be viewed as the counterpart of future limitations to the tax deductibility of contributions to retirement funds, which is expected to affect high-income individuals.

In addition to the abolition of tax on retirement funds, tax on lump sums payable by a retirement fund to members with a taxable income of less than R43 000 per year (the new income tax threshold) will also be abolished. This will result in an increase in retirement income for such taxpayers. It should be noted that the R120 000 tax-free amount of retirement fund lump sums has not been amended in the 2007 Budget Speech. The Minister did, however, mention that he would give attention to this and reconsider the current formula used to calculate the tax-free lump at retirement.

Regulatory requirements applicable to retirement funds will be streamlined by being moved from the Income Tax Act to the Pension Funds Act. This will result in reduced regulatory costs being incurred by retirement funds, also contributing to enhanced retirement benefits for members.

The above measures should be regarded merely as the start to a much bigger retirement reform process. The phasing in of a mandatory retirement saving arrangement for employees (and also encouraging self-employed people to contribute to such an arrangement) was also tabled as part of retirement reform measures. These measures will be the subject of further research and consultation in the future.

The immediate measures will benefit retirement fund members, as they will reduce the tax and costs payable by funds, thereby enhancing returns and also retirement and withdrawal benefits of members. Retirement funds thus become even more appealing investment vehicles for clients wanting to provide for their retirement.

In addition to the abovementioned retirement reforms, some other miscellaneous matters pertaining to retirement funds and compulsory annuities are also dealt with in the Budget Speech. It was also proposed to amend the drawdown rate on living annuities to ensure that drawdown levels remain in line with market factors. Current drawdown rates are allowed between 5% and 20%. It is proposed that the permissible drawdown rates be moved to between 2.5 % and 17.5%.

Another matter which needs to be addressed is the lack of a precise statutory definition for this term "annuity". Such a definition is required to determine the tax implications of guaranteed and living annuities.

Minister Manuel also made mention in his speech of the issue pertaining to the preservation of tax-free pre-1998 pension build-ups applicable to public servants. He has given the assurance that legislative amendments to retain such pre-1998 tax-free pension benefits will be considered.



13. "Sin Taxes"

As usual, the Minister was the bearer of bad news when it came to sin taxes. The following increases are proposed (with immediate effect):

- Tax on a packet of 20 cigarettes goes up by 60 cents
- Tax on a 340 ml can of beer goes up by 5 cents
- Tax on a 750 ml bottle of wine up by 10 cents; and
- Tax on a 750 ml bottle of spirits up by R1,88.

These changes to the excise taxes are expected to raise an additional R1.5 billion.

14. Wage Subsidy and Social Reform

A broad-based social security framework has been proposed for development and implementation during the 2007 - 2010 period. The objective of this proposal is to improve the labour market as well as share the benefits of economic progress achieved.

The Budget Speech contained some more detailed proposals aimed at alleviating unemployment - for example, that a wage subsidy be implemented by 2010. The objective of such a wage subsidy would be to reduce the cost of employment for businesses, alleviating high unemployment and facilitating social reform. It is envisaged that SARS will administer the social security tax and wage subsidy. More detailed plans and proposals will be tabled during 2007 for public discussion.

Conclusion

The Budget Speech has set in motion a number of ambitious reforms, all of which are ultimately aimed at creating equity and ensuring that all human life has equal worth. The initiation of these reforms is only possible due to the significant economic and financial progress achieved during previous years. The Budget Speech contained a significant number of relief measures for taxpayers. Personal income tax relief amounting to R8.4 billion has been granted to individual taxpayers alone.

Compiled by: PFA HR Legal

Date: 21 February 2007

