The **Exchange Control Amnesty Act Draft Regulations** are released for public comment.

The comment period for the Exchange Control Amnesty Act Draft Regulations closes on **Friday, 22 August 2003 at 17:00**. Due to time constraints, it will not be possible to respond individually to comments received. However, receipt of comments will be acknowledged and fully considered by the National Treasury, SA Revenue Service and the SA Reserve Bank.

National Treasury will act as coordinator for the receipt of comments. All comments must be submitted to:

Ms. Michelle Franks
E-mail: michelle.franks@treasury.gov.za
Fax No.: (012) 323 2917
Phone No.: (012) 315 5560

SOUTH AFRICAN REVENUE SERVICE

No. R. **AUGUST 2003**

DRAFT REGULATIONS TO BE ISSUED IN TERMS OF SECTION 30 OF THE EXCHANGE CONTROL AMNESTY AND AMENDMENT OF TAXATION LAWS ACT, 2003

By virtue of the power vested in me by section 30 of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003 (Act No. 12 of 2003), I, Trevor Andrew Manuel, Minister of Finance, hereby make the following regulations, as set out in the Schedule hereto, to give effect to the objects and purposes of Chapter I of that Act and to address certain unintended consequences, anomalies and incongruities in the Act.

SCHEDULE

Definitions

1. For the purposes of these regulations, unless the context otherwise indicates, any word or expression to which a meaning has been assigned in the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003, ("the Act") bears the meaning assigned thereto, and—

"disposal" means "disposal" as defined in the Eighth Schedule to the Income Tax Act, 1962;

"Income Tax Act, 1962, means the Income Tax Act, 1962 (Act No. 58 of 1962).

Provisions relating to donors to discretionary trust

2. For purposes of section 4 of the Act, a donor includes a person at whose instance a donation was made by a company.

3. For the purposes of section 4(2)*(a)* of the Act, the reference to any foreign asset of a discretionary trust which was acquired by way of a donation made by the donor contemplated in that section, includes—

(a) any asset of the discretionary trust the value of which is derived from the donation made by the donor;

(b) any asset acquired by the discretionary trust in exchange for, or from the proceeds from the disposal of, the asset originally donated by that donor; and

(c) any receipts and accruals derived from any asset originally donated or subsequently acquired, as contemplated in paragraph *(b)*.

4. Where a person has made an election in terms of section 4(1) of the Act in relation to a foreign asset of a discretionary trust, that person must, for purposes of the determination of any income or any capital gain or capital loss from the disposal of that foreign asset, be deemed—

(a) to have acquired that foreign asset on the same date that the discretionary trust acquired that foreign asset and for an amount equal to—

(i) in the case where that asset constitutes the original asset donated by that person to that discretionary trust, the sum of the market value of that asset on the date of that donation and any subsequent expenditure incurred by that discretionary trust in respect of that foreign asset; or

(ii) in the case of any subsequent asset acquired by the discretionary trust, as contemplated in regulation 3, the expenditure incurred by that discretionary trust in respect of that foreign asset; and

(b) to have used that foreign asset in the same manner as was used by that discretionary trust; and

(c) to hold that asset until the earlier date of either when—

(i) that foreign asset is disposed of by that discretionary trust to any other person; or

(ii) that person is in terms of the provisions of the Eighth Schedule to the Income Tax Act, 1962, treated as having disposed of that asset.

5. Where a person is in terms of section 4(1) of the Act deemed to hold any foreign asset of a discretionary trust, which was acquired by that discretionary trust by way of a donation made by that person after the date that the asset was accumulated as or converted to a foreign asset, that donation must, for purposes of section 17(1)*(b)* of the Act, be deemed to have been made before the date of that accumulation or conversion.

6. Nothing in the Act or these regulations must be construed as nullifying, for purposes of Part V of Chapter II of the Income Tax Act, any donation contemplated in section 4 and regulation 2.

Provisions relating to deceased estates

7. The provisions of section 17(1) shall apply in respect of any amount accumulated as or converted to a foreign asset as disclosed by the applicant in terms of section 6(3), which was not declared to the Commissioner in terms of the Estate Duty Act, 1955, notwithstanding the fact that the estate duty thereon could have been imposed only after the date of that accumulation or conversion.

Provisions relating to facilitators

8. A company, trust or deceased estate will be a related party if it complied with the requirements of the definition of "related party" in section 1 of the Act, on 28 February 2003.

9. Where the shares of a company are held by a trust and no person other than the applicant or relatives of the applicant are beneficiaries of that trust, that company shall be deemed to comply with the provisions of paragraph *(a)* of the definition of "related party" in section 1.

10. Where a company assisted more than one applicant by accumulating foreign assets or transferring funds or assets from the Republic, as contemplated in section 3(1)*(c)* of the Act, those applicants shall for purposes of the definition of "related party" in section 1, be regarded as one applicant.

Determination of leviable amount on value of assets securing debt

11. In determining the leviable amount for purposes of section 11 of the Act, an applicant may deduct from the market value of any foreign asset the amount owing as at 28 February 2003 in respect of any debt incurred outside the Republic to acquire that asset, if that asset serves as security for the repayment of that debt.

Foreign source income

12. For purposes of sections 6(2), 9(2) and 15 of the Act, the reference to receipts or accruals from a source outside the Republic means all amounts where the actual source thereof is outside the Republic, regardless of the fact that it may in terms of the Income Tax Act, 1962, have been deemed to be from a source within the Republic.

Provisions relating to domestic tax relief

13. The provisions of section 6(3)*(a)* of the Act apply in respect of all amounts contemplated in section 3(1)*(b)* of the Act, which were not declared to the Commissioner—

(a) in the case of donations tax or estate duty, on or before 28 February 2002; and

(b) in the case of income tax, in respect of any year of assessment ending on or before 28 February 2002.

14. For purposes of section 6(3)*(b)* and *(c)*, where the amounts were initially accumulated as or converted to foreign assets on or before 28 February 1998, the applicant need only disclose the year of assessment within which the amounts were so accumulated or converted.

15. The provisions of section 16 of the Act shall not be construed to impose the domestic tax amnesty levy more than once on any amount disclosed by the applicant or facilitator in terms of section 6(3), notwithstanding the fact that the applicant or facilitator, as the case may be, was required to declare that amount to the Commissioner under more than one provision of the Income Tax Act, 1962, or under both the Income Tax Act, 1962, and the Estate Duty Act, 1955.

Invalidity of approval

16. The provisions of section 20(1)*(b)* apply only in respect of foreign assets or foreign bearer instruments held by the applicant on 28 February 2003.

Procedures of Amnesty Unit

17. For purposes of evaluating all applications and granting or denying approval thereof in terms of Chapter I of the Act, the Chairperson may determine the procedures to be followed in the meetings of the amnesty unit.

18. The Chairperson of the Amnesty Unit may fix the quorum which is required for a decision by the Unit to grant or deny approval for amnesty.

EXPLANATORY NOTES ON THE DRAFT REGULATIONS

BACKGROUND

Section 30 of the Exchange Control Amnesty Act provides the Minister with broad regulatory authority to give effect to the objects and purposes of the amnesty. This regulatory authority is mainly intended to address unintended consequences, anomalies or incongruities that may arise during the amnesty review process. This broad grant of regulatory authority was necessary because the short time-frame for enacting the amnesty made it impossible to address many issues within the normal Parliamentary review process.

As far as unintended consequences, anomalies and incongruities are concerned, section 30 of the Exchange Control Amnesty Act directs special attention to foreign discretionary trusts (among others).

DISCUSSION

Provided below are the list of issues to be remedied by the proposed regulations. Most of these issues involve amendments to the legislation's envisaged tax treatment rather than amendments to the Exchange Control regulations. The issues covered stem from extensive discussions with private stakeholders over the course of the last several weeks.

Indirect donations to foreign discretionary trusts (paragraph 2)

The current Exchange Control Amnesty Act provides relief for parties with illegal foreign assets held through discretionary foreign trusts only to the extent these parties directly donated those foreign assets to the foreign trust. After wide consultation, we now understand that many parties made these donations to foreign discretionary trusts through indirect means. In particular, most individuals with discretionary foreign trusts utilised controlled South African companies to make the donation. The proposed regulations will accordingly allow amnesty for illegal foreign assets donated by South African companies to foreign discretionary trusts "at the instance" (i.e., upon the direction) of the applicant.

Growth within foreign discretionary trusts (paragraph 3)

Illegal foreign assets within a foreign discretionary trust are covered by the amnesty only to the extent those assets were donated to the foreign trust. The current rules fail to account for the fact that the originally donated assets may have been replaced with new assets over the years or that the donated assets (or the replaced assets) may have generated further funds within the foreign discretionary trust. The proposed regulations ensure that replacement assets and subsequent growth are fully included within the amnesty.

Tax cost of foreign discretionary trust assets (paragraph 4(a))

Parties wishing to avail themselves of the amnesty with respect to discretionary foreign trust assets can do so only to the extent those parties elect to be treated as directly holding those trust assets for tax purposes. The current wording fails to describe the tax cost (i.e., base cost in terms of capital gains/losses and cost price in terms of trading stock for purposes of ordinary revenue) for which foreign discretionary trust assets are deemed to have been acquired for purposes of the electing party. The proposed regulations treat the electing party as acquiring the asset for the same tax cost as acquired by the foreign discretionary trust.

Tax character of foreign discretionary trust assets (paragraph 4(b))

A second collateral issue stemming from the election concerns the character of a foreign discretionary trust asset in the deemed hands of the electing party. The regulations clarify this issue by stating that the asset has the same character as determined at the discretionary trust level. Hence, if the asset is trading stock in the hands of the foreign discretionary trust, the electing party must similarly be viewed as holding an asset as a trading stock.

Deemed disposals of foreign discretionary trust assets (paragraph 4(c))

A third collateral issue stemming from the deemed asset election concerns the time when the electing party is deemed to dispose of a foreign discretionary trust asset. The Exchange Control Amnesty Act currently provides that the electing party is deemed to have disposed of the asset when the foreign discretionary trust disposes of the asset (thereby triggering capital gain for the electing party upon the trust's disposal). However, the current act fails to state what happens when the electing party ceases to exist (or undergoes another form of deemed disposal event). For instance, the current act fails to specify what happens if an electing deceased estate winds-up before disposal of the asset by the foreign trust. Under current law, it would appear that a deemed disposal of assets could trigger gains for a deceased estate long after that estate ceased to exist. The proposed regulation accordingly treats the deceased estate as disposing of the foreign discretionary trust asset upon the deceased estate's cessation even if the foreign discretionary trust continues to hold the illegal foreign asset after the estate's cessation. The same rule applies for other forms of deemed disposals involving the electing party.

Donations (and transfers by will) from foreign accounts (paragraph 5)

The Exchange Control Amnesty Act provides amnesty for failure to pay donations tax if the undeclared sums involved are shifted to foreign locations. However, the amnesty inadvertently covers only a limited set of situations. For instance, the amnesty currently applies only if the undeclared donation (or transfer by will) comes from domestic locations with the funds subsequently shifted offshore (i.e. if the donation – or transfer by will – precedes the conversion into foreign assets). The amnesty does not apply if the

undeclared donation is made out of funds from a foreign location, such as a foreign bank. We understand that this omission is highly problematic because many parties shifted undeclared funds from foreign bank accounts into foreign discretionary trusts. The proposed regulations accordingly place these foreign donated assets on par with assets donated into foreign discretionary trusts from domestic accounts. Hence, foreign donated assets of this kind will be covered by the amnesty and will be subject to the same 2 per cent domestic levy.

Deemed ownership of discretionary foreign trust assets does not eliminate the existence of prior donations (paragraph 6)

The interaction between the deemed ownership rules for foreign discretionary trusts and the existence of prior donations is unclear. One can currently argue that a party electing deemed ownership of a trust asset is deemed never to have initially made a donation to that trust. The deemed elimination of the prior donation could create many unintended consequences. For instance, assume an applicant has committed a number of violations requiring amnesty, including the illegal donation of an asset to a foreign discretionary trust in June 2002. Also assume the applicant makes the election for deemed ownership of the trust asset as at 28 February 2003 for purposes of the amnesty. Under these circumstances, it could be argued that the election has the present effect of disregarding the prior donation (i.e., deeming the prior donation not to have occurred), thereby providing tax amnesty relief for the June 2002 donation (when no legislative intention of this kind clearly existed because the tax amnesty has a well-publicised 28 February 2002 cut-off). The proposed regulation accordingly clarifies that the election has no effect on the existence of prior donations.

Estate transfers from foreign locations (paragraph 7)

The Exchange Control Amnesty Act has the same shortcomings for failures to pay estate duty as for failures to pay donations tax (see paragraph 5 above). The amnesty applies only if the transfer comes from a domestic location with funds subsequently shifted offshore. The amnesty does not apply if the undeclared estate transfer is made from a foreign location, such as a foreign bank. The proposed regulations again place these foreign transferred assets within the ambit of the amnesty subject to the 2 per cent levy.

Date for determining related party facilitator status (paragraph 8)

The amnesty currently covers a wide variety of related party facilitators, including related companies, trusts and deceased estates. At issue is when related party status must be determined because no date for this determination exists under the legislation. The proposed regulation accordingly clarifies that related party status is determined as at 28 February 2003.

Company facilitators held through trusts (paragraph 9)

The amnesty currently provides explicit coverage for related company facilitators to the extent all the shares of a company are owned by the applicant (or both the applicant and the applicant's relatives). Indirect ownership of this kind through trusts is not explicitly covered, even though the underlying economics are the same. The proposed regulation accordingly extends amnesty relief for related company facilitators when all the company shares are held by applicants (and their relatives) through trusts.

Company facilitators held by multiple applicants (paragraph 10)

We understand that many structures formed for the evasion of Exchange Control and/or tax came in the form of a collaborative effort whereby multiple individuals illegally shifted funds offshore through a single company. For instance, a single company facilitator with five unrelated shareholders could have been used to illegally shift funds offshore equally on behalf of all the shareholders. The proposed regulation provides amnesty relief for the related company facilitator by treating all the applicants as a single applicant. Hence, relief exists for a related company facilitator with multiple unrelated shareholders only if all these shareholders apply for amnesty. Relief similarly applies if all the shareholders involved are trusts holding shares solely on behalf of separate applicants (or their relatives).

Levy on unauthorised foreign assets secured by foreign debt (paragraph 11)

An issue that frequently arises is how to impose the Exchange Control Amnesty Levy in situations involving foreign assets subject to foreign debt. A levy on gross value is unfair when the applicant at issue has derived only a net economic benefit. Differently stated, the amnesty levy should only be imposed on the assets transferred from South Africa or accumulated offshore without authorisation and their respective growth – not on foreign borrowings. The imposition of a large levy on indebted foreign property also creates problems in terms of amnesty logistics because the applicant may not have accessible liquid funds. The proposed regulations accordingly treat the Exchange Control Amnesty Levy as applying to the net value of illegal foreign assets to the extent those assets act as security for foreign debt as at 28 February 2003.

Former deemed domestic income (paragraph 12)

Prior to the adoption of worldwide tax in 2001, the South African tax system treated certain foreign income as "deemed" South African source income. The most important category of this deemed domestic source income involves foreign investment income earned by individuals, which were previously subject to "deemed" South African source treatment. With the implementation of worldwide taxation on 2001, this "deemed" South African source income was eliminated as superfluous since all income became subject to tax regardless of source. Unfortunately, the Exchange Control Amnesty Act could be interpreted as treating this former deemed South African income as domestic income for purposes of amnesty relief. As a result, this income (being deemed domestic) inadvertently receives only limited amnesty treatment, including required payment of the additional 2 per cent domestic amnesty levy. The proposed regulation accordingly reverses this result by treating this and other deemed domestic source income as actual foreign source income.

Domestic tax violations cut-off date (paragraph 13)

The Exchange Control Amnesty Act provides relief with respect to all foreign income tax violations occurring during the year of assessment ending on or before 28 February 2002. The purpose of this effective date cut-off is to ensure that persons cannot enter into new violations in expectation of the amnesty. However, the cut-off date for domestic violations was inadvertently omitted in the final version of the legislation. The proposed regulations accordingly limit the amnesty for domestic tax violations to the same effective date period as foreign tax violations.

Information required about dates of domestic tax violations (paragraph 14)

Applicants seeking amnesty for domestic tax violations must disclose the dates on which the domestic amounts were initially accumulated or converted offshore. The proposed regulations clarify that applicants need only disclose the years of assessments in which those assets were so accumulated or converted. Disclosure of exact days is not required regardless of whether the accumulation or conversion occurs before, on or after 28 February 1998.

No double domestic levy (paragraph 15)

The domestic amnesty provides relief from several domestic tax violations – most notably undeclared domestic income and donations illegally shifted offshore. Questions have been raised whether the 2 per cent domestic levy will apply for each violation even though the same sum is involved. For instance, if a party generated R100 000 of undeclared domestic income and also donated those funds offshore without declaring the donation, does the 2 per cent levy apply once with respect to the R100 000 sum involved or twice

because two domestic tax violations were involved? The proposed regulations clarify existing law, that the 2 per cent domestic levy will apply only once per sum involved.

Unlawful activities occurring after the amnesty will not adversely effect the amnesty (paragraph 16)

The invalidity of approval provisions contained within the Exchange Control Amnesty Act could be read to imply that unlawful activities (i.e., criminal activities generally outside the amnesty) will invalidate the amnesty even if the unlawful activities occur after the amnesty period. It was never intended that events occurring after the amnesty should have any effect on the success of an amnesty application. The legislation was designed only to invalidate approved applications premised on a false representation that the applicant was engaged in no unlawful activities in respect of assets held as at 28 February 2003. The proposed regulations accordingly clarify the legislation in this regard.

Internal amnesty procedures (paragraphs 17 & 18)

The Chairperson of the Amnesty Unit requested that we clarify his authority over the unit. The proposed regulations accordingly provide the Chairperson with the authority to determine the amnesty unit's procedures. The Chairperson will also have the authority to fix the quorum required for granting and denying amnesty applications.