COME INTO MY PARLOUR,
SAID THE SPIDER TO THE FLY!
The 2003 Income Tax Amnesty:
A golden opportunity or tax trap?

Dissertation submitted in partial fulfilment of the requirements for the degree of Master of Law in Taxation
At the University of the Witwatersrand
Due date: 12 September 2005

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DEDICATION

I dedicate this dissertation to my wife Tracy-Lee, and to my daughters Sabrina and Regan, for their love, and for permitting me the time and latitude to explore my passion.

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CHAPTER 1 - The pre-Amnesty environment

1.1 Introduction

From 1 June 2003 to 29 February 2004, qualifying residents with unauthorised foreign holdings could apply for exchange control and income tax amnesty (hereinafter "the Amnesty'). At first glance the Amnesty appears to be cheap at the price. Levies ranged from 2% in the case of domestic tax relief, to 10% for applicants who chose not to repatriate foreign assets in excess of certain exchange control thresholds. Some applicants did not even have to pay a levy to regularise their positions.

Special rules applied to offshore trusts included in the Amnesty. The importance of retaining these structures will be discussed, and a conclusion drawn that affected applicants enjoy some unique tax saving opportunities.

Amnesty was seen by some as a golden opportunity to pocket a "get out of jail free card[1]" for contraventions of applicable legislation. An analysis of the true cost of the Amnesty, in the context of a changed tax law, will demonstrate that the Amnesty was anything but cheap. On the contrary, successful applicants face a perpetual future tax cost after Amnesty, and will need to review their tax and estate planning initiatives in order to provide for this threat. Some tax planning suggestions will be offered, and evaluated in the context of the obvious and hidden costs of the Amnesty.

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[1] OMG ppt 2

1.2 Why was there a need for an offshore tax amnesty?

When the Minister of Finance tabled the Exchange Control Amnesty and Amendment of Taxation Laws Bill[2] (hereinafter "the Amnesty Act') on 15 May 2003,[3] he suggested that taxpayers with unauthorised foreign assets, had taken cognisance of the government's achievements in the sphere of global tax compliance, and motivated by fear and/or patriotic fervour, many were anxious to voluntarily regularise their tax and foreign exchange affairs.

The preamble of the Amnesty Act sets out the objectives of the legislation thus:

a) **To enable violators of Exchange Control Regulations and certain tax Acts to regularise their affairs in respect of foreign assets attributable to those violations;**

b) **To ensure maximum disclosure of foreign assets and to facilitate repatriation thereof to the Republic; and**

c) **To extend the tax base by disclosing previously unreported foreign assets.**

The Minister's introductory speech made no mention of the plethora of income tax and related regulation that had saturated the legal environment in the years immediately preceding the Amnesty. Nor was any reference made to the sometimes confusing, and often uncertain, regulations pertaining to offshore assets held by residents. Instead, the honourable Minister focussed on illegality and criminality.

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[2] Act 12 of 2003
[3] Manuel 2

It is beyond the scope of this report to examine the motivations for shifting or retaining undisclosed funds abroad, but it is important to note that:

a) Considerations of internationally accepted investment prudence, dictate that diversification on a global scale minimises the risk of exposure to a single emerging economy;

b) Laws that prohibit the free flow of capital, *albeit* with full income tax disclosure, are in themselves of doubtful legitimacy, particularly while enacted to protect a minority regime with a "laager" outlook, and with no regard to the sensibilities of the global village; and

c) In many instances foreign holdings had already been subjected to foreign taxes and death duties, and/or were owned by immigrant residents.

1.3 The tax treatment of foreign holdings before Amnesty.

The Amnesty Act, despite the insinuation contained in the Minister's introductory address, also offered welcome relief to persons who were not tax crooks, but who had unwittingly found themselves in technical infringement of complex income tax amendments, mostly of far reaching consequence. It is important to examine some of the applicable provisions, because it provides an insight into the range of transgressions for which Amnesty was applied, and also because in some instances these rules still govern the taxability of foreign holdings held by residents.

1.3.1 Source based taxation

Before January 2001, South Africa applied a source based system of taxation. Although "source" is much less important since the change to residence based taxation insofar as residents are concerned,[4] many applications for amnesty extended to transgressions of the Act that occurred before January 2001.

The Act is silent on the definition of the term "source", and it was not always clear whether a taxpayer was obliged to include foreign income in "gross income" as required by the Act, or not. The Appellate Division in *CIR v Lever Brothers Ltd* [5] determined that "source" meant "originating cause" and held:

"When the question has to be decided whether or not money received by a taxpayer is ''gross income'' within the meaning of the definition referred to above, two problems arise which have not always been differentiated from one another in decided cases. The first problem is to determine the source from which it has been received and when that has been determined; the second problem is to locate it in order to decide whether it is or is not within the Union"[6].

Usually, it is fairly simple to determine and locate the "originating cause" of income. It is clear from case law that international transactions would be more complicated. There are no hard and fast rules, and each case will have to be decided on its merits. The court in *Lever Brothers supra obiter* determined that it was even possible for the source of income to be partly in one country, and partly in another, but did not offer an equitable basis for dealing with this anomaly.

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[4] "source" is still relevant in determining the tax liability of non-resident taxpayers (who were excluded from applying in terms of the provisions of the Amnesty Act)

[5] 1946AD441,14SATC1

[6] Per Watermeyer CJ - 14SATC1 at 8-9

1.3.2 Deemed source and other possible infringements

The Income Tax Act also deems, what may, at first glance appear to be foreign receipts and accruals in regulated instances, to be from a source within the Republic. Tax legislation that may have been infringed by amnesty applicants who failed to include foreign deemed and other source income, in gross income in relation to their foreign holdings, included:[7]

a) Section 9C[8] – Since 1 July 1997, foreign investment income earned by persons ordinarily resident in South Africa, was deemed to be from a domestic source;

b) Section 9D – Came into effect from 1 July 1997 and determined the South African tax accountability of the income and accruals of Controlled Foreign Companies;

c) Sections 9(6) and (7) – Interest earned on certain foreign interest bearing arrangements from 1 July 1998 was deemed to be from a local source.[9]

d) Section 9E – Also, the subject of repeated amendment, this section, since 23 February 2000, has sought to regulate the taxability of foreign dividends;

e) Section 6 *quat* – Effective from 1 January 2001, this provision determines the rules for claiming foreign tax rebates;[10]

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[7] The list of possible infringements was in part compiled from notes taken at the Divaris pre-amnesty workshop;

[8] Repealed by s. 9 of Act No. 59 of 2000

[9] provided such income did not qualify for an exemption in terms of Sections 10(1)(h) and 10(1)(hA) RS 9, 2004 *JUTA'S INCOME TAX* 9(3)-(7)

f) Section 7(8)[11] – an anti avoidance provision that deems income diverted by a resident to a non resident to accrue to the former – effective 1 January 2001.[12]

g) Section 9F(3)[13] – regulated the timing of foreign accruals not immediately able to be remitted to the Republic – effective 1 January 2001;

h) Section 10(1)(*k*A) – read with Section 9F(1) and (2) dealt with the qualifying criteria for the tax exemption of foreign income received or accrued from specified foreign jurisdictions – effective 1 January 2001.

i) Section 25D - regulates the method of taxation in ZAR of income received or accrued in a foreign currency – effective 1 January 2001. These rules are complicated and have been repeatedly amended[14];

Deeming provisions by their very nature, seek to create a fiction, "a state of affairs that doesn't really exist.[15] Coupled with the genius of modern international financial engineering, and the use of derivative and hybrid instruments, it is small wonder then, that it was not always black or white whether foreign receipts and accruals were to be included in the gross income of a taxpayer or not. – Perhaps this is the origin of the expression "Grey Money Amnesty"?

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[10] Foreign tax rebates may only be claimed for taxes paid on foreign sourced income, and not taxes paid on income that is from a deemed local source. This can lead to severe tax hardship – see later at 4..3.2.3;
[11] The forerunner of this section was s. 9D(4)
[12] This is most relevant to applicants who made donations to offshore trusts;
[13] Repealed by s. 24 (1) of the Revenue Laws Amendment Act 45 of 2003.
[14] The rules (recently amended again in 2003) depend upon a variety of factors, including whether receipts and expenditure incurred are attributable to a permanent establishment outside the Republic.
[15] Professor Michael Katz at the Sanlam seminar;

1.3.3 Residence based taxation

Any doubt as to whether or not foreign receipts and accruals, deemed or otherwise, had an "originating cause" in the Republic and were generally therefore taxable, was largely removed, when South Africa changed from a "source based" system, to a "residence based" system of taxation,[16]with effect from 1 January 2001.[17] In terms hereof, residents (as defined[18]) are accountable to the Commissioner for worldwide receipts and accruals,[19] irrespective of their originating cause. The *2000 Budget Review*[20] confirmed that the change from "source based" taxation to "residence based" taxation would have the effect of:

"[broadening] the South African tax base, [limiting] opportunities for tax arbitrage, and [bringing] the tax system into line with generally accepted norms for taxing international transactions."[21]

The last decade has been characterised by a gradual relaxation of exchange control regulations. The change to residence taxation is a natural corollary of this relaxation, because it deters taxpayers from "exporting" their income tax liability abroad to the detriment of the *fiscus.*

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[16] See 2000 AS 813 at 813 where Professor Julia Boltar explains how the change from source to residence was achieved by amending the definition of "gross income" in s1 of the Act.
[17] Applicable to years of assessment commencing after this date
[18] The definition of "resident" was inserted into s1 of the Act by s 2 (h) of Act 59 of 2000 and amended by s. 33 (1) of Act 12 of 2003.
[19] Subject to certain exemptions eg foreign pensions and certain income earned abroad with qualifying absence from SA.
[20] *Silke* at 5-3
[21] At 22 of the Review

1.3.3.1 The meaning of 'resident"

It is important to define the term, both because of the change to residence based taxation, and because "residence" was one of the compulsory tax amnesty application qualifying criteria. The Act defines a resident as a natural person who is "ordinarily resident" in the Republic, or a natural person who was "physically present" in the Republic for regulated periods.[22] Residence is generally triggered for non-natural person taxpayers by "place of effective management.[23]"

Statute does not offer a clear definition of "ordinarily resident", but at common law this means:

"(The) country to which he would naturally and as a matter of course return from his wanderings; as contrasted with other lands it might be called his usual or principal residence.[It] would be described more aptly than other countries as his real home"[24]

The taxpayer bears the onus of proving that he/she is not "ordinarily resident" in the Republic, and yet no clearer definition of the term exists. Uninterrupted physical presence is not a requirement. Internationally, the courts have developed a variety of tests,[25]and SARS itself issued an Income Tax Interpretation Note[26]

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[22] Natural persons physically present in the Republic, for a period(s) exceeding 91 days in aggregate during the relevant year of assessment, as well as for a period or periods exceeding 91 days in aggregate during each of the three years of assessment preceding such year of assessment; and for a period or periods exceeding 549 days in aggregate during such three preceding years of assessment, are deemed to be resident with effect from the first day of that relevant year of assessment:

[23] A quirk of this definition is that it is possible for a non-natural person to be resident in two jurisdictions, eg where a foreign jurisdiction (with whom no double taxation agreement exists) applies a different criterion.

[24] Per Schreiner JA in Cohen v CIR 1946 AD 174 at 185 as cited by CIR v Kuttel 1992 (3) SA 2423 (A), 54 SATC 298, See also ITC 1501 53 SATC 314.

[25] eg the leading Canadian case of Thompson v Minister of National Revenue 2 DTC (SCC) where it was held that a person is ordinarily resident in the place 'where in the settled routine of his life he regularly normally and customarily lives' or 'at which he in mind and in facts settles into or maintains or centralises his ordinary mode of living with its accessories in social relations, interest and conveniences.' In the English case Shah v Barnet London Borough Council and Other Appeals 1983 1 ALL ER 226 (HL) 234b-c it was held that to be ordinarily resident in a specific country 'a person must be habitually and normally

setting out a non exhaustive list of factors to be taken into account. *JUTA'S INCOME TAX*[27] points out that the existence of the note itself makes it “clear that no hard and fast rules can be laid down”, and that each case will have to be decided on its own merits

While intention is relevant to “ordinary residence,” this is not so with the statutory physical presence test set out in statute.[28] As soon as a natural person has satisfied all three tests of physical presence, he/she becomes resident for purposes of the Act.[29] A person can be ordinarily resident in two jurisdictions.[30] It is even possible to be ordinarily resident in the Republic despite being absent throughout the entire year of assessment.[31] To add to the apparent confusion, “resident” has a different meaning for exchange control purposes, and refers to a person who has taken up residence or is domiciled in the Republic.[32]

1.3.3.2 Residence based taxation and foreign holdings

The change to residence based taxation had largely achieved its intended effect. The South African tax net had been widened with the flick of the legislators’ pen. The dilemma now facing residents with undisclosed foreign assets, was how to make disclosure to the Commissioner, under the new residence based system of taxation, *inter alia* in circumstances where:

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resident [t]here, apart from temporary or occasional absences of long or short duration.' (both as cited by RS 6, 2002 *JUTA'S INCOME TAX* - 1 representative taxpayer-2 under the interpretation of “resident”)

[26] 3 of 2002

[27] RS 6, 2002 *JUTA'S INCOME TAX* - 1 representative taxpayer-2 under the interpretation of “resident”

[28] s.1 defines “resident” and makes no reference to the reason for the presence;

[29] Residence is triggered from the first day of the year of assessment in which all three criteria are satisfied.

[30] *Silke* at 14-42

[31] *ibid* 30

[32] See (b) under the definition of “resident” in Section 1 of the Amnesty Act

a) There was non compliance with the Act, especially after the inclusion of passive foreign investment income on 1 July 1997; and/or

b) Exchange Control Regulations had been contravened; and/or

c) Disclosure of foreign income, might expose other infringements of the Act, eg where a donation of the foreign holding had been made to an “offshore trust,” and donations and other taxes had not been accounted for; or

d) Undisclosed domestic income had been shifted/retained abroad; or

e) “Whistle blowing legislation” imposed reporting obligations on accountable institutions,[33] and wide definitions of “unlawful activities” might lead to asset forfeiture and draconian sanctions;

Surely, if the price was right, many facing these predicaments, would jump at an opportunity to regularise their tax and foreign exchange positions?

1.3.4 Capital Gains Tax

Hard on the heels of residence based taxation, was Capital Gains Tax (“CGT”), which was introduced into the South African tax system with effect from 1 October 2001[34]. This was achieved with the insertion of a new Section 26A and a new Eighth Schedule to the Income Tax Act.[35]

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[33] cf s.29 of the Financial Intelligence Centre Act 38 of 2001
[34] By way of the Taxation Laws Amendment Act 5 of 2001
[35] 2001AS 808

Section 26A provides:

"There shall be included in the taxable income of a person for a year of assessment the taxable capital gain of that person for that year of assessment, as determined in terms of the Eighth Schedule."

The definition of "taxable income" was also amended to include:

"All amounts to be included or deemed to be included in the taxable income of any person in terms of this Act".

The *2001 Annual Survey of South African Law*[36], suggests that the original legislation was "introduced hastily and without proper consideration of the precise wording and consequences of each provision.

[Difficulties] continue[d] to arise when [interpreting] the amended Eighth Schedule", notwithstanding two further attempts by the legislator in the same year to clarify the position.[37]

It is respectfully contended that the 8th Schedule is a further example of the less than clearly drafted tax legislation prevailing immediately prior to Amnesty. South African taxpayers, applying a residence based system of taxation, were now accountable to the Commissioner for capital gains made on the disposal of assets not only in South Africa, but also abroad. As will be discussed later, the introduction of CGT, also has considerable ramifications for amnesty applicants, and amounts to a "hidden cost" of a successful application.

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[36] At 808

[37] Revenue Laws Amendment Acts 19 and 60 of 2001

1.4 Who could apply for tax amnesty?

Natural persons, a deceased estate, a close corporation or a trust, that were resident in South Africa for tax purposes,[38] were able to apply for domestic tax amnesty for contraventions of the Estate Duty and Income Tax Acts, arising from unauthorised foreign assets held on 28 February 2003. The effective date of the tax amnesty was 28 February 2002.[39] Companies, except under limited circumstances,[40] were not able to apply for amnesty. Amnesty was also available to qualifying persons (facilitators) who assisted (other than solely in an advisory capacity) applicants to accumulate foreign assets; or to transfer funds or assets out of the Republic.

An application for tax amnesty could not be made where the foreign holding:

a) related to an amount withheld or deducted from an employee in terms of Paragraph 2 of the Fourth Schedule to the Income Tax Act[41]; or

b) related to an amount of withholding tax payable on royalties in terms of Section 35 of the Income Tax Act[42];

Provision was also made for amnesty, if granted, to be revoked, if it transpired that a portion of the foreign holding was "wholly or partly" derived from the proceeds of any unlawful activity.[43] "Unlawful activity" means an

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[38] Residence for exchange control purposes was required in order to apply for exchange control amnesty.
[39] s. 15 of the Amnesty Act. The effective date of the exchange control amnesty was 28 February 2003
[40] a company was only able to apply when all the shares were held by a natural person applicant or his relatives, or a family trust. A company could also apply for relief as a facilitator.
[41] s.3(2)(a) of the Amnesty Act
[42] s.3(2)(b) of the Amnesty Act
[43] s. 20(1)(b) of the Amnesty Act

activity defined as such in the Prevention of Organised Crime Act (hereinafter "POCA").[44] The courts have recognised the need to interpret POCA restrictively,[45] but that Act patently extends the definition of an "unlawful activity" to include any contravention of the Vat Act.[46]

Public policy demanded that amnesty could not be granted where, before submission of the application, the applicant had received notice of an audit, investigation or other enforcement action relating to a contravention for which amnesty was sought.[47]

CHAPTER 2 - Offshore trusts

2.1 Background

Trusts date back to medieval times when wealthy knights, about to depart on the Crusades, entrusted their assets to a third party (usually a competent senior relative), to be administered for the benefit of their dependants while away waging war, or in the event of death.[48] Broadly speaking, a trustee stands in the shoes of both the creator of the trust (usually referred to as "the founder"), and the persons for whose benefit the trust was created (the "beneficiaries.")

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[44] Act 121 of 1998
[45] National Director of Public Prosecutions v Seevnarayan 2003 (2) SA 178 (C)
[46] Act 89 of 1991
[47] s 10(1)(b) of the Amnesty Act;
[48] " FTC brochure at page 3

2.2 General legal principles pertaining to trusts

Generally, at law a trust does not enjoy separate legal personality, although our law does recognise that ownership of property disposed of to a trust, vests in the trustees of that trust and no longer in the hands of the disposer. Trusts were initially omitted from the statutory definition of "persons." Section 1 of the Act was later amended to extend the definition of "person" to include "any trust", and accordingly a trust is liable for taxation as a separate taxpayer. Before this amendment, our courts recognised that income derived from trust assets was received by, or accrued to the trustees,[49] and not to the founder or beneficiaries.

SA residents with foreign assets might have donated their wealth to offshore trusts, as founder/settler, and together with their families, be a beneficiary. If the donation was made by the taxpayer before becoming ordinarily resident in SA,[50] or the foreign asset donated (or a replacement thereof[51]) was inherited[52] from a person who at time of death was not ordinarily resident in SA, or the foreign asset was accumulated from a trade carried on outside SA,[53] then the donor would not be liable for donations tax. If however, the donation was made by the founder when ordinarily resident in SA, and the donation of the foreign asset did not qualify for a recognised exemption, the taxpayer would be liable for donations tax, in some cases as much as 25%.[54]

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[49] *Thorne and Molenaar NNO v Receiver of Revenue Cape Town* 1976(2)SA50(C), 38 SATC 1 at SATC 6; see also *CIR v Friedman and others NNO* 1993(1)SA 353 (A), 55 SATC 39 and *Silke* 12- 24-1 and 2

[50] s 56(1)(g)(i) of the Act

[51] s 56(1)(g)(iii) of the Act

[52] s 56(1)(g)(ii) of the Act

[53] s 56(1)(g)(iv) of the Act;

[54] s 54 of the Act

2.3 Tax advantages of a trust

Rules that impute what may otherwise appear to be receipts and accruals in the name of the trust to the founder and beneficiaries exist by way of exception. These exceptions are statutorily codified in Sections 25B and Section 11(1)(d) of the 8th Schedule of the Act ('the vesting provisions"), which read with related provisions, transfer the liability for taxation to the beneficiaries of the trust. The anti-avoidance provisions of the Act seek to impute liability to the founder/ donor.

The "vesting provisions" transfer liability for taxation to resident beneficiaries who have acquired a vested interest to income or capital earned by the trust, either in terms of the provisions of the trust deed, or because the trustees have exercised their discretion to make an award to a beneficiary.[55]

Distribution of previously unvested trust assets will give rise to a CGT disposal[56].

"[Until then], there can be no accrual of any ascertainable amount of income to the beneficiaries….[As] soon as the trustee exercises his discretion, the contingent right of a beneficiary becomes a vested one, and he is liable to tax on the income distributed to him[57]"

Relinquishment of control over the trust assets by the founder is a key ingredient in the enquiry as to whether the trust is of an arm's length nature or not, or whether the trust is an *alter ego* of the founder. The deed of a discretionary trust typically contains the hallmarks of unfettered discretion, and confers on the trustees, complete freedom to distribute the income and capital of the trust to

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[55] whether or not this had been distributed to such beneficiary or not;
[56] paragraph 13(1)(d) of the 8th Schedule of the Act;
[57] Silke 12.1.5 "Trusts – General principles"

beneficiaries whenever, and in whatever percentage they deem appropriate. The trustees are authorised to make distributions to the exclusion of beneficiaries, and may even donate the entire trust fund to a charitable institution.[58] The founder in fact "trusts" the party managing the trust to adhere to "instructions" that are carefully framed as a "Letter of Wishes" to refute the contention that the founder still exercises control over the trust property.

2.4 Tax arbitrage and offshore trusts

Tax arbitrages may arise where the trust is liable, if at all, for taxation in a foreign jurisdiction. Rates of taxation can be dramatically dissimilar. Some countries have CGT while others do not. Jurisdictional definitions differ,[59] as might the interpretation of "look through rules."[60] If SA tax jurisdictional requirements do not create a basis to tax the offshore trust, the lower or zero rate of taxation where the trust is liable for taxation, will reduce wealth erosion through taxation to the extent of the saving.

Section 25B (2A) of the Act is a statutory measure fashioned by the legislature to address tax arbitrage, and the loss of revenue to the *fiscus.* It provides that if a resident acquires a vested or contingent right to capital of a non resident trust, and such capital arose from income received by or accrued to such trust, which would have constituted income if such trust had been a resident of South Africa, such amount shall be included in the income of the resident.

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[58] See for example FTC and Guinness Flight standard trust deeds
[59] This can even lead to dual residence;
[60] Such as Controlled Foreign Company and Permanent Establishment definitions;

2.5 Anti – avoidance measures.

2.5.1 General propositions

The cornerstone judicial statement on tax avoidance,[61]can be found in the words of Justice Learned Hand who said:

"[There] is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant"

The distinction between that which constitutes a legitimate arrangement of one's tax affairs, and that conduct which constitutes tax evasion, is often represented by a fine line. There are many common law examples where the courts have applied a substance over form test, opting to classify the taxability of the arrangement as to its substance, rather than its form. Melamet J, President of the Special Court for Hearing Income Tax Appeals, succinctly set out the position when he said:

" Dit is 'n bekende beginsel in die inkomstebelastingreg dat die klem gele word op die substansie van die transaksie en nie die regsvorm waarin dit geklee is nie[62]"

2.5.2 Statutory anti-avoidance provisions and offshore trusts

Section 103 of the Act is a general statutory anti avoidance provision, inserted into law to counter-act schemes designed to escape tax liability, whether such schemes were entered into before or after the commencement of the section.[63]

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[61] A minority opinion in *Silke* 19 -3 from the case *Commissioner v Newman* at 159 F 2d 848(CCA-2 1947)
[62] ITC 1518 (1989)54 SATC 113 at 131 the learned judge cited *SIR v Sidley* 1977(4)SA913(A),39 SATC 153 at 159-60 both as cited by *Silke* at 19-3 footnote 4c
[63] s 103(3) of the Act

Section 7 of the Act targets a range of instances that might otherwise result in a reduction of tax for donors and disposers. Sections 7(5) and 7(8) and 25B specifically attribute income earned by a trust to the disposer under applicable circumstances, and Paragraphs 70, 72 and 80 of the Eighth Schedule, contain similar capital gains tax related provisions. Donations that are disguised as loans are regarded as disposals for the purposes of the anti-avoidance measures.[64]

The anti avoidance provisions posed a tax hazard to persons who had donated (previously undisclosed) offshore assets to trusts, and where neither the donation nor receipts and accruals earned in the name of the trust, had been accounted for.

2.6 Estate planning advantages of a trust

Trusts, by their nature, are able to survive the founder. Assets housed in a trust do not form part of the planner's deceased estate, and are not subject to estate duty. Growth on trust property takes place within the trust, and not in the estate of the founder, and as such will be exempt from estate duty. This gives rise to an estate planning technique called "pegging the value of the estate," because the value of the asset for deceased estate account purposes is limited to the value of the asset at the time it is transferred to the trust. This transfer/ disposal is often structured in the form of a sale of the asset, with the seller receiving a credit loan account in the books of the trust for the amount of the purchase price outstanding. Where the deceased is a creditor of a trust, the amount of this indebtedness is an asset in the deceased estate, and will have to be brought into account for estate duty purposes.

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[64] See *Ovenstone v* SIR 1980(2) SA 721 (A), 42SATC 55; See also *CIR v Berold* 1962(3) SA 748(A), 24SATC 729 at 735-6 all as cited by *Silke* at 10.64 and 5 and especially footnote 97.

As will be discussed later, the choice by amnesty applicants to deem offshore trust assets to be their own property under applicable circumstances, impacts on the resident's income tax affairs, without disturbing the estate planning advantages of retaining the trust.

2.7 Non-tax related advantages of a trust

Trusts also became popular for a variety of non taxation reasons.[65] They are pursued to preserve wealth for future generations, and offer anonymity[66]and protection against unsuitable matrimonial unions and creditor claims.

2.8 Section 4 of the Amnesty Act – "Taxing the Golden Egg"[67]

Amnesty applicants were generally wealthy, sophisticated, and tax averse. An amnesty that did not extend to offshore trusts would have been a waste of time. Section 4[68] of the Amnesty Act contains special rules for applicants, who had donated foreign assets to, or were beneficiaries of, non resident discretionary trusts. In terms hereof, applicants could elect to deem offshore trust property to be their own assets for income tax and exchange control purposes. This is a dramatic statutory provision, and represents the source of some golden tax planning opportunities. It also has the potential to cause a deep level shaft collapse. An election as contemplated by the section, can, in the absence of effective tax planning, also lead to an erosion of previously undisclosed foreign nest eggs, now the target of residence based taxation in South Africa.

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[65] FTC brochure – page 4
[66] In certain foreign jurisdictions (eg Guernsey), there is no requirement that the trust deed be publicly filed.
[67] Investec legal department pre- amnesty seminar held at the end of December 2003;
[68] s 4 of the Amnesty Act was the topic of much controversy and was amended several times.

2.8.1 Section 4 qualification criteria

Applicants, who wished to avail themselves of the deeming provision in Section 4, had to satisfy the following requirements:

a) The applicant had to be a donor or a beneficiary of the offshore trust; and

b) The trust[69] had to be discretionary;[70] and

c) The trust had to be non resident[71]; and

d) At least part of the offshore trust property had to have been donated by the applicant; [72] and

e) At least part of the trust property must have been wholly or partly derived from assets held in contravention of exchange controls, or not have been disclosed to the Commissioner[73]; and

f) The asset must have been held by the trust on 28 February 2003; and

g) The asset must not have vested in a beneficiary of the trust;[74]

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[69] It is doubtful whether the Lichtenstein creations of the *Anstalt* (Establishment) and *Stiftung* (Foundation) would qualify as a "trust" as envisaged by s.4 – see Spitz – page 4 and 5*supra*

[70] No definition is offered by the Amnesty Act;

[71] This poses particular problems where the "effective place of management" of the trust (and therefore its residence) might be construed to be in South Africa, if correspondence was accepted at one branch of a South African institution, and couriered overnight to a foreign branch office of that same institution.

[72] s 4 (2)(a) of the Amnesty Act. "Donation" included a deemed donation as contemplated in s 58 of the Income Tax Act and also extended to authorised assets housed in an offshore trust together with unauthorised assets donated to the trust.

[73] s 4(2)(b) of the Amnesty Act

[74] Although s 4 would not apply, if the asset had vested, the beneficiary might have been able to apply in their own right as an applicant

2.8.2 The effect of the election in terms of Section 4

Provided all the above criteria were satisfied, the election[75] would mean that the applicant was deemed to have held the foreign asset,

a) for the purposes of the Exchange Control Amnesty from the date of acquisition of that asset by the offshore trust;[76] and

b) for the purposes of the Income Tax Act,[77], from the first day of the last year of assessment ending on or before 28 February 2003,[78]

until disposal by the trust,[79]death of the donor,[80] the applicant ceased to be a resident,[81]or the deceased estate, close corporation or trust ceases to exist in law,[82] in which event:

a) The applicant was deemed to have acquired the foreign asset for an amount equal to the sum of its market value on 1 March 2002, and any subsequent expenditure incurred by that discretionary trust in respect of that foreign asset[83]; and

b) The applicant was free to deal with the foreign asset in the same manner as it could be dealt with by that discretionary trust from 28 February 2003;[84] and

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[75] s.4 of the Amnesty regulations deemed the election to have been made on 28 February 2003.
[76] S 4(3)(a)(i) of the Amnesty Act
[77] Other than Parts V and VII and Chapter II of the Income Tax Act;
[78] S 4(3)(a)(ii) of the Amnesty Act – for natural person taxpayers this means since 1March 2002.
[79] S 4(c)(i) of the Amnesty Regulations issued in terms of s 30 of the Amnesty Act;
[80] S 4(c)(ii) of the Regulations;
[81] S 4(c)(ii) of the Regulations;
[82] S 4(c)(iii) of the Regulations;
[83] S 4(a) of the Regulations;
[84] S 4(b) of the Regulations;

c) Any income received or accrued, or expenditure incurred by the offshore trust after 1 March 2002, would be deemed to have been received or accrued or incurred, during the period that the foreign asset was so deemed to be held by the applicant;[85]

CHAPTER 3 -The scope of the Amnesty

3.1 Included in the Tax Amnesty.

In exchange for the payment of a domestic tax levy of a mere 2%,[86] calculated with reference to the amount of the previously undisclosed transaction against which domestic tax relief was sought, a successful applicant would receive:

a) Exemption from tax on undeclared foreign income until 28 February 2002;[87]

b) Exemption, where applicable, from donations tax, STC, estate duty and income tax on undeclared amounts arising in the Republic, and shifted and/or accumulated offshore, until 28 February 2002.[88]

c) Exemption from penalties and interest on taxes until 28 February 2002.[89]

d) Immunity from criminality and prosecution for disclosed offences committed in terms of relevant tax and estate duty legislation until 28 February 2002.[90]

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[85] s. 4(h) of the Regulations;
[86] s 16 of the Amnesty Act
[87] s 15 of the Amnesty Act
[88] ss 17(1) and (3) of the Amnesty Act
[89] s 17(1) of the Amnesty Act – "shall not be liable for the payment of any tax or duty…"
[90] s.17(1)

In all cases, an applicant did not enjoy tax (or exchange control) amnesty in respect of undisclosed foreign funds.

3.2 Excluded from the tax amnesty

Much like social *mores* dictated that Vat and PAYE transgressions were unpardonable, and gave rise to disqualifying amnesty qualification criteria, considerations of public policy, required that tax relief did not extend to:

a) A credit for taxes already paid in respect of unauthorised assets;[91]and

b) Taxes that may be payable, or become payable, by an applicant in consequence of any return or information furnished to the Commissioner by that applicant before the date of the amnesty application.[92]

c) A credit for deductions/allowances/losses or rebates relating to any amount in respect of which tax amnesty was granted.[93]

3.3 Reserve Bank Circular D405

3.3.1 Foreign inheritances and immigrant funds

Immigrants to the Republic, who wished to leave funds abroad, are required to make a declaration to an authorised dealer, and provide an undertaking that they would not place these foreign funds at the disposal of a South African resident.[94]

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[91] s 18(a) of the Amnesty Act
[92] s 18(b) of the Amnesty Act
[93] ss 19(a) and (b) of the Amnesty Act

Residents,[95] who wished to retain foreign inheritances received before 17 March 1997 abroad, are required to make a similar declaration.[96] Foreign inheritances received after that date, were not required to be reported to the authorities, and could be retained abroad as part of the resident's foreign capital allowance. Accordingly there was no need to apply for exchange control amnesty in respect of such a foreign inheritance.

Natural persons, who earned foreign income abroad before 1 July 1997, were required to repatriate such income to the Republic.[97]

Contravention of these regulations is an offence falling within the scope of the exchange control portion of the amnesty, and therefore initially curable via the payment of an exchange control levy. In all cases, "deemed source," and later "residence based taxation," meant that receipts and accruals attaching to foreign inheritances (whether received before or after 17 March 1998), and to immigrant funds legally or illegally retained abroad, had to be brought into account for tax purposes by South African resident taxpayers.

Where a taxpayer had not accounted to the Commissioner for receipts and accruals relating to such funds, and/or donated these holdings (to an offshore trust) without paying donations tax, an application for domestic tax relief would be required to regularise the tax position up to 28 February 2002.

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[94] s C.2(F) of the Exchange Control Rulings
[95] For exchange control purposes
[96] Regulations 6 and 7 of the Exchange Control Regulations
[97] Exchange Control Regulation 6

When the Amnesty was announced, there was widespread consternation from immigrants and persons who had retained undisclosed foreign inheritances received before 17 March 1998 abroad. These persons were vehemently opposed to paying exchange control levies of up to 10% to regularise their foreign holdings, particularly because, the funds had mostly already been taxed in the foreign jurisdiction, and/or been subjected to foreign estate duties. Furthermore, inheritances received after that date did not require disclosure and could be retained abroad without the payment of an exchange control levy.

The authorities recognised that a substantial number of taxpayers would "escape" the amnesty net, and feared damage to the integrity of the process and a loss of revenue. In a welcome *albeit* regrettably belated step, SARB published Reserve Bank Circular D405[98] containing an "administrative concession."[99] The Circular enabled immigrants and heirs of foreign deceased estates who had infringed exchange control regulations, to make a declaration to an authorised dealer, and in so doing receive amnesty without having to pay an exchange control levy.

The Circular made it clear however, that the Reserve Bank concession did not extend to transgressions of the Income Tax or Estate Duty Acts, and a separate application for tax amnesty would still have to be submitted to the Amnesty Unit, if applicable.

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[98] Circular D405 was included into the Amnesty Act by item 2 of the Schedule to the Regulations promulgated in terms of s 30 of the Amnesty Act.
[99] Circular D405 1 *supra*

3.3.2 Unauthorised foreign loans

South African residents[100] are not, without special Reserve Bank authorisation, permitted to make use of gearing when structuring their foreign investments.

The last decade has been characterised by a boom in the international property market, and it became increasingly popular for South African husbands and wives,[101] each using their foreign capital allowance of R750 000, to combine their resources to place a deposit on a property with a greater value. A loan would then be raised from a foreign lending institution for the balance of the purchase price by using the property as collateral. Rental income would typically fund the mortgage bond instalments at competitive interest rates.

This is a commonly used property investment mechanism, but the Exchange Control Regulations specifically outlaw the raising of foreign loans,[102] and accordingly such borrowers were in infringement of the law.

Reserve Bank Circular D405 offered persons who had raised foreign loans to regularise their positions by making a declaration to an Authorised Dealer before the expiry of the Amnesty deadline.[103] The Circular contained a further concession inasmuch as the amount of the loan could be subtracted from the value of the unauthorised foreign asset, in order to calculate the exchange control levy.

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[100] For Exchange Control purposes

[101] Also tax payers in good standing, who had been granted the R750 000 foreign capital allowance combined funds to act in a syndicate.

[102] Whether for property or otherwise

[103] 29 February 2004

Although this declaration would regularise the exchange control infringement, it did not for example, exonerate any failure to account for income earned on the geared asset eg rental income, and this would have to form part of a separate application for tax amnesty.

Sadly, the provisions of Sections 19(a) and (b) of the Amnesty Act specifically deny applicants the right to claim a deduction for interest paid to the lender, although this is an expense incurred in the production of (rental) income[104].

3.3.3 74/26 Structures

Acting often on professional advice, certain natural person residents set up 74/26 structures. In terms of this construction, the investor would directly or indirectly[105] acquire a substantial shareholding of a non resident company. Non-resident Co would in turn, acquire a majority shareholding in Resident Co (74%), and the investor and/or his family would hold the balance (26%). The investor would then sell certain selected growth assets to the Resident Co, and receive a credit loan account in respect of the purchase price outstanding from time to time.

The transfer of the growth assets to Resident Co was pursued in the hope of achieving similar estate planning advantages discussed at 2.6 *supra*, but with the added advantage, that capital distributions from Resident Co could *prima facie* be legitimately exported to the foreign shareholder. These distributions in turn, could then be further invested to grow "outside" the estate of the investor, all without

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[104] See 3.2(c) *supra*
[105] Usually via a non resident discretionary trust

appearing to contravene Exchange Control Regulations. The legitimacy of this structure was always the subject of much debate. Reserve Bank Circular D405[106]for the first time, issued a pronouncement on 74/26 schemes, and declared such structures to be in contravention of Regulation 10(1)(c).[107]

Applicants willing to make the required disclosures would be given an administrative type *nolle prosequi*, but were required to unwind the structure and;

a) Acquire into their own names, the shares in Resident Co (previously held by Non-resident Co) at historic cost, before the expiry of the Amnesty;[108] and

b) Either repatriate funds exported by Resident Co to Non-resident Co, together with any growth thereon, within 90 days of the expiry of the Amnesty, in exchange for the payment of a 5% exchange control levy;[109] or retain such funds abroad, in exchange for disclosure to an Authorised Dealer, and payment of a 10% levy within the same time period.

Unlike other exchange control levies payable in terms of the Amnesty, levies emanating from “74/26 structures” would be reduced by a “Transaction Recoupment.” This recoupment, would comprise the amount of tax and/or or duty levied in terms of the Income Tax Act, the Stamp Duties Act[110] and/or the Transfer Duty Act[111] payable by the resident in consequence of having to make the

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[106] At page 3 *supra*
[107] Of the Exchange Control Regulations
[108] At 5.2.1
[109] Circular D405 at 5.2.2
[110] Act No 77of 1968;
[111] Act No 40 of 1949;

disposals necessary to unwind the structure and/or to repatriate the funds.[112] Applicants have three years from the expiry of the Amnesty to provide documentary evidence of taxes and duties paid, failing which they will lose the right to claim the recoupment. The recoupment may not exceed the amount of the exchange control levy paid, and applicants will receive no interest on amounts held by SARB before repayment.[113]

It is noteworthy that amnesty applicants are otherwise precluded from claiming any levy reduction for taxes incurred as a result of disposals required to fund levies and/or repatriation. Is this because 74/26 schemes are less unlawful?

CHAPTER 4 – The true cost of Amnesty

4.1 Unbelievably cheap at the price?

Initially, a strict interpretation of the Amnesty Act required an applicant applying for domestic tax relief, to pay a levy of 2% on the value of each and every taxable event previously undisclosed to the Commissioner. Later the statute was amended to require the levy to be paid only once.[114]

This was a gigantic concession for taxpayers with undisclosed domestic income that had been shifted offshore, and who had also donated such funds to an offshore trust, without paying donations tax. Further income might have been received or accrued on investments pursued, and not disclosed to the

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[112] For example Capital Gains Tax
[113] Circular D405 at 6.3
[114] Regulation 16 promulgated in terms of s 30 of the Amnesty Act.

Commissioner. Despite at least three sets of transgressions, the taxpayer was able to receive amnesty by paying the 2% domestic tax levy out of local resources only once, and legally retain the assets abroad in the offshore trust.[115]It is not surprising then, that many jumped at the opportunity to regularise their tax positions, at a cost that must anger law abiding taxpayers, who paid average rates of tax approaching 38.5%, and who had adhered to the letter of Exchange Control Regulations. The constitutional implications of this concession if and when tested, will make for some interesting legal debate.

4.2 The obvious costs of Amnesty

The obvious costs of amnesty (where applicable) are:

a) The two percent domestic tax levy, payable once on the amounts previously not disclosed to the Commissioner;[116]

b) An exchange control levy of ten percent of undisclosed foreign assets held on 28 February 2003 in excess of the applicant's normal offshore allowance;[117]

c) An exchange control levy (if applicable) of five percent calculated with reference to the value of funds repatriated that were in excess of the applicant's foreign investment allowance as at 28 February 2003;[118]

Not too onerous? – Well…. "Come into my parlour"…. said the spider to the fly!

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[115] Facilitators too were only required to pay the domestic tax levy once, and where an applicant for domestic tax relief was also a facilitator, the domestic tax levy of 2% was also only payable once (regulation 16)
[116] s 16 of the Amnesty Act.
[117] s 12 of the Amnesty Act;
[118] s 12 of the Amnesty Act;

4.3 The Hidden Costs of Amnesty

4.3.1 Hidden Cost 1 – an increase in tax through progressive taxation

Tax amnesty was granted until 28 February 2002. Natural person applicants were required to regularise their income tax positions from 1 March 2002, and to include worldwide receipts and accruals into their tax returns as part of the "residence based system of taxation."[119]

The following illustrations show just how expensive the inclusion of previously undisclosed income can become:

Illustration 1 – The taxability of previously undisclosed income:

	Onshore (in isolation)	**Offshore (in isolation)**
Taxable income	**R600 000**	**R300 000**
Tax payable[120]	**R210 070(A)**	**R90 070(B)**

The "newly" disclosed taxable income in isolation, will give rise to an income tax liability of R 90 070 in the year of assessment. But this is only half the story. The progressive nature of the South African tax tables means that the applicant will not just be required to pay an amount of tax equivalent to A plus B. The taxable income will first have to be aggregated, before determining overall tax liability, resulting in the increased income being taxable at the applicable marginal rate.[121]

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[119] Including receipts and accruals earned in relation to offshore trust property after 28 February 2002, deemed in terms of s 4(1) of the Amnesty Act to be property of the applicant.

[120] Individual 2004/5 tax scales for persons younger than 65 years of age

[121] And possibly even pushing a lower income earning taxpayer into a higher marginal rate

Illustration 2 – The affect of progressive taxation:

Onshore taxable income	**R600 000**
Offshore taxable income	**R300 000**
Total taxable income	**R900 000**
Total tax payable	**R330 070**

In the first example, an aggregate of A and B amounted to an already increased total liability of R300 140 and yet, because of progressive taxation, the applicant is required to pay R330 070. A further increase of R 29 930!

It is also noteworthy, that because Amnesty was *inter alia*[122] conditional upon the punctual submission of the applicant's 2002/3 tax return,[123] and this had to include a complete disclosure of worldwide receipts and accruals for that tax year. The exchange control levy was calculated with reference to the value of unauthorised assets held on 28 February 2003, which included gains of an income and capital nature earned during the 2002/3 year of assessment.[124] An applicant with a marginal rate of tax of 40%, who chose not to repatriate foreign holdings, and pay a 10% levy for the right so to do,[125] would therefore pay an effective rate of 50% on the portion of the declared foreign assets that comprised taxable income during the 2002/3 tax year – Not so cheap after all!

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[122] Non levy payment, or if the funds were derived from "unlawful activities" would also vitiate approval.
[123] s 20(1) of the Amnesty Act
[124] ss 11 and 12 of the Amnesty Act.
[125] Payable on amounts held in contravention of exchange controls after deducting the unutilised portion of the applicant's foreign investment allowance.

4.3.2 Hidden Cost 2 – Increased capital gains tax exposure

4.3.2.1 Redemption to fund levy may be a CGT disposal

Together residence based taxation and CGT, conspire to tax disposals that result in taxable capital gains made on amnesty holdings after 28 February 2002. Redemption of an asset to pay a levy, might lead to a CGT disposal.[126] (Unlike the tax levy which could be paid from local reserves, the exchange control levy was compulsorily payable from the foreign holding).[127]

4.3.2.2 Limitation of base cost

"For purposes of the Eighth Schedule to the Income Tax Act, 1962, the base cost of any foreign asset in respect of which approval for amnesty was granted [may] not exceed the sum of the value in foreign currency of that foreign asset on 28 February 2003 as disclosed for purposes of the determination of the exchange control amnesty levy and any expenditure allowable in terms of paragraph 20 of the Eighth Schedule to the Income Tax Act, 1962, as is incurred after that date[128]"

On 28 February 2003, Global equity markets were reeling after the March 2000 Dot-Com stock market crash, and were still struggling to recover from the devastation of the September 11 terror attacks. Portfolios with any degree of market related exposure, including traditional savings vehicles were depressed in foreign currency terms. Consider this- an applicant making a disposal of a sanitised asset after 28 February 2003, might be doing so at a loss when compared to the original cost of the asset, and yet be taxed on a capital gain determined with reference to the statutory CGT valuation imposed by the Amnesty Act.

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[126] Unless raised from an asset excluded from the definition of a "disposal"
[127] s 13 of the Amnesty Act
[128] s 28(2) of the Amnesty Act

4.3.2.3 Disposals in foreign currency

Paragraph 43 of the Eighth Schedule regulates the calculation of capital gains and losses arising out of the acquisition and disposal of assets in a foreign currency. *Fieta Slendebroek*[129]explains how the prevailing CGT regime can lead to the inequitable tax treatment of SA tax residents. The learned tax practitioner argues:

a) Paragraph 43(4) of the Act determines that in the case of foreign equity instruments, and in the case of assets where the gain is derived or deemed in terms of Section 9(2) to be from a South African source, both the proceeds and expenditure of those assets will have to be converted into ZAR for tax purposes at the average rate of exchange prevailing in the relevant years;

b) Section 9(2) deems a gain made by a resident from the disposal of an asset (other than immovable property),which is not attributable to a permanent establishment of the resident outside South Africa[130], to be from a South African source;

Accordingly, the disposal of foreign shareholding by a resident is deemed to be from an SA source, and both the base cost and the proceeds would have to be converted into ZAR in order to compute the capital gain/loss. Now assume an amnesty applicant owns 15% shares in a Tanzanian Company,[131] having a base cost of $1 million (when the USD exchange rate was R8). Assume further that the

[129] Slendebroek
[130] If the income is attributable to a permanent establishment outside SA, the taxable income is determined in the currency of the jurisdiction where the permanent establishment is situated.
[131] An example used by Mrs Slendebroek has been modified to include amnesty applicants;

shares are sold for $ 1million at a time when the applicable exchange rate is R9. Although no commercial gain has been realised in USD, for SA tax purposes, the proceeds have to be converted back into ZAR, resulting in a gain of R1 million.

The learned practitioner explains further how Section 6*quat* of the Act, enables a rebate to be claimed only when foreign taxes are paid on income **from a foreign source**. Since Tanzania taxes the sale of shares at a rate of 20%, and no tax rebate may be claimed by the resident who has sold the shares because Section 9(2) deems the proceeds to be from a South African source, our diligent resident taxpayer might end up paying tax twice.

This is inequitable, especially if the resident was an amnesty applicant who actually paid a purchase price for the shares greater than $1 million, but who, notwithstanding an earlier date of purchase, is obliged to use a base cost determined in accordance with the statutory valuation discussed earlier.

4.3.3 Hidden Cost Number 3 – Estate duty and CGT on death

Section 2(1) of the Estate Duty Act[132] provides:

"Estate duty shall be charged upon the dutiable amount of the estate calculated in accordance with the provisions of this Act and shall be levied at the rate set out in the First Schedule."

Section 3(1) of the same Act provides:

"For the purposes of this Act the estate of any person shall consist of all property of that person as at the date of his death and of all property which in accordance with this Act is deemed to be property of that person at that date.

[132] Act No 45 of 1955;

Foreign assets that qualify for exemptions from "property" for the purposes of the Act are owned by persons that are not ordinarily resident in the Republic. Foreign assets owned by deceased amnesty applicants who were ordinarily resident in SA at the time of death, will have to be brought into account for estate duty purposes. In addition for CGT purposes:

"A deceased person, subject to certain exemptions, is treated as having disposed of his or her assets, [to] his or her deceased estate for proceeds equal to the market value of those assets at the date of that person's death."[133]

CGT may be paid by an heir over three years if this exceeds 50% of the inheritance,[134] but CGT and estate duty, are charges that can seriously denude provision for heirs.

Newly revealed "amnesty assets" will increase these potential estate liabilities. Existing estate plans may be seriously disrupted, especially where there is insufficient liquidity to meet these contingencies. Assets may have to be liquidated by the executor at a commercially inopportune time, causing prejudice to provision made by the deceased for dependants.

Life Assurance remains a cost effective way to pre-fund estate duty and CGT payable on death.[135] Affected amnesty applicants may be unable to afford the higher premiums required to fund this increased provision, or worse still, be unable to secure the life cover they require because of medical loadings or lack of insurability. Older amnesty applicants will be hardest hit.

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[133] para 40 of the Eighth Schedule to the Act;
[134] para 41 of the Eighth Schedule;
[135] Note: life insurance proceeds payable on death, unless forming part of a recognised exemption, are "deemed property" in the estate of the deceased life assured.

CHAPTER 5 – The death of secrecy

5.1 The secrecy provision of the Income Tax Act

Generally, a taxpayer' right to secrecy stems from Section 4 of the Act:

"[The] Commissioner …..shall preserve and aid in preserving secrecy with regard to all matters that may come to his …knowledge in the performance of his or her duties ……, and shall not communicate any such matter to any person whatsoever other than the taxpayer concerned …. nor suffer or permit any such person to have access to any records in the possession or custody of the Commissioner except in the performance of his duties under this Act or by order of a competent court."

This is a fundamental principle of tax law, and consistent with the constitutional right to privacy.[136]

In *Union Government v Shiu,*[137] Rumpff J submitted that the secrecy provision:

"encourages full disclosure and obtains and retains the confidence of persons supplying necessary information"

Secrecy also facilitates increased disclosure to the *fiscus* where revelation of sensitive information could lead to embarrassment or conflict with business associates, creditors and competitors.

5.2 Bank Secrecy

The principles of English Law, as expounded in *Tournier v National Provincial and Union Bank of England,* [138] generally govern bank secrecy law in South Africa[139]. The court held that when a bank contracts with a client to open an

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[136] s 14 of the Constitution
[137] 1955 (1) SA 298 (T) at 300, 20 SATC 28 at 30
[138] [1924] 1 KB 461 as cited by (2001) 13 SAMLJ 580 at 588 *supra*

account it will, subject to certain limitations,[140] usually be bound by the contract to maintain the confidentiality of client information, alternatively, it will be so bound by the "tacit consensus"[141] of the contracting parties to do so.

The Promotion of Access to Information Act[142] creates the right of access to information required for the protection or exercise of any legal rights. The existence of a bank's common law duty of secrecy is statutorily recognised, albeit in the form of an exception, by Section 64(1) of that Act, which obliges a bank to refuse to disclose information that might cause commercial harm to a customer.

5.3 Secrecy and Amnesty

Statutory dilutions of the rights of fiscal and banking secrecy, and especially the Financial Intelligence Centre Act, increased the likelihood of the detection of unauthorised foreign holdings, possible prosecution and financial ruin. This must have contributed to the decision by many to apply for amnesty;

The Amnesty Act contained further statutory dilutions of fiscal secrecy and required the applicant to make substantial disclosures. Commercial associates of the applicant, acting as investors and/or facilitators, may have been less willing or have disagreed with the decision to apply for amnesty. An application might contain information incriminating the associate, placing a prospective applicant in an extremely invidious position.

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[139] See Densam (Pty)Ltd v Cywilnat (Pty)Ltd 1991(1) SA 100(A)
[140] (2001)13SAMLJ 601 at 602 cites: under compulsion of law; if there is a public duty to disclose; it was in the interests of the bank to do so; the customer expressly or impliedly gave consent for disclosure;
[141] (2001)13SAMLJ 580 at 588 *supra*
[142] Act 2 of 2000

5.4 Statutory erosions of banking and fiscal secrecy

5.4.1 Specific dilutions

The legislature has steadily enacted statutory provisions to dilute the taxpayer's right to financial and fiscal secrecy. This attack on financial secrecy gained momentum in the years immediately preceding Amnesty. Examples include:

a) The statutory provisos contained in Section 4 of the Act;

b) Section 81(2) of the Insolvency Act[143] which permits disclosure by SARS to the trustee of an insolvent estate;

c) Section 73 of the Prevention of Organised Crime Act[144] which allows disclosure by SARS to the prosecutorial authorities;

d) Section 108(5) of the Act[145] which is of specific concern to Amnesty applicants because, it authorises disclosure by SARS to a foreign jurisdiction for the purposes of determining immunity in terms of a double taxation agreement.

e) It remains to be seen whether Sections 74 and 74A of the Act, which allows the Commissioner to request anything required from the taxpayer *or any other person*, extends to a Bank or not because it "does not explicitly authorise and compel banks to disclose information about their customers."[146]

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[143] Act 24 of 1936
[144] Act 121 of 1998
[145] See also the notes in *Juta's Income Tax* RS 9, 2004 at 4-4;
[146] see (2001) 13 SAMLJ 601 at 611

5.4.2 The Financial Intelligence Act 38 of 2001 (FICA)

Perhaps the most draconian of all the statutory erosions of financial secrecy can be found in the provisions of FICA.

Section 36(1) of that Act imposes an obligation on SARS to disclose and report relevant information and transactions to the Financial Intelligence Centre.

Section 29 of the Act imposes on so called "Accountable Institutions" obligations to report suspicious and/or unusual transactions, including transactions deemed to be so because of *inter alia* the nature of the transaction, or because a statutory presumptive threshold has been passed.[147]

Several foreign jurisdictions statutorily entrench a banker's general duty of confidentiality and secrecy.[148] Taxpayers with undisclosed holdings often carefully selected foreign banks because of their record of secrecy, and felt secure that they would escape detection. However, FICA bred a new fear that a future repatriation, required perhaps to maintain post retirement standards of living, might trigger a reporting obligation. Many applied for Amnesty to alleviate the emotional stress of this uncertainty.

The following extract from the *Explanatory Memorandum on the second reporting exemption in terms of FICA*[149] gives a sense of the hostility of the authorities to non applicants:

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[147] Cash transactions above regulated minimums and international financial activity is specifically identified;
[148] (2001) 13 SAMLJ 601 at 601
[149] The FICA explanatory memorandum

"The full force of the law remains applicable to any undisclosed funds that should have been disclosed under the amnesty process. Accordingly, where an applicant sought and received advice, but failed to file an amnesty application, or where an applicant did not seek amnesty advice and did not file an amnesty application, [advisors] must report any proposed transactions to the Centre under section 29 of the FIC Act[150]"

5.4.3 The Amnesty Act contains further dilutions

SARB generally cannot gain access to taxpayer information from SARS due to the legislative secrecy provisions contained in various tax Acts. SARS's ability to obtain access to records from SARB is similarly limited due to the legislative secrecy provisions contained in its governing Act"[151].

Section 24(3) of the Amnesty Act expressly extends the secrecy provisions of the Act to members of the Amnesty Unit, but the Amnesty Act itself,[152] contains a further dilution of the taxpayer's right to secrecy. A new proviso has been inserted into the Income Tax Act[153] that permits the Commissioner to make disclosures to SARB, of information that may be required to exercise **any power** or perform **any function or duty** in terms of Exchange Control Regulations.[154]

"Enforcing Exchange Control and the taxation of foreign income presents unique difficulties. Officials need to overcome information barriers posed by foreign legal restrictions. It is accordingly essential that extra measures be taken in order to ensure an enhanced flow of information to overcome these difficulties"[155]

Multi-jurisdictional considerations undoubtedly demanded that information be exchanged between SARS and SARB, in order to facilitate the operation and

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[150] The FICA Explanatory Memorandum at 5
[151] The Amnesty Explanatory Memorandum 41
[152] s 34
[153] S 4(c)iii
[154] issued under s 9 of the Currency and Exchanges Act 9 of 1933
[155] The Amnesty Explanatory Memorandum 41

enforcement of the amnesty legislation, but the scope of the exemption is too wide, and will enable information to be shared beyond the purpose for which the exemption was created. The uses that this information can be put to, in a hostile, technologically assisted environment of improved enforcement, is worrying. A balance must be struck between the interests of the state, and those of the taxpayer, and it is hoped that our courts will apply a restrictive interpretation of the secrecy dilution provisions of the Amnesty Act, should the need arise.

5.3.4 Amnesty application to contain detailed disclosures

Amnesty applicants were obliged to make detailed disclosures in order to successfully apply for domestic tax relief including:

a) A statement of foreign assets and liabilities as at 28 February 2002, reflected at both historic cost and estimated market value in the foreign currency of the country in which that foreign asset was situated or liability was incurred;[156]

b) A detailed description of the asset and its location including foreign bank account numbers, if applicable;

c) The founding document of the offshore trust as at 28 February 2003 where an application was made in terms of the deeming provision in Section 4;[157]

d) A foreign balance sheet as at 28 February 2003 for exchange control amnesty purposes;

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[156] s7 of the Amnesty Act
[157] s 4(4) of the Amnesty Act

Detailed disclosures are a further hidden cost of Amnesty and a price to be paid to regularise previous contraventions. It is likely, that many potential applicants did not trust the motives of a revenue collection agency with a less than perfect record of human rights advancement, and were discouraged from applying because of the nature of disclosures required, and the embarrassing position in which they might find themselves with non-applicants, incriminated by entries indelibly recorded in founding documentation.

CHAPTER 6 – Selected tax planning considerations.

The following post amnesty planning considerations are relevant to natural person applicants, and will be examined in the context of the hidden costs of amnesty highlighted earlier.

6.1 The advantages of retaining the offshore trust

Section 4 Amnesty applicants are in a uniquely privileged position because:

6.1.1 Offshore capital allowance remains in trust

Generally, the foreign investment allowance is not available to trusts. Besides exchange control considerations, resident taxpayers, wishing to transfer their allowance to an offshore trust for deceased estate planning purposes, would be discouraged from doing so because of donations tax, and because of the income attribution and anti-avoidance provisions discussed earlier.

As outlined previously, a 2% domestic tax levy was payable by the applicant to cure the non disclosure of the donation for tax purposes. If the asset donated had been shifted from domestic tax non disclosures, the levy would have been payable only once. Significantly, the domestic tax levy, unlike the exchange control levy,[158]could be paid from domestic resources. It was therefore possible to retain the foreign holding intact without having to redeem a portion thereof to pay the domestic tax levy.

Although a Section 4 applicant becomes accountable for receipts and accruals made by the offshore trust, from 1 March 2002 until disposal:

a) The income and capital attribution rules *supra* do not apply in respect of any income or capital gains made by the trust before 1 March 2002[159]; and

b) The anti avoidance provisions of the Act have been suspended;[160]and the founder may deal freely with the trust property,[161] including the pursuit of tax saving initiatives for the trust, in order to reduce personal income tax; and

c) The successful applicant has retained the long term advantages of housing the now increased foreign investment allowance in the offshore trust.

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[158] which could only be paid from abroad
[159] S 7(a) of the Regulations;
[160] s 4(3)(b) of the Amnesty Act;
[161] Regulation 4(b)

6.1.2 Estate and post death tax planning advantages are maintained.

Although the income tax advantages of retaining the foreign holding in the offshore trust during the donor's lifetime might have been nullified by the Section 4 election, this is not true insofar as the estate planning and post death tax advantages of retaining the offshore trust is concerned. The election by the applicant terminates at death.[162] From this date the taxpayer is deemed to have disposed of the foreign asset for a consideration equal to its market value on the date of disposal,[163] giving rise to CGT accountability for the deceased estate.[164]

From the date of death and this disposal, and the termination of the deeming provision, the nexus between the non resident discretionary trust and the South African Income Tax and Estate Duty Acts, is for the moment broken. This has two major advantages:

a) No estate duty is payable on the death of the donor or discretionary beneficiaries of the offshore trust; and

b) Income received by or accruing to the trust is not taxable in South Africa;[165]

Distributions made by the offshore trust to a resident South African beneficiary after the death of the founder/applicant, will give rise to CGT accountability for

[162] s 4(c)(ii) of Regulations issued ito s.30 of the Amnesty Act;
[163] s 4(3)(b) of the Amnesty Act
[164] The capital gain will be represented by the difference between the market value of the deemed assets on 1 March 2002 (and any subsequent expenditure incurred by that discretionary trust in respect of that foreign asset), and the market value of the deemed assets on the date of disposal;
[165] Unless the provisions of s.25B (2A) of the Act are applicable. (see earlier at 2.4)

that beneficiary.[166] A distribution made to a non – resident beneficiary will have no South African tax consequence. This has considerable advantages for applicants with loved ones residing abroad.[167]The retention of the offshore trust has re-opened the door for beneficiaries to explore tax arbitrages, after the death of the donor.

6.2 Tax effective investment selection

Investec Trust argues in favour of capital growth investments because:

"Income and capital gains are….. taxed at different rates in SA, and the offshore trustees, by identifying suitable investment products, can…seek to ensure that [returns] are in the form of capital gains. [They can also] defer receipt of income indefinitely or time receipt of income to meet the beneficiaries' requirements.[168]"

While capital is taxed more favourably than income in South Africa, and capital growth products offer the prospect of a return less eroded by income tax, appropriate investment advice must extend to the selection of an underlying asset that best suits the investor's requirements. Factors such as appetite for risk, liquidity, capital preservation, and future provision, must also be evaluated. An investment should not be pursued because of its tax benefits alone.

Section 4 applicants would also be well advised to restrict their analysis to products that offer tax savings to both the trust and the natural persons. In terms

[166] ibid 56
[167] Investec 1
[168] Ibid 173

of the election, receipts and accruals from the trust property will have to be accounted for in the donor's personal income tax return, and certain constructions are not tax effective if pursued in the name of a trust[169]

6.2.1 Insurance wrappers.

"Preferential tax treatment is afforded to insurance policies to encourage long-term savings."[170]

Substantial amnesty monies will be/are housed in traditional savings vehicles offered by long term insurers. An examination of other investment products such as roll-up funds, which seek to explore tax efficiencies by deferring the realisation of gains to maturity,[171] will need to stand over to another day. For the moment at least, because of their popularity, it is necessary to examine the tax advantages of long term insurance policies in the context of the hidden tax costs of amnesty identified earlier.

6.2.1.1 The four fund approach

The foundation for tax savings available via these constructions can be found in Section 29A of the Income Tax Act. In terms hereof, South African long term insurers are required to establish four separate funds in which funds are held:[172]

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[169] eg a voluntary term certain annuity does not qualify for a capital exemption ito s. 10(1)(a) of the Act.
[170] *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2001* at 87 (*Silke at Chapter 24-96*)
[171] Many of these products are yet to be tested in our courts – many of these structures function using discounts and premiums, and "s 24J related problems" cannot be disregarded. It has become common for financial institutions to insert clauses in their investment documentation permitting maturity values to be adjusted should their understanding of the tax environment at the time of issuing the contract be flawed. This clause too is offensive, and may yet itself be subject to consumer protection evaluation.
[172] s 29A(4) of the Income Tax Act

1) An untaxed policyholder fund for retirement and benefit funds, tax exempt funds and annuity contracts;

2) An individual policyholder fund for non company owned policies;

3) A company policyholder fund for policies owned by a company; and

4) A corporate fund for policies not qualifying for the three funds referred to above, and for business conducted outside the Republic;

"Look through rules"[173]are used to determine the fund into which a policyholder's investment is to be placed. Where the owner of a policy is a trust, AND all the beneficiaries of such trust are natural persons, the policy will form part of the individual policyholder fund[174]just like a policy taken out by a natural person.

Each fund is taxed in the hands of the long term insurer as if it were a separate taxpayer, each applying different regulated principles of taxation.[175] This is commonly referred to as "the four fund approach" of taxation. The rate of taxation of the individual policyholder fund is 30%.[176] Disposals by the individual policyholder fund that give rise to taxable capital gains, are therefore taxed at an effective rate of 7.5%[177] in the hands of the insurer.

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[173] *Silke* at 17.14A- Insurance — long-term: new regime
[174] s 29A(5)(a) of the Income Tax Act;
[175] s 29A(10)
[176] Para 2(f) of Schedule 1 of the Amnesty Act fixes the rate for individual policyholder funds at 30%
[177]An individual inclusion rate of 25% of the taxable capital gain is taxed at the flat rate of 30%;

An insurer is obliged to transfer an investment to the applicable fund[178] when it becomes aware of a change of policy ownership, or of any change affecting the status of the owner of a policy. The addition of a trust beneficiary that is not a natural person, for example, will therefore result in the policy being transferred to the company policyholder fund, and being subjected to a higher rate of taxation.

6.2.1.2 Proceeds of long term insurance policies not taxable

Generally, long term insurance policy proceeds, unless part of a profit making scheme, are of a capital nature,[179] and may be disregarded by qualifying taxpayers[180] for CGT purposes, if the policy is a "policy" as defined in Section 29A of the Income Tax Act.[181]

Section 29A defines a "policy" as a long-term policy taken out in terms of the Long Term Insurance Act.[182] Read with related regulation this means:

a) The policy must have been issued by a resident South African insurer or a branch office of that insurer; and

b) The policy must have been owned by the initial policyholder for five years;

Unfortunately, the CGT exemption is not available to residents who own long-term policies issued by foreign insurers. The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2001*[183] explains:

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[178] s 29A(6)
[179] *Silke* at 3.32
[180] There are other requirements eg the policy may not be a second hand policy, the proceeds must be payable to the original policyholder, or his spouse or in terms of an order of court.
[181] Para 55(2) of the Eighth schedule; see also *Silke* at 24-.96;
[182] Act 52 of 1998

"Although the build-up in these [foreign] policies is not subject to income tax in the Republic they will be subject to [capital gains tax] on disposal by applying the normal principles for determining a capital gain or capital loss on disposal."

Foreign policy proceeds paid to a resident will therefore amount to a CGT disposal, even though the underlying investment may have been subjected to taxation in another jurisdiction in the hands of the foreign insurer. Amnesty applicants with foreign insurance policies, or those contemplating investing with a foreign insurer, should evaluate these tax consequences in the context of their overall investment requirements.

6.2.1.3 Reducing the tax cost of amnesty with a "tax wrapper."

Long term insurance policies[184] issued by South African insurers or their foreign branch offices, can, and do, materially reduce the hidden income tax cost of amnesty for natural persons, including Section 4 applicants. The investment platform operates to "ring fence" tax liability in a "wrapper," because investment returns are taxed without reference to the marginal rate of the policyholder. The flat taxation rate of 30%, results in an immediate tax saving of 25%, for investor's with a 40% marginal rate of tax,[185] because, neither the investment income, nor the policy proceeds, are included in the gross income of the applicant.

Tax wrappers can also play a meaningful role in keeping a retired[186] investor's marginal rate of tax down. Consider the following illustrations;

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[183] At 87 as cited by *Silke* at 24-.96
[184] usually structured as endowments or 'sinking funds'
[185] 10% of 40%
[186] This also applies to taxpayers who, before retirement, have a marginal rate of tax of less than 40%.

a) If income in the policy was generated via an investment that did not offer the "insulation" of the wrapper, and was instead earned in the investor's own name, this might have the effect of pushing up the marginal rate of tax applicable to supplementary investment income;

b) The relinquishment of an asset which gives rise to a CGT disposal is taxed with reference to the disposer's marginal rate – for example- a tax rate of 30% will mean that taxable capital gains made by the retired investor will be taxed at an effective rate of 7.5%, whereas a tax rate of 40% will result in that same capital gain being taxed at an effective rate of 10% - quite a difference, especially when the net capital gain made is required to generate supplementary retirement income – The "tax wrapper" has kept the disposer's overall rate of tax down, and has therefore indirectly reduced the taxability of the disposal of a capital asset outside the wrapper;

c) The proceeds of domestic long term insurance policies are not taxable in the hands of the owner. Retired investors should be encouraged to leave matured policies with the insurer, and part fund their living expenses via capital withdrawals made out of the policy in accordance with the insurer's "bonus rate." The after tax nature of these withdrawals means that the retiree's overall tax rate on other retirement income will be lower.

If the underlying investment contained within the "wrapper," is purely of a capital nature, no tax will be payable on any income for there is none, and wealth erosion will limited to the 7.5% CGT charge – much lower than the investor's probable effective CGT rate of 10%, or even 20% if the case of a trust!

Investec notes that capital growth investments are taxed more favourably than income generating investments. Such investments are generally more tax effective, but with minor exceptions,[187] do not contain suitable underlying capital guarantees for conservative investors. Amnesty investors must not forget their financial objectives, and refrain from pursuing foreign tax wrappers solely because of their perceived tax advantages.

6.2.2 Reducing the tax cost of amnesty with retirement annuities

Taxpayers may, subject to certain exceptions, in order to determine their taxable income, deduct contributions to a retirement annuity fund ("RAF") up to a maximum of 15 per cent[188] of their non-retirement funding income.[189] Certain contributions to a RAF may not be deducted,[190]however,

"[these] provisions [shall] apply for the purpose of determining the taxpayer's total taxable income whether derived from the carrying on of any trade or otherwise;[191]

While this means that taxable capital gains must be excluded from the calculation to determine the 15% allowable deduction, (because capital gains are part of taxable income and not income), [192]it is clear that all investment income, both domestic and foreign, can be brought into account for purposes of the calculation. This offers some unique advantages for natural persons with legitimate foreign holdings, including successful amnesty applicants because:

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[187] For example, zero-cost collars with underlying capital guarantees.
[188] s 11(m) of the Income Tax Act;
[189] Generally income not taken into account for the purposes of a pension or provident fund;
[190] eg restrictions on what constitutes "non retirement funding income" apply.
[191] s 11(m)(vi)
[192] 1999 *JUTA'S INCOME TAX* - 11(m)-2

a) Foreign interest income is prejudicially taxed, and only R1000 is exempt from gross income.[193] RAF contributions enable a taxpayer to save tax at the highest applicable marginal rate because the amount contributed to the RAF will directly reduce taxable income at that rate;

b) The RAF contributions can be paid out of domestic resources without reducing the foreign holding;

c) A long term insurer must invest RAF contributions in the "untaxed policyholder fund, creating an even more effective "tax wrapper" to further insulate the policyholder from tax on the increasing value of the fund;

d) The RAF deduction enables taxpayers to save at their highest marginal rates during high earning years of employment, and to defer taxability of annuity income derived from the RAF, to retirement when taxable income is lower[194].

7. CHAPTER 7 – Conclusion

7.1 The 2003 Tax Amnesty – an olive branch to tax dodgers?

A former Commissioner of Inland Revenue, Trevor van Heerden, speaking at the South African Chamber of Business in December 1997, replied to a question posed about a recently completed domestic tax amnesty that had been met with only a muted response, as follows:

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[193] Currently, a taxpayer older than 65 years of age is not taxed on the first R22 000 of domestic interest income, and a taxpayer younger than 65 is exempt on the first R16000 of domestic interest income;
[194] A retirement annuity must be matured between the taxpayer's 55th and 70th birthdays;

"It has always been our view that a tax amnesty is not the way. Those who practise tax-dodging do not and will not expose themselves to the future in return for forgiveness of the unknown [if] they can live with their consciences. The deterrent to tax-dodging is the probability of being caught and the consequential penalties"[195].

Much has happened in our fledgling democracy since this threatening utterance. A spirit of forgiveness and reconciliation took hold. Following the National Unity and Reconciliation Act,[196] the Truth and Reconciliation Commission (hereinafter "the TRC") was mandated to examine human rights abuses perpetuated during the dark days of apartheid. The TRC Amnesty Committee was charged with evaluating amnesty applications for politically motivated criminal activity.

Perhaps this same spirit of conciliation persuaded Revenue to alter its stance on an amnesty to residents with "grey money" shifted abroad with political motivations during the apartheid years. Perhaps the Honourable Minister of Finance, Trevor Manuel MP, had to be "dragged kicking and screaming into offering the amnesty."[197] It is more likely, that the economic advantages of broadening the tax base and raising easy cash from levy payments, did not escape the eagle eye of the tax legislator either.

An amnesty for political crime and a tax amnesty are surely very different. In the *2004 South African Law Journal*[198], Antje Pedain published a study of the decisions of the TRC Amnesty Committee, entitled - *Was Amnesty a Lottery?*

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[195] *THE TAXPAYER* January 1998 - Volume 47 No 1 at 1.1
[196] Act 34 of 1995
[197] A press comment of unknown citation observed at the time of the announcement of the amnesty.
[198] 2004 SALJ 785

The report identifies the "divergent success rates for applicants from different perpetuator groups, [and verified that] the spectre of bias [had unfortunately raised] its head again"[199]

The TRC Amnesty also contained pre–qualification criteria, and:

"provided the applicant did not act out of personal malice, ill will or spite directed against the victim or solely for personal gain, the Committee would then consider his conduct in the light of further criteria."

In the case of the 2003 Tax and Exchange Control Amnesty, the applicant's "crime" arguably found its root in human materialism, and the desire to preserve wealth for selfish and familial reasons.

The Tax Amnesty offered South African taxpayers the choice of whether to come clean or not. The window period for application was, however, far too short – It was already three months into the, twice delayed, and once extended amnesty, that Circular D405 was issued by SARB to provide relief for immigrants, heirs and limited other persons. Would it perhaps not have been more conciliatory to extend the period of the window, with later applications carrying an increasing levy on a sliding scale? How many applicants lost to the process, were even aware of the Amnesty? How many were not afforded an opportunity to have their questions answered, and their fears and suspicions allayed? The Amnesty Unit readily confirms that they continued to receive a deluge of amnesty applications months after the expiry of the Amnesty deadline,[200] which they may not process.

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[199] 2004SALJ 785 at 828
[200] Discussions held between the author and Advocate Mahlangu SC, Chairman of the Amnesty Unit.

7.2 The Tax Man Cometh![201]

Globally, the OECD[202] has made great strides in the sphere of tax compliance, and the sharing of information between revenue collection agencies will be a major money spinner for a technologically much improved SARS.

The “once sacrosanct”[203] secrecy provisions of the Act have been steadily eroded, and financial institutions, facing draconian criminal sanction and fines sounding in billions, are bound by “whistle blowing legislation” such as FICA to report deemed suspicious and unusual transactions. The names of convicted tax offenders are posted on public bulletin boards, and powers of search and seizure have been statutorily expanded to enable George Orwell-type revenue inspectors to make short notice surprise visits on their innocent until proven guilty prey.

History records that Alfonso Capone, the great American crime boss, was finally incarcerated in a maximum security penitentiary by District Attorney Elliot Ness, not on charges of murder or bank-robbery, but for tax evasion. South Africa’s criminal justice system also draws no distinction between the place of incarceration for murderous bandits, and convicted tax evaders.

7.4 The need to plan ahead

South African taxpayers who wisely applied for amnesty, can be assured that the tax man not only cometh – he has been, and now knows exactly what he is

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[201] The title of an editorial dealing with increased revenue collection enforcement which appeared in *THE TAXPAYER* January 1998 - Volume 47 No 1

[202] Organisation of Economic Co-operation and Development

[203] From notes taken at the Divaris workshop

looking for. – He has a sworn declaration to refer to when assessing tax returns until death, and even thereafter!

It is submitted that the Amnesty WAS a golden opportunity to regularise contraventions of applicable tax and exchange control regulations. It WAS ridiculously cheap at the price, BUT ONLY IF legitimate tax planning strategies are employed to mitigate the ramifications of a successful application. Taxpayers that fail to modify their tax conduct in a post amnesty environment, and fail to provide for the hidden costs of amnesty adumbrated herein, may well discover that the Amnesty was anything but cheap, and must be prepared to have their wealth steadily chiselled away by residence based taxation.

Perhaps then, the TRC Amnesty and the 2003 Tax Amnesty were not that different after all! Both are as controversial, both as "morally troublesome."[204] Both required a full and complete disclosure by the applicant. Both were somewhat of a lottery!

In the unlikely event that a further tax amnesty lies ahead, it will not be on as favourable terms. The short duration of this Amnesty bears testimony to that. Non-applicants that intend to remain tax residents of South Africa will have to tread very carefully. Such taxpayers face a terrible dilemma.

No provision whatsoever exists in the Amnesty Act for late applications to be considered. Indeed, even an application to the High Court to condone the late

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[204] 2004SALJ 785 at 785

filing of an amnesty application, even with extreme extenuation, has no basis in law, because the application period was statutorily defined;[205]

Approaching the Commissioner now, *albeit* with contrition and remorse, may well be met with a hostile reception, and a straight forward question: - “Why did you not apply when you had the chance?”

[205] s.10(1)(a) of the Amnesty Act;

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6) Insolvency Act 24 of 1936;
7) Prevention of Organised Crime Act 121 of 1998;
8) Promotion of Access to Information Act 2 of 2000;
9) Revenue Laws Amendment Acts 19 of 2001;
10) Revenue Laws Amendment Acts 60 of 2001;
11) Revenue Laws Amendment Act 45 of 2003;
12) Second Reporting Exemption in terms of the Financial Intelligence Centre Act,2001 (R1354 in GG27011 dated 19 November 2004)
13) Taxation Laws Amendment Act 5 of 2001