TAX UPDATE

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3.

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1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the first quarter of 2017, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

The aim of this summary is for clients, colleagues and friends alike to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. The reader is invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

The first quarter of a year is normally dominated by the Budget and this year was no exception. Go through the index and when an aspect may impact you, consider the implications.

Some interesting tax cases are reported herein. I was involve in XO, ITC 1888 and ITC 1889.

In XO the SCA accepted the law, but misapplied the facts. Still a useful case for planning purposes for tour operators to manage VAT implications.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions. It is however important to note that these publications are not law, but may bind SARS. Taxpayers should nonetheless consider these publications carefully to determine whether, and how, they are actually applicable to their own circumstances.

Enjoy reading on!

I am glad I learned in school about parallelograms instead tax. It's really come in handy this parallelogram season. (sic.)

2. NATIONAL BUDGET

2.1. Personal income tax

Government proposes a new top personal income tax bracket of 45% for taxable incomes above R1.5 million per year. The previous top bracket of 41% was set at R701 301. The primary, secondary and tertiary rebates, and the levels of all the taxable income brackets, will be increased by 1% from 1 March 2017. The tax-free threshold will increase from R75 000 to R75 750. However, since the increase is below the expected level of inflation, taxpayers will face a real increase in the effective personal income tax rate in 2017/18. This also requires a four percentage point increase in the tax rate for trusts.

2017 year of assessment		**2018 year of assessment**	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R188 000	18% of each R1	R0 – R189 880	18% of each R1
R188 001 – R293 600	R33 840 + 26% of the amount above R188 000	R189 881 – R296 540	R34 178 + 26% of the amount above R189 880
R293 601 – R406 400	R61 296 + 31% of the amount above R293 600	R296 541 – R410 460	R61 910 + 31% of the amount above R296 540
R406 401 – R550 100	R96 264 + 36% of the amount above R406 400	R410 461 – R555 600	R97 225 + 36% of the amount above R410 460
R550 101 – R701 300	R147 996 + 39% of the amount above R550 100	R555 601 – R708 310	R149 475 + 39% of the amount above R708 310
R701 301 and above	R206 964 + 41% of the amount above R701 300	R708 311 – R1 500 000	R209 032 + 41% of the amount above R708 310

		R1 500 001 and above	R533 625 + 45% of the amount above R1 500 000
Rebates		**Rebates**	
Primary Secondary Third rebate	R13 500 R7 407 R2 466	Primary Secondary Third rebate	R13 650 R7 479 R2 493
Tax threshold		**Tax threshold**	
Below age 65 Age 65 and over Age 75 and over	R75 000 R116 150 R129 850	Below age 65 Age 65 and over Age 75 and over	R75 750 R117 300 R131 150

2.2. Medical tax credits

To counter the effect of inflation, the medical tax credit will be increased for the first two beneficiaries from R286 to R303 per month, and for the remaining beneficiaries from R192 to R204 per month. Future adjustments will be balanced with the funding requirements of national health insurance.

2.3. Tax-free savings

Tax-free savings accounts were introduced on 1 March 2015 with an annual allowance of R30 000. The 2014 Budget stated that the allowance would be increased in line with inflation. Government proposes increasing the annual allowance to R33 000.

2.4. Additional support for employee bursaries

The need for improved skills in the economy justifies additional support for bursaries. Currently, if an employee has an income of less than R400 000 and their employer provides a bursary to them or their relatives, the value of the bursary, up to a limit, will not be taxable in the hands of the employee. Government proposes to increase the applicable threshold and the monetary limits for bursaries.

Government proposes to increase the income eligibility threshold for employees from R400 000 to R600 000, and the monetary limits for bursaries from R15 000 to R20 000 for education below NQF level 7, and from R40 000 to R60 000 for qualifications at NQF level 7 and above.

2.5. Dividend withholding tax

Dividend income paid to shareholders is taxed at a rate of 15%. After accounting for corporate income tax, which is paid before a distribution of dividends, the combined statutory tax rate on dividends is 38.8%. Currently, South Africa's combined statutory tax rate on dividend income falls below the OECD average.

To reduce the difference between the combined statutory tax rate on dividends and the top marginal personal income tax rate, government is increasing the dividend withholding tax rate to 20%, effective 22 February 2017. The exemption and rates for inbound foreign dividends will also be adjusted in line with the new rate, effective for years of assessment commencing on or after 1 March 2017.

2.6. Withholding tax on immovable property sales

To align with the increased effective capital gains tax rate, government proposes to increase the withholding tax on immovable property sales by non-residents. Rates will be increased from 5% to 7.5% for individuals, 7.5% to 10% for companies and 10% to 15% for trusts.

2.7. Expanding the VAT base

Government will look to expand the VAT base in 2018/19. It is proposed that the

zero-rating on fuel be removed. This will be subject to consultation leading up to the 2018 Budget. To mitigate the effect on transport costs, government will consider combining this with either a freeze or a decrease in the fuel levy.

To address base erosion and profit shifting, businesses providing foreign electronic services to South African consumers have been required to register for VAT since 1 June 2014. In line with the 2015 Budget announcement, the regulations are being updated to broaden the scope of electronic services that are subject to VAT and to remove some uncertainties and practical difficulties. Taxable services will now include cloud computing and services provided using online applications.

The proposed changes will be published for public comment during 2017.

2.8. Transfer duty

To provide relief for lower- and middle-income households, government proposes to raise the duty-free threshold on purchases of residential property from R750 000 to R900 000, effective 1 March 2017.

2017 year of assessment		**2018 year of assessment**	
Property value	**Rates of tax**	**Property value**	**Rates of tax**
R0 – R750 000	0% of property value	R0 – R900 000	0% of property value
R750 001 – R1 250 000	3% of the property value above R750 000	R900 001 – R1 250 000	3% of the property value above R900 000
R1 250 001 – R1 750 000	R15 000 + 6% of the property value above R1 250 000	R1 250 001 – R1 750 000	R10 500 + 6% of the property value above R1 250 000
R1 750 001 – R2 250 000	R45 000 + 8% of the property value above R1 750 000	R1 750 001 – R2 250 000	R40 500 + 8% of the property value above R1 750 000

R2 250 001 – R10 000 000 R10 000 000 and above	R85 000 + 11% of property value above R2 250 000 R937 500 + 13% of property value above R10 000 000	R2 250 001 – R10 000 000 R10 000 000 and above	R80 500 + 11% of property value above R2 250 000 R933 000 + 13% of property value above R10 000 000

2.9. Measures to protect the income tax base

In November 2015, the Group of 20 (G20) governments endorsed a package of measures to curb base erosion and the shifting of profits to low-tax countries. The base erosion and profit shifting project is now being implemented. Many countries, including South Africa, have begun incorporating the preventative measures into domestic legislation.

South Africa worked with more than 100 jurisdictions in crafting the multilateral instrument that will swiftly modify and implement tax treatyrelated measures without the need to renegotiate each tax treaty bilaterally.

It was adopted on 24 November 2016 and governments, including South Africa, are expected to sign the multilateral instrument on 7 June 2017. Government has also committed to the automatic exchange of financial account information from 1 September 2017. Large multinational companies will be required to file country-by-country transfer-pricing reports with SARS from 31 December 2017.

Government is strengthening its efforts to curb excessive debt financing,which erodes the tax base, and will review the current regime in light of OECD recommendations.

South Africa's position on the Group of 20/OECD action plan on base erosion and profit shifting

Action item	South Africa's position
Digital economy	Foreign businesses supplying digital services in South Africa are already required to register as VAT vendors. The regulations are under review. South Africa is a member of the new Task Force for the Digital Economy, which is looking at direct taxes.
Hybrid mismatches	Recommendations on transparent entities are being incorporated into the multilateral instrument. South African law has measures to limit double deductions, income exclusions where there is no corresponding deduction, and deductions with no inclusions. Further refinements may be considered in future.
Controlled foreign company rules	South Africa's controlled foreign company rules have been internationally acknowledged as being well designed and were recommended as one of three options for countries to implement.
Interest deductions	Government is strengthening its efforts to curb excessive debt financing, which erodes the tax base, and will review the current limitation in light of OECD recommendations.
Harmful tax practices	South Africa participated in the Forum on Harmful Tax Practices and recently completed its self-review of preferential

	regimes, bringing it in line with OECD member countries.
Treaty abuse	New treaties will be aligned with the minimum standards, while the multilateral instrument will take care of existing treaties. On treaty shopping (where a person who benefits from a tax treaty between two countries, but is not a resident of either, by establishing a shell entity or conduit in one of the countries), South Africa has chosen the principal purpose test because it is to a large extent aligned with its domestic general anti-avoidance rules. Under this test, the benefits of a tax treaty are denied if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of entering into any arrangement or transaction.
Permanent establishment status	South Africa's future tax treaty negotiations will take the recommendations dealing with fragmentation of activities and avoidance of permanent establishment status through specific activity exemptions into account. The aim is to prevent entities artificially avoiding their status as a permanent establishment (a fixed place of business) by breaking up their cohesive business into smaller operations.
Transfer pricing (alignment of outcomes	SARS is updating the Transfer Pricing

with value creation)	Practice Note in line with OECD Transfer Pricing Guidelines to include new guidance on the arms-length principle and an agreed approach to ensure appropriate pricing on intangibles that are difficult to value.
Data analysis (measuring and monitoring)	South Africa shares the view that effective measuring and monitoring through improved statistics and evaluation is important for curbing base erosion and profit shifting, and it will continue to work with other countries.
Mandatory disclosure	The Tax Administration Act (2011) contains rules dealing with reportable arrangements. These rules require taxpayers who have entered into reportable arrangements to report the details of these arrangements to SARS. They set out information to be submitted and who must disclose or submit the information. The South African reportable arrangement rules have been used as a benchmark in the final BEPS Action 12 recommendations.
Transfer pricing documentation	The Tax Administration Act provides the legal basis for country-by-country reporting, where the term 'international tax standard' has been included, covering country-by-country reporting. Regulations were gazetted in December 2016. For multinational enterprises with fiscal years starting on or after 1

	January 2016, the first country-by-country reports will be required to be filed with SARS from 31 December 2017.
Dispute resolution	The South African treaty model will be updated to incorporate the minimum standards. However, like other developing countries participating in the G20/OECD project, South Africa has not committed to mandatory binding mutual agreement procedure arbitration.
Multilateral instrument	South Africa is among more than 100 countries and jurisdictions that have reached consensus on the multilateral instrument capable of incorporating tax treaty-related base erosion and profit shifting measures into the existing network of bilateral treaties. The multilateral instrument was adopted in November 2016.

2.10. Remedial action for bargaining councils

Some bargaining councils have not deducted pay-as-you-earn (PAYE) from a large number of members for holiday and end-of-year payments. The tax treatment of sick-leave payments and income generated within the councils may also have been incorrect. As a result, these funds have been non-compliant with tax legislation for an extended period of time. Because some of the funds are at risk of closure or are likely to suffer severe financial distress from high penalties for non-compliance, and given the unique circumstances of this case, a certain level of relief will be considered. The bargaining councils that have defaulted are expected to be fully compliant and will not be afforded relief in future.

2.11. Amending foreign employment income-tax exemption in respect of South African residents

Currently, if a South African resident works in a foreign country for more than 183 days a year, foreign employment income earned is exempt from tax, subject to certain conditions. This exemption is for employees of private-sector companies. In terms of the residence-based system of taxation, South African residents are taxed on their worldwide income. However, this exemption on foreign employment income appears excessively generous. If a resident works in a foreign country for more than 183 days with no tax payable in the foreign country, that foreign employment income will benefit from double non-taxation. It is proposed that this exemption be adjusted so that foreign employment income will only be exempt from tax if it is subject to tax in the foreign country.

2.12. Refining measures to prevent tax avoidance through the use fo trusts

In 2016, an anti-avoidance measure aimed at curbing the tax-free transfer of wealth to trusts through the use of low-interest or interest-free loans was introduced in the Income Tax Act (1962). This anti-avoidance measure deems any interest foregone in respect of low-interest or interest-free loans to a trust to be donations that are subject to donations tax at a rate of 20%. However, some taxpayers have already attempted to circumvent the anti-avoidance measure by making low-interest or interest-free loans to companies owned by a trust. To counter abuse, it is proposed that the scope of this anti-avoidance measure be extended to cover these avoidance schemes. In addition, it is proposed that the anti-avoidance rule should not apply to trusts that are not used for estate planning, for example, employee share scheme trusts and certain trading trusts.

2.13. Clarifying the rules relating to the taxation of employee share-based schemes

In 2016, amendments were made to the Income Tax Act to introduce anti-avoidance measures dealing with schemes where restricted shares are allocated to employees through employee share-based incentive schemes. The shares are then liquidated in return for an amount qualifying as a dividend. However, the 2016 changes did not fully address the interaction between section 8C and the provisions of the Eighth Schedule that exclude gains arising from the vesting or disposal of a restricted equity instrument from capital gains tax. It is proposed that the interaction be clarified.

2.14. Retirement reforms – Preservation of benefits after reaching normal retirement dates

In 2014, amendments were made to the Income Tax Act to allow individuals to elect to retire, and the date on which the lump sum benefit accrued to the individual depended on the date on which the individual elected to retire and not on the normal retirement age. Currently, once the individual elects to retire, the Income Tax Act does not cater for the transfer of lump sum benefits from one retirement fund to another. It is proposed that transfers of retirement interests be allowed from a retirement fund to a retirement annuity fund, subject to fund rules.

2.15. Retirement reforms – Tax-exempt status of pre-March 1998 build-up in public sector funds

Currently, the Income Tax Act makes provision for the tax-free transfer of pre-March 1998 lump sum benefits from a public-sector fund to a pension fund. It is proposed that subsequent transfers of these lump sum benefits to another pension fund be tax free.

2.16. Retirement reforms – Removing time limit to join an employer umbrella fund

Existing employees who do not join a newly established employer umbrella fund have 12 months within which to join the fund, after which they are unable to join. To encourage employees to contribute towards their retirement and remove practical difficulties, it is proposed that the 12-month limit be removed and that employees be allowed to join without time restriction, subject to the rules of the fund.

2.17. Tax implications of debt forgone – Alignment of the tax treatment of debt forgone for mining companies

Mining companies have a special tax regime in section 36 of the Income Tax Act that requires them to account for their capital expenditure differently from other companies. The current relief provided in paragraph 12A of the Eighth Schedule to the Income Tax Act, allowing a debtor to reduce the base cost of the allowance asset with the amount of a debt that is cancelled, waived, forgiven or discharged, does not apply to mining companies. As a result, mining companies are required to recoup debt that is cancelled, waived, forgiven or discharged without reducing their tax-deductible capital expenditure. To address this disparity, it is proposed that the tax treatment of debt forgone for mining companies be aligned with the tax treatment applied to companies in other sectors.

2.18. Tax implications of debt forgone – Alignment of the tax treatment of debt forgone for dormant group companies or companies under business rescue

Paragraph 12A of the Eighth Schedule to the Income Tax Act provides relief in respect of debt that is cancelled, waived, forgiven or discharged in respect of loans between companies within the same group.

However, the intra-group relief does not extend to section 19 of the Income Tax Act dealing with debt used to finance tax-deductible operating expenditure. As a result,

companies that used intra-group debt to finance tax-deductible operating expenses are required to recoup the debt. In the case of dormant group companies or companies under business rescue, not having this relief is cumbersome as such companies would not have the resources to pay tax on the debt recouped. It is proposed that the current relief for group companies available in paragraph 12A of the Eighth Schedule be extended to section 19.

2.19. Tax implications of debt forgone – Debt settled for consideration other than cash

In the current economic climate, debtors may make compromises with their creditors. This could include the issuing of shares where the issue price of the shares reflects the face value of the debt. It is proposed that the conversion of debt into equity be allowed. However, provision will be made to recoup capitalised interest on the debt in respect of which an interest deduction was previously claimed.

2.20. Addressing the circumvention of anti-avoidance rules – Addressing the abuse of disguised sale of share using share buybacks

In the 2016 *Budget Review*, tax avoidance schemes involving share buybacks were highlighted for review. Such schemes involve a company buying back shares from its current shareholders to avoid the tax consequences of share disposals. The seller receives payment in the form of a dividend that may be exempt from normal tax and dividends tax, instead of paying tax on the sale of shares. Following the announcement in 2016, no specific countermeasures were introduced. It is

therefore proposed that specific countermeasures be introduced to curb the use of share buyback schemes.

2.21. Addressing the circumvention of anti-avoidance rules – Addressing the abuse of artificial repayment of debt

Since the introduction of the current tax rules for debt forgiveness, it has come to government's attention that creditors and debtors are entering into short-term shareholding structures that attempt to circumvent income tax resulting from a recoupment triggered by the debt forgiveness rules. To achieve this, a creditor will subscribe for shares in its debtor and pay the debtor for those shares. The debtor will in turn use the subscription amount paid to settle its debt with the creditor. Soon after the payment is effected, the original shareholder of the debtor will buy the shares that the creditor subscribed for at a slight premium. This slight premium will cover the capital gains tax that the creditor will be liable for in respect of the shares in the debtor sold to the shareholder. This means the fiscus loses normal tax revenue on the recoupment and only receives the lower capital gains tax. It is proposed that measures be introduced to prevent these structures.

2.22. Addressing the circumvention of anti-avoidance rules – Interaction between the 'in duplum' rule and the statutory tax legislation

The *in duplum* rule aims to protect debtors by limiting the amount of the total interest a creditor can charge. The effect of the rule is that interest on a debt ceases to accrue where the total amount of the interest equals the outstanding principal debt. Various anti-avoidance provisions in the Income Tax Act may be undermined should the *in duplum* rule apply. Some taxpayers may be relying on this rule to distort the quantification of the tax benefit derived from low-interest or

interest-free loans. These taxpayers aim to avoid income tax determined on the difference between the amount of interest actually incurred and the amount of interest that would have been incurred at the official rate. It is proposed that the tax rules dealing with low-interest or interest-free loans be amended to explicitly exclude the application of the *in duplum* rule to ensure their efficacy.

2.23. Addressing the circumvention of anti-avoidance rules – Addressing circumvention of dividend-stripping rules

The Income Tax Act has rules that target dividendstripping avoidance schemes. If a company borrows money from a party it is selling shares to and the company declares a dividend that is tax-free before the sale of the shares, such dividends are subject to income tax or capital gains tax in the hands of the seller. For these anti-avoidance rules to apply, the debt funding for the shares must be provided by the purchaser or be guaranteed by any connected person in relation to the purchaser. Government has identified schemes whereby loans for the purchase of the shares are raised from another party, such as a loan from a bank. It is proposed that additional measures be introduced to curb circumvention of dividend-stripping rules.

2.24. Addressing the circumvention of anti-avoidance rules – Changes to the definition fo contributed tax capital

The definition of 'contributed tax capital' was introduced in the Income Tax Act in 2008, when the Companies Act came into effect. It is a notional amount derived from contributions made to a company by shareholders in respect of a certain class of shares. It is reduced by any capital that is subsequently transferred by the company to one or more of the shareholders and is commonly known as a capital distribution. Government has identified a mechanism whereby companies with foreign parents increase their contributed tax capital, thus arguably avoiding the payment of dividends tax through capital distributions. These capital distributions

are not subject to capital gains tax in the hands of the foreign parent if the underlying investment is not in immovable property in South Africa. It is proposed that amendments be made in the tax legislation to prevent the abuse of the definition of contributed tax capital.

2.25. Corporate reorganization rules – Tax implication on the assumption of contingent debt

The Income Tax Act provides for the tax-free transfer of assets for corporate restructuring purposes, subject to certain limitations on how the transfer is funded. The only acceptable means of funding the transfer of assets is by obtaining shares in the buyer of assets or the buyer assuming the debts of the seller. Cash or other assets are not acceptable. With respect to debt, only unconditional obligations are currently catered for. However, a seller and buyer may negotiate a selling price after considering and taking into account some of the future contingent liabilities of the seller. Where the parties agree that the buyer will assume some of the future contingent liabilities of the seller, there is a real economic effect on the sale as the seller will be freed from future costs relating to those contingent liabilities. It is proposed that the assumption of future contingent liabilities be considered as an acceptable consideration under the corporate reorganisation rules.

2.26. Corporate reorganization rules – Interplay between real estate trusts (REITs) and corporate reorganization rules

Section 25BB of the Income Tax Act stipulates that REITs are not entitled to claim certain capital allowances. This is because REITs are subject to a special tax dispensation that allows them to deduct their shareholder distributions against rental income as the shareholders bear the tax liability. The REIT is precluded from claiming allowances on its assets, which means that an anomaly arises when a REIT is party to a reorganisation transaction, because its assets would not qualify as allowance assets. This anomaly means the rules on reorganisation do not apply to transactions involving REITs. It is proposed that the legislation be amended to

make provision for corporate reorganisation rules to apply to transactions involving REITs.

2.27. Extension of collateral and securities lending arrangement provisions

Government has been gradually introducing measures to address concerns about the limited scope of tax relief provisions dealing with collateral and securities lending arrangements. In 2016, legislative changes were made to include listed government bonds as allowable instruments for securities lending and collateral arrangements. In light of the ongoing review, it is proposed that changes be made to extend the current provisions of collateral and securities lending arrangements to include listed foreign government bonds.

2.28. Amendments to third-party backed shares provisions

Currently, all dividends arising directly or indirectly from transactions and arrangements involving preference shares guaranteed by third parties are deemed ordinary revenue, subject to 'qualifying purpose' exemptions, to which the anti-avoidance rules do not apply. The qualifying purpose exemptions are too narrow, and may impede legitimate transactions. It is proposed that the current exemption on third-party backed shares with regard to asset-backed securities be further refined to cover all qualifying purposes.

2.29. Changes in the tax treatment of banks and financial institutions – Consideration of the tax treatment of banks an other financial institutions due to International Financial Reporting Standard (IFRS) 9

In 2018, the financial reporting of financial assets and liabilities will no longer be governed by International Accounting Standard (IAS) 39, but will be replaced by IFRS 9. Currently, section 24JB of the Income Tax Act, which deals with the

taxation of financial assets and liabilities of banks and other financial institutions, follows the accounting treatment contemplated in IAS39. It is proposed that the tax treatment of the financial assets and liabilities of banks and other financialinstitutions under section 24JB of the Income Tax Act be aligned with IFRS 9, except for the treatment ofimpairments.

2.30. Changes in the tax treatment of banks and financial institutions – Exclusion of impairment adjustments from the determination of taxable income in section 24JB

In 2012,SARS issued a directive for the tax treatment of doubtful debts for banks. The SARS directive was basedon and limited to the accounting treatment as contemplated in IAS 39. As the accounting standard forbanks and other financial institutions is changing from IAS 39 to IFRS 9, it is proposed that the principlesof the SARS directive be reviewed and incorporated in the Income Tax Act. It is also proposed that section24JB exclude impairent adjustments provided for under IFRS 9 as these impairment adjustments aim toprovide for future risks instead of focusing solely on the current losses in the determination of taxableincome as contemplated in section 24JB.

2.31. Changes in the tax treatment of banks and financial institutions – Application of hybrid debt instrument rules in section 8F in respect of banks and other financial institutions that taxed under section 24JB

Section 8F of the Income Tax Act ensures that where debt exhibits certain equity-like features, interest on the debt is not allowed as a deduction for the borrower and the interest is treated as a dividend *in specie* for both the borrower and the lender and may be subject to dividends tax. If the borrower is a bank or financial institution, as contemplated in section 24JB, it is argued that the deduction of interest may still be allowed due to the application of section 24JB, despite the

current anti-avoidance provisions available in section 8F. It is proposed that it be clarified that section 8F overrides the provisions of section 24JB.

2.32. Changes in the tax treatment of banks and financial institutions – Addressing the mismatch in the application of par. 12A of the Eighth Schedule and section 24JB

Under the debt reduction rules, a debtor must reduce the base cost of an asset that was funded with debt by any amount of that debt that is subsequently cancelled, waived, forgiven or discharged. In the case of debt that is cancelled, waived, forgiven or discharged within a group of companies, the Income Tax Act makes provision that the debtor will not be required to reduce the base cost of the asset. However, in instances where the debt is provided by a financial institution to its fellow group company and the loan is cancelled, waived, forgiven or discharged, an anomaly arises because the debtor will not be required to reduce the base cost of the asset while the financial institution may, in terms of section 24JB, still benefit from a deduction in respect of the amount of the loan forgiven. Government proposes measures that prohibit mismatches on the tax treatment of reduced or waived loans between a financial institution and another company that is part of the same group of companies as the financial institution.

2.33. Tax amendments due to the Solvency Assessment and Management framework for long-term insurers

In 2016, amendments were made in the Income Tax Act as a result of the Solvency Assessment and Management reforms. Government has noted concerns regarding the application and interpretation of the tax amendments. It is proposed that amendments be made in the legislation to address these concerns.

2.34. Mining environmental funds

In 2006, section 37A of the Income Tax Act was introduced to cater for mining

environment rehabilitation by mining companies as envisaged in the Mineral and Petroleum Resources Development Act (2002), making contributions to mining rehabilitation trusts tax deductible, subject to certain conditions. In November 2015, the Department of Environmental Affairs published regulations in terms of the National Environmental Management Act (1998) for financial provisioning for the rehabilitation, management and effects of mine closures for mining companies. To take into account some of the financial provisioning requirements, amendments will be made to the Income Tax Act. In addition, it is proposed that the current provisions aimed at curbing abuse of the benefit of tax-deductible contributions (by using such funds for purposes other than rehabilitation) be strengthened.

2.35. Partial ownership of land donated under land-reform initiatives

In 2016, amendments were made to the Income Tax Act to provide for an exemption from donations tax and capital gains tax on land-reform initiatives, as outlined in Chapter 6 of the National Development Plan. These changes provide for an exemption where full ownership of the land is transferred. As full ownership of the transferred land is not always envisaged in the National Development Plan, it is proposed that the current exemption be extended to allow partial ownership of land under appropriate circumstances.

2.36. Refinement of the venture capital company regime

Government has been gradually making changes to the venture capital company regime to encourage investment in small and medium-sized enterprises. It is proposed that further changes be made to the regime to remove impediments to investment, such as rules relating to investment returns and the qualifying company test.

2.37. Clarifying the scope of relief for international donor funding

organisations

South Africa is a recipient of official development assistance from international donor funding organisations. Currently, the Income Tax Act provides special tax relief for these organisations. However, the tax treatment of these donor organisations is not aligned. It is therefore proposed that changes be made in the Income Tax Act to align the tax treatment of international donor funding organisations.

2.38. Assisting micro businesses growing into small and medium-sized enterprises

Qualifying micro businesses (with turnover up to R1 million a year) and small business corporations (with turnover less than R20 million a year) are eligible for preferential corporate income tax rates. The former are taxed on turnover, while the latter are taxed on taxable income. There are no transitional measures for micro businesses that grow sufficiently to migrate into the small business corporation tax regime. This can result in unforeseen tax liabilities and administrative penalties. Government proposes to reduce associated administrative penalties so that businesses can transition smoothly.

2.39. Tax treatment of foreign member funds

The South African government will be establishing foreign member funds to enable local and foreign fund managers to establish and manage funds targeted for investments into the rest of Africa and the world. To make foreign member funds attractive, they will benefit from a special tax dispensation. Foreign investors investing in the funds for onward investment into the rest of Africa or elsewhere will be exempt from withholding tax on interest. However, fees earned by local asset managers and collective investment scheme managers for investment management services will be subject to tax in South Africa.

2.40. Changes to the tax treatment of domestic treasury management companies

In 2013, amendments were made in the Income Tax Act to make provision for qualifying domestic treasury management companies to be eligible for tax relief in respect of foreign currency gains and losses. The qualifying criteria for domestic treasury management companies in relation to tax residence will be reviewed as they are overly restrictive.

2.41. Tax implications of controlled foreign companies and offshore foreign trusts

In 2015, the *Budget Review* announced that measures would be introduced on the treatment of foreign companies held by interposed trusts. However, no specific countermeasures were introduced in this regard. It is therefore proposed that specific countermeasures be introduced to curb abuses.

2.42. VAT – Clarifying the VAT treatment on leasehold improvements

The VAT Act (1991) does not currently provide guidelines in respect of the VAT treatment of leasehold improvements effected by the lessee to the leasehold property during the period of a lease agreement. It is proposed that amendments be made to the act to clarify the VAT treatment in respect of the time and value of supply of leasehold improvements on leasehold property.

2.43. VAT vendor status of municipalities

The local government elections of 3 August 2016 have led to the disestablishment or merger of certain municipalities. As a result, the affected municipalities had to either cancel their VAT registrations or apply for new VAT registrations. It is proposed that transitional measures be provided to address this.

2.44. VAT – Amending the definition of 'resident of the republic' for VAT purposes

The VAT Act contains a definition of 'resident of the republic' for VAT on cross-border supplies based on the definition of 'resident' in the Income Tax Act. However, if a foreign company is effectively managed from South Africa, it will be regarded as a resident of South Africa. This implies that goods or services supplied by a South African company to the foreign company will be subject to VAT and no zerorating provisions are applicable. If the foreign company is not required to register for VAT but bears South African VAT because it is a resident, the VAT that is borne will become a business cost, as that company cannot deduct that VAT as input tax. The definition of 'resident in the republic' in the VAT Act will be amended to provide for such situations.

2.45. VAT – Repealing the 2011 amendment dealing with the value to be placed on inter-warehouse sales

If goods are imported into South Africa and entered for home consumption, the goods are subject to VAT. The VAT is calculated by taking into account the value for customs duty purposes, plus any customs duty levied thereon, plus 10% of the value of the goods. However, when goods are imported into the country and entered for storage in a licenced warehouse, but have not been entered for home consumption, and such goods are then sold from one warehouse to another, the value to be placed on such goods is the *higher* of the above calculation, or the actual amount in money paid, or the open market value of the goods. This was determined in terms of a 2011 amendment to the VAT Act. Prior to 2011, the value was deemed to be the *lower* of these amounts. The 2011 amendment was never implemented due to administrative and compliance complexities and it is proposed that it should be repealed with retrospective effect.

2.46. VAT – Postponing the 2015 amendment dealing with the VAT treatment of the national housing programme

In 2015, amendments were made to the VAT Act to abolish the zero rating of the supply of goods and services for government's national housing programme, with effect from 1 April 2017. However, both the National Treasury and municipalities are not ready to make the VAT amendments. It is proposed that the effective date for this amendment be postponed for two years.

2.47. VAT – Clarifying the zero-rating of international travel insurance

It is proposed that the zero-rating provision pertaining to international travel be clarified, including, for example, while the traveller is still in the country of departure, while the traveller is still being transported to or from the original point of departure in South Africa, and while the traveller is not actually travelling, but is in a hotel room.

2.48. VAT – Clarifying the VAT treatment of services supplied in connetion with particular movable property situated in an export country

The term 'movable property' is not defined in the VAT Act. In terms of the Companies Act, movable property includes securities or shares. Securities or shares in a foreign incorporated company that is listed on the JSE could be interpreted to mean movable property that is situated in an export country. The VAT Act makes provision for the zero rating of services (fees charged) that are supplied directly in connection with movable property that is situated in an export country at the time the services are rendered. This implies that services supplied relating to securities or shares in a foreign incorporated company listed on the JSE should be subject to zero-rated VAT. It is proposed that changes be made to the VAT Act to clarify the tax treatment of these services.

2.49. Tax Administration – Approval of organizations receiving tax-deductible donations

It is proposed that the Income Tax Act be amended to confirm the current approval process of public benefit organisations receiving tax-deductible donations. This is in addition to the approval of their tax exempt status.

2.50. Tax Administration – Transitioning interest calculation rules under the Tax Administration Act

It is proposed that amendments be made to further clarify the transitional rules for the calculation of interest on tax debts under the Tax Administration Act to ensure that they do not result in inconsistencies, or the under- or over-accrual of interest.

2.51. Tax Administration – Employees' tax and reimbursement of travel expenses

To facilitate and simplify the calculation and administration of employees' tax, it is proposed that only the portion of the travel expenses reimbursed by an employer that exceeds the rate or distance fixed by the Minister of Finance by notice in the Gazette in terms of the current law should be regarded as remuneration for purposes of determining employees' tax.

2.52. Tax Administration – Application of the cap on deductible retirement fund contributions

It is currently not clear how the overall annual cap of R350 000 on contributions to pension, provident and retirement annuity funds should be applied when determining monthly employees' tax. It is proposed that the amount of R350 000 be spread over the tax year, which is a more prudent approach.

2.53. Tax Administration – Tax Board

It is proposed that clarification be made that the chairperson of the Tax Board has the final decision as to whether or not an accountant or commercial member must form part of the constitution of the Tax Board.

2.54. Tax Administration – Decisions by SARS

It is proposed that all decisions of SARS that are not subject to objection and appeal should be subject to the remedies under section 9 of the Tax Administration Act.

2.55. Tax Administration – Accrual of interest payable by SARS

Interest that is payable by SARS could accrue over a number of tax years. To avoid complications in taxing that interest or interest that is adjusted for previous tax years, it is proposed that interest payable by SARS should be deemed to accrue to the recipient on the date of payment thereof by SARS.

3. CASE LAW

3.1. XO Africa Safaris CC v C:SARS

XO was a registered VAT vendor in terms of the VAT Act.

X) had assembled tour packages for foreign tour operators ('FTOs') arranging for group and individual foreign tours to South Africa.

The aforementioned tour packages included accommodation, travel, restaurant bookings and recreational activities, such as golf, safaris, whale watching and the like (local services).

Some of the tour groups were in South Africa partly for business and partly for

social purposes, in which event the packages included arranging meeting facilities and the like.

XO had operated a business involving the supply of services to FTOs which were non-resident in South Africa. The accommodation would be used, the meals eaten and the other activities enjoyed, by the members of the tour groups assembled by the FTOs. They or, in some cases involving commercial groups, their employers would pay the FTO for the right to enjoy these services and activities and these individuals had no direct contractual connection with XO who had contracted with the FTO.

XO accepted that this involved a supply of services to the FTO, but claimed that it was a supply that was zero-rated in terms of s 11(2)(*l*) of the VAT Act.

SARS contended that these services did not fall within section 11(2)(*l*) of the VAT Act but were subject to the standard rate of VAT of 14% in terms of section 7(1) of the Act.

SARS had given a letter of audit findings to XO which indicated its intention to raise VAT at the standard rate on the supply of 'tour packages and services' to FTOs during the tax periods to February 2008 and 2009 and April 2010.

XO's attorneys had responded by indicating that XO would object to any assessment raised on that basis and the promised letter of objection was forthcoming.

The objection was upheld in regard to penalties and interest but was disallowed in relation to the assessment to VAT.

XO then took SARS' decision on appeal to the Western Cape Tax Court which had dismissed XO's case and had held that XO had directly supplied the local services to the FTOs and/or their customers on their behalves and accordingly VAT was payable at the standard rate and this appeal was with the leave of that court.

According to SARS, XO had contracted local suppliers to provide local services to itself and thereafter XO had supplied the local services to the FTO or the FTO's customers when they were in the Republic. It did this, according to SARS, by concluding contracts for the supply of the local services with the hotels, restaurants and other providers of such services and contracting separately with the FTOs to

provide those services to the members of the tour parties when they were in South Africa.

When the agreements were concluded with the FTOs, neither the FTOs nor their customers were in the Republic and once an agreement between XOand an FTO was concluded, XO arranged the local services with the local supplier if, it had not already done so, as was often the case. If prior arrangements had been made these would be confirmed and XO then invoiced the FTO for a lump sum which included the local service provider's costs and its own mark-up. The FTOs were not advised and had no knowledge of the prices charged by the local suppliers.

The issue in this case was primarily concerned with the application of section 11(2)(*l*) of the VAT Act to XO's activities.

Section 11(2)(*l*) provided at the relevant time that zero-rating applied when services are supplied to a client who is not a resident of the Republic provided that the services are not carried out directly in connection with land or any improvement thereto or movable property physically inside the Republic at the time the service is physically rendered . . . or if the said person or such other person is in the Republic at the time the services are rendered.

XO had contended that its services should be zero-rated because it did not supply or render the local services directly to the FTO or its customers but it submitted that it had entered into a back-to-back agreement with the FTO in terms whereof the local supplier would give it an undertaking that it would render the local services to the customers identified to it by XO.

According to XO the local supplier would then supply the customer with local supplies when the customer arrived in the Republic, thereby discharging its obligations XO by performance in favour of the *adjectus solutionis gratia* nominated by it. On this basis it was contended that the local suppliers rendered services to XO by performing their contracts in favour of the tourists; that XO had rendered the service of organising the package to the FTO and the FTO had a contract with the foreign tourists to ensure that they would receive services while in South Africa from the local suppliers.

The nub of XO's case was that the local services were rendered by the local

supplier directly to the FTO or its customers because XO had no direct relationship with the customers.

It was XO's case that the service which it provided to the FTOs in terms of the back-to-back agreement was not a local service and hence attracted VAT at zero *per cent* because it was a service supplied to a person who was neither resident nor present in South Africa.

Judge Mathopo held the following:

(i) That the issue in this case was primarily concerned with the application of section 11(2)(*l*) of the VAT Act to XO's activities and the cardinal consideration in determining the intention of the legislature was to interpret the provision in the context of the Act as a whole, and its history and the *explanatory memoranda* in the event of any uncertainty.

(ii) That it was clear that the resolution of this dispute required consideration of the following:

- What services did XO supply?
- To whom did XO supply such services?
- Were the parties to whom such services were supplied, residents of, or present in the Republic when such services were supplied?

In order to resolve these issues regard should be had to the applicable statutory provisions as well.

(iii) That the difficulty confronting XO's argument was that it was wholly inconsistent with the facts as they had emerged from the evidence and the documents. It was correct insofar as it stated that XO had contracted with local suppliers to provide local services to foreign tourists, whom XO would identify but it was wholly incorrect when it stated that the only services that it supplied to the FTOs were the organisational services involved in assembling the tour package and nothing else.

(iv) That the letter of agreement, standard terms and conditions of contract and the itinerary attached to the letter of agreement proclaimed unequivocally that XO was providing materials and services consisting of accommodation,

meals, entertainment, gifts, transport and the like as specified in the itinerary. That was what XO had undertaken to provide to the FTOs and that is what it was paid to provide and that is what it provided. The fact that in order to perform its obligations towards the FTOs it in turn had to acquire those goods and services from local suppliers was neither here nor there. Its contract was to provide those goods and services. How it did so was no concern of the FTO and it provided those goods and services, not directly to the FTO, but to other persons who were in the Republic at the time that the goods and services were provided. That served to exclude these services from the class of services that enjoy zero rating under section 11(2)(*l*) of the Act.

(iv) That SARS was accordingly correct in saying that the supply of the services attracted VAT at the standard rate.

(v) That the court was taken to the various amendments of section 11(2)(*l*) which had led to the current version of the section around which the dispute between the parties revolved and that history showed that the statutory purpose underlying section 11(2)(*l*) was to ensure that where services were rendered to a foreigner by a person liable to pay VAT, but the services themselves were rendered in South Africa and the benefit of them was enjoyed in the Republic, they would not enjoy the benefit of zero-rating and VAT would be payable at the standard rate.

(vi) That XO's argument was unsustainable because if it was followed, it would mean that notwithstanding the fact that the services were consumed in the Republic and XO would have a claim for input VAT in relation thereto, the *fiscus* would forego the 14% output tax levied on the supply of local services by it.

(vii) That the Supreme Court of Appeal had already held in *Master Currency (Pty) Ltd* v *C: SARS* that the purpose of section 11(2)(*l*) was to ensure that when services are consumed in South Africa VAT is payable at the standard rate.

Appeal dismissed with costs, including the costs of two counsel.

3.2. Dale v Aeronastic Properties Ltd and others

Dale sought an order placing Aeronastic, a company which had been wound up on 28 August 2014, under supervision and thus commencing business rescue proceedings pursuant to section 131 of the Companies Act 71 of 2008 ('the Act').

During November 2009, SARS, being the third respondent, had issued an assessment against the Aeronasticrelating to a claim for input tax in respect of value-added tax. The assessment had disallowed Aeronastic's claim in the amount of R14 million which had resulted finally in Aeronastic becoming liable to SARS in the sum of R28 million.

Subsequently, SARS took judgment against the Aeronastic in the amount of R47 945 101 in the Magistrates' Court pursuant to section 40(2)(*a*) of the Value-Added Tax Act and the aforesaid amount included penalties and interest.

Thereafter, SARS applied for the liquidation of Aeronastic on the basis that it was factually and commercially insolvent, in terms of the assessment which had resulted in a liability for SARS in the amount of R28 million plus the interest and penalties.

Aeronastic had appealed against this assessment to the Tax Court but, significantly, this appeal was dismissed on 28 August 2013 on the strength of an agreement entered into between Aeronastic and SARS.

The judgment by Cossie AJ on 27 October 2014, which had set out the reasons why Aeronastic was placed under final liquidation, was illuminating for the purposes of the present dispute. It sets out the facts of the assessment for VAT briefly as follows: On 28 February 2009, Aeronastic purchased helicopters, helicopter components and spares from a company called Summer Days Trading 709 (Pty) Ltd which was represented by Mr Gary van der Merwe. SARS had disallowed Aeronastic's claim for input tax in the sum of R14 million and, as a result, Aeronastic became liable for the payment of R28 million being the additional tax in terms of section 60 of the Value-Added Tax Act. In arriving at its decision, SARS had concluded that the transaction between Summer Days and Aeronastic was a scheme to obtain an undue tax benefit in terms of section 73 of the Act.

It appeared that Aeronastic's argument in this particular case was that while the debt relied upon by SARS was presently owed, this debt would fall away once the order of the Tax Court had been rescinded, the appeal was reheard and it was found that SARS had incorrectly applied section 73 of the Act.

In developing its case, Aeronastic, to a large extent, had relied on a report by a tax advisor who had advised it that SARS had misapplied section 73 of the Act.

Cossie AJ had found that SARS was correct in its contention that there was an objection to the assessment which was finalised and no application had been made for review of the order of the tax court and neither had payment been received and for these reasons the court was satisfied that it was just and equitable to grant the order for the winding-up of Aeronastic.

It was clear that the tax dispute between SARS and Aeronastic had been settled and there was nothing that the court now hearing this application could do insofar as any further adjudication of the tax dispute matter was concerned.

The only issue therefore before the court was to determine the application that Aeronastic be placed under business rescue in terms of section 131 read with section 131(4)(*a*) of the Companies Act.

The key section in dealing with this application was section 131(4) which provided that, after considering an application in terms of subsection (1), the court may make an order placing the company under supervision and commencing business rescue proceedings if the court is satisfied that:

- The company is financially distressed;
- The company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or, contract, with respect to employment-related matters; or
- It is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company; or
- The court may dismiss the application together with any further necessary and appropriate order, including an order placing the company under liquidation.

The term 'financially distressed' as employed in this section is defined in section 128(1)(*f*) of the Act in the following terms:

- It appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or
- It appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.

Judge Davis held the following:

(i) That there had been some dispute as to whether a company could be placed into business rescue if it was already insolvent but in terms of section 131(4)(*a*)(iii) of the Act a court can grant an application for business rescue if it is just and equitable to do so for financial reasons and that followed irrespective of whether or not the company was financially distressed and, accordingly, this requirement of section 131(4) of the Act was met in this case.

(ii) That the problem facing Aeronastic was the requirement that in terms of section 131(4)(*a*)(iii) of the Act, a court must be satisfied that there is a reasonable prospect of rescuing Aeronastic.

(iii) That to rescue a company within the framework of business rescue meant achieving one of the goals provided for in section 128(1)(*b*) of the Act, namely 'either to restore the company to a solvent going concern, or at least to facilitate a better deal for creditors and shareholders than they would secure from a liquidation process.'

(iv) That the primary goal was to facilitate the continued existence of the company in a state of solvency but the attainment of its secondary goal may suffice, for a successful application, namely that, even if the achievement of the primary goal cannot be shown to be viable, a business rescue may facilitate a better return for the creditors or shareholders of the company than would result from immediate liquidation.

(iv) That for the aforementioned reason, what was incumbent upon Dale in order to succeed in this application for business rescue, was to place

before the court a factual foundation for the existence of a reasonable prospect that one or other of the desired purposes of business rescue could be achieved.

(v) That, however, the application for business rescue was so skeletal that without a postponement and hence the development of a further set of arguments, it would be impossible for the court to grant the application in terms of the tests outlined by the court.

(vi) That the only evidence upon which Dale sought to base his case was that the asset of Aeronastic, which had already been sold in the amount of R4 million, which was the price obtained at a properly advertised auction sale, had been grossly undervalued as in Dale's view the true value was in the amount of R89 million and he had appended a valuation report to his papers.

(vii) That Dale's founding affidavit read together with his supplementary affidavit provided no basis for a business rescue application and, given the non-compliance with the clear test required for an application for business rescue, there was no basis upon which to grant this application.

(viii) That the court also refused to afford Dale a postponement which it considered to be 'another desperate attempt to obstruct the implementation of a final order which was granted in circumstances which renders that order unassailable.'

(ix) That it was also contended by the fourth respondent that were a business rescue application to be granted, somehow this would serve to exclude from the calculation of Aeronastic's solvency, the debt owing to SARS.

(x) That, in so doing, it sought to rely on the decision in *C: SARS* v *Beginsel NO and Others* 75 SATC 87 which turned on the question as to whether SARS enjoyed a preferential claim, and hence whether the business rescue practitioner had incorrectly determined that SARS' voting interest should not be afforded a different status to that of ordinary creditors. Hence, the case turned on the meaning of section 150(2)(*b*)(v) of the Act, namely whether the business rescue plan could be created which would specify the order of

preference in which the proceeds of property would be applied to pay creditors, if the business rescue plan was adopted.

(xi) That, as Fourie J put it in the *Beginsel* judgment: 'The issue to be determined is whether or not SARS is to be treated as a preferent creditor in business rescue proceedings.' (At para 21.)

(xii) That, in response and referring to the *Beginsel* judgment, it was noted that 'this decision cannot support an argument that, if Aeronastic is placed into business rescue, the claim by SARS disappears from the calculation of whether Aeronastic is financially distressed. It was further argued that if SARS is not a preferent creditor then other creditors would be able to obtain a better return, if the business rescue application is granted and business rescue therefore proceeded . . . But the [*Beginsel*] finding surely cannot be employed to support an argument that, as SARS' claim stands on the same footing as other claims, that in and of itself is sufficient to claim that the alternative purpose of business rescue can be achieved, namely improved return for creditors and shareholders.'

(xiii) That the animating idea of business rescue's alternative purpose is to ensure a more advantageous realisation of assets and consequently a better return. In turn, this brings the analysis back to a search for the proof of an enhanced sale of the asset. In this case, absent the evidence which would suggest that the business rescue would realise significantly more in proceeds on behalf of creditors than would a final liquidation order, the argument must stand to be rejected. In other words, the papers do not support the argument that an improved return by virtue of a business rescue would be forthcoming.

The application was dismissed with costs.

3.3. ITC 1888

The taxpayer, being ABC (Pty) Ltd, had been incorporated on 24 February 2000 and was a wholly-owned subsidiary of DX Ltd (Australia).

The taxpayer, prior to 2002, had established a 120-seat call centre in Cape Town which it used to provide services to telecommunication companies and the Cape Town call centre had assets, such as telephonic and computer equipment and software.

The taxpayer, from December 2001, had terminated its cellular service provider contracts and had disposed of its cellular telephone subscriber bases to certain telecommunication companies and, as a consequence of this, certain legal disputes arose between the taxpayer and some of the aforementioned telecommunication companies for amounts allegedly due to the taxpayer and the taxpayer continued to own the call centre and was bound to a lease agreement over the property in which the Cape Town call centre was housed.

The taxpayer's holding company, DX Ltd, was looking to divest itself of its shares in the taxpayer and was introduced to the Y Group who used JK (Pty) Ltd ('JK') to purchase the Cape Town call centre at a purchase price of R1 million.

An agreement of sale was concluded on 1 March 2002 for the purchase of the call centre which excluded the shares and was referred to as the 'sale of assets agreement.' JK was granted the option to purchase the shares in the taxpayer on a future date when the legal disputes with the telecommunication companies had been resolved.

JK, in November 2002, was looking for a buyer for the taxpayer, even though it had not yet acquired the shares in the taxpayer and shortly after the dispute with the telecommunication companies was settled, JK exercised its option to purchase the shares in the taxpayer and on 5 March 2003 DX Ltd concluded a sale of shares agreement with JK, hereafter referred to as 'the first change of shareholding'.

Mr A, who owned the H group of companies ('H'), had had a vision since the late 1990s of establishing a business which would provide business processing outsourcing ('BPO') services and he took certain measures to give effect to that vision. H already had a glass fitment call centre in Johannesburg, referred to as 'MNO branch' and H had developed its processing systems, referred to as 'GPS', to the extent that insurance companies had become reliant on their system and it was looking to provide processing services to its main competitor, VD.

At about the same time JK was looking to sell the call centre because it was not making optimum use of its 120 seats and all it wanted was to lease back 30 seats, which was all that it required.

Moreover, Mr A was interested in acquiring a call centre in premises separate from those of H, so that he could attract VD's business and he was also interested in diversifying into other categories of claim processing, other than glass claims. He also believed that Cape Town was becoming the call centre destination for international companies and he expressed an interest in acquiring the Cape Town call centre.

H had employed Mr B to start a due diligence process on the taxpayer already during November 2002 and, as part of that process, H had access to the taxpayer's annual financial statements, including the draft financial statements for the 2002 year, management accounts, the sale of assets agreement and relevant correspondence.

A report on the due diligence process was submitted to H on 4 December 2002 in which it was stated that the taxpayer had ceased trading after year-end and that it had an assessed loss and that there was a risk that SARS could apply section 103(2) of the Income Tax Act and disallow the assessed loss.

From December 2002 through to March 2003, while the taxpayer was not trading, H had made various offers to JK to acquire the shares in the taxpayer. At some point during March 2003 the negotiations had ceased but were later revived and this culminated in H acquiring the shares in the taxpayer in November 2003, this being 'the second change in shareholding.'

H had nominated MM Investments (Pty) Ltd as the purchaser and the purchase price had been fixed at R3,85 million. The sale was subject to a lease agreement between JK and the taxpayer in which JK leased 30 seats in the Cape Town call centre from the taxpayer for R210 000 per month.

During 2002, H and its competitor VD had discussions about outsourcing business and they signed a Memorandum of Understanding in September 2003 setting up a joint call centre which would consolidate the work hitherto undertaken by H and VD separately but eventually the joint venture between H and VD did not materialise

and H merely performed BPO work for VD.

SARS had issued a revised assessment against the taxpayer in respect of its 2005–2008 years of assessment in which taxpayer's claim for the set-off of its income against the balance of assessed losses carried forward from previous years had been disallowed, leaving taxpayer with an income tax assessment in the amount of R19 342 685 plus interest.

SARS had disallowed the taxpayer's objection against the aforesaid assessment, having relied on section 103(2) of the Income Tax Act.

SARS contended that JK knew that the object of its acquisition of the taxpayer's shares was to convert the taxpayer into a going concern by June 2003, which was the end of its financial year, and then to sell the shares to H who would channel its income through the taxpayer and then set off the assessed loss against that income.

SARS further contended that had it not been for the first change in shareholding, the second transfer of shares to H would never have occurred.

SARS also contended that the transaction in question had been concluded solely or mainly for the purpose of utilising such assessed loss and the purpose test was a subjective test.

Taxpayer then appealed to the Tax Court against the disallowance of its objection.

The issue for determination by the court was whether the requirements for the application of section 103(2) of the Act had been met.

Section 20(1) of the Income Tax Act allows a taxpayer to set off against the income derived by him from conducting of a business, the balance of the assessed loss incurred by him in any previous year of assessment that has been carried forward from the preceding year of assessment.

Section 103(2) was introduced to prevent a specific type of tax avoidance, namely the trafficking in assessed losses and the following three requirements must all be met before section 103(2) can be applied:

- There must be an agreement affecting a company or trust, or a change in the shareholding of a company, members' interest of a close corporation or

trustees or beneficiaries of a trust;

- The above must result in a receipt or accrual of income or a capital gain by the company or trust;
- The purpose of the agreement or change is solely or mainly to utilise any assessed loss, any balance of assessed loss, any capital loss or any assessed capital loss to avoid or reduce a tax liability.

When the aforesaid requirements are met, the use of the assessed loss is denied and the income that was channelled to the other entity may not be set-off against the assessed loss of this other entity.

In this case the parties were *ad idem* that the requirement that there must have been an agreement affecting the taxpayer or a change in shareholding in the taxpayer had been met and that the change in shareholding to which this case was limited was the change in taxpayer's shareholding from DX Ltd to JK and not the H change in shareholding, in other words the first change in shareholding (*ie* from DX Ltd to JK) was the relevant change in shareholding for purposes of the case now before the Tax Court.

It should be noted that in *ITC 1876* (which case should be read together with this case) Rogers J had held, in an interlocutory application in the same matter, that the SARS could not rely on the second change in shareholding because it had been exclusively the first change in shareholding that had formed the basis of the satisfaction of SARS in the application of section 103(2) of the Act to the facts of this case that had given rise to the additional assessment in dispute.

Judge Allie held the following:

(i) That in terms of section 20(1) of the Income Tax Act there were three requirements that had to be met in order for a taxpayer to set off an assessed loss against taxable income: (1) taxpayer must be carrying on a trade; (2) The assessed loss may only be set-off against income derived from that trade; (3) Before the taxpayer could carry forward its assessed loss from the immediately preceding year of assessment, the taxpayer must have carried on a trade during the current year of assessment. If it was found that the taxpayer did not carry on a trade during the relevant year of

assessment, the taxpayer will forfeit its right to carry forward the balance of the assessed loss.

(ii) That for SARS to rely on section 103(2) to disallow the set-off of the assessed loss or the balance of the assessed loss in this matter, SARS must be satisfied that the following three requirements of section 103(2) had been met: (1) There must have been an agreement affecting the taxpayer or a change in shareholding in the taxpayer and the parties were *ad idem* that this requirement had been met and that the change in shareholding to which this case was limited was the JK change in shareholding (*ie* the first) and not the H change in shareholding(*ie* the second); (2) The circumstances in respect of the first requirement must have resulted directly or indirectly in income or any capital gain accruing to the taxpayer and (3) The agreement or change in shareholding must have been entered into solely or mainly for the purpose of utilising any assessed loss, any capital loss or any assessed capital loss.

(iii) That SARS had contended that the income had 'directly or indirectly' accrued to taxpayer as a result of the aforementioned change in shareholding but the direct or indirect result requirement was, however, an objective requirement.

(iv) That, however, section 103(2) limited SARS' power to disallow the set-off of such assessed loss against such income and it was therefore important to identify the unbroken chain (unbroken causation) and the tainted income.

(iv) That although section 103(2) of the Act referred to 'any' change in shareholding; 'any' proceeds, 'any' time, 'any' person, 'any' assessed loss, 'any' such income, the section clearly contemplated a causal link between the change in shareholding, the motivation for acquisition of the shares by the person who seeks to utilise the assessed loss, and the means by which that income came to be owned and declared by the taxpayer.

(v) That the more contentious aspect of the formulation was the motivation for the change in shareholding and those taxpayer companies that could show a sound commercial purpose for the acquisition of the shares would have less difficulty in establishing that they did not fall foul of the section.

(vi) That the evidence led in the case lent itself to the conclusion that the specific transaction had strong commercial substance, as opposed to being an attempt to purely utilise the assessed losses acquired. Moreover, by acquiring the taxpayer company with the 120 seat operational call centre in Cape Town, Mr A had begun to fulfil his vision of, *inter alia*, providing services to his largest competitor, VD, through the medium of a company that did not carry the H name and H was developing systems and intellectual property that could be used for the expansion of the new company. Moreover, the new company could become part of the initiative to promote Cape Town as a call centre location for international markets and H could expand its own clientele base in Cape Town.

(vii) That if the income had been received or accrued to the taxpayer company when JK had acquired the shares, then JK would most likely have fallen foul of section 103(2). However, since the income had been derived from the efforts of H and after it had acquired the shares, it is H's motivation in acquiring the shares that ought to be relevant in determining whether section 103(2) could be applied.

(ix) That, however, the parties were limited to the JK acquisition of shares by the earlier court order and hence the causal link between the JK's motivation for the acquisition and the income had to be established if section 103(2) was to find application.

(x) That section 103(2) did not contain the words 'direct or indirect' in isolation and those words were complemented by the word 'result'. The income having found its way into the taxpayer company must result from a change in shareholding. If the legislature intended it to be any remote cause, the section would have been expressed in a manner which reflected that the income could derive from any cause whatsoever.

(xi) That in *ITC 1123* 31 SATC 48 the *nexus* between the accumulation of taxable income and the change in shareholding was palpable on the facts of that case and in *New Urban Properties Ltd* v *SIR* 27 SATC 175 it was held that it will always be a question of fact whether a company has derived income 'directly or indirectly' as a result of the change in shareholding.

(xii) That section 103(4) made clear the purpose of section 103(2), which was, to limit the circumstances in which an assessed loss could be utilised to situations other than those where the shares were acquired with the specific intention of utilising the assessed loss and the section prohibited intentional tax avoidance through the acquisition of shares in a company with an assessed loss that could otherwise be utilised.

(xiv) That section 103(4) was silent on the income aspect referred to in section 103(2) for a patently obvious reason: implicit in the presumption that a specific intention to utilise an assessed loss would have been formed at the time when the shares were acquired, was some foreseeable amount and source of income against which the loss could be set-off.

(xv) That in situations where the chain of causation was broken between the change in shareholding and the income against which the assessed loss is sought to be set-off, that income would not be as a result of the change in shareholding at all with the operative word being 'result' irrespective of whether it was direct or indirect.

(xvi) That the breaking of the chain of causation was referred to in delictual cases as the *novus actus interveniens*, that is, a new intervening event.

(xvii) That *in casu* the income had been derived from a later, intervening event and the income was not contemplated at the time when JK had acquired the shares.

(xviii) That even if it could be argued that JK had acquired the shares with the specific intention of selling them later to new shareholders who could utilise the assessed loss, it could not be said that JK had contemplated at the time of its acquisition, that the new shareholders would in fact have declared sufficient income to utilise the assessed loss. However, the evidence revealed that when JK had exercised the option to purchase the shares in September 2002, H had not yet begun to negotiate with the Y Group for the purchase of the taxpayer's shares and when JK acquired the shares in March 2003 it was merely giving effect to a legally binding agreement that it had activated in September 2002.

(xix) That, accordingly, the taxpayer had discharged the *onus* of showing that the sole or main purpose in the H change in shareholding was not to acquire the company to utilise its assessed loss and the H group's vision and projected business plan dovetailed with the existing call centre business that the taxpayer had been engaged in prior to the acquisition of the shares in the taxpayer.

The appeal was upheld and the additional assessments were set aside and referred back to SARS for re-assessment.

3.4. ITC 1889

The taxpayer, in 2008, had become the wholly owned subsidiary of KL (Pty) Ltd ('KL') and during 2009 the taxpayer made land owned by it available to KL and on the land KL undertook the development of residential property units in a development known as 'M' and commercial property in Cape Town.

By agreement between KL and the taxpayer during the development process, KL had funded taxpayer's cash flow requirements on loan account *via* inter-company shareholder loans in order to avoid external finance to fund business operations being obtained.

On 2 April 2009, KL issued a tax invoice to the taxpayer in respect of a taxable supply of R82 095 000, inclusive of VAT, at the rate of 14%, in respect of the development of the residential component of the M development.

The taxpayer, following receipt of the invoice, claimed an input tax deduction in respect of the VAT in the amount of R10 081 842,10 and had received payment of this amount from SARS.

After the taxpayer had paid the input tax it had received from SARS to KL by way of a cash payment, KL paid the output tax to SARS in the same amount.

The remaining liability due to KL in terms of the invoice, being R72 013 158, was credited to the loan account of KL in the books of the taxpayer, in accordance with the funding arrangement between the two companies,

SARS was not out of pocket in that the invoice gave rise to output tax obligations

on the part of KL and enabled taxpayer to claim an input tax deduction equal to the amount for which KL was obliged to account to SARS.

Both KL and the taxpayer considered that the liability under the invoice had been paid after KL's loan account had been credited and the February 2010 annual financial statements of the taxpayer and KL recorded the amount as neither a current liability nor current asset.

In the taxpayer's financial statements it was converted to a long-term debt, while in KL's financial statements it was dealt with as a non-current asset on the understanding that the long-term debt liability would be paid as and when the development properties were sold through increasing and decreasing the loan accounts between the two companies.

Given the agreed funding arrangement, the amount could not have been claimed by KL as a bad debt for VAT purposes or any other purpose and had the taxpayer been required to pay KL the amount invoiced, it would have had to borrow the funds from KL to do so, in which case KL's loan account in the books of the taxpayer would have been credited with the same amount.

SARS had conducted an audit in 2013, four years after the invoice in issue had been raised, and had determined that the consideration in respect of the service rendered had not been paid in a period of twelve months after the expiry of the tax period in which the input tax had been claimed as was required by the provisions of section 22(3) of the VAT Act.

The effect of section 22(3) was that where a vendor had claimed an input tax deduction on the basis of a tax invoice, but had not made payment of the relevant consideration within a period of twelve months, the transaction was effectively reversed, which had the result of counteracting the benefit of the input tax previously deducted because the consideration had not been paid.

The VAT Act was amended with effect from 10 January 2012 by the addition of section 22(3A) into the Act and has no bearing on the current matter as it arose after the tax period in issue in this matter, but it is noteworthy that the effect of this insertion into the Act was that section 22(3) no longer applies where the supplier and recipient in question are both members of the same group of companies.

The taxpayer contended that the crediting of KL's loan account by it in the context of the funding arrangement between these two group companies constituted 'payment made', 'in respect of' goods and services reflected in the invoice given that it was funded by KL *via* agreed inter-company loan accounts.

Respondent contended that, given the definition of an 'invoice' in the Act, the effect of the tax invoice issued was that the taxpayer was obliged to pay the amount invoiced to KL and hence recording the amount in the loan account of KL in the books of the taxpayer did not constitute 'payment' of the full consideration and remained a debt on the books, so justifying the provisions of section 22(3) being invoked.

Judge Savage held the following:

(i) That the issue in the appeal turned on whether, having regard to the provisions of section 22(3) of the Act, the crediting of a loan account constituted payment of full 'consideration' within a period of twelve months after the taxpayer had claimed an input tax deduction for the VAT component of the invoice raised by KL as a related company or not.

(ii) That it had been stated in *C: SARS v Capstone 556* (*Pty*) *Ltd* that a commercial meaning should be given to statutory concepts and in that matter the remarks of Lord Hoffmann in *MacNiven* (*Inspector of Taxes*) v *Westmoreland Investments Ltd* [2001] 1 All ER 865 at para 32 to the effect that statutory language was intended to refer to commercial concepts was approved.

(iii) That the commercial transaction in the current matter arose within the context of an agreed funding arrangement between the taxpayer and KL as group companies, confirmed by the taxpayer's witnesses and the legitimacy of this agreement could not be called into question.

(iv) That, given this funding arrangement, had KL's loan account not been credited in the manner it was, KL would have been required to advance funds to the taxpayer in order for its own invoice to be settled. KL could not have sued the taxpayer for a cash payment of the invoice, nor could it have claimed the amount in question as a bad debt for VAT or other tax

purposes given the funding arrangement in place. It followed that both KL and the taxpayer did not expect that KL would be paid in cash for the relevant supply, as was confirmed by the taxpayer's witnesses in evidence. What was rather contemplated was that the invoice would be settled by crediting the loan account of the holding company KL in the books of the taxpayer as its wholly-owned subsidiary.

(iv) That crediting the loan account did not however extinguish the taxpayer's liability to KL as what it did was to move the liability from a current one to a long-term liability in the books of the taxpayer and this distinguished what the taxpayer owed on loan account from what it had owed on the invoice.

(v) That the dispute turned on whether, in adjusting the liability to a long-term one, the taxpayer had complied with section 22(3)(*b*) of the Act insofar as it 'paid the full consideration in respect of such supply' which was the subject of the invoice it had received from KL.

(vi) That while none of the decisions referred to considered whether the crediting of a loan account in circumstances such as arose in this matter constituted payment of an invoice raised, it appeared to the court that, as in *CIR* v *Guiseppe Brollo Properties* (*Pty*) *Ltd* 56 SATC 47, the enquiry turned on the overriding purpose of the loan account liability incurred and the undisputed evidence for the taxpayer in this matter was that the purpose of the loan liability incurred was to discharge the invoice debt and the issue then was, with this being the purpose, whether the conversion of the liability from one arising from an invoice into a loan liability, constituted payment of consideration for purposes of section 22(3).

(vii) That in relation to the supply of goods and services to any person 'consideration' included 'any payment made or to be made' whether 'in money or otherwise, or any act or forbearance.' To the extent that payment amounted to the discharge of an obligation to another, there was no reason as to why an obligation under an invoice may not be discharged through the creation of another liability such as one under a loan. As much was accepted in *C: SARS* v *Scribante Construction* (*Pty*) *Ltd* 64 SATC 379 in which it was accepted that it was permissible for payment of a dividend

declared, at interest, to take the form of a credit to shareholders' loan accounts and the effect is to discharge one obligation through the creation of another.

(ix) That the court was not persuaded that it was a requirement of payment that there be an enrichment or impoverishment in the manner contemplated by Melunsky J in *ITC 1768* 66 SATC 151, although quite clearly there may exist distinct instances of gain and loss in the discharge of one liability and the creation of a different liability on the facts of any matter.

(x) That from the *Explanatory Memorandum* to the Taxation Laws Amendment Bill 1996 it was apparent that subsections (3), (4) and (5) were introduced into section 22 with a specific aim: what was intended by the inclusion of these subsections was to rectify the position in relation to irrecoverable debts and it was the prejudice to the *fiscus* which motivated the amendments in that it allowed the opportunity for deliberate manipulation by creating bad debts with a view to creating a tax benefit. It followed that the introduction of section 22(3) was aimed at preventing such deliberate manipulation and was not aimed at circumstances such as arose in the current matter, in order to bar an invoice from being considered paid through the creation of a loan account liability where a funding arrangement existed between group companies.

(xi) That on the facts before the court there had been no such deliberate manipulation in creating a bad debt with a view to creating a tax benefit either by the taxpayer or KL and the fact that in 2012 section 22(3A) had been introduced so as to provide expressly that subsection (3) would not be applicable in respect of a taxable supply made by a vendor which is a member of a group of companies, to another vendor which is a member of the same group of companies, supports the interpretation as to the purpose of section 22(3) as one aimed at deliberate manipulation and not one aimed at *bona fide* transactions between companies within a group in circumstances in which there was no loss to the *fiscus*.

(xii) That it followed therefore that the crediting of KL's loan account by the taxpayer in the context of the funding arrangement between the two

companies amounted to payment of 'consideration' in relation to the supply of goods and services invoiced. It was not required of KL to make a cash payment to the taxpayer in order to enable the taxpayer to settle the invoice with KL in cash, and had this occurred the conduct would have risked accusations of the 'round-trip financing' in section 80D of the Income Tax Act 58 of 1962 of which the legislature disapproved. Precisely the same outcome was achieved given the funding arrangements between the parties through the crediting of KL's loan account in the books of the taxpayer in circumstances in which there had been no deliberate manipulation.

(xiii) That the appeal should therefore succeed given that the jurisdictional fact required for the application of section 22(3), being non-payment of the consideration within twelve months, was not satisfied.

Appeal upheld with costs.

4. INTERPRETATION NOTES

4.1. VAT – The supply of goods or services by the travel and tourism industry – No. 42(Issue 2)

This Note provides guidance to local entrepreneurs in applying current VAT legislation to the supply of tour packages and related goods or services to non-resident tourists and foreign tour operators, with specific emphasis on the application of section 11(2)(*l*). It does not deal with the supply of hunting safari packages or other supplies made by professional hunters and taxidermists.

Most local entrepreneurs offer or assemble a marketable tour package comprising a range of services. These tour packages may be sold or assembled directly by the local entrepreneur to or on behalf of a non-resident tourist, or to or on behalf of a foreign tour operator, who may then on-sell the tour package to a non-resident tourist. The local entrepreneur profits by either adding a mark-up to the total cost of the tour package supplied or by receiving a commission for the service of assembling the tour package. As a result of the uncertainty that exists regarding the proper VAT treatment of goods or services supplied by local entrepreneurs, this

Note is intended to clarify the relevant principles to be applied in order to achieve consistency in the travel and tourism industry.

Local entrepreneurs acting as agent on behalf of a foreign tour operator or non-resident are only allowed to zero-rate the supply of arranging the tour for which a fee or commission is earned where the foreign tour operator or non-resident is situated outside of the Republic at the time the tour is arranged. Should the non-resident or foreign tour operator be present in the Republic when the services of the local entrepreneur are enlisted, the services supplied by the local entrepreneur must be standard-rated.

Tour packages and the components that make up a tour such as accommodation, transport, sightseeing and other goods or services supplied by a local entrepreneur as principal to non-residents or foreign tour operators are subject to VAT at the standard rate, unless the supply is exempt under section 12 or is for example, international flights that is subject to VAT at the zero rate.

The zero-rating of any supplies made by the local entrepreneur is subject to the local entrepreneur retaining the supporting documentary evidence as is acceptable to the Commissioner. This is set out in Interpretation Note 31 (Issue 3).

4.2. Contingent Liabilities assumed in the acquisition of a going concern – No. 94

This Note sets out the income tax implications for the seller and purchaser when the purchase price of assets acquired as part of a going concern is settled or partly settled by the assumption of contingent liabilities.

The expression 'sale of a business as a going concern' is generally used to refer to the circumstances in which a person sells all or a part of a business which is capable of separate operation and constitutes an income-earning activity in its own right at the date of sale. The nature of the particular business will dictate the assets which need to be transferred in order to ensure that the business (or part of it) is capable of operating in its own right.

A business, generally speaking, does not need to be transferred with any liabilities

in order to be able to operate as an income-earning operation in its own right. Liabilities may, however, need to be transferred for legal reasons (for example, a requirement under environmental laws) or commercial reasons (negotiated between the parties). The nature of the liabilities transferred or taken over could be absolute and unconditional (for example, trade creditors or loan obligations) or conditional (for example, leave pay provisions, bonus provisions, post-retirement medical aid provisions and warranty provisions).

The sale of a business as a going concern can be structured in a variety of ways. The purchase price is often settled by the purchaser through a combination of a cash payment to the seller, the undertaking to settle specified debts on behalf of the seller, the assumption of specified contingent liabilities (that is, the undertaking to settle a seller's contingent liabilities if and when the contingent liabilities materialise), a loan account and the issue of shares (when the purchaser is a company). This Note considers the income tax implications for the seller and purchaser when a portion of the purchase price is settled by the purchaser assuming the seller's contingent liabilities.

In summary, when the seller disposes of a business as a going concern and the purchase price of the assets disposed of is partly settled by the purchaser assuming a free-standing contingent liability:

- the seller must include the agreed value of the free-standing contingent liability assumed by the purchaser in gross income and proceeds (as appropriate);
- the seller does not incur expenditure in relation to the assumption of the free-standing contingent liability by the purchaser and is not entitled to a deduction;
- the purchaser will incur expenditure only if the free-standing contingent liability materialises and the purchaser is required to incur expenditure in settling the liability at that time; and
- in the purchaser's hands the assumption of the free-standing contingent liability relates to the assets acquired and any deduction must be determined with reference to the deduction and allowance provisions which

> apply to the particular assets whose purchase price was settled or partly settled by the assumption of the free-standing contingent liability.

Embedded obligations and valuation provisions depress the value of the asset and do not represent an additional amount of proceeds.

4.3. Deductions – Corrupt activities fines and penalties – No. 54 (Issue 2)

Section 23(*o*) prohibits the deduction for income tax purposes of expenditure incurred in respect of:

- corruption or a corrupt activity; or
- a fine or penalty imposed as a result of an unlawful activity.

This Note examines the meaning and scope of section 23(*o*).

Corruption and corrupt activities hamper democratic processes, good governance, sustainable development and fair business practices. According to its long title, the PCCA Act provides, amongst others, for:

> 'the strengthening of measures to prevent and combat corruption and corrupt activities; … [and] for the offence of corruption and offences relating to corrupt activities.'

Its preamble notes, amongst others, the following:

- The Constitution enshrines the rights of all people in the Republic and affirms the democratic values of human dignity, equality and freedom.
- The Constitution places a duty on the State to respect, protect, promote and fulfil all the rights as enshrined in the Bill of Rights.
- Corruption and related corrupt activities undermine those rights, endanger the stability and security of societies, undermine the institutions and values of democracy and ethical values and morality, jeopardise sustainable development, the rule of law and the credibility of governments, and provide a breeding ground for organised crime.

- The illicit acquisition of personal wealth can be particularly damaging to democratic institutions, national economies, ethical values and the rule of law.
- There are links between corrupt activities and other forms of crime, in particular organised crime and economic crime, including money-laundering.
- Corruption is a transnational phenomenon that crosses national borders and affects all societies and economies, and is equally destructive and reprehensible within both the public and private spheres of life, so that regional and international cooperation is essential to prevent and control corruption and related corrupt activities.
- A comprehensive, integrated and multidisciplinary approach is required to prevent and combat corruption and related corrupt activities efficiently and effectively.
- It is the responsibility of all States to prevent and combat corruption and related corrupt activities, and this requires mutual cooperation.
- The United Nations has adopted various resolutions condemning all corrupt practices, and urged member states to take effective and concrete action to combat all forms of corruption and related corrupt practices.
- The Southern African Development Community Protocol against Corruption, adopted on 14 August 2001 in Malawi, reaffirmed the need to eliminate the scourges of corruption through the adoption of effective preventive and deterrent measures and by strictly enforcing legislation against all types of corruption.
- The Republic of South Africa desires to be in compliance with and to become Party to the United Nations Convention against Corruption adopted by the General Assembly of the United Nations on 31 October 2003.1
- It is desirable to unbundle the crime of corruption in terms of which, in addition to the creation of a general, broad and all-encompassing offence of corruption, various specific corrupt activities are criminalised.

The Organisation for Economic Co-operation and Development (OECD) 1996 Recommendation on the Tax Deductibility of Bribes to Foreign Public Officials sought to put an end to the claiming of bribes paid to foreign public officials as tax-deductible expenses. Many countries (including South Africa) have gone one step further and have prohibited the deductibility of all bribes, irrespective of the identity or status of the recipient.

Section 23(*o*) was introduced into the Act by section 28(1)(*e*) of the Revenue Laws Amendment Act 31 of 2005 with effect from 1 January 2006. It applies to any year of assessment commencing on or after that date.

Before the introduction of section 23(*o*), the Act did not specifically address the non-deductibility of expenses incurred on bribes or fines resulting from unlawful activities, and the matter had to be considered under the general deduction formula [section 11(*a*) taking into account section 23(*g*)]. A notable exception is section 23(*d*) that prohibits the deduction of:

> 'any tax imposed under this Act or interest or penalty imposed under any other Act administered by the Commissioner;'.

Some commentators argued that bribes, fines and penalties actually incurred in the course of carrying on a trade were deductible for income tax purposes if they were an inevitable concomitant of the trade of the taxpayer. On that basis the nature of the payment itself was relevant only to the question whether, in the circumstances, the expense could be said to have been actually incurred in the course of a trade and in the production of the taxpayer's income. The issue as to whether the amount is prohibited as a deduction under section 23(*o*) does not arise if an expense does not pass the positive test in section 11(*a*).

In ITC 1490 a cartage contractor sought to claim a deduction for traffic fines under section 11(*a*). The court held that to allow the fines as a deduction would be contrary to public policy, frustrating the legislative intent and allow a punishment imposed to be diminished or lightened. The court added that the fines did not play any actual part in the earning of the income and were not an inevitable concomitant of the business of a cartage contractor.

Although the court in the above case and in a number of others found in favour of

the *fiscus*, it was considered desirable to introduce a specific legislative provision barring the deduction of fines and penalties as a matter of good governance and to reinforce South Africa's anti-corruption drive. From a policy perspective the deduction for income tax purposes of fines and penalties relating to unlawful activities cannot be justified. The granting of a deduction for fines and penalties would reduce the burden of the penalty or fine and be contrary to the rationale of the law under which it is imposed.

Section 23(*o*) is solely concerned with expenditure. It is not concerned with whether income has been derived by a taxpayer through legal or illegal means.

Section 23(*o*) has put it beyond doubt that corrupt payments such as bribes, fines and penalties for unlawful activities are not deductible for income tax purposes. However, the deductibility of bona fide commercial penalties remains unaffected by the provision. Such commercial penalties are subject to the normal tests for deductibility under the general deduction formula.

4.4. Exemption from income tax: Foreign employment income – No. 16 (Issue 2)

This Note discusses the interpretation and application of the foreign employment remuneration exemption in section 10(1)(*o*)(ii).

The requirements to qualify for the exemption, which are set out in section 10(1)(*o*)(ii), are discussed in this Note. The correct method of apportionment is also examined, as well as how the exemption affects gains included in income upon the vesting of any equity instrument under section 8C.

The terms of tax treaties vary from treaty to treaty, and so the possible effects of tax treaties are not discussed in this Note.

4.5. Trading stock: Assets not used as trading stock – No. 11 (Issue 4)

This Note provides guidance on the application and interpretation of paragraph (*j*A) and its interaction with other provisions of the Act.

Taxpayers sometimes manufacture capital assets for use in their businesses which are similar to the trading stock which they manufacture for resale. The treatment of the amount received or accrued on disposal of such manufactured capital assets was the subject of a dispute between SARS and the taxpayer in *C: SARS v Volkswagen of South Africa (Pty) Ltd.* The taxpayer in that case manufactured motor vehicles for sale to the public but also manufactured vehicles for its own use which it used for some time and then sold. SARS argued that the proceeds on disposal of the latter vehicles was of a revenue nature. However, the court disagreed, holding that the amount derived from the disposal of these vehicles was of a capital nature.

As a result of the decision in the *Volkswagen* case, paragraph (*j*A) was inserted into the definition of 'gross income' in section 1(1). The effect of this deemed inclusion in gross income means that despite the amounts derived from the disposal of such assets being of a capital nature, they are deemed to be gross income and the assets remain trading stock until disposed of.

Any amount received by or accrued to a taxpayer from the disposal of a paragraph (*j*A) asset used as a capital asset on or after 12 December 2001 must be included in the taxpayer's gross income. This inclusion in gross income means that a paragraph (*j*A) asset constitutes 'trading stock' as defined in section 1(1) and section 22 will therefore apply.

In order to avoid double taxation, amounts included in paragraph (*j*A) are specifically excluded from inclusion in income under section 8(4)(*a*) and 22(8)(*b*)(iv).

The deductibility of costs associated with paragraph (*j*A) assets will be considered under section 11(*a*) read with section 23(*g*). No capital allowances can therefore be claimed for these assets

4.6. Trading stock: Inclusion in income when applied, distributed or disposed of otherwise than in the ordinary course of

trade – No. 65 (Issue 3)

This Note provides guidance on the application and interpretation of section 22(8) which deems an amount to be included in income when trading stock is applied, distributed or disposed of in specified circumstances, otherwise than by sale at market value in the ordinary course of trade.

The cost of acquisition of trading stock should in principle not be deductible if it is:

- withdrawn for private consumption;
- donated;
- sold otherwise than in the ordinary course of the taxpayer's trade for less than its market value; or
- distributed *in specie* to a holder of shares.

A deduction results from these events because there would be no inclusion in income of closing stock while the cost price would have been allowed as a deduction.

In these circumstances the purpose of the expenditure has changed to one that is not productive of income. Section 22(8) accordingly provides for a deemed inclusion in the taxpayer's income. The amount of the inclusion (for example, at cost, written-down value or market value) will depend on the manner in which the trading stock has been applied, distributed or disposed of.

Section 22(8) deems an amount to be included in a taxpayer's income when trading stock is:

- applied for private or domestic use or consumption;
- donated;
- disposed of otherwise than in the ordinary course of trade for a consideration less than its market value;
- distributed *in specie* by a company;
- used or consumed in the course of trade or disposed of at market value otherwise than in the ordinary course of trade; or

- no longer held as trading stock.

The amount to be included in income is, in the case of trading stock:

- applied for private or domestic use or consumption, its cost price or written-down value, or if the cost price cannot be determined, the market value;
- donated to an approved public benefit organisation or other qualifying entity referred to in section 18A, the value taken into account under section 22; or
- in any other case, the market value.

Consideration received for trading stock which is less than its market value is excluded from section 22(8) because the amount would already be included in gross income.

A taxpayer using or consuming trading stock for the purposes of trade is deemed to incur an amount of expenditure equal to the income inclusion under section 22(8) and may qualify for a tax deduction or allowance if the requirements of the relevant deduction or allowance provision are met.

Section 22(8) does not apply to:

- livestock or produce; or
- any assets the receipts or accruals from the disposal of which are included in gross income under paragraph (*j*A) of the definition of 'gross income'.

4.7. Circumstances in which certain amounts received or accrued from the disposal of shares are deemed to be of a capital nature – No. 43 (Issue 6)

This Note provides clarity on the interpretation and application of section 9C, which deems the amount derived from the disposal of certain shares held for a continuous period of at least three years to be of a capital nature.

The first step in determining a person's income tax liability on the disposal of shares is to determine whether the amount received or accrued is of a capital or revenue nature. Any amount received or accrued of a capital nature is specifically

excluded from a person's 'gross income' as defined in section 1(1) unless specifically included.

The distinction between capital and revenue is fundamental to the tax system, but neither concept has proved capable of a satisfactory definition in the Act. The question whether shares are held as trading stock or as an investment will to a large extent depend on the intention of the taxpayer.

Despite guidelines laid down by case law, the determination of whether the amount received or accrued on the disposal of a share falls on capital or revenue account is often a contentious matter which can lead to costly and protracted legal disputes. For a discussion on the capital *versus* revenue issue, see the *Tax Guide for Share Owners* (Issue 5) and the *Comprehensive Guide to Capital Gains Tax* (Issue 5).

While section 9C eliminates uncertainty over the capital nature of qualifying shares, it does not apply to all types of shares, nor does it apply to disposals of shares within three years of acquisition or returns of capital or foreign returns of capital received or accrued within that period. Accordingly, it does not provide absolute certainty on whether income tax or CGT should be levied in all circumstances.

Section 9C provides taxpayers with certainty that if they hold equity shares for at least three years, the gains and losses on disposal will be of a capital nature regardless of the intention with which the shares were originally acquired. Similarly, a return of capital or foreign return of capital will be regarded as being of a capital nature once the equity shares have been held for at least three years. Not all types of shares qualify under section 9C; for example, non-participating preference shares, shares in foreign companies (other than shares listed on a South African exchange) and participatory interests in portfolios of collective investment schemes in property fall outside section 9C. Its provisions are now mandatory and no election is required or even possible. The wider ambit of section 9C has necessitated the inclusion of a number of anti-avoidance measures. The capital or revenue nature of shares disposed of within three years of acquisition will continue to be determined according to principles laid down by case law.

Section 9C came into operation on 1 October 2007 and applies to the disposal of qualifying shares on or after that date.

4.8. VAT treatment of public authorities and grants – No. 39 (Issue 2)

This Note deals with the VAT treatment of public authorities and grants. In particular, it explains the policy framework within which the law operates and the impact of the amendments in this regard which came into effect on 1 April 2005, especially the following:

- The application of the zero rate under sections 11(2)(*n*), 11(2)(*t*), 11(2)(*u*) and 11(1)(*r*) which deal with certain payments made by or to public authorities, constitutional institutions and municipalities.
- The application of the deeming provisions under sections 8(5) and 8(5A) in respect of certain supplies and payments made by or to public authorities, designated entities and municipalities.
- Distinguishing between a receipt or payment constituting consideration for an actual supply of goods or services which is taxable at the standard rate and the receipt or payment of an unrequited amount being a 'grant'.
- Determining whether or not an entity is a 'public authority', and consequently, whether that entity must register and account for VAT.
- Determining whether certain input tax and output tax adjustments apply to public authorities.

In general, this Note aims to explain the VAT status of public authorities (government departments listed in the PSA and other quasi-government entities listed in the PFMA) and the VAT implications of different transactions that may be concluded between such entities and vendors, including the payment of grants.

The VAT treatment of public authorities and grants can be summarised as follows with effect from 1 April 2005:

- The definition of 'public authority' was amended to include all the government departments listed in Schedules 1, 2 and 3 of the PSA, as well as the public entities listed in Schedules 3A and 3C of the PFMA. The

definition excludes constitutional institutions and business orientated public entities (listed in Schedules 1, 2, 3B and 3D of the PFMA).

- PFMA entities listed in Schedules 1, 3A and 3C which registered for VAT before 1 April 2005, were required to deregister for VAT (unless they were notified as required under paragraph (*b*)(i) of the definition of 'enterprise'). Relief from the output tax which would otherwise have been payable upon deregistration under section 8(2) was provided to these entities. (Proviso (iv) to section 8(2).)
- SARS may not retrospectively register any public entity listed in Schedules 1, 3A and 3C of the PFMA which failed to register before 1 April 2005. Such entities were therefore not liable to account for any output tax, nor could they claim any refund in respect of any period before 1 April 2005. (Proviso to section 23(4).)
- Section 40A was introduced to provide a relief mechanism for a public authority or public entity listed in Schedules 1, 3A or 3C of the PFMA that was registered for VAT before 1 April 2005, but incorrectly treated a payment as a zero-rated 'transfer payment' before that date if it was assessed for that liability. SARS was also prevented from raising an assessment in respect of those incorrectly treated payments. Section 40A was subsequently deleted as the issues addressed in the provision have prescribed.
- The definition of 'transfer payment' as well as section 11(2)(*p*) that zero-rated the receipt of those payments were both deleted. The definition of 'transfer payment' was replaced with the definition of 'grant' to provide more certainty as to which payments (appropriations or subsidies) from government qualify for zero-rated tax treatment.
- Grants to vendors (other than designated entities) are zero-rated under sections 8(5A) and 11(2)(*t*). This includes a gratuitous payment by a municipality to a private vendor (other than a designated entity, which is not a welfare organisation) provided the payment is truly gratuitous as contemplated in section 67 of the MFMA and has not been incorrectly classified as such. Examples of designated entities are business entities

listed in Schedules 2, 3B and 3D of the PFMA, entities listed in Schedules 3A and 3C of the PFMA that have been notified to register by the Commissioner, and municipal entities.

- Payments made by the Department of Human Settlements to vendors including municipalities) under a national housing programme do not qualify as zero-rated grants. The potential zero-rating of such payments must be considered under sections 8(23) and 11(2)(*s*).
- An appropriation in terms of the DOR Act such as a 'municipal infrastructure grant' or 'equitable share' also qualifies as a zero-rated 'grant', unless the recipient is a 'designated entity' (not being a welfare organisation).
- A 'grant' excludes procurement and other methods of acquiring goods and services by constitutional institutions, public authorities and municipalities (that is, the payment must not constitute consideration paid in respect of the actual supply of goods or services under section 7(1)(*a*) to the entity making the payment, or for a specific taxable supply by the recipient to a third party).
- Section 8(5) was amended so that it now only applies to a 'designated entity'. Payments made to designated entities, which are for enterprise purposes, generally attract VAT at the standard rate.
- Designated entities may only zero rate payments from constitutional institutions, public authorities or municipalities when:
    - the amount is a grant for training employees (SETA grants received), or
    - the recipient is a 'welfare organisation' and the funds are for the purposes of carrying out 'welfare activities' for the benefit of persons other than the person making the payment.

5. DRAFT INTERPRETATION NOTES

5.1. Deductions in respect of scientific or technological research

and development

This Note provides guidance on the interpretation and application of section 11D, which contains an incentive to taxpayers carrying on R&D. Amendments to legislation up to 1 January 2015 are taken into account for purposes of this Note.

Section 11D was introduced in 2006 to encourage private-sector investment in R&D undertaken within the Republic.

Although the section has undergone many significant changes since its introduction, its purpose remains the same. Important changes introduced from 1 October 2012 are the pre-approval process administered by the DST, the appointment of a Committee and the extension of the mandate of the Committee as discussed in this Note.

Another fundamental change is that the deduction for capital expenditure incurred on any building, machinery, plant, utensil or article used for R&D purposes has been moved from section 11D to sections 12C and 13.

A deduction for R&D expenditure incurred before 1 October 2012 must be sought under section 11D before its amendment. For this purpose, Interpretation Note 50 dated 28 August 2009 is still relevant.

The information contained in this Note provides broad principles in interpreting the legislation pertaining to the deduction for scientific or technological R&D. As the facts and circumstances pertaining to specific R&D activities or projects differ, each case must be considered on its own merits.

The deduction of the 150% deduction is subject to the requirements of section 11D(1).The onus is on the applicant to prove to the Minister that it complies with the requirements of section 11D.

The R&D tax incentive is a privilege granted to taxpayers undertaking R&D and the legislation regulating this incentive will be applied strictly and narrowly in order to ensure effective administration of the incentive.

The approval of any R&D application is the responsibility of the Minister. It remains the responsibility of the Commissioner to verify whether the deductions incurred are directly and solely for purposes of the approved R&D.

A withdrawal of an approval by the Minister will result in a recoupment of expenditure already claimed and allowed under section 11D(2) irrespective of the prescription periods under the TA Act.

5.2. Connected persons

This Note provides guidance on the interpretation and application of the definition of 'connected person' in section 1(1).

Section 1(1) of the Value-Added Tax Act 89 of 1991 contains a definition of 'connected persons'. Apart from the fact that the term is defined in the plural, there are a number of other significant differences between the value-added tax definition and the income tax definition. For example, the value-added tax definition includes the estates of deceased and insolvent persons, a partnership and in specified circumstances a branch or division of a person, while the income tax definition does not. Although the two definitions share some common features, this Note focuses on the income tax definition only and should not be relied on for purposes of interpreting the value-added tax definition.

Section 1 of the TA Act defines 'connected person' as meaning 'a connected person as defined in section 1 of the Income Tax Act'.

The Income Tax Act 113 of 1993 introduced the definition of 'connected person' into section 1. This definition is central to specific anti-avoidance provisions that regulate the tax consequences of transactions entered into between related taxpayers. Such related-party transactions are more likely to be open to manipulation in order to secure a fiscal advantage than transactions entered into between unconnected parties, hence the need for specific rules to deal with connected persons.

The definition of 'connected person' in section 1(1) identifies those persons that are connected persons in relation to the following persons:

- A natural person
- A trust
- A connected person in relation to a trust

- A member of a partnership or foreign partnership
- A company
- A close corporation

The definition of 'connected person' also establishes the reverse relationship between the persons that are connected persons in relation to the above persons.

For purposes of paragraphs (*a*)(ii), (*b*), (*b*A) and (*d*)(vi)(*bb*) a portfolio of a collective investment scheme is excluded from a trust.

For the purposes of the definition of 'connected person', a portfolio of a collective investment scheme in securities is treated as a company. Paragraph (*d*) must be applied to determine if a person is a connected person in relation to a portfolio of a collective investment scheme in securities.

A portfolio of a collective investment scheme in property is included in the definition of 'company' as defined in section 1(1) if it qualifies as a REIT as defined in paragraph 13.1 (x) of the JSE Limited Listings Requirements. In determining whether a particular person is a connected person in relation to a REIT, paragraph (*d*) must be considered.

A deceased estate is deemed to be a natural person under section 25(5) except for the purposes of the rebates under sections 6, 6A and 6B. Under paragraph 40(3) of the Eighth Schedule, the disposal of an asset by the deceased estate of a natural person is treated in the same manner as if that asset had been disposed of by that natural person. Thus, for the purposes of the Eighth Schedule, the disposal of an asset by the deceased estate to a relative of the deceased person would be treated as a disposal to a connected person in relation to the deceased estate.

Under paragraph 83 of the Eighth Schedule, the disposal of an asset by the insolvent estate of a person whose estate was sequestrated must be treated in the same manner as if that asset had been disposed of by that person. Thus, for the purposes of the Eighth Schedule, the disposal of an asset by the insolvent estate to a connected person in relation to the natural person whose estate was sequestrated, will be treated as a disposal between connected persons.

A deceased or insolvent estate would be a connected person in relation to a trust

under paragraph (*b*)(i) if it was a beneficiary of that trust, making the trust a connected person in relation to the deceased or insolvent estate under paragraph (*e*). Other beneficiaries of the trust and the deceased or insolvent estate would be connected persons in relation to one another under paragraph (*b*A). A deceased or insolvent estate could be a connected person in relation to a company or a close corporation under paragraph (*d*)(iv) and (vi), making the company or close corporation a connected person in relation to the deceased or insolvent estate under paragraph (*e*).

The holders of shares in a company are not connected persons in relation to one another by virtue of their holding of shares but may be connected through another relationship which would bring them within one of the paragraphs of the definition of connected person.

The wording of a particular provision of the Act will determine the time at which the existence of any 'connected person' relationship must be determined. It will also determine whether an expanded or restricted meaning of the term as defined in section 1(1) must be applied.

5.3. Classification of risk policy and the once-off election to transfer certain policies or classes of policies issued before 2016 to the risk policy fund

This Note provides guidance on:

- the interpretation and application of the definition of 'risk policy' in section 29A(1); and
- the once-off election by an insurer to transfer certain policies or classes of policies issued before 1 January 2016 to the risk policy fund under section 29A(13B).

The taxable income derived by any insurer in respect of any year of assessment must be determined in accordance with the Act, but subject to sections 29A and 29B.

Every insurer is required to establish five separate funds and to maintain such funds. These funds form the foundation for the operation of section 29A as a whole. The taxable income derived by an insurer in respect of the untaxed policyholder fund, the individual policyholder fund, the company policyholder fund, the corporate fund and the risk policy fund must be determined separately in accordance with the Act as if each such fund had been a separate taxpayer.

The risk policy fund was introduced as one of the five funds because of concerns that the taxation of insurers under the previous four funds did not distinguish between investment and risk business. In practice, a risk policy will pay out a specified cash amount on the happening of an event regardless of the amount of investment income earned during the term of the policy. This could result in a loss in respect of a specific policy. Section 29A was thus amended to provide that risk policies be taxed in the risk policy fund.

Some insurers requested guidance relating to which policies issued on or after 1 January 2016 can be classified as risk policies. The once-off election by an insurer to transfer qualifying policies or classes of policies to the risk policy fund also needs clarification.

The risk policy fund has been introduced as a fifth fund for insurers to distinguish between investment and risk business. Any policy issued by an insurer during any year of assessment commencing on or after 1 January 2016 meeting the requirements of the definition of 'risk policy' must be allocated to the risk policy fund.

An insurer has a once-off election to transfer all policies or one or more classes of policies issued before 1 January 2016 to the risk policy fund if those policies or classes of policies meet the necessary requirements.

5.4. Exemption from income tax: Remuneration derived by a person as an officer or crew member of a South African ship

This Note provides guidance on the circumstances under which section 10(1)(*o*)(iA) exempts the remuneration, derived by a person as an officer or crew member of a South African ship, from normal tax.

Section 12Q was inserted into the Act on 1 April 2014 and applies to years of assessment commencing on or after that date. The amendment came about as part of a new tax regime that provides tax relief for South African shipping companies. The purpose of the amendments was to encourage ships to carry the South African flag by making South Africa more competitive internationally. Various exemptions from normal tax, capital gains tax, dividends tax as well as cross-border withholding tax on interest, were introduced.

Section 10(1)(*o*)(iA) was introduced simultaneously, to exempt any form of remuneration received by or accrued to any officer or crew member of a South African ship, which is mainly engaged in international shipping or fishing outside the Republic, regardless of the period or periods spent abroad. Amounts qualifying for exemption will not form part of remuneration, and would thus not be subject to the deduction or withholding of employees' tax.

The issue of double taxation and the application of various double tax treaties are not discussed in this Note, since the application of double taxation varies from treaty to treaty.

The remuneration of officers or crew members of a South African ship mainly engaged in 'international shipping' as defined in section 12Q(1), or a South African ship mainly engaged in fishing outside the Republic, is exempt from taxation.

In certain circumstances, the remuneration of officers or crew members may not qualify for the exemption in section 10(1)(*o*)(iA). It may, however, be possible that the remuneration of these officers or crew members qualify for the exemption under section 10(1)(*o*)(i) or 10(1)(*o*)(ii).

5.5. Loss on disposal of depreciable assets

This Note gives guidance on the interpretation and application of section 11(*o*), which grants a deduction for a loss on disposal of a qualifying depreciable asset as a result of alienation, loss or destruction.

Section 11(*o*) provides for the deduction of an allowance on the alienation, loss or destruction of an asset used by a taxpayer in the carrying on of a trade. The

allowance is subject to the following requirements:

- the taxpayer must make an election to claim the allowance as a revenue loss;
- the asset must be a qualifying asset, that is, it must have qualified for an allowance or deduction under specified sections of the Act;
- the expected useful life of the asset must not exceed 10 years as determined on the date of the original acquisition of the asset; and
- the cost of the asset must exceed the sum of any amount received or accrued from the alienation, loss or destruction of the asset and the amount of any allowance or deduction claimed or claimable against the asset.

A taxpayer may elect to claim a deduction under section 11(*o*) for the alienation, loss or destruction of a qualifying depreciable asset if the expected useful life of the asset does not exceed 10 years. An apportionment will be required to the extent the section 11(*o*) allowance was not incurred in the course of the taxpayer's trade.

If a taxpayer is entitled to but does not elect to claim a deduction under section 11(*o*), a capital loss will be determined under the Eighth Schedule.

The amount of the section 11(*o*) allowance is generally equal to the excess of the cost of the asset over the sum of any amount received or accrued from the alienation, loss or destruction of the asset and the amount of any allowance or deduction claimed or claimable against the asset. Otherwise stated, the section 11(*o*) allowance is equal to the amount by which the consideration received or accrued on disposal of the asset is less than its tax value. Tax value for this purpose means the actual cost of the asset (as opposed to the value of the asset) less the qualifying capital allowances.

Depending on the facts of the case, certain restrictions may apply to the determination of proceeds, cost or the amount of the section 11(*o*) allowance itself.

5.6. Withholding tax on royalties

This Note provides guidance on the interpretation and application of sections 49A

to 49H which relate to withholding tax on royalties.

The withholding tax on royalties applies to royalties paid by a resident to a non-resident for the use of intellectual property belonging to the non-resident. Like other withholding taxes, withholding taxes on royalties can potentially be reduced or eliminated by a tax treaty between the states of the contracting parties.

The withholding tax on royalties was previously contained in section 35, which provided for a withholding rate of 12%. Owing to the need for uniformity between the different types of withholding taxes, the withholding regimes were amended. Section 35 was accordingly repealed1 and replaced with sections 49A to 49H with effect from 1 July 2013. The withholding rate was increased to 15% with effect from 1 January 2015.

Sections 49A to 49H deal with the withholding tax on royalties. In essence a royalty is an amount received or accrued for the use of intellectual property as defined in section 23I or for the imparting of scientific, technical, industrial or commercial knowledge or information as well as the rendering of assistance or service in connection with the application or use of such knowledge or information. A foreign person who receives or to whom an amount accrues in the form of a royalty is liable for the payment of a withholding tax on the royalty. The person paying the royalty is, however, obliged to withhold the tax.

For royalties paid or which became due and payable on or after 1 July 2013 but before 1 January 2015, the withholding tax was required to be calculated at a rate of 12% of the amount of royalties paid. For all royalties that are paid or become due and payable on or after 1 January 2015, the withholding tax must be calculated at a rate of 15% of the amount of royalties paid.

Provision is also made for an exemption from withholding tax as well as a refund of the tax to the foreign person. If the royalty is exempt or a reduced rate applies owing to the application of a tax treaty, the foreign person is obliged to submit a declaration form to the person making payment of the royalty within a prescribed period.

5.7. Section 24I – Gains or losses on foreign exchange

transactions

This Note provides guidance on the interpretation and application of section 24I. Section 24deals with the income tax treatment of foreign exchange gains and losses on exchange items as well as premiums or like consideration received or paid in respect of FCOCs entered into and any consideration paid in respect of an FCOC acquired by certain persons.

The tax treatment of transactions denominated in a foreign currency often requires a consideration of section 24I and other provisions of the Act. This Note identifies some of the situations in which one or more of these provisions may apply. For example, if trading stock, the purchase price of which is denominated in USD, is purchased on credit from a supplier, the provisions of section 25D and section 24I are relevant.

This Note withdraws and replaces Practice Note 4 dated 8 March 1999 'Income Tax: The Treatment of Gains and Losses on Foreign Exchange Transactions in terms of section 24I of the Income Tax Act.

The amendments in the Taxation Laws Amendment Act 15 of 2016 are included in this Note.

Section 24I governs the income tax treatment of foreign exchange gains and losses on exchange items as well as premiums or like consideration received or paid in respect of FCOCs entered into and any consideration paid in respect of an FCOC acquired by specified persons.

Although the application of the section is limited to those persons listed in section 24I(2), the ambit of section 24I(2) is wide which results in the section being applicable to a large number of persons and transactions.

Under section 24I, exchange differences calculated for a year of assessment are generally included in or deducted from income whether realised or not and whether of a capital or revenue nature. The legislation was drafted in this manner in line with the view that gains and losses on foreign exchange transactions largely represent finance charges and as a result must be brought to account on a revenue basis for tax purposes at the end of a year of assessment even if not realised.

There are limited circumstances in which the inclusion of a foreign exchange gain or loss calculated in respect of an exchange item in a particular year of assessment is deferred and recognised in a later year of assessment.

Section 24I(3) provides for an inclusion in or deduction from income of an exchange difference on an exchange item as well as any premium or like consideration received by or paid by a person under an FCOC entered into by that person or any consideration paid for an FCOC acquired by a person. The term 'exchange item' of or in relation to a person means an amount in a foreign currency:

- which constitutes any unit of currency acquired and not disposed of by that person;
- owing by or to that person on a debt incurred by or payable to such person;
- owed by or to that person in respect of an FEC; or
- when that person has the right or contingent obligation to buy or sell that amount under an FCOC.

Section 24I applies to the following persons indicated in section 24I(2):

- Any company.
- Any trust carrying on any trade.
- Any natural person who holds any amount in a foreign currency which constitutes a unit of currency, or which is owing to that person on a debt payable to that person, as trading stock.
- Any natural person or trust in respect of any amount in foreign currency –
    - owed by or to that person in respect of an FEC; or
    - when that person has the right or contingent obligation to buy or sell that amount under an FCOC.
- Any of the persons referred to above that are non-resident in relation to an exchange item that is attributable to a permanent establishment of that person in the Republic.

- Any CFC for purposes of determining its net income under section 9D(2A) that must be included in the income of persons that are residents under section 9D(2).

An exchange difference is determined on each exchange item for the year of assessment in which such exchange item arose and every subsequent year of assessment until and including the year of assessment in which such exchange item is realised.

The exchange difference for a specific year of assessment is determined by multiplying the foreign currency amount of the exchange item by the difference between the ruling exchange rate on the commencement date in that year of assessment and the ruling exchange rate on the final date in that year of assessment.

Section 24I(4) provides that, subject to section 11, to the extent that a debt owing to a person has become bad, the amount of any foreign exchange gain relating to that debt that is or was included in the income of a person in the current or any previous year of assessment must be deducted from the income of that person, and the amount of any foreign exchange loss relating to that debt that is or was deducted from the income of that person in the current or any previous year of assessment must be included in the income of that person.

Section 24I(6) prohibits the deduction from or inclusion in income of an amount referred to in section 24I(3) under any other provision of the Act.

Section 24I(7) provides for the carry-forward of the inclusion in, or deduction from, a person's income of certain exchange differences and premiums or other consideration which arose or were paid or became payable in a year of assessment before the year of assessment during which the assets referred to in section 24I(7)(*a*) were or are brought into use for the purposes of the person's trade. The foreign exchange gain or loss is generally carried forward to the year of assessment in which the assets to which they relate are brought into use for purposes of that person's trade. In certain circumstances the carried forward exchange difference may be recognised in a year of assessment before the year of assessment in which the relevant asset is brought into use. Special rules apply to mining assets.

Section 24I(8) provides that any foreign exchange loss sustained on a transaction entered into by a person, or any premium or other consideration paid in respect of or under an FCOC entered into or acquired by a person, shall not be allowed as a deduction from such person's income under section 24I(3), if the transaction was entered into or the FCOC was entered into or acquired solely or mainly to enjoy a reduction in tax as a result of a deduction from income.

Under section 24I(10A)(*a*) an exchange difference arising during any year of assessment in respect of an amount in a foreign currency owing by or to a person on a debt shall not be included in or deducted from the income of that person if at the end of that year of assessment that person and the other party to the contractual provisions of the debt form part of the same group of companies or are connected persons in relation to each other and if certain requirements are met.

Section 24I(12) determines that when a person holds any exchange item and section 24I at any time during a year of assessment:

- becomes applicable to that person, that exchange item shall be deemed to have been acquired at that time for the purposes of section 24I; or
- ceases to apply to that person, that exchange item shall be deemed to have been realised at that time for the purposes of section 24I.

In applying section 24I, regard must be had to other provisions of the Act, amongst others, the definition of 'trading stock' in section 1(1), sections 3(4)(*b*), 6*quat*, 8(4)(*a*), 9(2)(*l*), 9(4)(*e*), 9D, 11(*a*), 11(*i*), 11(*j*), 19, 20(2), 22(3)(*a*)(i), 24J and 25D, paragraphs 12A and 43 of the Eighth Schedule, and paragraph 4(1) of the Tenth Schedule.

5.8. Disposal of an enterprise or part thereof as a going concern

This Note sets out the:

- VAT implications regarding the supply of an enterprise disposed of as a going concern;
- requirements for zero-rating the supply of an enterprise disposed of as a going concern; and

- VAT treatment of the supply of goods or services used partly for carrying on the enterprise disposed of as a going concern and partly for other purposes.

A vendor making taxable supplies of goods or services in the course or furtherance of its enterprise, is required under section 7(1)(*a*) to levy VAT at the standard rate on these supplies. However, this levying of VAT is subject to the zero-rating provisions of section 11.

A vendor applying the zero-rate to a supply that does not comply with the requirements is liable for the tax, interest and penalties applicable to that supply.

6. BINDING PRIVATE RULINGS

6.1. BPR 256 – Mining rehabilitation

This ruling determines, amongst other things, the tax consequences resulting from the proposed rehabilitation of land that forms part of mining areas by way of a bio-energy project.

Unless otherwise indicated, in this ruling references to sections are to sections of the Income Tax Act or the Value-Added Tax Act applicable as at 28 November 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the provisions of:

- the Income Tax Act:
  - section 1(1) – the definition of 'gross income';
  - section 8(4)(*a*);
  - section 11(*a*); and
  - section 37A.
- the VAT Act:

- section 1(1) – the definition of 'enterprise';
- section 16;
- section 17; and
- section 20.

Parties to the proposed transaction

Company A: A mining company incorporated in and a resident of South Africa

Company B: A mining company incorporated in and a resident of South Africa

Trust B: A resident rehabilitation trust as contemplated by section 37A

Description of the proposed transaction

Company A and Company B propose to rehabilitate certain land that forms part of their mining areas by restoring it to a land use which they argue conforms to the generally accepted principles of sustainable development as contemplated in section 37A(1)(*a*). The companies propose to implement a bio-energy project that has land use aims endorsed by the Department of Minerals and Resources (DMR) (the bio-energy project).

The bio-energy project will be financed and implemented through the following transaction steps:

- Step 1: Amendment of Trust B's trust deed
  - Company A contributed funds for the rehabilitation of its mining areas to Trust A of which Company A is a beneficiary. Company A previously claimed deductions for those contributions made under the now repealed section 11(*hA*) and, thereafter, under section 37A. Financial provision for the rehabilitation of Company B's mining area was made in Trust B, of which Company B is a beneficiary.
  - Currently, Trust A is underfunded while Trust B is overfunded. The current assets in Trust B exceed its anticipated liabilities. Consequently, it is intended that the bio-energy project is to be funded by Trust B.
  - The DMR has approved that Company A has access to the

overfunding in Trust B. It is accepted as a fact that Company A may access the surplus fund in Trust B for the benefit of the beneficiaries of Trust A.

  - As a result of the DMR's approval, Trust B will amend its deed by adding Company A as a beneficiary of Trust B, whereafter the financial provision in Trust B will also be available to cover Company A's statutory rehabilitation obligations.

- Step 2: Conversion of plant on Company A's mining area
  - Company A will convert a redundant metallurgical plant on its mining area (plant) into a biogas anaerobic digestion plant to process crops and generate green biogas. Company A will incur the cost for the conversion of the plant.
  - Company A will, thereafter, be reimbursed for the costs incurred in converting the plant, once the DMR has audited and approved that the expenditure incurred by Company A was for closure rehabilitation work, and the trustees of Trust B have satisfied themselves that all payments to be made by Trust B to Company A will be for purposes of final closure rehabilitation. The reimbursement will be made from the surplus funds available in Trust B, in accordance with the approval obtained from the DMR.
- Step 3: Reclamation and levelling of Company B's tailings dam and planting of initial crops (initial phase)
  - Company B will restore land used for a tailings dam on its mining area to a state where it becomes suitable for the planting of crops and will, thereafter, plant and cultivate certain non-edible perennial crops (crops) on the rehabilitated tailings dam.
  - The costs incurred by Company B for the reclamation, levelling and preparation of the land for it to become suitable to grow crops will be part of Company B's closure rehabilitation and its statutory rehabilitation obligations in respect of its mining area.
  - Company B will incur the closure rehabilitation expenses, but will be

reimbursed by Trust B, once the DMR has audited and approved that the expenditure incurred by Company B was for closure rehabilitation work, and the trustees of Trust B have satisfied themselves that all payments to be made by Trust B to Company B will be for purposes of final closure rehabilitation. The reimbursement will be made from the funds in Trust B, in accordance with the approval obtained from the DMR.

- The crops, when harvested in the initial phase of the project, until the plant is fully operational, will be used as test feedstock for the plant. Company B will supply the harvested crops in the initial phase to Company A at no cost on the basis that the closure rehabilitation expenses will have been reimbursed by Trust B. These crops will be used as test crops during the conversion of the plant.

- Step 4: Growing and supply of crops after rehabilitation (post rehabilitation)
  - The approval by the DMR of the rehabilitation of the plant and Company B's land, once undertaken, will mark the end of the rehabilitation process and the commencement of normal business operations for the companies.
  - Company B will continue to grow and harvest crops on its land and sell those crops to Company A at cost.
- Step 5: Production of biogas after commissioning of the plant
  - Company A will acquire the crops from Company B to produce biogas.
  - This biogas will be supplied to Company B, at cost plus 5%, through a pipeline. Company B will in turn use the biogas to generate electricity to be applied directly in its mining operations.
  - The cost of the pipeline will be shared by Company A and Company B as follows:
    - Each party will be responsible for the cost of that portion of the pipeline that is to be built on its land.

- Company A will contract with the contractor who will build the pipeline. The contractor will invoice Company A for the cost of the entire pipeline.
- Company A will invoice Company B for the cost attributable to that portion of the pipeline that is built on Company B's land.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The adding of Company A as a beneficiary of Trust B will not result in any adverse tax consequences for the parties under section 37A(6), (7), or (8).
- The proposed amended trust deed of Trust B will comply with the provisions of section 37A.

Note: This ruling does not deal with the impact of the provisions of the Regulations pertaining to the Financial Provisions for Prospecting, Exploration, Mining or Production Operations, published under the National Environmental Management Act 107 of 1998, currently in force and with which the companies are required to comply as from 20 February 2019.

- Company A will not be entitled to claim a deduction on the costs to be incurred to rehabilitate the plant under section 11(*a*).
- The reimbursement by Trust B to Company A will not constitute 'gross income' for Company A as defined in section 1(1).
- The reimbursement by Trust B to Company A will not constitute a taxable recoupment for Company A under section 8(4)(*a*).
- Section 37A(7) will not apply to the costs to be incurred by Company B for the reclamation of the land, the levelling off of the ground, and the preparation of the land to plant crops, to the extent that the DMR approves

such costs as rehabilitation costs as contemplated in section 37A(1)(*a*).

- Section 37A(7) will not apply to the costs to be incurred by Company B for the planting of the first set of crops, to the extent that the DMR approves such costs as rehabilitation costs as contemplated in section 37A(1)(*a*).
- Company B will not be entitled to claim a deduction of the costs to be incurred for the reclamation, levelling and preparation of the tailings dam under section 11(*a*).
- Company B will not be entitled to claim a deduction of the costs to be incurred for the planting of the first set of crops during the initial phase under section 11(*a*).
- The reimbursement by Trust B to Company B will not constitute 'gross income' for Company B as defined in section 1(1).
- The reimbursement by Trust B to Company B will not constitute a taxable recoupment for Company B under section 8(4)(*a*).
- Company B will conduct a farming trade in relation to the costs to be incurred for the planting and harvesting of crops post rehabilitation.
- Company B will be entitled to claim a deduction from its mining income for the purchase price to be incurred to acquire the biogas under section 11(*a*).
- Company B will be entitled to claim a deduction from its farming income of the expenses to be incurred for the planting and harvesting of the crops post rehabilitation, subject to the provisions of the First Schedule to the Act.
- The amount to be received by Company B from Company A for the supply of crops post rehabilitation must be included in Company B's gross income derived from farming.
- Company A will conduct a separate non-mining trade in relation to the conversion of the crops to biogas post rehabilitation.
- Company A will be entitled to claim a deduction of the purchase price of the crops supplied by Company B at cost post rehabilitation under section 11(*a*).

- The income to be received by Company A from Company B for the supply of biogas will constitute gross income from a separate non-mining trade of Company A.
- Company A will be entitled to deduct input tax on the conversion of the plant and the building of the pipelines on its land to transport the biogas from the plant to Company B subject to complying with the provisions of sections 16, 17 and 20 of the VAT Act.
- Company B will be entitled to deduct input tax on the reclamation of the land, the levelling, preparation and restoration of the land to grow crops, the harvesting of these crops and the building of the pipelines on its land to transport the biogas from the plant to Company B subject to complying with the provisions of sections 16, 17 and 20 of the VAT Act.
- Trust A and Trust B are not regarded as conducting an 'enterprise' as defined in section 1(1) of the VAT Act.

6.2. BPR 257 – Islamic Financing Arrangement

This ruling determines the income tax consequences of an Islamic financing arrangement, known as a 'mudaraba' arrangement, for the parties.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 27 October 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 1(1) – definition of 'gross income';
- section 8F;
- section 8FA;
- section 11(*a*) read with section 23(*g*);
- section 19;

- section 24J;
- section 24JA;
- section 24JB;
- section 25B; and
- paragraph 12A.

Parties to the proposed transaction

The Applicant: An unlisted public company incorporated in and a resident of South Africa

The Trust: A vesting trust, to be established under the laws of South Africa

The Sukuk Certificate Holders: Members of the general public who will make capital contributions to the Trust and become its beneficiaries (the Class)

Description of the proposed transaction

The Applicant, in consultation with the Registrar of Banks, has resolved to proceed with an offer of a tier 2 capital instrument in the form of tier 2 certificates via a mudaraba arrangement.

Members of the general public will be invited to subscribe for sukuk certificates which will be issued by the Trust in terms of an investor subscription agreement.

The Trust will in turn subscribe for the tier 2 certificates which will be issued by the Applicant, as a mudaraba arrangement. These arrangements between all the parties to be involved are jointly referred to as a mudaraba sukuk.

The funds raised by the Applicant are to assist the Applicant to manage its capital adequacy requirements, as prescribed by the Registrar of Banks in terms of the Banks Act 94 of 1990, by Regulation 38(14) of the Regulations relating to Banks (published under Government Notice R1029 in *Government Gazette* 35950 of 12 December 2012). This is intended to allow the Applicant to expand its operations.

The funds to be raised from the issue of the tier 2 certificates will be invested in the

Applicant's general pool which will earn a profit from mudaraba arrangements, which essentially entail the joining of the skills of the Applicant with the funds of the Trust to earn a shared profit from the intended joint use of the skills and the funds. This return will be paid to the Trust and then onward, after accounting for the Trust's expenses, to the Class.

The proposed steps will be as follows:

- A vesting trust, (the Trust) will be established under the laws of South Africa.
- The Trust will raise funding from investors (the Class), subject to the trust deed, the investor terms and conditions and in terms of the investor subscription agreement.
- The Trust will apply the amounts received from the Class to subscribe for the tier 2 certificates to be issued by the Applicant in terms of the mudaraba arrangement.
- In terms of the mudaraba arrangement, the Trust will be the capital provider (in Islamic terms, be the '*rab al-maal*') and the Applicant will provide the labour (in Islamic terms, be the '*mudarib*').
- The Applicant will invest the mudaraba capital raised from the issue of the tier 2 certificates in an Islamic business portfolio of sharia-compliant arrangements (deposit pool).
- Profits from the investment of the mudaraba capital will be shared between the Applicant and the Trust in a pre-determined profit-sharing ratio.
- Any profits to be received by or accrued to the Trust will be passed on to the Class, in accordance with the conduit principle.

The salient features of the mudaraba sukuk, as set out in the relevant agreements referred to above, will be as follows:

- Distributable profits of the deposit pool, if any, will be allocated between the Applicant as the *mudarib*, the Trust and other depositors of the Applicant in accordance with an agreed profit sharing ratio.

- The Applicant will calculate the periodic distribution amounts due to the Trust based on a pre-determined profit-sharing ratio. Payment of these periodic distribution amounts will be made monthly in arrears, on the last day of each month in each year. Periodic distribution amounts that are not paid to the Trust will be credited to a mudaraba reserve by the Applicant and re-invested for the benefit of the Trust. The mudaraba reserve is sub-ordinated on the same basis as the tier 2 certificates.
- The Trust will in turn make payments of periodic distribution amounts pro-rata to the Class according to their respective holdings. Periodic distribution amounts are payable monthly in arrears on each distribution date (the last day of each month in each year).
- The term of the instrument is for a 10 year period, although the Applicant will have the right to redeem the instrument after five years, upon which the Trust will give notice to redeem all the sukuk certificates.
- The redemption or variation of the tier 2 certificates will be subject to the following conditions:
    - prior consent from the Registrar of Banks; and
    - at the time of the notice of redemption or variation and following the redemption or variation, the Applicant will be compliant with regulatory capital requirements.
- The tier 2 certificates and as a result the sukuk certificates may be written off either partly or in full, in certain circumstances as set out in the terms and conditions of their issue.
- No recourse shall be had for the payment of any amount owing in terms of the proposed transaction, or a claim against the Trust or the Applicant, to the extent that the sukuk assets and the tier 2 certificates have been exhausted following which all obligations of the Trust and the Applicant shall be discharged.

<u>Conditions and assumptions</u>

This binding private ruling is subject to the following additional conditions and

assumptions:

- The mudaraba arrangement will be a 'sharia arrangement' as defined in section 24JA(1).
- The proceeds of the tier 2 certificates will not be recognised as profit and loss in the statement of comprehensive income in respect of the financial assets and liabilities of the Applicant.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Section 24JA, insofar as it applies to a 'sukuk' as defined, will not apply to the sukuk certificates to be issued by the Trust.
- The proceeds from the issue of the sukuk certificates will not form part of the Trust's 'gross income' as defined in section 1(1).
- The proceeds from the issue of the tier 2 certificates will not form part of the Applicant's 'gross income' as defined in section 1(1).
- Section 24JA(2) will apply to the mudaraba agreement to be entered into between the Applicant and the Trust. Accordingly, the periodic distribution amounts received by or accruing in favour of the Trust will constitute 'interest', as defined in section 24J(1).
- The periodic distribution amounts paid to the Trust will be deductible by the Applicant, under section 11(*a*) read with section 23(*g*).
- The periodic distribution amounts will retain their nature as interest on distribution to the Class under section 25B(1).
- As the Class have vested rights to the income of the Trust, section 25B(1) will apply and as a result thereof, the Trust will have no income as the Trust's income will be deemed to be the income of the Class.
- If any tier 2 certificate is redeemed for less than its subscription price, section 19 and paragraph 12A will not be applicable to the difference between the subscription amount and the redemption amount.

- Sections 8F and 8FA will not apply to the mudaraba agreement.
- Section 24JB will not apply to the mudaraba agreement.

6.3. BPR 258 – Corporate Restructuring

This ruling determines the tax consequences resulting from a group restructuring involving multiple transactions to be undertaken in terms of the corporate roll-over rules and the consequences of the controlled foreign company rules in relation to the restructuring.

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Income Tax Act applicable as at 25 October 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the provisions of:

- the Income Tax Act:
    - section 1(1) – definitions of 'contributed tax capital', 'foreign return of capital', 'group of companies' and 'return of capital';
    - section 9D;
    - section 24BA;
    - section 41 – definition of 'group of companies';
    - section 42;
    - section 45;
    - paragraph 1 – definition of 'value shifting arrangement';
    - paragraph 11(1)(*g*) and (2)(*b*);
    - paragraph 12(4);
    - paragraph 24(1);

- paragraph 64B(4); and
- paragraph 76B.

- the STT Act –
  - section 2(1)(*a*)(ii).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

First Co-Applicant: A company incorporated outside South Africa and not a resident

Second Co-Applicant: A company incorporated outside South Africa and not a resident

Third Co-Applicant: A company incorporated outside South Africa but a resident

Description of the proposed transaction

The Applicant is the ultimate holding company for its group's offshore interests.

The Applicant holds all of the ordinary shares in the First Co-Applicant. The ordinary shares constitute 'equity shares' as defined in section 1(1).

The First Co-Applicant holds the following shares:

- All of the ordinary shares in the Second Co-Applicant. The ordinary shares constitute 'equity shares' as defined in section 1(1) and are held as capital assets. The market values of the shares exceed their respective base costs.
- A portion of the ordinary shares in the Third Co-Applicant. The ordinary shares constitute 'equity shares' as defined in section 1(1) and are held as capital assets. The market values of these shares exceed their respective base costs.

The Applicant holds a portion of the ordinary shares in the Third Co-Applicant. The Second Co-Applicant holds the remainder of the ordinary shares in the Third Co-Applicant. These ordinary shares constitute 'equity shares' as defined in section 1(1) and are held by the Applicant and the Second Co-Applicant as capital assets.

The market values of the ordinary shares exceed their respective base costs.

The Applicant intends to simplify the shareholding structure of the Third Co-Applicant so that it becomes a wholly-owned subsidiary of the Applicant.

The proposed transaction steps to implement the restructuring will be as follows:

- Transaction step 1

  The First Co-Applicant will dispose of its entire shareholding in the Second Co-Applicant to the Applicant in terms of an 'intra-group transaction' contemplated in paragraph (*b*) of the definition of that term in section 45(1) on loan account and at book value.

- Transaction step 2

  The Applicant will subscribe for and the Second Co-Applicant will issue ordinary shares to the Applicant.

- Transaction step 3

  The Second Co-Applicant will change its residence and will become a resident of South Africa.

- Transaction step 4

  The First Co-Applicant will dispose of its ordinary shares held in the Third Co-Applicant to the Second Co-Applicant in terms of an 'asset-for-share transaction' contemplated in paragraph (*a*) of the definition of that term in section 42(1) at book value. The Second Co-Applicant will issue ordinary shares to the First Co-Applicant in consideration for the disposal of the shares in the Third Co-Applicant that will constitute more than 10% of the ordinary shares of the Second Co-Applicant.

- Transaction step 5

  The Second Co-Applicant will dispose of its ordinary shares held in the Third Co-Applicant to the Applicant in terms of an 'intra-group transaction' contemplated in paragraph (*a*) of the definition of that term in section 45(1) on loan account and at book value.

- Transaction step 6

- The Second Co-Applicant will partially reduce its share capital. Its directors will elect that the portion of its share capital to be returned to its shareholders should come out of contributed tax capital.
- The amount payable in respect of the portion of the reduction of share capital attributable to the First Co-Applicant will be settled in cash.
- The amount payable in respect of the portion of the reduction of share capital attributable to the Applicant will be set-off against the amount payable in respect of the loan account owing by the Applicant to the Second Co-Applicant in terms of transaction step 5.

- Transaction step 7
  - The First Co-Applicant will partially reduce its share capital. Its directors will elect that the portion of its share capital to be returned to the Applicant should come out of contributed tax capital.
  - The amount payable in respect of the portion of the reduction of share capital attributable to the Applicant will be set-off against the amount payable in respect of the loan account owing by the Applicant to the First Co-Applicant in terms of transaction step 1.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Transaction step 1 i) The disposal by the First Co-Applicant of its shares held in the Second Co-Applicant to the Applicant on loan account and at book value will be an 'intra-group transaction' as defined in paragraph (*b*) of the definition of that term in section 45(1). The roll-over relief set out in section 45(2) will apply to the disposal as follows:
  - the First Co-Applicant will dispose of its shares in the Second Co-Applicant as capital assets and the Applicant will acquire the shares

as capital assets;

- the First Co-Applicant will be deemed to have disposed of the shares in the Second Co-Applicant for amounts equal to the base costs of the shares on the date of that disposal; and
- the Applicant and the First Co-Applicant will, for purposes of determining any capital gain or capital loss in respect of the disposal of the shares in the Second Co-Applicant by the First Co-Applicant, be deemed to be one and the same person with respect to:
  - the date of acquisition of the shares in the Second Co-Applicant by the First Co-Applicant and the amount and date of incurral by the First Co-Applicant of expenditure in respect of the shares in the Second Co-Applicant allowable under paragraph 20; and
  - any valuation of the shares effected by the First Co-Applicant, as contemplated in paragraph 29(4). ii) The Applicant and the First Co-Applicant do not form part of the same 'group of companies' as defined in section 41. In accordance with section 45(3A)(*b*), the First Co-Applicant will not be regarded as having acquired the debt owing in terms of the 'intra-group transaction' contemplated in section 45(1) for a base cost of nil.

- Transaction step 2
  - The subscription price to be paid for the subscription of shares by the Applicant in the Second Co-Applicant will be the contributed tax capital of the Second Co-Applicant.
  - The issue of the shares by the Second Co-Applicant to the Applicant will not be a disposal for purposes of paragraph 11.
- Transaction step 3
  - The exclusions in section 9D(9A)(*a*)(iii) will not apply to transaction step 3. The Second Co-Applicant will not be regarded as having

disposed of its assets and immediately re-acquired them at market value for purposes of paragraph 12(4) read with paragraph 24 as a result of its change of residence to South Africa.

- Paragraph 24(1) will not apply to the transaction in step 3.

- Transaction step 4
  - The disposal by the First Co-Applicant of its ordinary shares held in the Third Co-Applicant to the Second Co-Applicant at book value will be an 'asset-for-share transaction' as contemplated in paragraph (*a*) of the definition of that term in section 42(1). The roll-over relief provisions contained in section 42(2) will apply to the transaction as follows:
    - the First Co-Applicant will be deemed to have disposed of its shares held in the Third Co-Applicant to the Second Co-Applicant for amounts equal to the base costs of the shares on the date of disposal;
    - the First Co-Applicant will be deemed to have acquired the shares in the Second Co-Applicant on the date that it acquired the shares in the Third Co-Applicant and for a cost equal to any expenditure in respect of the shares in the Third Co-Applicant incurred by the First Co-Applicant that is allowable under paragraph 20 and to have incurred those costs at the date of incurral by the First Co-Applicant of such expenditure. Such costs must be treated as expenditure actually incurred and paid by the First Co-Applicant in respect of the shares in the Second Co-Applicant for the purposes of paragraph 20;
    - the First Co-Applicant and the Second Co-Applicant will, for purposes of determining any capital gain or capital loss in respect of a disposal of the shares in the Third Co-Applicant by the First Co-Applicant, be deemed to be one and the same person with respect to:

- ✓ the date of acquisition of the shares in the Third Co-Applicant by the First Co-Applicant and the amount and date of incurral by the First Co-Applicant of any expenditure in respect of those shares allowable under paragraph 20; and
- ✓ any valuation of the shares effected by the First Co-Applicant within the period contemplated in paragraph 29(4); and

- any valuation of the shares held by the First Co-Applicant in the Third Co-Applicant effected by the First Co-Applicant within the period contemplated in paragraph 29(4) will be deemed to have been effected in respect of the shares in the Second Co-Applicant acquired in terms of the asset-for-share transaction.

- The First Co-Applicant and the Second Co-Applicant will, immediately before and after the Second Co-Applicant acquires the shares in the Third Co-Applicant, form part of the same 'group of companies' for purposes of the definition of that term in section 1(1). Section 24BA will not apply to the disposal by the First Co-Applicant of its shares held in the Third Co-Applicant to the Second Co-Applicant.

- Transaction step 5
  - Based on the specific facts of this application, the shares acquired by the Second Co-Applicant in the Third Co-Applicant in terms of transaction step 4 will have been acquired and held by the Second Co-Applicant on capital account even though they will be disposed of to the Applicant shortly after acquisition and the Applicant will acquire them as capital assets.
  - The disposal by the Second Co-Applicant of its shares held in the Third Co-Applicant to the Applicant at book value will be an 'intra-group transaction' as defined in paragraph (*a*) of the definition of

that term in section 45(1). The following roll-over relief provided for in section 45(2) will apply to transaction step 5:

- the Second Co-Applicant will be deemed to have disposed of its shares held in the Third Co-Applicant for amounts equal to the base costs of those shares on the date of that disposal; and
- the Second Co-Applicant and the Applicant must, for purposes of determining any capital gain or capital loss in respect of a disposal of the shares held in the Third Co-Applicant by the Second Co-Applicant, be deemed to be one and the same person with respect to:
  - ✓ the date of acquisition of the shares by the Second Co-Applicant and the amount and date of incurral by the Second Co-Applicant of expenditure in respect of the shares allowable under paragraph 20; and
  - ✓ any valuation of the shares effected by the Second Co-Applicant, as contemplated in paragraph 29(4).

  - The Applicant and the Second Co-Applicant form part of the same 'group of companies' as defined in section 1(1). In accordance with section 45(3A)(*b*), the Second Co-Applicant will be regarded as having acquired the debt owing in terms of the intra-group transaction for a base cost of nil.
  - Section 42(7) will not apply to transaction step 5.

- Transaction step 6
  - The amount payable by the Second Co-Applicant to the Applicant and First Co-Applicant will constitute a 'return of capital' as defined in section 1(1) and a reduction of 'contributed tax capital' as defined in section 1(1).
  - The amount of the return of capital payable by the Second Co-Applicant to the Applicant which will be set-off against the loan

amount that will be owed by the Applicant in terms of transaction step 5 will discharge the Applicant's obligations to the Second Co-Applicant in terms of the loan account.

- The amount of the return of capital payable to the Applicant and the First Co-Applicant respectively will reduce the base costs of the shares to which the return of capital relates in accordance with paragraph 76B(2). As the amount of the return of capital will not exceed the base costs of those shares, no capital gains tax liability will arise for the Applicant and the First Co-Applicant in respect of the reduction of the Second Co-Applicant's share capital.
- The return of capital which will be set-off against the amount payable by the Applicant in respect of the loan account to be owed to the Second Co-Applicant in terms of transaction step 5 will discharge the loan account and in accordance with section 45(3A)(*c*), the amount of the return of capital equal to the face value of the loan amount payable must be disregarded in determining the Second Co-Applicant's aggregate capital gain and the nil base cost determined under section 45(3A)(*b*) will not apply.

- Transaction step 7
  - The amount payable by the First Co-Applicant to the Applicant will constitute a 'foreign return of capital' as defined in section 1(1) and a reduction of 'contributed tax capital' as defined in section 1(1).
  - The amount of the foreign return of capital payable by the First Co-Applicant to the Applicant which will be set-off against the loan amount to be owed by the Applicant in terms of transaction step 1 will discharge the Applicant's obligations to the First Co-Applicant in terms of the loan account.
  - The amount payable by the First Co-Applicant in respect of the foreign return of capital to the Applicant will reduce the base costs of the shares to which the foreign return of capital relates in accordance with paragraph 76B(2). As the amount of the foreign

return of capital will not exceed the base costs of the shares, no capital gains tax liability will arise for the Applicant in respect of the reduction of the First Co-Applicant's share capital. If, for any reason, the amount of the foreign return of capital exceeds the base costs of the shares, any capital gain in respect of the foreign return of capital will be disregarded under paragraph 64B(4).

- The Applicant and the First Co-Applicant do not form part of the same 'group of companies' as defined in section 41(1). Section 45(3A)(*b*) and (*c*) will not apply to the loan account of the First Co-Applicant that will arise in transaction step 1 and the settlement of the loan account by way of set-off in this transaction step.

- Transaction steps 1, 2, 4 and 5
  - The disposals at book value in terms of the asset-for-share transaction and the intra-group transactions in transactions steps 1, 4 and 5 will each not result in a 'value shifting arrangement' as defined in paragraph 1 and therefore a disposal for purposes of paragraph 11(1)(*g*).
  - No STT will be payable on the:
    - disposal by the First Co-Applicant of its shares in the Second Co-Applicant to the Applicant in terms of transaction step 1;
    - issue of shares by the Second Co-Applicant to the Applicant in terms of transaction step 2;
    - disposal by the First Co-Applicant of its shares in the Third Co-Applicant to the Second Co-Applicant in terms of transaction step 4; and
    - disposal by the Second Co-Applicant of its shares in the Third Co-Applicant to the Applicant in terms of transaction step 5.

6.4. *BPR 259 – Capital gains tax implications for an employee share trust*

This ruling determines the capital gains tax consequences for an employee share trust on the vesting of the shares in the employees of a company and the companies' subsidiaries as the consequence of an employee share ownership plan (plan).

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs to the Eighth Schedule to the Act applicable as at 19 October 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 8C;
- paragraph 20(1)(*h*)(i);
- paragraph 35;
- paragraph 38; and
- paragraph 80.

<u>Parties to the proposed transaction</u>

The Applicant: A public company incorporated in and a resident of South Africa

Employer Companies: Private companies incorporated in and residents of South Africa that are subsidiaries of the Applicant

The Trust: An employee share ownership trust that is established in and a resident of South Africa

Qualifying Employees: Eligible employees of the Applicant or its subsidiaries who are residents of South Africa

<u>Description of the proposed transaction</u>

As part of its commitment to Black Economic Empowerment (BEE), the Applicant wishes to attract and retain black employees for the Applicant and its subsidiaries. Consequently, eligible employees (Qualifying Employees) will obtain equity shares

in the Applicant pursuant to the implementation of the plan.

The Applicant will implement the plan for qualifying employees. The plan requires each Employer Company to identify qualifying employees and recommend to the board of directors of the Applicant (board) that such Qualifying Employees be incentivised through the plan. The board may at its discretion elect employees who were not identified by an Employer Company to participate in the plan. The Qualifying Employees will not be required to make any contributions in order to participate in the plan.

The proposed steps for implementing the plan will be as follows:

- Shares in the Applicant (group shares) will be issued by the Applicant to the Trust.
- The Employer Companies will settle the subscription consideration for the group shares issued to the Trust in cash, equal to the market value of the group shares. Alternatively, the subscription amount will be left outstanding on loan account against the relevant Employer Company.
- The Qualifying Employees will acquire participation interests in the Trust, (units), which will confer proportional vested rights to:
    - the Trust income over a five year period;
    - the underlying group shares on specified dates; and
    - voting rights attaching to the aggregate number of shares conferred by each unit.

Once the proposed steps with regard to the plan have been followed, ownership of the group shares will vest in each Qualifying Employee on specified dates, provided that the qualifying employee is still in the employ of the Applicant or an Employer Company.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The Trust will not realise a capital gain or loss on the disposal of the group shares when those shares vest in the Qualifying Employees.

6.5. BPR 260 – Interest on loans used to acquire shares

This ruling determines the continuing deductibility of interest on loans used to acquire shares in companies that will be liquidated following the distribution to the borrower as a dividend *in specie* of the businesses operated by those companies.

In this ruling references to sections are to sections of the Income Tax Act as at 25 November 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of section 24J read with section 23(*f*) and (*g*).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

Company A: A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of the Applicant

Company B: A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of the Applicant

Company C: A company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of Company B

Description of the proposed transaction

The Applicant is the main trading subsidiary within a group of listed companies. The Applicant has always sought to make new acquisitions by buying the assets and the businesses from companies that are the sellers. In a small minority of cases, however, the Applicant was compelled to buy the shares in the companies rather than the assets and the business itself. In those cases in which the Applicant acquired the shares, it immediately took steps to procure the distribution of the assets and the businesses of the companies as a liquidation distribution under

section 47 of the Act. In these cases the purchase price was paid by the Applicant out of its available cash reserves.

For the acquisition of the shareholding in Company A and Company B, the Applicant had to incur debt in order to fund the acquisitions. The Applicant has been able to rely on section 24O of the Act to claim the deduction for the interest arising in respect of the debts incurred.

Company B is solely a holding company of Company C that is the operating company under Company B.

The Applicant would have preferred, subsequent to the acquisitions of the shares of both Company A and Company B, to have caused the companies to distribute their assets and their businesses *in specie* immediately after these acquisitions to the Applicant, under section 47 of the Act, and then to liquidate or deregister those subsidiaries. However, the Applicant was not prepared to undertake that step without first obtaining a binding private ruling under Chapter 7 of the TA Act, confirming that the interest will continue to be deductible following such distribution. The Applicant could not obtain such a ruling at that time, since the issue under consideration was on the list of additional considerations in respect of which the Commissioner may reject an application for an advance ruling, as contemplated in section 80(2) of the TA Act.

It was the Applicant's intention, as soon as the relevant loan had been repaid, to cause the underlying company to distribute its assets and its business as contemplated in section 47 of the Act.

It came to the Applicant's attention that the Commissioner had issued a revised notice under section 80(2) of the TA Act, in which the matter concerning the deductibility of interest incurred by a company on debt used to finance the acquisition of shares in another company for the purpose of acquiring the underlying assets or the business had been removed from the list.

Accordingly, the Applicant now wishes to eliminate Company A and Company B.

The Applicant proposes to undertake the following steps:

- Company B will unbundle all its shares in Company C to the Applicant in terms of an unbundling transaction under section 46 of the Act.

- Liquidation distributions by Company A and Company C will be effected as contemplated in section 47 of the Act.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The interest incurred on the loans owing by the Applicant, which were obtained to fund the acquisition of the shares in Company A and Company B, will continue to be deductible. The interest will not be disallowed as a deduction under section 23(*f*) and (*g*) of the Act.

Additional note

This ruling does not cover the application of any general anti-avoidance provision to the proposed transaction.

6.6. BPR 261 – Repurchase of restricted equity instruments

This ruling determines the tax consequences for an employee share trust that is obliged to repurchase restricted equity instruments.

In this ruling references to sections and paragraphs are to sections of the Act and paragraphs of the Eighth Schedule to the Act applicable as at 12 January 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of:

- section 8C;
- paragraph 20(3)(*b*); and
- paragraph 80(2) and (2A).

Parties to the proposed transaction

The Trust: A trust registered in and a resident of South Africa

Company A: A company incorporated in and a resident of South Africa

Company B: A company incorporated in and a resident of South Africa

The Participants: Beneficiaries who are holding vested interests in the Trust

Background

The Trust was created to benefit certain key employees (Participants) of a group of companies (group) of which Company A forms part. The Trust is a black empowerment employee share incentive trust established to acquire, hold and, in appropriate circumstances, sell equity shares for the benefit of its beneficiaries.

The Trust holds shares in Company A. Company A in turn holds 26% of the shares in Company B and is the empowerment shareholder for the group.

The beneficiaries have all been awarded personal rights against (units in) the Trust. A beneficiary becomes a Participant only upon the vesting of those rights which entitle him or her to participate in the income and capital of the Trust in accordance with his or her proportional interest.

A unit represents the rights of a beneficiary to benefit from the sale of the shares in Company A, as and when a sale occurs and if the beneficiary's rights have vested at that point. Once a unit has vested, it is referred to as a 'trust interest' as opposed to a unit.

A Trust Interest is the personal right of a Participant (in his or her capacity as a vested beneficiary), enforceable against the trustees to participate in the income and capital (including capital gains) of the Trust, based on the number of units of the Participant's trust interest. A trust interest is expressed as a percentage determined by dividing the number of units constituting a Participant's trust interest by the total number of units held in the pool at the relevant time.

A Participant can forfeit his or her trust interest under certain circumstances and may not freely dispose of it. Specifically, the Participant will forfeit his or her vested interest upon lawful termination of his or her employment or when he or she is declared insolvent or commits an act of insolvency. Under these circumstances, the Participant will forfeit his or her trust interest and any allocated units for no consideration. A Participant is also only allowed to dispose of his or her trust

interests to the Trust and even then, subject to certain restrictive conditions regarding the process, the timing and the trustees' ability to dispose of the Company A shares to fund the repurchase.

A Participant is entitled to receive all cash dividends and other cash payments of any nature whatsoever in respect of the Company A shares. The Participant is also entitled to receive all cash payments or distributions of the capital or premium received by the Trust in relation to the Company A shares less certain amounts deducted from those cash distributions, in proportion to each Participant's trust interest. Where cash distributions are paid on the sale of Company A shares, those cash distributions will, after the deduction of certain amounts like realisation costs and taxes, be deemed to have vested in the Participants in proportion to each Participant's trust interest.

Proposed transaction

The proposed transaction entails the trustees making an award to the Participants by selling certain of its Company A shares and by repurchasing the whole or any portion of their trust interests from them, depending on what the trustees can afford out of the sale proceeds. The trust interest will be repurchased at the fair value of the Company A shares associated with the portion of each Participant's total trust interest, after deducting from the sale proceeds the costs and the taxes which may be incurred in order to raise the funds required to purchase the trust interests (including any capital gains tax which may be payable to procure the sale of the underlying Company A shares), and the repurchase price will be paid in cash.

A Participant will, on and with effect from the date specified in the notice signifying the trustees' intention to purchase his or her trust interest, cease to be a Participant in respect of the trust interests repurchased.

The proposed transaction will be implemented through the following transaction steps:

- The trustees will give written notice to the Participants of their intention to repurchase a portion of each Participant's trust interest.
- The trustees will use their endeavours to sell sufficient Company A shares to fund the purchase of the trust interests.

- Upon the successful sale of the Company A shares, the trustees will purchase the identified trust interests from the relevant Participants.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The proceeds received by the Trust on the disposal of the Company A shares will accrue to the Trust, which will calculate any capital gain or capital loss that arise as a result of the disposal.
- Paragraph 20(3)(*b*) will apply to reduce the base cost of the Company A shares held by the Trust, by the proportionate contributions made by the group companies to enable the Trust to acquire the Company A shares.
- If the Trust derives any capital gains from the disposal of the Company A shares linked to the trust interests, those gains will not be taxable in the Trust under paragraph 80(2) and paragraph 80(2A) will also not apply.
- Section 8C will apply in respect of the vesting of the Participants' restricted equity instruments. Any gain or loss determined in respect of the vesting of those restricted equity instruments will be subject to employees' tax to be withheld by the Trust.

6.7. BPR 262 – Employer-provided transport service

This ruling determines the value to be placed on a taxable benefit that will begranted by an employer to its employees by rendering a transport service to them to convey them from a certain point to their place of work and back.

In this ruling references to paragraphs are to paragraphs of the Seventh Scheduleto the Inome Tax Act applicable as at 16 January 2017. Unless the context indicatesotherwise any word or expression in this ruling bears the meaning ascribed to it inthe Act.

This is a ruling on the interpretation and application of:

- paragraph 2(*e*); and
- paragraph 10(1)(*b*) and (2)(*b*).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Employees: The employees of the Applicant

Description of the proposed transaction

The Applicant proposes to implement a transport scheme to assist the Employees to travel to and from work safely and more efficiently. Due to the nature of the Applicant's business, the Employees are required to commence and end their normal working days at times when public transport is either not available or very limited.

For purposes of implementing the scheme, the following two types of transport service concepts are proposed:

- The Shuttle Service Concept

  A shuttle service will connect each of the Applicant's business units to a public transport interchange nearest to the relevant business unit. This service will be available where the nearest interchange is situated more than 500 metres walking distance from the business unit where the Employee works. The Employees will make use of public transport services to travel from their homes to this nearest transport interchange and back, but will use the shuttle service between the transport interchange and the relevant business unit. This service is intended to serve the Employees who work shifts during normal business hours.

- The Direct Service Concept

A dedicated transport service will be provided between a specifically identified central point (collector's point) in a residential area where an Employee resides and the business unit where the Employee works. The Employees will be required to organise their own transport from their homes to the collection points and back. This service will only be available where the nearest available public transport is situated more than 500 metres walking distance from the business unit where the Employee works. In addition, this service will only be available to Employees whose work is core to the operation of the Applicant and who works shifts that are difficult to align with existing public transport services.

The collector's points will be fairly distributed in the Applicant's discretion and the routes designed in a circular format to allow maximum coverage of the particular area, taking into account its size and density.

The Applicant will engage with independent shuttle transport service providers to pick up the Employees from their various public transport interchanges or collector's points and drop them off at their places of work, and to pick them up from their places of work at the end of their shifts and drop them off at their particular public transport interchanges or collector's points.

The independent shuttle transport service provider will invoice the Applicant directly at agreed intervals for the transport services provided. The Applicant will carry the costs of the shuttle services delivered. The Employees will not be required to pay any consideration for the services to be provided.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- No value will be placed on the taxable benefit to be granted by the Applicant to its employees by rendering a transport service to them to convey them from a public transport interchange or a collector's point to their place of work and back.

6.8. BPR 263 – Hybrid interest

This ruling determines the income tax consequences of the entitlement to and the payment of a share in the profit of the Co-Applicant to the Applicant in the context of a funding arrangement, as well as the re-characterisation rules contained in section 8FA.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 6 December 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 8FA;
- section 10(1)(*k*)(i), read with paragraph (*hh*) of the proviso thereto;
- section 24J(1) – definition of 'interest';
- section 24JB(2)(*b*);
- section 64D;
- section 64E;
- section 64EA;
- section 64F; and
- section 64FA.

<u>Parties to the proposed transaction</u>

The Applicant: A public company incorporated in and a resident of South Africa

The Co-Applicant: A private company incorporated in and a resident of South Africa2

<u>Description of the proposed transaction</u>

The Applicant conducts business as an investment bank. As part of the Applicant's normal business operations, it grants credit facilities and advances loans to its

clients. The Co-Applicant is a client of the Applicant and the owner-developer of a shopping centre.

The Applicant concluded two interest-bearing loan agreements with the Co-Applicant; a senior loan facility and a mezzanine loan facility. As consideration for making available the funding in terms of these loan agreements, the Applicant, the Co-Applicant and the Co-Applicant's shareholder concluded a profit sharing agreement.

In terms of the profit sharing agreement the Applicant will be paid a share of the profit that is to be realised in the event of, amongst other things, the sale of the immovable property or the sale of the shares in the Co-Applicant (expressed in the profit sharing agreement as a specific rand amount).

The proposed transaction is the imminent sale of all of the shares in the Co-Applicant to a REIT.

The amount of the profit share, to which the Applicant will become entitled to upon the execution of the proposed transaction, is the result of negotiation between the parties at the time of the conclusion of the profit sharing agreement and is influenced by the expected future fair value of the property as well as the Applicant's expected return on the funding provided.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The profit share constitutes 'interest' as defined in section 24J(1) for the Applicant and the Co-Applicant.
- The profit share constitutes 'hybrid interest' for purposes of section 8FA, with the following consequences under section 8FA(2):
    - For purposes of the Act, this amount is deemed to be a dividend *in*

specie that is declared and paid by the Co-Applicant to the Applicant on the last day of the year of assessment of the Co-Applicant, during which this amount is incurred by the Co-Applicant.

- This deemed dividend *in specie* is not deductible by the Co-Applicant under the Act.
- For purposes of the Act, this amount is deemed to be a dividend *in specie* that is declared and paid to the Applicant on the last date of the year of assessment of the Co-Applicant, during which this amount accrues to the Applicant.

- The profit share will constitute a 'dividend' for purposes of section 24JB and will be excluded, as a result, under section 24JB(2)(*b*).
- Paragraph (*hh*) of the proviso to section 10(1)(*k*)(i) will not apply to the profit share that is deemed to be a dividend *in specie,* received by the Applicant and will be exempt from normal tax under section 10(1)(*k*)(i).
- The dividend *in specie* will be exempt from dividends tax under section 64F, read with section 64FA, if the necessary declaration and undertaking are submitted to the Co-Applicant.

6.9. BPR 264 – Venture capital company shares

This ruling determines whether each share to be issued by a venture capital company (VCC) and another company (target company) will be an 'equity share' as defined in section 1(1) and whether the target company will be a controlled group company for purposes of the definition of 'qualifying company' in section 12J(1).

In this ruling references to sections are to sections of the Income Tax Act applicable as at 5 January 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definition of 'equity share' and 'controlled group company'; and
- section 12J(1) – definition of 'venture capital share', 'qualifying company'

and 'qualifying share'.

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

The Target Company B: A company incorporated in and a resident of South Africa

The Investors: Persons investing as shareholders in the Applicant

Description of the proposed transaction

The Applicant is a company which has been approved as a VCC under section 12J.

The Applicant proposes to raise funds by issuing shares to the Investors. These funds will be allocated to the Target Company. The proposed transaction steps will be implemented as follows:

- Transaction step 1
  - The Applicant's board of directors will classify and assign preferences, rights, limitations and other terms to a class of its ordinary shares (class A ordinary shares) which will rank *pari passu* with all its other ordinary shares.
  - The Investors, who wish to invest in the Target Company, will subscribe for class A ordinary shares in the Applicant, and a management company (Manco A) will co-invest in the Applicant.
- Transaction step 2
  - The Applicant will use the subscription price to be received from the Investors to subscribe for class A ordinary shares in the Target Company.
  - The Applicant will subscribe for no more than 69% of the total equity shares to be issued by the Target Company. The capital which the Applicant will contribute to the Target Company will be disproportionately high compared to the number of shares which it will hold in the Target Company. Although the Applicant will subscribe for no more than 69% of the equity shares in the Target

Company, it will contribute in excess of the 69% of the Target Company's capital.

- The total equity shares to be issued by the Target Company will comprise of ordinary shares and class A ordinary shares. Target Company's class A ordinary shares will rank *pari passu* with all its other ordinary shares.
- The Target Company will issue the remaining 31% of its equity shares (ordinary shares) to a management company (Manco B).
- Manco B is not required to contribute capital to the Target Company.

The rights attaching to the shares will be as follows:

- The Applicant's ordinary shares will entitle their holders to:
  - vote on every matter to be decided by the shareholders of the company. A share will entitle the holder to one vote for each ordinary share; and
  - share in the net assets of the Applicant upon its liquidation together with the Applicant's class A ordinary shareholders.
- The Applicant's class A ordinary shares will entitle their holders to:
  - share in distributions from only the Target Company. The class A ordinary shareholders may not share in any distributions from any other target company in which the Applicant may invest;
  - share in the net assets of the Applicant upon its liquidation together with the other ordinary shareholders of the Applicant;
  - vote on every matter on which the shareholders are required to vote in relation to the Target Company's class A ordinary shares and on any proposal to amend the preferences, rights, limitations and other terms associated with the Target Company's class A ordinary shares in accordance with the relevant provisions of the Applicant's memorandum of incorporation (MOI); and

- one vote on every matter on which that shareholder may vote, for each class A ordinary share held in the Applicant.

- The Target Company's ordinary shares will entitle their holders to:
  - vote on every matter to be decided by the shareholders of the company. A share will entitle the holder to one vote for each ordinary share held in the Target Company; and
  - share with the Target Company's class A ordinary shareholders in the net assets of the company upon its liquidation.
- The Target Company's class A ordinary shares will entitle their holders to:
  - vote on every matter to be decided by the shareholders of the company. A class A ordinary share will entitle its holder to one vote;
  - be paid the full amount of each and every distribution in respect of the class A ordinary shares, subject to the relevant provisions of the Companies Act, the MOI of the Target Company and any other applicable laws, in priority to the holders of the Target Company's ordinary shares and or the holders of any other class of shares in the company; and
  - share with the Target Company's ordinary shareholders in the net assets of the Target Company upon its liquidation. In respect of all other distributions, the full amount of each and every distribution must be made only to the holders of the Target Company class A ordinary shares.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- For purposes of the definition of 'venture capital share' in section 12J(1), each of the Applicant's ordinary shares and each of the Applicant's class A

ordinary shares will constitute an 'equity share' as defined in section 1(1).

- For purposes of the definition of 'qualifying share' in section 12J(1), each of the Target Company's ordinary shares and each of the Target Company's class A ordinary shares will constitute an 'equity share' as defined in section 1(1).
- For purposes of the definition of 'qualifying company' in section 12J(1), the Target Company will not constitute a 'controlled group company' as long as the number of equity shares to be held by the Applicant in the Target Company will constitute less than 70% of the total number of equity shares, despite the fact that the Applicant may invest more than 70% of the aggregate share capital in the Target Company in monetary terms.

6.10. BPR 265 – Amalgamation transaction

This ruling determines the tax consequences for a company that intends to dispose of its assets in terms of an 'amalgamation transaction' as defined in section 44(1). The company holds loans and preference shares in the company that will acquire the assets.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act and paragraphs of the Eighth Schedule to the Act applicable as at 7 November 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 19;
- section 44; and
- paragraph 12A.

<u>Parties to the proposed transaction</u>

The Applicant: A private company incorporated in and a resident of South Africa

The Co-Applicant: A company incorporated in and a resident of South Africa

Company A: A company incorporated in and effectively managed outside South Africa, the sole shareholder of the Applicant and the majority shareholder of the Co-Applicant

Company B: A company incorporated in and a resident of South Africa that is dormant

Description of the proposed transaction

The Applicant sold its business to the Co-Applicant a number of years ago as a going concern in terms of an intra-group transaction, to introduce a BEE shareholding into its structure. The Co-Applicant settled the purchase price by way of:

- a payment in cash;
- issuing redeemable preference shares to the Applicant; and
- creating an interest bearing loan in favour of the Applicant.

Currently, the only assets of the Applicant are:

- loans to the group companies of the Applicant which includes the Co-Applicant;
- preference shares held in the Co-Applicant; and
- shares held in Company B which have a nil value.

The Applicant does not have any liabilities.

A few years after the Applicant sold its business to the Co-Applicant, a portion of the interest bearing loan to the Co-Applicant was settled with the proceeds from the issue of preference shares. The interest payable on the outstanding loan is currently not being serviced. The Co-Applicant has been making a loss because of this for the last few years. Therefore the Co-Applicant proposes to take steps to improve the company's statement of financial position.

As the parties are currently anticipating the exit of the BEE shareholders, there will no longer be a need to have two separate companies. The business of the Applicant and the Co-Applicant will therefore be amalgamated.

The Applicant and the Co-Applicant are both registered as vendors for value-added

tax purposes. The latest annual financial statements of the Co-Applicant reflect a positive shareholder's equity balance.

The proposed steps for implementing the amalgamation transaction are as follows:

- The Applicant will dispose of all of its assets (other than assets to be used to settle debts incurred in the normal course of trade, if any) to the Co-Applicant. The Co-Applicant will acquire the capital assets of the Applicant as capital assets.
- In consideration for the assets so acquired the Co-Applicant will issue ordinary shares to the Applicant with a value equal to the face value of the loan and the market value of the preference shares. The market value of the portion of the shares to be issued by the Co-Applicant relating to the loan will be equal to the face value of the loan. It has not been impaired in terms of the annual financial statements.
- The Applicant will distribute the ordinary shares to be obtained in the Co-Applicant to Company A as a distribution *in specie*, to enable it to dispose of all its assets in order to be deregistered, liquidated or wound up.
- The Applicant will take the steps prescribed by section 44(13)(*a*) to liquidate, wind up or deregister within 36 months of the date of the amalgamation transaction.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The proposed transaction will comply with paragraph (*a*) of the definition of an 'amalgamation transaction' as defined in section 44(1).
- Section 44(2) will apply to the proposed transaction: The Applicant will be deemed to have disposed of the assets for amounts equal to their respective base costs on the date of disposal. The Co-Applicant and the Applicant must, for purposes of determining any capital gain or capital loss

in respect of a disposal of any of those assets by the Co-Applicant, be deemed to be one and the same person in respect of the date of acquisition of the asset in question by the Applicant and the amount and date of incurral by the Applicant of any expenditure in respect of that asset allowable under paragraph 20 and any valuation effected in respect of the asset by the Applicant under paragraph 29.

- No 'reduction amount' as defined in section 19(1) and paragraph 12A(1) will result from the proposed transaction.

Additional note

This ruling does not cover the application of any general anti-avoidance provision to the proposed transaction.

6.11. BPR 266 – Acquisition of a business in exchange for the assumption of liabilities and the issuing of a loan note

This ruling determines the tax consequences resulting from the acquisition of a business of a company in exchange for the assumption of the liabilities of that company and the issuing of a loan note in favour of that company. It also determines the deductibility of interest on a loan incurred to finance the repayment of the loan note.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 19 January 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 7B;
- section 11(*a*);
- section 23(*g*);
- section 23N; and
- section 24J(2).

Parties to the proposed transaction

The Applicant: A company incorporated in and a resident of South Africa

Company A: A company established in a foreign country and a resident of South Africa

Holdco: A listed company incorporated in and a resident of South Africa that holds 100% of the shares in the Applicant and in Company A

Description of the proposed transaction

Holdco has been rationalising its group structure.

Pursuant to that exercise, the Applicant will acquire Company A's business at fair market value in exchange for the assumption of Company A's liabilities (including contingent liabilities) and the issuing of a loan note in favour of Company A in terms of an intra-group transaction. The contingent liabilities will consist of the following provisions –

- leave pay;
- bonuses; and
- post-retirement medical aid.

Within 18 months of the acquisition, Company A will call upon the Applicant to repay the loan note. The Applicant will approach a third party bank to obtain an interest bearing loan to do so. Company A will distribute the cash thus received from the Applicant as a dividend to Holdco.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- The requirements of section 11(*a*) read with section 7B and 23(*g*) must be met at the time when the leave pay and bonus contingent liabilities materialise.
- The requirements of section 11(*a*) read with section 23(*g*) must be met at the time when the post-retirement medical aid contingent liabilities materialise.

In assessing whether the requirements of the sections referred to above are met, the expenditure must be evaluated within the context of the nature of the going concern's business as was carried on by Company A prior to the proposed transaction and by the Applicant subsequent to the proposed transaction without considering the fact that the assumption of the contingent liabilities by the Applicant will be part of the consideration for the acquisition of Company A's business. The circumstances under which the contingent liabilities arose in Company A will therefore be relevant.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The expenditure to be incurred by the Applicant in respect of the leave pay and bonus contingent liabilities will be deductible.
- The expenditure to be incurred by the Applicant in respect of the post-retirement medical aid contingent liability will be deductible.
- The interest to be incurred on the loan will be deductible by the Applicant under section 24J(2), subject to the limitations as set out in section 23N.

6.12. BPR 267 – Dividends tax and the most favoured nation clause in a tax treaty

This ruling determines whether dividends tax must be withheld when a dividend is paid to the beneficial owner that is a resident of the Kingdom of Sweden. Sweden and South Africa concluded the SA/Sweden tax treaty which, when read with the Protocol, includes a 'most favoured nation' clause.

In this ruling references to sections and articles are to sections of the Income Tax Act and articles of the SA/Sweden treaty and the Protocol applicable as at 7 December 2016. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act or the Protocol.

This is a ruling on the interpretation and application of:

- sections 64G(3) and 108;
- article 10 of the SA/Sweden tax treaty published in *Government Gazette* (GG) 16890 dated 27 December 1995 as amended by articles I and II of the Protocol published in *GG* 35268 dated 23 April 2012; and
- article 10 paragraph 1 of the SA/Kuwait tax treaty published in *GG* 29815 dated 20 April 2007.

Parties to the proposed transaction

The Applicant: A private company incorporated in and a resident of South Africa that is a wholly-owned subsidiary of Company A

Company A: A company incorporated in and a resident of Sweden

Description of the proposed transaction

Company A is the beneficial owner of the shares in the Applicant and of any dividends that may accrue in respect of those shares. The Applicant proposes to pay a dividend to Company A.

Article II of the Protocol lays down that:

> '[i]f any agreement or convention between South Africa and a third state provides that South Africa shall exempt from tax dividends ... arising in South Africa, or limit the tax charged in South Africa on such dividends ... to a rate lower than ... [5%], such exemption or lower rate shall automatically apply to dividends ... arising in South Africa and beneficially owned by a resident of Sweden'.

In this regard, the SA/Kuwait tax treaty provides in article 10 paragraph 1 that should dividends be paid by a company that is a resident of South Africa to a resident of Kuwait who is the beneficial owner, those dividends would be taxable in Kuwait only.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The Applicant will not be required to withhold dividends tax from the dividend payments to Company A if Company A complies with the documentary requirements in section 64G(3).

7. BINDING CLASS RULING

7.1. BCR 56 – Amalgamation of portfolios of declared fund collective investment schemes with registered hedge fund collective investment schemes

This ruling determines the income tax and securities transfer tax consequences resulting from the amalgamation of hedge fund portfolios that have been declared collective investment schemes (CISs) with registered hedge fund CISs pursuant to a change in the law governing hedge fund portfolios.

In this ruling references to sections and paragraphs are to sections of the relevant Income Tax Act and paragraphs of the Eighth Schedule to the Income Tax Act and the STT Act, applicable as at 30 September 2016.

Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- the Income Tax Act:
  - section 1(1), definition of:
    - 'portfolio of a collective investment scheme';
    - 'portfolio of a declared collective investment scheme'; and
    - 'portfolio of a hedge fund collective investment scheme';
  - section 41, definition of:
    - 'asset';
    - 'company';

        - 'disposal'; and
        - 'equity share';
    - section 44; and
    - paragraphs 1, definition of 'asset' and 'disposal', 3, 10, 11 and 61(3).
- the STT Act:
    - section 8(*a*)(ii).

Class

The Class Members to whom this ruling applies are:

- five Product Trusts and their beneficiaries;
- seven Manager Trusts and their beneficiaries;
- five Fund of Funds (FOF) Registered Hedge Fund CISs; and
- seven Registered Hedge Fund CISs.

Parties to the proposed transaction

The Applicant: A listed company incorporated in and a resident of South Africa, registered as a long-term insurer under the Long-Term Insurance Act 52 of 1998

Co-Applicant 1: A company incorporated in and a resident of South Africa, authorised as a manager in terms of the Collective Investment Schemes Control Act 45 of 2002 (the CISCA) for five FOF Registered Hedge Fund CISs

Co-Applicant 2: A listed company incorporated in and a resident of South Africa, registered as a bank under the Banks Act 94 of 1990

Co-Applicant 3: A company incorporated in and a resident of South Africa, authorised as a manager in terms of the CISCA for the seven Registered Hedge Fund CISs

The Product Trusts: Five trusts, each established in and a resident of South Africa

The Manager Trusts: Seven trusts, each established in and a resident of South Africa

The FOF Registered Five FOF Registered Hedge Funds CISs nominated

Hedge Fund CISs: by the Product Trusts to which the trusts will transition their assets

The Registered Hedge Seven Registered Hedge Fund CISs nominated by the

Fund CISs: Manager Trusts to which the trusts will transition their assets

Description of the proposed transaction

The Applicant is the sole beneficiary of four of the five Product Trusts and Co-Applicant 2 is the sole beneficiary of the remaining Product Trust. Each beneficiary of a Product Trust has vested rights to the income received by or accrued to the trustee and the capital of the Product Trust concerned.

The Applicant and Co-Applicant 2 funded each of the Product Trusts of which they are beneficiaries.

The Applicant issued policies which reference the investment performance of the Product Trusts.

The Product Trusts are the beneficiaries of the Manager Trusts and made capital contributions to the Manager Trusts. In accordance with the provisions of the trust deed of each of the Manager Trusts, the beneficiaries have, *pro rata* to their capital contribution to each Manager Trust, vested rights to the income received by or accrued to the trustees and to the capital of each relevant Manager Trust.

The Applicant and Co-Applicant 2 are therefore indirectly the ultimate investors in the Manager Trusts.

Each Product Trust and each Manager Trust is a 'hedge fund' as defined in Government Notice 141, dated 25 February 2015 published in *Government Gazette* 38503 (notice). In terms of the notice, each Product Trust and each Manager Trust was declared to be a CIS under section 63 of the CISCA with effect from 1 April 2015.

In order to comply with the notice, a person that conducted the business of a hedge fund was required, within 6 months as from 1 April 2015, to lodge with the Registrar of Collective Investment Schemes (the Registrar) an application for registration as a manager to operate a hedge fund in accordance with section 42 of the CISCA. As an alternative to registration, the Registrar granted a general

exemption under Board Notice 140 of 2015, published in *Government Gazette* 39220, in terms of which persons conducting the business of a hedge fund could notify the Registrar by not later than 30 September 2015 of a newly registered portfolio operated by a manager under the CISCA, to which the applicable portfolio of the hedge fund that existed on 1 April 2015 would be transitioned.

The trustees of each Product Trust and each Manager Trust opted for the general exemption to apply to them and duly informed the Registrar of the newly registered portfolios to which they would transition their respective portfolios.

Pursuant to their elections, each Product Trust intends to transfer all of its assets and liabilities (other than assets required to settle debts incurred in the ordinary course of its trade and to satisfy reasonable anticipated liabilities for the administration of its liquidation or winding up) to a nominated newly registered portfolio of a FOF Registered Hedge Fund CIS, by way of an amalgamation contemplated in section 99 of the CISCA and/or the Guidance Note on the transition process issued by the Financial Services Board (FSB) on 16 August 2016 (number HF01A) (first amalgamation).

Similarly, each Manager Trust will transfer all of its assets and liabilities (other than assets required to settle debts incurred in the ordinary course of its trade and to satisfy reasonable anticipated liabilities for the administration of its liquidation or winding up) to a Registered Hedge Fund CIS by way of an amalgamation contemplated in section 99 of the CISCA and/or the already-mentioned Guidance Note (second amalgamation).

Each Product Trust will distribute the participatory interest it acquires in the FOF Registered Hedge Fund CIS to its beneficiary after which each Product Trust will be liquidated or its existence will be terminated. Similarly, each Manager Trust will distribute the participatory interest it acquires in the Registered Hedge Fund CIS to its beneficiaries and each Manager Trust will be liquidated or its existence will be terminated.

Subsequent to the second amalgamation, each Registered Hedge Fund CIS may be required to rebalance its portfolio by disposing of certain assets acquired in terms of that amalgamation transaction within 18 months of such acquisition as part of the normal investment authority of the portfolio.

The trustees of each Product Trust and each Manager Trust will take the following steps to terminate the respective trusts within the time periods as prescribed in section 41(4) of the Act:

- adopt resolutions to terminate and deregister the relevant trusts which will be adopted with the prior written consent of the relevant founder and relevant beneficiary of each trust; • settle the liabilities of each trust from their assets and distribute the residual assets of each trust to the respective beneficiaries in accordance with the provisions of each trust deed; and
- once all of the assets have been so distributed, submit an application to the Master of the High Court having jurisdiction to deregister each trust.

Conditions and assumptions

This binding class ruling is subject to the additional conditions and assumptions that the liabilities which will be assumed by each Registered Hedge Fund CIS will constitute debt that was incurred by the relevant Manager Trust more than 18 months prior to the disposal of its assets to that Registered Hedge Fund CIS, or debt that was incurred within a period of 18 months before that disposal, but in that event it will either constitute the refinancing of the debt referred to already, or debt which arose in the ordinary course of the business undertaking which will be disposed of, as a going concern, to that Registered Hedge Fund CIS.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- Both the first and the second amalgamation transactions, regarding the transfer of assets from each Product Trust to a FOF Registered CIS and from each Manager Trust to a Registered Hedge Fund CIS, will each constitute an 'amalgamation transaction', as defined in paragraph (*a*) of the definition of that term in section 44(1) of the Act.

  Consequently, section 44(2) will apply to each amalgamation transaction as follows:

  - each trust will be deemed to have disposed of their assets to the

respective registered CIS for amounts equal to their respective base costs on the date of disposal; and

- the trusts and the respective registered CISs must, for purposes of determining any capital gain or capital loss in respect of a future disposal by the registered CIS of any of those assets, be deemed to be one and the same person in respect of the date of acquisition of the asset in question by the trusts and the amount and date of incurral by the trusts of any expenditure allowable under paragraph 20 and any valuation effected under paragraph 29 by the trusts in respect of the asset.

- Any transfer of shares from each of the Product Trusts to a FOF Registered CIS and from the Manager Trusts to a Registered Hedge Fund CIS in terms of the first amalgamation transaction and the second amalgamation transaction respectively will qualify for an exemption from securities transfer tax under section 8(1)(*a*)(ii) of the STT Act.

- The distribution of the participatory interests acquired by each of the Product Trusts in a FOF Registered CIS and by each of the Manager Trusts in a Registered Hedge Fund CIS to the relevant beneficiaries will qualify for relief under sections 44(6)(*a*) and (*b*), and 44(8) of the Act respectively, in that:

  - each trust must disregard the relevant disposal for purposes of calculating its taxable income or assessed loss; and

  - each beneficiary will be regarded as having disposed of its interest in the relevant Product Trust or Manager Trust at its base cost or the amount taken into account under section 11(*a*) or section 22(1) or (2) of the Act. The beneficiary will be regarded as having acquired the participatory interest in the relevant FOF Registered CIS or Registered Hedge Fund CIS on the date that the beneficiary acquired its interest in the relevant Product Trust or Manager Trust for a cost equal to its base cost or the amount taken into account under section 11(*a*) or section 22(1) or (2) of the Act.

- Despite the application of section 44(5) of the Act, no amount will be taken into account under paragraph 10, in respect of the disposals by the FOF Registered CISs of their interests in the Manager Trusts in terms of the second amalgamation transaction, as each of those disposals will not give rise to a capital gain as a result of section 44(2) of the Act applying to the disposals.
- Despite the application of section 44(5) of the Act, no amount will be taken into account under paragraph 10, in respect of the subsequent disposal of assets by the Registered Hedge Fund CISs after the second amalgamation transaction, as each of the Registered Hedge Fund CISs is required to disregard capital gains or losses in accordance with paragraph 61(3).
- Provided the appropriate steps have been taken to terminate the Product Trusts and the Manager Trusts within the time period prescribed in section 44(13)(*a*) of the Act, section 44(13) of the Act will not apply to limit the application of the roll-over relief provided for under section 44(2) of the Act.

8. BINDING GENERAL RULING

8.1. BGR 9 – Income Tax – Taxes on income and substantially similar taxes for purposes of South Africa's tax treaties

For the purposes of this ruling:

- **'OECD Model'** means the OECD Model Tax Convention on Income and on Capital;
- **'tax treaty'** means an agreement for the avoidance of double taxation;
- **'treaty relief'** means relief from double taxation.

<u>Purpose</u>

This BGR identifies the taxes administered by SARS which in its opinion constitute taxes on income or substantially similar taxes for purposes of South Africa's tax treaties.

Background

A tax treaty generally provides for relief for:

- specified taxes, usually listed under Article 2 of a tax treaty, in existence at the time the tax treaty is entered into; and
- any identical or substantially similar taxes on income that are imposed after the date of signature of the tax treaty in addition to, or in place of, existing specified taxes.

Ruling

Taxes on income

The following taxes as at publication date of this BGR are taxes on income and therefore qualify for treaty relief under South Africa's tax treaties:

- Normal tax on taxable income, which includes a taxable capital gain (section 5)
- Tax on foreign entertainers and sportspersons, a final tax [section 47B(1)]
- Turnover tax on micro businesses (section 48A)
- Withholding tax on royalties, a final tax [section 49B(1)]
- Withholding tax on interest, a final tax [section 50B(1)]
- STC (dividends declared before 1 April 2012) [section 64B(2)]
- Dividends tax (dividends declared and paid on or after 1 April 2012) [section 64E(1)]

For purposes of the above list, the following are not taxes on income but represent advance payments of normal tax:

- Amounts withheld from payments to non-resident sellers of immovable property in South Africa (section 35A)
- Employees' tax (Fourth Schedule to the Act)

- Provisional tax (Fourth Schedule to the Act)

Taxes that are not taxes on income or similar taxes

South African taxes as at the date of publication of this BGR that are not taxes on income or similar taxes, and which do not qualify for treaty relief, include the following:

- Customs and excise duties
- Diamond export levy
- Donations tax
- Estate duty
- International oil pollution compensation fund contributions levy
- Royalty levied on the transfer of a mineral resource extracted from within South Africa
- Securities transfer tax
- Skills development levy
- Transfer duty
- Unemployment insurance contributions
- Value-added tax

The above list is not exhaustive.

8.2. BGR 25 – Income Tax – Exemption: Foreign Pensions – Issue 2

For the purposes of this ruling:

- **'Republic'** means 'Republic' as defined in section 1(1);
- **'resident'** means 'resident' as defined in section 1(1);

Purpose

This BGR provides clarity on the interpretation and application of the words 'from a

source outside the Republic' in section 10(1)(*g*C)(ii) in relation to pension payments that are received by or accrue to a resident.

Background

Section 10(1)(*g*C)(ii) exempts from normal tax any pension received by or accrued to a resident from a source outside the Republic as consideration for past employment outside the Republic.

The term 'source outside the Republic' can be interpreted to mean either the originating cause which gave rise to that pension (foreign services rendered), or the location from which the pension is received (namely, where the fund is situated).

The term 'past employment outside the Republic' refers to services rendered outside the Republic. Only the portion of a pension that relates to services rendered outside the Republic is exempt from income tax.

Ruling

The term 'source outside the Republic', for purposes of section 10(1)(*g*C)(ii), refers to the originating cause which gives rise to the pension income, namely, where the services have been rendered.

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

Application

The following formula is used to calculate the portion of a pension that will be exempt due to services rendered outside the Republic: Foreign services renderedTotal services rendered × Total pension received or accrued

Exclusion

Section 10(1)(*g*C)(ii) has been amended and, with effect from 1 March 2017, the exemption will no longer apply to any lump sum, pension or annuity paid or payable by a 'pension fund', 'provident fund', 'pension preservation fund', 'provident preservation fund' or 'retirement annuity fund' as defined in section 1(1) (irrespective of where the services were rendered) other than to amounts transferred to such fund from a source outside the Republic.

8.3. BGR 29 – Income Tax – Unbundling transactions: Meaning of 'as at the end of the day after that distribution' – Issue 2

For the purposes of this ruling:

- **'business day'** as defined in the JSE Limited Listings Requirements means any day other than a Saturday, Sunday or any other day on which the JSE is closed;
- **'expenditure'** means expenditure as defined in section 46(3)(*b*);
- **'JSE'** means the securities exchange operated by JSE Ltd;
- **'last day to trade or LDT'** bears the meaning as defined in the JSE Limited Listings Requirements, namely, 'the last business day to trade in a security in order to settle by record date to be able to qualify for entitlements or to participate in an event. All trades done from commencement of trade on LDT + 1 will be excluding entitlements';
- **'record date'** or **'RD'** bears the meaning as defined in the JSE Limited Listings Requirements, namely, 'the date on which the holdings, upon which the event entitlement is based are ascertained. Record date is one settlement period after LDT (currently 3 business days). Record date must be on a Friday or, if Friday is a public holiday, the last trading day of the week';
- **'section 46'** means section 46 of the Income Tax Act;

<u>Purpose</u>

This BGR addresses the interpretation of the words 'at the end of the day after that distribution' as used in section 46(3)(*a*)(v) in relation to an unbundling company listed on the JSE. It does not address consecutive unbundling transactions occurring on the same day or the determination of the market value of shares in an unlisted unbundled company.

<u>Background</u>

Section 46 provides parties to an unbundling transaction with relief from various

taxes that would otherwise become payable.

A shareholder who acquires unbundled shares through an unbundling transaction must allocate a portion of the expenditure and any market value on valuation date attributable to the unbundling shares to the unbundled shares under section 46(3)(*a*)(i)(*aa*).

In making this allocation, section 46(3)(*a*)(v) requires that the shareholder must use the ratio that the market value of the unbundled shares, *'as at the end of the day after that distribution'*, bears to the sum of the market values, as at the end of that day, of the unbundling shares and the unbundled shares.

Application of the law

The JSE Equities Rules are binding on members of the JSE, their clients and agents. Under these rules shares in an unbundling company trade inclusive of the right to the unbundled shares up to and including LDT and begin trading exclusive of that right on the first business day after LDT.

Unbundled shares in a listed unbundled company would begin trading independently of the shares in the unbundling company on LDT + 1. A holder of unbundling company shares on LDT takes delivery of the unbundled company shares only on record date + 1, that is, LDT + 4. Such a holder is nevertheless able to trade in the unbundled company shares from the commencement of LDT + 1 by contractual arrangement, with settlement being made on a rolling 'T + 3' (trade plus three days) basis. In other words, the seller is obliged to deliver the shares to the buyer on the third business day following the day on which the shares were disposed of.

The prices of the unbundling and unbundled company shares tend to fluctuate during the initial period of trading on LDT + 1 owing, amongst other things, to the number of sellers entering the market but should stabilise by the close of business on that day.

In order to achieve a fair allocation between the unbundling and unbundled shares, the market values as at the end of the first business day after LDT must be used when applying the ratio as specified in section 46(3)(*a*)(v).

Thus if LDT falls on a Tuesday,4 the first business day after LDT will fall on the

next day (Wednesday) and the closing prices on the Wednesday must be used (assuming the Tuesday and Wednesday are both business days).

The same listed prices should be used in performing the allocation for certificated listed shares since such shares can be traded on the JSE only after they have been dematerialised.

Ruling

For the purposes of section 46(3)(*a*)(v) and with reference to the market values of the unbundling and unbundled company shares, 'as at the end of the day after that distribution' means in relation to shares unbundled under section 46 of the Act by an unbundling company listed on the JSE:

- the closing price of the unbundling company shares on LDT +1; and
- the closing price of a listed unbundled company's shares on LDT + 1.

8.4. BGR 37 – VAT – Zero-rating of international travel insurance

For the purposes of this ruling –

- **'inbound policy'** means a travel policy which provides insurance cover in respect of a passenger transported from an export country to South Africa or between two places in South Africa as part of an international journey;
- **'international journey'** means a journey commencing from the 'point of departure' in South Africa to a destination outside South Africa (and *vice versa*), including (where applicable) stopovers *en route* to the destination, time spent in the destination country and the return journey;
- **'outbound policy'** means a travel policy which provides insurance cover in respect of a passenger transported from South Africa to a destination in an export country or from a place outside South Africa to another destination outside South Africa as part of an international journey;
- **'point of departure'** means the insured person's normal place of business, residence or other location from where the insured person departs to commence an 'international journey' in a direct and uninterrupted manner;

- **'policy document'** means a document which is evidence of a contract of insurance, including any renewal notice, premium notification or endorsement in respect thereof;
- **'stopover'** means a stop, delay or brief stay as a result of a multi-staged international transport service supplied to the insured, which is less than 24 hours from the time of arrival to the commencement of the next stage of the international journey or longer period resulting from circumstances beyond the insured's control such as flight delays;
- any other word or expression bears the meaning ascribed to it in the VAT Act.

The purpose of this BGR is to make an arrangement under section 72 relating to the zero-rating of international travel insurance.

A person travelling to an export country may obtain travel insurance to cover risks, such as medical care and lost baggage. The insurance is generally provided under an outbound or inbound insurance policy document which covers the entire journey or cover may be limited to a certain number of days that the insured is travelling. Insurers generally determine a single premium with reference to the insured's destination and the duration of cover required.

The supply of travel insurance while the insured is transported as part of an international journey qualifies for zero-rating under section 11(2)(*d*). This section does however not extend to zero-rating insurance cover provided during the period that the insured is:

- transported to and from the insured's original point of departure; and
- not being transported while on the international journey (for example, while the insured stays in a hotel).

Consequently, these insurance services would be subject to VAT at the standard rate, unless an arrangement is made under section 72. On the basis that, for all practical purposes, insurers regard the supply of international travel insurance as a single supply in respect of which a single premium is charged (irrespective of whether the insured is being transported or not) there is a difficulty in the application of the VAT Act.

Ruling

An arrangement is made under section 72 to allow insurers to zero rate travel insurance supplied in respect of an international journey which includes periods during which the insured is:

- outside South Africa but not being transported while on an international journey; and
- inside South Africa while *en route* to the place of departure from another place in South Africa as part of the international journey (and *vice versa*).

This arrangement will only apply if the cover is provided under a single outbound or inbound policy levying a single premium.

In instances where the local and international travel are covered by separate policies, only the supply of international travel insurance qualifies for zero-rating whereas the local travel insurance is subject to VAT at the standard rate.

8.5. BGR 38 – VAT – The value-added tax treatment of the supply and importation of vegetables and fruit

For the purposes of this ruling:

- **'catering services'** means the services of providing people with food and beverages at social events, gatherings, conferences or similar events;
- **'Item'** means an Item in Part B of Schedule 2 to the VAT Act;
- **'section'** means a section of the VAT Act;
- **'similar establishments'** includes, but is not limited to:
    - in the case of restaurants
        - a restaurant section in a store;
        - hotels;
        - guest-houses;
        - hospitals, and

- in the case of stores
  - supermarkets;
  - hypermarkets;
  - wholesale stores; and
  - all other kinds of grocery stores;

Purpose

This BGR sets out the VAT rate applicable to the supply and importation of vegetables and fruit, and withdraws BGR (VAT) 18 dated 27 March 2013 'The Zero-Rating of Various Types of Dates'.

Ruling

Zero-rated supplies

The supply of vegetables and fruit that have not been cooked or treated in any manner except for the purpose of preserving such vegetables and fruit in their natural state, is zero-rated under section 11(1)(*j*) read with Item 12 and Item 13 respectively.

Fresh and frozen vegetables and fruit supplied in the following manner are regarded as not having been 'treated' as envisaged in the said Item numbers, and therefore qualify for zero-rating:

- Cut (including vegetables and fruit cut into specific shapes)
- Diced
- Sliced
- Shredded
- Crushed
- Minced
- Pureed
- Peeled
- De-pitted

- Compressed

The aforementioned zero-rating applies regardless of whether the vegetables and fruit are sold individually (for example, a punnet of strawberries or a pocket of potatoes) or mixed (for example, mixed diced carrots and potatoes or mixed chopped strawberries and kiwi fruit).

Frozen vegetables and fruit that have been blanched in hot water are regarded as having been 'treated' for the purpose of preserving the vegetables and fruit in their natural state, and therefore, the supply of such frozen vegetables and fruit qualify for the zero rating.

The supply of a mix or a combination of vegetables and fruit by a store or similar establishment, whether or not at the delicatessen section of the establishment, may be zero-rated unless the vegetables and fruit fall under Standard-rated supplies.

The vendor must obtain and retain documentary proof substantiating the vendor's entitlement to apply the zero rate under section 11(3).

<u>Standard-rated supplies</u>

Vegetables and fruit supplied in the following manner are specifically excluded from Items 12 and 13 respectively, and the supply of such vegetables and fruit is subject to VAT at the rate of 14% under section 7(1)(*a*):

- Cut, diced, sliced or peeled vegetables or fruit to which any other substance has been added whether or not separately packed in the same container (other than for purposes of preserving the vegetables or fruit in their natural state). Examples are:
    - sachet of spices added to sliced mushrooms;
    - fruit juice added to sliced fruit or a mixture of vegetable and fruit; and
    - salad dressing and/or cheese added to a green salad (for example, a mixture of slices of lettuce, cucumber and tomato).

- Fresh or frozen vegetables and fruit that have been treated with an additive for the purpose of adding colour or flavour (for example, glucose, sugar or salt).
- Dehydrated, dried, canned or bottled vegetables or fruit.
- Vegetables or fruit smoothies or juices, and any similar products.

The supply of vegetables and fruit in the course of carrying out any agreement for the furnishing or serving of any meal, refreshment, cooked or prepared food or any drink, so as to be ready for immediate consumption when supplied, is subject to VAT at the rate of 14% under section 7(1)(*a*). The supply of vegetables and fruit by a restaurant or similar establishment, or in the course of providing catering services, is therefore subject to VAT at the rate of 14% under section 7(1)(*a*), irrespective of whether they fall under Zero-rated supplies.

Importation of vegetables and fruit

The importation of vegetables and fruit listed in Zero-rated supplies is, under section 13(3) read with paragraph 7(*a*) of Schedule 1 to the VAT Act, exempt from the VAT levied under section 7(1)(*b*).

The importation of vegetables and fruit listed in Standard-rated supplies is subject to VAT at the rate of 14% under section 7(1)(*b*).

8.6. BGR 39 – VAT – VAT treatment of municipalities affected by changes to municipal boundaries

For the purposes of this ruling, unless the context indicates otherwise:

- **'existing municipality'** means a municipality in the form in which it existed before any municipal boundary change;
- **'municipal boundary change'** means any change or re-determination of municipal boundaries from the effective date published by way of a Notice in a Provincial *Government Gazette* under section 12 of the Local Government: Municipal Structures Act 117 of 1998;

- **'Structures Act'** means the Local Government: Municipal Structures Act 117 of 1998;
- **'superseding municipality'** means a municipality into which an existing municipality or part thereof is merged, or a new municipality that has been created to supersede an existing municipality or municipalities, or parts thereof as a result of a municipal boundary change;

Purpose

The purpose of this BGR is to make an arrangement under section 72 relating to the VAT treatment of the transfer of any assets, liabilities, rights and obligations pursuant to the merger, creation and disestablishment of municipalities as a result of any municipal boundary change.

Background

From time-to-time the Municipal Demarcation Board may consider applications to change municipal boundaries under the Structures Act.

The municipal boundary changes which affect so-called 'existing municipalities' are dealt with under section 31 of the Local Government: Municipal Demarcation Act 27 of 1998. In terms of that Act, the legal, practical and other consequences resulting from the area of a municipality being wholly or partially incorporated in or combined with the area of another municipality must be dealt with under the Structures Act.

Section 14 of the Structures Act regulates the effects of the establishment of a municipality on existing municipalities and provides, amongst others, that:

- a municipality established under section 12 of the Structures Act supersedes the existing municipality or municipalities to the extent that the existing municipality or municipalities fall within that area;
- the superseding municipality becomes the successor in law of the existing municipality (subject to certain provisions dealing with the sharing of functions between local municipalities and district municipalities); and
- the notice required under section 12 of the Structures Act must contain certain information about the disestablishment as well as the various

aspects relating, for example, to staff matters and the transfer of administrative records, assets, liabilities, rights and obligations from the existing municipality to the superseding municipality or municipalities.

The VAT Act does not have a comparable provision to section 14 of the Structures Act which deals with the potential supplies of goods or services which may occur as a result of any municipal boundary change.

Ruling

Following from the discussion above, an arrangement is hereby made under section 72 to the effect that in the case of the transfer of any assets, liabilities, rights and obligations as a result of a municipal boundary change, the existing municipality and the superseding municipality shall be deemed to be one and the same person.

The effect of this ruling is that as at the effective date of the municipal boundary change:

- no supply of any goods or services is made by the existing municipality for the purposes of section 7(1)(*a*), and consequently, there will be no output tax payable by the existing municipality under section 16(4);
- no goods or services are acquired by the superseding municipality from the existing municipality, and consequently, no input tax deduction will be allowed under section 16(3) to the superseding municipality;
- no change of use adjustments under section 18 will be allowed to, or required by, either the existing municipality or the superseding municipality;
- an output tax or input tax adjustment may be required as contemplated in section 15(5) in a case where the existing and superseding municipalities do not account for VAT on the same accounting basis;
- the provisions of section 8(2) will not apply to the existing municipality upon its disestablishment and subsequent deregistration for VAT purposes unless any goods or rights capable of assignment, cession or surrender are not transferred to the superseding municipality as a result of the municipal boundary change, in which case, section 8(2) shall only apply to that extent;

- for the purposes of sections 16(2), 16(3), 17(1), 20 and 21, any valid tax invoice, debit or credit note or other prescribed document which has been issued in the name of the existing municipality, may be used as acceptable documentary proof for the purposes of deducting input tax or other allowable deduction in the name of the superseding municipality for a period of six months after the effective date of the municipal boundary change, provided such deduction has not previously been allowed to the existing municipality;
- for the purposes of calculating the superseding municipality's apportionment percentage as prescribed by section 17(1) and the related annual adjustment, symbols (a), (b) and (c) in the Formula in BGR 4 (Issue 3) shall be the aggregate of the values of those symbols for the existing and superseding municipalities for the financial year concerned;1 and
- as a superseding municipality becomes the successor in law of the existing municipality, the superseding municipality is liable to account to SARS for any VAT liability or outstanding VAT returns in relation to the activities of the existing municipality which arose before the effective date of the municipal boundary change.

8.7. BGR 40 – Remuneration paid to non-executive directors

For the purposes of this ruling:

- **'NED'** means a non-executive director of a company;
- **'paragraph'** means a paragraph of the Fourth Schedule to the Act;
- **'remuneration'** means remuneration as defined in paragraph 1;

Purpose

This BGR provides clarity on the employees' tax consequences of income earned by an NED, as well as the effect those employees' tax consequences could have

on the prohibition against deductions by office holders under section 23(*m*).

This BGR should be read in conjunction with Binding General Ruling (Value-added Tax) 41, which deals with the VAT consequences of amounts earned by NEDs.

Background

Since the so-called statutory tests contained in paragraph (ii) of the exclusions to the definition of 'remuneration' were amended in 2007, there has been uncertainty over whether the amounts payable to an NED are subject to the deduction of employees' tax. In the 2016 Budget, the Minister of Finance announced that this matter will be properly investigated. These investigations have culminated in SARS issuing this BGR.

Discussion

The concept of a non-executive director

An NED is not defined in the Act. The King III report states that crucial elements of an NED's role are that an NED:

- must provide objective judgment independent of management of a company;
- must not be involved in the management of the company; and
- is independent of management on issues such as, amongst others, strategy, performance, resources, diversity, etc.

In this context, 'independence' does not have the same meaning as it does under the *locatio conductio operis* of the common law. It simply means '*the absence of undue influence and bias*…'.

For purposes of this BGR, SARS considers an NED to be a director who is not involved in the daily management or operations of a company, but simply attends, provides objective judgment, and votes at board meetings.

Are the amounts paid to non-executive directors remuneration?

SARS accepts that the nature of the duties of an NED mean that NEDs are not common law employees. The only way that an NED would be subject to employees' tax is if the so-called statutory tests apply. These tests provide that,

notwithstanding that an amount may have been paid in respect of services rendered to a person carrying on an independent trade, the recipient is deemed to be an employee if two requirements have been satisfied: the 'premises' test; and the 'control or supervision' test. The tests operate as follows:

- Under the 'premises' test, the services must be performed mainly at the premises of the client. 'Mainly' in this context means a quantitative measure of more than 50%.
- Under the 'control or supervision' test, either control or supervision must be exercised over one of the following:
    - The manner in which the duties must be performed; or
    - The hours of work.

It is only if **both** tests are satisfied, (that is, both the premises test, and the control or supervision test) that the recipient is deemed to not be carrying on an independent trade, and will thus be receiving 'remuneration' for employees' tax purposes. If only one of these tests is satisfied, or neither, the deeming rules will not apply.

If an NED is not deemed to be an employee, and is not a common law employee, the amounts payable to such NED will not be 'remuneration'.

It has been suggested that payment made by a company to an NED for time spent in preparation for board meetings, for example, payment of an hourly rate for a specified number of hours before each meeting, creates a form of control or supervision over the hours of the NED.

This is an incorrect application of the control or supervision test. The mere fact that there is a contractual nexus regulating the number of hours for which preparation time may be billed, does not mean that the control or supervision is being exercised over the hours during which an NED's duties are performed. Such payments will not satisfy this test. This rule does not apply to non-resident independent contractors.

<u>The prohibition against deductions for office holders</u>

Section 23(*m*) prohibits the deduction of certain expenses for employees and office

holders. Two of the important triggers for this section to come into operation, are that:

- the expenditure, loss or allowance must relate to an office held; and
- the taxpayer must derive 'remuneration' in respect of that office.

Directors are holders of an office. Accordingly, if they receive 'remuneration', section 23(*m*) will operate to prohibit certain deductions. However, if they do not receive remuneration, section 23(m) will not apply and the ordinary rules for deductibility of expenditure, losses or allowances will apply.

Ruling

For purposes of determining whether an NED receives 'remuneration', it is accepted that such NED is not a common law employee. It is further accepted that no control or supervision is exercised over the manner in which such NED performs his or her duties, or the NED's hours of work.

The director's fees received by an NED for services rendered as an NED on a company's board, are thus not 'remuneration', and are not subject to the deduction of employees' tax.

It is further accepted that because the amounts received by an NED are not 'remuneration', the prohibition under section 23(*m*) will not apply in respect of such fees.

This ruling does not apply in respect of non-resident NEDs.

8.8. BGR 41 – VAT – VAT treatment of non-executive directors

For the purposes of this ruling:

- **'NED'** means a non-executive director;
- **'non-resident'** means a person that is not a 'resident of the Republic' as defined in section 1(1) of the VAT Act;
- **'remuneration'** means remuneration as defined in paragraph 1 of the Fourth Schedule to the Act;

Purpose

This BGR deals with the VAT treatment of the activities conducted by NEDs and clarifies whether those activities fall within the ambit of proviso (iii)(*aa*) or proviso (iii)(*bb*) to the definition of 'enterprise' in section 1(1).

This BGR must be read in conjunction with BGR (Income Tax) 40, which provides clarity on whether director's fees for services rendered by NEDs fall within the definition of 'remuneration' in the Fourth Schedule to the Act.

Background

It is stated in BGR (Income Tax) 40, that as a result of certain amendments in 2007 to the exclusions contained in the definition of 'remuneration' in the Fourth Schedule to the Act, some uncertainty developed as to whether the amounts payable to an NED are subject to the deduction of employees' tax. This uncertainty also extends, by implication, to the application of proviso (iii) to the definition of 'enterprise' in section 1(1) which excludes the activities of an employee, but includes the activities of a so-called 'independent contractor'.

The question therefore arises as to whether NEDs should be regarded as:

- employees or deemed employees under the Fourth Schedule to the Act so that their income is subject to employees' tax; or
- independent contractors that may be liable to register for VAT if their fees for services rendered exceed the VAT registration threshold of R1 million in any consecutive period of 12 months; or
- being subject to both employees' tax and VAT.

Application of the law – employee or independent contractor?

The courts have highlighted a number of factors to be taken into account to distinguish between an employment contract (employee) and a contract for services (independent contractor). However, as there is no absolute test which can be applied to distinguish between the two types of contract, for the purposes of this BGR and proviso (iii) to the definition of 'enterprise':

- an employee is a person who commits his or her productive capacity to another person (the employer) in terms of an *employment contract*; and
- an independent contractor is a person who commits his or her labour to the

recipient (employer) to produce a given result in terms of a *contract for services*.

The VAT treatment of employees and independent contractors is dealt with in proviso (iii) to the definition of 'enterprise' in section 1(1).

Proviso (iii)(*aa*) to the definition of 'enterprise' refers to the services rendered by a person (employee) to an employer under an *employment contract*. This is a reference to the services of a so-called 'common law employee'. The effect is that such services can never qualify as an enterprise activity. As such, the employee cannot register for VAT and will not charge VAT on any salary, wages, commission or similar amount which is paid or payable by the employer in that regard.

Proviso (iii)(*bb*) to the definition of 'enterprise' refers to the services rendered by an 'independent contractor' to the employer (recipient) under a *contract for services* in circumstances where such enterprise is carried on independently of the recipient. In other words, the activities of the service provider show the hallmarks of an independent business (enterprise) activity carried on by that person as opposed to the services rendered by an employee under an employment contract. In addition, even if a person is an employee as contemplated in proviso (iii)(*aa*), that person is not necessarily prevented from conducting enterprise activities outside of the employment contract as contemplated in proviso (iii)(*bb*). In such a case, that person may be liable to register and charge VAT in respect of such enterprise activities carried on independently.

The fact that certain independent contractors such as labour brokers or personal service providers are *deemed* to earn 'remuneration' under the Fourth Schedule to the Act does not affect the independent nature of that person's activities for VAT purposes. It is therefore incorrect to conclude that an independent contractor must be regarded as an employee for VAT purposes merely because that person's income is deemed to be 'remuneration' which is subject to employees' tax under the Fourth Schedule to the Act. The income earned by NEDs does not, in any event, fall within the ambit of those deeming provisions. However, an NED may voluntarily request that employees' tax be deducted from any directors' fees which are paid to him/her.

Similarly, the factthat a non-resident NED earns 'remuneration' under the Fourth

Schedule to the Act does not affect the independent nature ofthat non-resident NED's activities under proviso(iii)(*bb*) to the definition of 'enterprise' and any potential liability for that person to register for VAT in the Republic. However, the focus of attention in such cases will be on how the NEDs services are rendered. For example, a non-resident NED will be carrying on an enterprise if the services are physically performed in the Republic on a continuous or regular basis, or if the services are conducted on a continuous or regular basis through a fixed or permanent place in the Republic.

Ruling

VATtreatmentof NEDs

It is concluded in BGR(Income Tax) 40 that an NED is not considered to be a common law employee. This is based on the view that the services must be supplied independently and personally by the NED. Any director's fees paid or payable to an NED for services rendered in that capacity is therefore not regarded as 'remuneration'. It follows that for VAT purposes an NED is treated as an independent contractor as contemplated in proviso(iii)(*bb*)to the definition of 'enterprise' in section1(1) in respect of those NED activities.

Liability of NEDs to registerfor VAT

An NED that carries on an enterprise in the Republic is required to register and charge VAT in respect of any director's fees earned for services rendered as an NED if the value of such fees exceed the compulsory VAT registration threshold of R1million in any consecutive 12-month period as provided in section 23(1). This rule applies whether the NED is an ordinary resident ofthe Republic or not.

An NED may also choose to register for VAT voluntarily under section 23(3) if the value of such fees does not exceed the compulsory VAT registration threshold prescribed in section 23(1).

8.9. BGR 42 – No-value provision in respect of transport services

For the purposes of this ruling –

- **'employee'** means 'employee' as defined in paragraph 1;
- **'employer'** means 'employer' as defined in paragraph 1;
- **'paragraph'** means a paragraph of the Seventh Schedule to the Act;

Purpose

This BGR provides clarity on the no-value provision in respect of transport services rendered by an employer to employees in general for transport services provided from their homes to place of employment and *vice versa*.

Background

Employers often provide employees with transport services from their homes to their place of employment either for no consideration or for a consideration which is lower than the actual cost of the service provided. Such transport service is a taxable benefit in the hands of the employee, but may attract no value where certain requirements have been met. There is uncertainty as to the application of the no-value provision as provided for in paragraph 10(2)(*b*).

Discussion

Paragraph 2(*e*) provides that a taxable benefit is deemed to have been granted by an employer to an employee if any service has, at the expense of the employer, been rendered to the employee for his or her private or domestic purposes. The cash equivalent of the value of the taxable benefit is calculated under paragraph 10(1), and the no-value provisions are provided for under paragraph 10(2).

Paragraph 10(2)(*b*) provides that the taxable benefit will attract no value where any transport service is rendered by any employer to his employees in general for the conveyance of such employees from their homes to the place of their employment and *vice versa*.

The word 'homes' is very specific and denotes a specific dwelling in which the employee resides or inhabits. The question that arises is whether, from an interpretive perspective, the word 'homes' should be restricted to the exact position of an employee's specific dwelling. An employee could, for example, live in a block of flats, on a farm, or in a rural area with little or no accessible roads. The employee may be required to walk to the nearest accessible road to obtain the

transport service which could, for example, be kilometres away from his or her dwelling.

Taking the above into consideration, an employer may arrange for employees living within a certain radius to be collected from or dropped off at a common area or central point between the employees' homes and place of employment. An employer may also provide transport services for only part of the trip between the employees' homes and place of employment.

Ruling

Transport services provided to employees to and from any collection or drop-off point *en route* to or from the employees' homes and place of employment is accepted to fall within the provisions of paragraph 10(2)(*b*). No value will, therefore, be placed on these transport services.

This ruling constitutes a BGR issued under section 89 of the Tax Administration Act 28 of 2011.

9. DRAFT BINDING GENERAL RULING

9.1. BGR … – Associations: Funding requirements

For the purposes of this BGR:

- **'entity'** means any 'entity' defined in section 30B(1) which has been approved as an association by the Commissioner under section 30B(2);
- **'government'** means the government of the Republic in the national, provincial or local sphere contemplated in section 10(1)(*a*);
- **'section 30B'** means the section which sets out the conditions and requirements that an entity must comply with in order to obtain and retain approval as an association so as to enjoy exemption from normal tax under section 10(1)(*d*)(iii) or section 10(1)(*d*)(iv)(*bb*);

Purpose

This BGR provides clarity on the interpretation and application of the funding

requirement in section 30B(2)(*b*)(ix).

Background

The Commissioner must approve an entity for purposes of section 10(1)(*d*)(iii) or section 10(1)(*d*)(iv)(*bb*) if that entity has submitted a copy of its constitution or written instrument under which it has been established and it complies with the conditions and requirements set out in section 30B(2)(*b*).

An entity includes any:

- mutual loan association, fidelity or indemnity fund, trade union, chamber of commerce or industry (or an association of such chambers) or local publicity association; or
- non-profit company, society or other association of persons established to promote the common interests of persons, being members of such company, society or association of persons, carrying on any particular kind of business, profession or occupation.

A requirement for such entities to obtain approval as an association under section 30B(2) is that, among other things, substantially the whole of the entity's funding must be derived from its annual or other long-term members or from an appropriation by the government.

Discussion

The word 'funding' is not defined in the Act, and should therefore be interpreted according to its ordinary meaning as applied to the subject matter relating to which it is used unless the ordinary meaning creates an absurdity or ambiguity. It is important when giving words and expressions their ordinary meaning, to consider the context in which such words or expressions are used.

The ordinary dictionary meaning of 'funding' is –

'money provided, especially by an organisation or government, for a particular purpose' and 'financial resources provided to make some project possible'.

The word 'funding' referred to in section 30B(2)(*b*)(ix) therefore generally refers to the financial resources of an entity for the financing of its activities in the furtherance of its sole or principal object for which it has been established.

The requirement in section 30B(2)(*b*)(ix) is that substantially the whole of the entity's funding must be derived from its annual or long-term members or from an appropriation by the government. In the strict sense the term 'substantially the whole' is regarded by SARS to mean 90% or more. SARS will, however, in exceptional circumstances accept a percentage of not less than 85%.

The funding requirement does not require an entity to derive its funding solely from membership or subscription fees. An entity is also not prohibited from deriving funding from non-members, provided substantially the whole of its funding is derived from its annual or long-term members or from an appropriation by the government.

Ruling

It is not a requirement in section 30B(2)(*b*)(ix) that an entity derive funding solely from membership or subscription fees. An entity that receives funding other than in the form of a membership or subscription fee from any annual or long-term member will also qualify as funding for purposes of section 30B(2)(*b*)(ix).

An entity will also not fall foul of the requirements in section 30B(2)(*b*)(ix) if funding is derived from any non-member provided that at least 90% and in exceptional circumstances not less than 85% of the total funding is derived from its annual or long-term members or from an appropriation of government.

This ruling constitutes a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011.

9.2. BGR … – Treatment of transport, insurance and handling expenses

For the purposes of this BGR:

- **'EBIT'** means earnings before interest and taxes as determined under section 5;
- **'the Act'** means the Mineral and Petroleum Resources Royalty Act 28 of 2008;
- **'Schedule'** means a Schedule to the Act;

- **'section'** means a section of the Act;
- **'transfer'** means transfer as defined in section 1(1); and
- any other word or expression bears the meaning ascribed to it in the Act.

Purpose

This BGR provides clarity on the treatment of expenditure incurred in respect of transport, insurance, and handling of refined and unrefined minerals for purposes of sections 5(3)(*c*) and 6(3)(*a*) and (*b*), respectively.

Background

A royalty is imposed under section 2 upon transfer of a mineral resource extracted from within the Republic. A transfer occurs when an extractor disposes of a mineral resource or when its mineral resource is lost, stolen, consumed or destroyed provided that such mineral resource has not previously been disposed of, lost, stolen consumed or destroyed.

The rate at which the royalty is calculated is determined in accordance with the following formulae contained in section 4:

- 0,5 + [EBIT/ (gross sales × 12,5 for refined mineral resources)] × 100
- 0,5 + [EBIT/ (gross sales × 9 for unrefined mineral resources)] × 100

The calculation of the rate of royalty payable is therefore dependent on the determination of EBIT and gross sales figures. EBIT is calculated under section 5 and 'gross sales' is calculated under section 6.

Gross sales must be determined without any regard to any expenditure incurred in respect of transport, insurance and handling of a refined and unrefined mineral after that mineral was brought to the condition specified in Schedule 1 or 2 (whichever is applicable) or to effect the disposal of that mineral resource.

Similarly, EBIT must also be determined without any regard to any expenditure incurred in respect of transport, insurance and handling of a refined and unrefined mineral after that mineral was brought to the condition specified in Schedule 1 or 2 (whichever is applicable) or to effect the disposal of that mineral resource.

The meaning of 'without regard to'

The phrase 'without regard to' is not defined in the Act and should therefore be interpreted according to its ordinary dictionary meaning having regard to the context in which it is contained unless the ordinary meaning creates absurdity or ambiguity.

'Without', and 'regard' are defined in the *Oxford Dictionaries* as:

'[i]n the absence of' and '[c]onsider or think of in a certain way'

The Online Word Reference Dictionary defines 'without regard to' as:

'despite, without considering, regardless of, notwithstanding, regardless, leaving aside, aside from, in spite of, even with, disregarding'.

The phrase 'without regard to' is widely defined, therefore the context in which the phrase is used must be considered.

In *Joffin and Another v Commissioner of Child Welfare, Springs*, the court held that the words 'have regard to' in their ordinary meaning simply mean 'bear in mind' or 'do not overlook'. The term 'with regard to' and 'having regard to' means that something must be taken into consideration, looked at or born in mind, therefore, 'without regard to' means something must not be taken into consideration.

Consequently, when one considers the context in which the phrase 'without regard to' is contained, the appropriate dictionary meaning would be 'disregarding' and the present tense 'disregard' is to exclude or ignore something. It does not imply that there must be a deduction in respect of transport, insurance and handling expenses that have been incurred after the mineral resource is brought to the condition specified or to effect the disposal of that mineral resource.

<u>Treatment of transport, insurance and handling costs</u>

Expenditure incurred in respect of transport, insurance and handling to bring the mineral resource to the condition specified in Schedule 1 or 2 (whichever is applicable) must be taken into account in the determination of gross sales and EBIT.

All expenditure in respect of transport, insurance and handling incurred after the mineral resource is brought to the condition specified in Schedule 1 or 2 must not be taken into consideration when calculating gross sales and EBIT.

Only transport, insurance and handling expenditure incurred in order to bring the mineral resource to the condition specified in Schedule 1 or 2 can be taken into account when determining gross sales and EBIT.

Ruling

The ordinary dictionary meaning of the phrase 'without regard to', as contained in sections 5(3) and 6(3) respectively, means that the expenditure incurred in respect of transport, insurance and handling:

- after the mineral resource is brought to the condition specified in Schedule 1 or 2; or
- to effect the transfer of that mineral resource,

must not be taken into account when determining gross sales and EBIT for purposes of calculating the royalty percentage. Such costs will not qualify as a deduction in the determination of gross sales or EBIT.

In the event that such costs are on charged and included in the price of the mineral resource sold, the sales price may be adjusted to disregard such amounts from the calculation of gross sales and EBIT. The onus of proof rests with the extractor to prove that such amounts were taken into account and included in the price of the mineral resource.

9.3. BGR … – VAT – Supply of potatoes

For the purposes of this ruling, unless the context indicates otherwise –

- **'Part A'** means Item 6 of Part A of Schedule 2 to the VAT Act;
- **'Part B'** means Item 12 of Part B of Schedule 2 to the VAT Act;
- **'seed potatoes'** means potatoes which have been certified as seed potatoes under the South African Seed Potato Certification Scheme;

Purpose

This BGR sets out:

- the factors that will be considered by the Commissioner in determining whether potatoes are being supplied:

- as seed under Part A, to be used or consumed for agricultural, pastoral or other farming purposes; or
- as vegetables under Part B, that is, the supply consisting of foodstuffs; and

- the general VAT treatment of the supply of potatoes under Part A and Part B.

Ruling

Factors to consider when distinguishing between potatoes supplied under Part A or Part B

In order to distinguish between potatoes supplied as seed under Part A and potatoes supplied as foodstuffs under Part B, the intention of the vendor supplying the potatoes must be determined at the time of supply. In determining the stated intention of the supplier, the Commissioner may consider, amongst others, the following objective factors:

- The description of the potatoes as contained in the tax invoice issued by the supplier.
- The status of the recipient of the potatoes. For example, is the recipient a VAT-registered vendor carrying on agricultural, pastoral or other farming operations and authorised under Clause 7 on the Notice of Registration to acquire the goods concerned at the zero rate.
- The consideration paid for the potatoes. For example, the price paid for seed potatoes may be significantly higher than potatoes supplied as foodstuffs.
- The labelling or packaging in which the potatoes are supplied. For example, seed potatoes are required, under the South African Seed Potatoes Certification Scheme, to be supplied in containers which are labelled in a specific manner.

Potatoes supplied under Part A

These are potatoes supplied as seed for cultivation under Item 6 of paragraph 1 of Part A. The supply of these potatoes is zero-rated under section 11(1)(*g*) subject to

the provisions of paragraph 2 of Part A.

In the event that the vendor does not comply with the statutory requirements set out in paragraph 2 of Part A, the supply of the potatoes must be subject to VAT at the rate of 14% under section 7(1)(*a*). Furthermore, the vendor supplying the potatoes may not zero-rate the supply under Part B if the vendor's intention (as determined using the factors in **2.1**) is to supply the potatoes in question as seed but failed to comply with the requirements of paragraph 2 of Part A.

Potatoes supplied under Part B

These are potatoes supplied as foodstuffs (that is, vegetables) under Item 12 of paragraph 1 of Part B. The supply of these potatoes is zero-rated under section 11(1)(*j*).

Documentary proof

The vendor must, under section 11(3), obtain and retain documentary proof substantiating the vendor's entitlement to apply the zero rate under section 11(1)(*g*) or (*j*).

Specifically with regard to section 11(1)(*g*), paragraph 2 of Part A requires the recipient to have been issued with a Notice of Registration in which authorisation is granted for goods to be acquired at the zero rate. The recipient must be in possession of a valid copy of such a Notice of Registration at the time of supply, a tax invoice must be issued containing the particulars required under section 20(4) and the supply of the goods must not be prohibited under section 7*bis* of the Fertilizers, Farm Feed, Agricultural Remedies and Stock Remedies Act 36 of 1947.

9.4. BGR … – VAT – Deduction of input tax in respect of second-hand gold

For the purposes of this ruling, unless the context indicates otherwise:

- **'carat'** means a unit for measuring the purity of gold on the gold carat scale, which expresses the proportion of gold in parts per 24 by mass in comparison to the full mass of the item, that is, each carat indicates that 1/24th of the whole item consists of pure gold;

- **'foreign gold coin'** means any gold coin minted outside South Africa;
- **'gold'** means the chemical element with symbol AU and atomic number 79;
- **'notional input tax'** means an amount contemplated in subparagraph (*b*) of the definition of 'input tax' as defined in section 1(1) of the VAT Act.
- **'solely of gold'** means at least 99,5% pure gold;
- **'sole purpose'** means the only purpose for which the vendor acquired gold;
- **'same state without further processing'** means without undergoing any transformational process which may change the purity, quality or form of the gold in any way;
- **'substantially the same state'** means the principal essentials of the item containing gold is not changed with reference to the gold as a whole.

Purpose

This BGR sets out the instances in which the supply of gold is regarded to be a supply of 'second-hand goods' as defined in section 1(1) and when notional input tax may be deducted in respect thereof.

Background

A vendor that acquires second-hand goods, including goods made from precious metals, from a seller that is not a vendor, may deduct notional input tax. This allows for the unlocking of part of the VAT on goods previously paid by final consumers as those goods re-enter the formal supply chain.

In 2014, changes were made in the VAT Act to amend the definition of 'second-hand goods' to specifically exclude 'gold' and 'goods containing gold' from the definition and thereby denying the notional input tax credit on these goods. The policy rationale for the 2014 amendments was to curb fraudulent notional input tax deductions on the acquisition of gold and gold jewellery. The amendment was not intended to have a negative impact on legitimate transactions within the second-hand goods industry.

In order to address the above mentioned concern, the 2014 amendments were revised to limit the extent of the exclusion contained in the definition of 'second-

hand goods' as contained in section 1(1). This amendment comes into operation on 1 April 2017.

Discussion

Vendors acquiring second-hand gold from non-vendors may not deduct input tax in respect thereof unless the exceptions to the definition of 'second-hand goods' are met. This definition distinguishes between three classes of supplies which are discussed below.

Goods consisting solely of gold [paragraph (*aa*)]

Goods consisting solely of gold can only be regarded as second-hand goods if the gold is acquired for the sole purpose of supplying it in the same state without further processing.

Purity of gold

For purposes of this BGR, 'solely' means that the goods must consist of at least 99% pure gold. On the basis that 100% purity is unattainable, 24 carat gold is accepted as consisting solely of gold as this designation is only allowed by industry where the gold content is at least 99,5%.

In instances where a person acquires a piece of gold jewellery which seems to consist only of gold; that is, no other precious metals, stones or gems are attached to that piece, it does not mean that the item consists solely of gold. Gold is a very soft metal to which other metals are added to improve durability. These alloys, including yellow, white and rose gold, will not qualify as consisting solely of gold. Consequently any goods consisting of less than 24 carats gold, for example, an 18 carat wedding ring, should be considered under 'Other goods containing gold [paragraph (cc)]

Even though some South African gold coins consist solely of gold, these coins will not be regarded as second-hand goods due to the specific exclusion contained in the definition of 'second-hand goods'.

Purpose for which gold was acquired

The vendor must acquire these goods for the sole purpose of supplying it in the same state without any further processing. At the date of acquisition, the vendor's only intention must therefore be to supply the gold to another person in the course and furtherance of the vendor's enterprise. Any goods acquired for a dual purpose do not qualify as 'second-hand goods'.

Same state without further processing

In order to qualify for the notional input tax deduction, the gold must be supplied in the same state without any further processing. The vendor may not melt the gold or subject the gold to any transformational process which may change the purity, quality or form of the gold in any way. The vendor may however clean and polish the gold before supplying it to another person.

Gold coins [paragraph (*bb*)]

Gold coins contemplated in section 11(1)(*k*) are specifically excluded from the definition of 'second-hand goods'. Consequently, gold coins issued by the South African Reserve Bank in accordance with section 14 of the South African Reserve Bank Act 90 of 1989 (or that remain in circulation per provision (1) of that section) will not be regarded as second-hand goods. These coins include Kruger Rands and gold coins in the National Geographic, Natura, Protea and R1 series, as well as any other gold coins declared by the Ministry of Finance to be legal tender.

Other goods containing gold [paragraph (*cc*)]

A vendor may only deduct notional input tax in respect of second-hand gold acquired from a non-vendor if the goods are acquired for the sole purpose of supplying those goods in the same or substantially the same state to another person.

Other goods

This residual category includes all other goods that contain gold,

which do not fall within goods consisting solely of gold or gold coins, such as:

- gold jewellery, including 18 and 9 carat gold items;
- foreign gold coins that consist of less than 99% gold, such as the American Eagle series and British Gold Sovereign;
- computer components;
- medical equipment;
- electronic appliances; and
- dentures.

Substantially the same state

The term 'substantially' means the principal essentials of the gold contained in the goods is not altered or transformed. If the vendor therefore changes a small or nominal detail of the goods containing gold, it will not preclude the vendor from deducting notional input tax.

In instances where the vendor acquires goods containing gold and change the nature thereof, for example, where the vendor buys gold rings which are melted before being sold as earrings, no notional input tax is allowed on acquiring the gold from a non-vendor.

Ruling

Goods that are regarded as 'consisting solely of gold'

The following goods are regarded as 'consisting solely of gold' for purposes of item (ii)(*aa*) of the definition of 'second-hand goods':

- Gold bars and ingots
- Foreign 24 carat gold coins such as the Australian Lunar series, Chinese Panda series, One Ounce Britannia (minted since 2013), Canadian Maple series and Australian Nuggets
- Any other certified 24 carat gold item

Goods that are regarded as 'other goods containing gold'

The following goods are regarded as 'other goods containing gold' which are supplied in substantially the same state for purposes of item (ii)(*cc*) of the definition of 'second-hand goods':

- Jeweller resizing a ring before resale
- Replacing a precious stone in a gold ring before resale
- Combining single 22 carat gold coins to form a set for resale
- Upgrading a computer before resale
- Replacing faulty parts before reselling medical equipment or electronic appliances

In instances where the vendor melts (or intends to melt) the gold acquired from a non-vendor, the gold will not qualify as 'second-hand goods' due to the transformational nature of the process.

Deduction of notional input tax

A vendor may deduct notional input tax in respect of goods listed above:

- if the goods are acquired with the only intention to supply the goods to another person in the same state without further processing;
- if the goods are acquired only to supply the goods to another person;

provided the goods are acquired in the course or furtherance of that vendor's enterprise and the requirements of section 16(2)(*c*) read with section 20(8) are met.

Kruger Rands and gold coins in the National Geographic, Natura, Protea and R1 series as well as any other gold coins declared by the South African National Treasury to be legal tender are not regarded as 'second-hand goods'.A vendor is therefore not entitled to deduct any notional input tax where these coins are acquired from a non-vendor.

10. GUIDES

10.1. VAT 421 – Guide for short-term insurance

This guide is a general guide concerning the application of the VAT Act to short-term insurance transactions in South Africa.

When VAT was introduced on 30 September 1991, supplies of short-term insurance became subject to VAT, but long-term insurance was exempt (being 'financial services'). At that time, certain other fee-based services, for example, providing financial advice, arranging financial services and debt collection services were also regarded as exempt financial services. However, from 1 April 1995, the VAT Act was amended to exclude such services from the definition of 'financial services' from that date. The supply of credit guarantee insurance which was also initially exempt became taxable from 1 October 1996.

This guide deals with the VAT implications of transactions related to short-term insurance business in South Africa and the accounting in respect thereof. Included is a discussion on how insurance and related transactions impact on brokers, agents and other intermediaries as they play an important role in the insurance industry. The guide does not deal with long-term insurance services, except to the extent that it serves to clarify the distinction between long-term insurance, short-term insurance and other goods and services supplied in the course of writing short-term insurance business. The guide will focus mainly on the following aspects:

- The nature and meaning of 'insurance'

  Before delving into the application of the VAT law in regard to short-term insurance, we will first establish what is meant by the term 'insurance', which has both an ordinary legal meaning as well as a defined meaning for VAT purposes. The distinction is important in that the VAT treatment of transactions is based primarily on the characterisation of the underlying supplies. We will also mention some of the main legal principles upon which insurance is based, as well as clarify the distinction between long-term and short-term insurance.

- Supply of short-term insurance

  Generally, VAT is payable at the standard rate on the supply of risk cover in terms of a short-term insurance policy There are, however, certain instances when the supply of insurance will be subject to VAT at the zero rate. Premiums payable in respect of long-term insurance such as life assurance and endowment policies are generally exempt from VAT. As with any type of legal contract involving supplies, there will be a supplier and a recipient. These two parties will be referred to in this guide as **'the insurer'** or **'reinsurer'** and **'the insured'** or **'cedent'** respectively.

  The explanation of the VAT implications of providing and receiving short-term insurance services includes:

  - how and when VAT must be accounted for on transactions and payments;
  - the rules regarding the classification of supplies and the issuing of tax invoices; and
  - whether output tax must be declared and input tax may be deducted on premiums and other payments associated with insurance contracts.

- Supplies made by brokers, agents and other intermediaries (agents)

  In the insurance business, agents are often involved in the conclusion of the transaction and the maintenance of the policy. As these agents play an important role in the insurance industry, the guide also deals with the VAT consequences of persons who act as agents and clarifies, amongst others:

  - whether these agents are liable to register and account for VAT in respect of the receipt of premiums, commissions, fees and other types of income received;
  - whether these agents are regarded as employees or independent contractors; and
  - the calculation of commissions.

- Deemed supplies arising from indemnity payments and third party

transactions

An indemnity payment made under a contract of insurance would not normally be considered to be payment for a supply of goods or services. However, the VAT Act specifically deems such a payment to be in respect of a taxable supply of services made by the insured or cedent to the insurer or reinsurer (subject to a few exceptions). There are also a number of different ways in which insurance claims can be settled. There is also the matter of excess payments to consider. The guide will therefore discuss these different methods to enable vendors to establish whether certain events will trigger a liability for output tax or a right to deduct input tax or any other deduction.

The approach of this guide in dealing with the topics mentioned is set out below.

Chapter 1: Sets out the policy framework which governs the VAT treatment of insurance in general. It also describes the scope of topics concerning short-term insurance transactions that will be covered in the guide and the approach adopted.

Chapter 2: Explores some of the principles which underpin the law of insurance in South Africa and the ordinary meaning of the term 'insurance'. Included, is a description of what insurance is all about and a discussion of some of the differences between short-term and long-term insurance. This chapter is important in coming to terms with the main principles of insurance law so that the VAT implications of certain insurance-related transactions explained later in the guide can be understood.

Chapter 3: Introduces the reader to the most important VAT concepts, terms and definitions mentioned in the guide so that the VAT treatment of supplies which are explained in later chapters can be understood. Key points addressed in this chapter include an explanation of the terms 'enterprise' and 'financial services' in the context of insurance, as well as the meaning of the term 'insurance' which is specifically defined for VAT purposes and is wider than the ordinary meaning. The chapter also explains the difference between taxable and non-

taxable supplies which is fundamental in establishing whether output tax must be declared and input tax may be deducted.

Chapter 4: Provides a brief overview of the legal concepts 'agent' and 'principal'. This is important as the VAT consequences of a transaction cannot be determined until the contractual relationship between the parties is established. These concepts are particularly important with regard to supplies of insurance as agents, brokers and other intermediaries play an important role in the insurance industry in writing and maintaining policies of insurance and providing auxiliary services which are related to the supply of insurance.

Chapter 5: Deals with how VAT should be accounted for in respect of the different types of supplies made by insurers and intermediaries including the timing rules. The chapter sets out the general rules with regard to classifying supplies, record-keeping, invoicing and documentation required.

Chapter 6: Focuses on the VAT treatment of specific taxable supplies made by insurers and intermediaries in the short-term insurance industry as well as allowable deductions in respect of these supplies. It discusses the VAT treatment of premium income which may be paid directly to the insurer or collected *via* intermediaries as well as commissions and fees charged for other types of supplies which are typically found in the insurance industry. Imported services are also dealt with in this chapter.

Chapter 7: This chapter focuses on the VAT implications of settling claims and the different ways in which this can be done. The most important aspects include how to deal with input tax from the insurer's perspective when making trade payments and indemnity payments. From the insured's perspective, the most important aspects include the VAT treatment of the deemed supply which may arise as a result of receiving an indemnity payment, as well as the VAT treatment of excess payments.

Chapter 8: Deals exclusively with reinsurance and explains the VAT treatment of distinctive aspects of reinsurance, including time of supply, tax invoices, cedent commission, indemnity payments and recoveries.

10.2. Tax exemption guide for Public Benefit Organisations in South Africa (Issue 5)

This guide provides general guidance on:

- approval and taxation of public benefit organisations; and
- approval under section 18A to issue tax-deductible receipts.

The guide deals with the following taxes that may affect organisations approved as public benefit organisations:

- Income tax
- Estate duty
- Dividends tax
- Skills development levy
- Value-added tax
- Unemployment insurance fund
- Donations tax
- Transfer duty
- Securities transfer tax
- Capital gains tax
- Employees' tax
- Customs and excise

Information relating to taxes, duties, levies and contributions reflect the rates applicable as at the date of issue of this guide.

NPOs play a significant role in society by undertaking shared responsibility for the social and developmental needs of the country, thus relieving the financial burden that would otherwise fall on the state. Tax benefits are designed to assist NPOs by augmenting their financial resources and providing them with an enabling

environment in which to achieve their objectives.

The mere fact that an organisation has a non-profit motive or is established or registered as an NPO under the NPO Act, or is established as an NPC does not mean that it automatically qualifies for preferential tax treatment or approval as a PBO.

An organisation will enjoy preferential tax treatment only after it has applied for and been granted approval as a PBO by the Commissioner and continues to comply with the relevant requirements and conditions set out in the Act.

Internationally, NPOs are granted some degree of preferential tax treatment including donor incentives, although the eligibility criteria and available benefits vary from country to country.

In South Africa, religious, charitable and educational institutions of a public character used to be fully exempt from income tax and other taxes. In the absence of comprehensive case law and statutory definitions, the Commissioner was burdened with the interpretation and application of the exemption provisions and often unable to accommodate worthy organisations because their activities did not fall within the letter of the Act.

The Minister, following recommendations by the Katz Commission, announced in his 2000 Budget Speech wide-ranging changes to legislation regulating the income tax exemption of NPOs. The objective of the legislation was to group certain types of entities together, treat them uniformly and provide more certainty for both taxpayers and the Commissioner on the qualifying requirements for an exemption from income tax.

Section 10(1)(*c*N) and section 30 were introduced into the Act to deal with previously exempt entities. These sections introduced the concept of 'PBO' carrying on a 'PBA'. The provisions of these sections are more detailed and comprehensive resulting in improved consistency and certainty.

The type of organisations permitted to issue section 18A receipts entitling donors to a tax deduction has also been extended considerably to include a much broader spectrum of PBAs. Under the repealed legislation this benefit was substantially limited to donations made to secondary and tertiary educational institutions.

Specific punitive measures have been introduced in the Act to deal with situations in which a PBO or section 18A-approved organisation misuses its approval or exemption status or does not comply with the provisions of the Act.

Since the introduction of the revised tax system for PBOs in 2001, Government has continued to adjust the tax system and amended legislation to address needs and problems identified.

10.3. Guide on the US Foreign Account Tax Compliance Act (FATCA) (Issue 2)

This is a general guide on the application and interpretation of specific issues arising from the statutory obligations placed on South African Financial Institutions in terms of the Agreement between the Government of the Republic of South Africa and the Government of the United States of America (the Agreement). While this guide reflects SARS' interpretation of the Agreement, taxpayers who take a different view are free to avail themselves of the normal avenues for resolving such differences.

Automatic exchange of information (AEOI) involves the systematic and periodic transmission of 'bulk' taxpayer information by the source country to the residence country. An effective model for automatic exchange of information requires a common standard on the information to be reported by financial institutions and exchanged with residence jurisdictions to establish a global approach to combatting offshore tax evasion.

The Organisation for Economic Co-operation and Development (OECD) has, together with the Group of Twenty (G20), developed a standardised, secure and cost effective model for bilateral automatic exchange of information. On 23 February 2014, the G20 Finance Ministers endorsed the Common Reporting Standards for automatic exchange of tax information (CRS Standard). South Africa is one of the early adopters of the CRS Standard and has committed to commence exchange of information automatically on a wider approach from 2017.

Section 26 of the Tax Administration Act 28 of 20117 (TA Act) was amended to require a person to submit a return as required under an international tax

agreement or an international tax standard. The SA CRS Regulation was published by the Minister and applies from 1 March 2016. These Regulations provide for the annual automatic exchange of information between South Africa and current and any future participating jurisdictions of financial account information, including balances, interest, dividends and sales proceeds from financial assets, reported by financial institutions to the respective jurisdictions. The information reported cover accounts held by individuals and entities, including trusts and foundations. It sets out the account information to be exchanged, the financial institutions that need to report, the different types of accounts and taxpayers covered, as well as due diligence procedures to be followed by financial institutions.

The SARS' Business Requirement Specification: Automatic Exchange of Information (BRS: AEOI) has been extended to require affected financial institutions to provide similar information as required under the Agreement on U.S. persons to all non-residents. Although the Agreement caters for elective thresholds (for example, $50 000 threshold for Depository Accounts of New Individual Accounts), these will not apply to the extended ambit of the BRS catering for AEOI based on the OECD common reporting standards as well as domestic requirements.

Introduction to FATCA

Background

In 2010 the United States in an effort to enhance tax compliance by U.S. Persons Foreign Account Tax Compliance Act (FATCA) which institutes identification and reporting obligations on Reporting Financial Institutions The reporting regime requires Reporting Financial Institutions to report information to the United States Internal Revenue Service (IRS) relating to U.S. account holders. In 2012 the U.S. introduced a model intergovernmental agreement (IGA) to enable countries to assist their residents affected by FATCA.

On 9 June 2014 the Government of the Republic of South Africa and the Government of the United States of America signed an intergovernmental agreement to improve international tax compliance and to implement the provisions of FATCA (Agreement). The Agreement was *Gazetted* on 13

February 2015 with a date of entry into force of 28 October 2014. In terms of Article 10 of the Agreement, this was the date of South Africa's written notification to the United States that South Africa had completed its necessary internal procedures for entry into force of this Agreement. Therefore, Reporting South African Financial Institutions (Reporting Institutions) must comply with the requirements and obligations set out in the Agreement from 1 July 2014. The benefit of compliance with the Agreement for South African financial institutions is that they would not be subject to a 30% withholding tax on U.S. source income, unless they fail to resolve non-compliance with the obligations under the Agreement within 18 months after being notified by the Competent Authority of such significant non-compliance.

The U.S. has developed a framework to enter into IGAs with partner jurisdictions around the world to facilitate Financial Institutions compliance with FATCA:

- Model 1 IGAs provide for Financial Institutions to identify and report information with respect to each U.S. Reportable Account to their relevant domestic authority. The domestic authority [in South Africa's case, South African Revenue Service (SARS)] will in turn share the information with the U.S. IRS.
- Model 2 IGAs provide for Financial Institutions to identify and report information with respect to each U.S. Reportable Account directly to the U.S. IRS, which is supplemented by information exchange upon request between the U.S. IRS and its relevant government counterpart.

South Africa entered into a Model 1 IGA. SARS is therefore required to exchange the information with the IRS in accordance with Article 26 of the Double Taxation Convention in force between South Africa and the U.S.

In accordance with the Agreement a Reporting South African Financial Institution is required to obtain information on Reportable Accounts as from 1 July 2014 and report this information to SARS. The manner in which reporting is to be done is specified in SARS' BRS: AEOI which is available

on the SARS website.

A Financial Institution must determine if it has a reporting obligation in terms of the Agreement. A Financial Institution that is a Reporting Financial Institution in terms of the Agreement, has to apply the prescribed due diligence procedures in order to identify and report on U.S. Reportable Accounts and on payments to certain Nonparticipating Financial Institutions (NPFIs).

For purposes of the Agreement a South African Financial Institution is a Financial Institution resident in South Africa but excluding any branch of such Financial Institution that is located outside South Africa. Any branch of a Financial Institution not resident in South Africa will meet the definition of 'South African Financial Institution', if the branch of that Financial Institution is located in South Africa.

Each category of Financial Institution is determined by a set of criteria which must be met. An Entity, which is a non-U.S. Entity, that does not meet the definition of 'Financial Institution' will be regarded as a Non-Financial Foreign Entity (NFFE).

The terms 'Financial Institution' and 'Financial Account' are specifically defined in the Agreement.

The first reporting period in terms of the BRS: AEOI specifications was 1 July 2014 to 28 February 2015. The information required for the first reporting period should have been submitted to SARS by 30 June 2015. Thereafter the required information must be submitted annually at the end of May for the reporting period ending February. Article 3(3)(a) prescribes the information required for each reporting period with respect to U.S. Reportable Accounts.

Scope of FATCA

This section provides a broad overview of the scope of FATCA and more detail follows under separate chapters in the guide.

FATCA applies to an Entity that is a 'Financial Institution' as described in Article 1(1) that maintains Financial Accounts where the Account Holder is

a:

- Specified U.S. Person; or
- passive entity with Controlling Persons28 that are Specified U.S. Persons.

The aforementioned Financial Accounts are regarded as Reportable Accounts and the Reporting Institution must identify and report on all such accounts by applying the due diligence procedures.

An 'Entity' is defined in the Agreement as a legal person or a legal arrangement such as a trust, partnership or an association. An individual or group of individuals acting together will not be classified as an Entity.

An Entity or its representative should ask the following questions to establish if it is required to obtain and provide to SARS the information described in the Agreement:

- Am I a 'Financial Institution'?
- Do I maintain 'Financial Accounts'?
- Are there indicators that any of the account holders are a U.S. Person or a Specified U.S. Perso?
- After applying the relevant due diligence, do I have any Reportable Accounts?
- Am I a Non-Reporting Financial Institution or have accounts that are excluded from the definition of 'Financial Account'?

A South African Financial Institution will be classified as either a Reporting Financial Institution or a Non-Reporting Financial Institution. A South African Financial Institution or other Entity resident in South Africa will be a Non-Reporting South African Financial Institution if it as a Non-Reporting South African Financial Institution or that otherwise qualifies as a deemed-compliant FFI or an exempt beneficial owner under relevant U.S. Treasury Regulations. Reporting Institutions with no Reportable Accounts will be required to submit a nil return to SARS.

In addition to and for the 2015 and 2016 reporting years only, a Reporting Institution must submit the name of each NPFI to which it has made payments and the aggregate amount of such payments

Structure of the Agreement

The Agreement is divided into four distinct but interrelated parts:

- The core text of the Agreement
- Annex I
- Annex II
- A Memorandum of Understanding (MOU)

The core text

The core text lays down the general commitments and obligations of both South Africa and the United States. It provides and sets out:

- The definitions (Article 1)
- The obligations to obtain and exchange information with respect to Reportable Accounts (Article 2)
- The time and manner of exchange of information (Article 3)
- The application of FATCA to South African Financial Institutions (Article 4)
- Collaboration on compliance and enforcement (Article 5)
- Mutual commitment to continue to enhance the effectiveness of information exchange and transparency (Article 6)
- Consistency in the application of FATCA to Partner Jurisdictions (Article 7)
- Consultations and amendments (Article 8)
- Annexes (Article 9)
- Terms of Agreement (Article 10)

Annex I

Annex I sets out in detail all due diligence obligations that a Reporting Institution, unless otherwise exempt, has to apply to be compliant with the Agreement. It provides rules and provisions regarding the identification and reporting on U.S. Reportable Accounts who are clients and on payments to certain NPFIs.

Annex II

Annex II lists those Entities that shall be treated as exempt beneficial owners or deemed-compliant FFIs and accounts that are excluded from the definition of 'Financial Accounts'.

Memorandum of Understanding

The Memorandum of Understanding (MOU) signed on 9 June 2014 confirms the understanding between representatives of the Republic of South Africa and the United States of America with regard to the reporting responsibility in a case of securities registered with a South African Central Securities Depository. The text of the MOU has been ratified in Parliament and is legally enforceable in the same manner as the other parts of the Agreement.

Most favoured nation clause

Article 7 makes provision for South African Financial Institutions to benefit from what is commonly known as the 'most favoured nation clause'. In the event that any more favourable terms under Article 4 or Annex I are afforded to another Partner Jurisdiction as contemplated in the Agreement, South Africa will be granted the benefit of such more favourable terms.

It is stipulated that the more favourable terms must be contained in a signed bilateral agreement with such other Partner Jurisdiction in terms of which the Jurisdiction is committed to the same obligations and subject to the same terms and conditions as South Africa as contained in Articles 2 and 3 and Articles 5 to 9.

In terms of the Agreement the United States will notify South Africa of more favourable terms that have been afforded to another Partner Jurisdiction and unless South Africa declines in writing, the more favourable terms will

automatically be applicable and effective as of the date of signing of the Agreement incorporating the more favourable terms. SARS will post notices on its website if it has declined the more favourable terms.

If a Financial Institution believes that terms afforded to another Partner Jurisdiction would meet the requirements of 'more favourable' but these have not been considered by the IRS to be more favourable, it must be brought to the attention of the Competent Authority who will approach the United States for clarity and to decide on the possible application of such more favourable terms for purposes of the Agreement.

Interaction with U.S. Regulations

Reporting Institutions must apply the definitions described in the Agreement. The Agreement allows for the following exceptions to the rule:

- Article 1(2) provides that any term not otherwise defined in the Agreement shall, unless the context requires otherwise or the Competent Authorities agree to a common meaning (as permitted by domestic law), have the meaning that it has at that time under the law of the Party applying this Agreement. Any meaning under applicable tax laws of that Party will prevail over a meaning given to the term under other laws of that Party.
- In terms of Article 4(7) South Africa may use, and may permit Reporting Institutions to use a definition in relevant U.S. Regulations in lieu of a corresponding definition in the Agreement, provided that such application would not frustrate the purposes of the Agreement.
- In determining if an Entity is a Related Entity to another Entity under Article 1(1)(jj), South Africa may treat an Entity as not a Related Entity to another Entity if the two Entities are not members of the same expanded affiliated group as defined in section 1471(e)(2) of the U.S. Internal Revenue Code.

A Financial Institution that wishes to apply a definition in the U.S. Regulations must notify SARS by sending an email to SARS_EOI@sars.gov.za .

Interaction with Financial Action Task Force Recommendations

The Financial Action Task Force (FATF) Recommendations are mentioned twice in the Agreement and provide, essentially, that the concepts of 'Investment Entity' and 'Controlling Persons' shall be interpreted in a manner that is consistent with the FATF Recommendations.

FATF is an inter-governmental policy-making body that has a ministerial mandate to establish international standards in order to fulfil the FATF mandate. The FATF Recommendations set out a comprehensive and consistent framework of measures that countries should implement in order to combat money laundering and terrorist financing.

In terms of the Agreement, Reporting Institutions must apply the principles of the FATF Recommendations in interpreting the concepts 'Investment Entity' and 'Controlling Persons'.

10.4. Tax Guide for Share Owners

This guide provides general guidance on the taxation of share owners.

In recent years an increasing number of persons have become share owners. Many investors have turned to participation in the stock exchange either directly through share ownership or indirectly through collective investment schemes in an attempt to derive a return that beats inflation. The proliferation of broad-based employee share incentive arrangements has also contributed to share ownership among South Africans.

This guide summarises some of the key aspects holders of shares need to be aware of in computing their liability for income tax and CGT. It is primarily aimed at resident individuals who own shares in their own names. However, many of the principles covered apply equally to companies and trusts, and when appropriate the more obvious differences in the treatment of these entities have been highlighted.

Non-residents are generally not subject to CGT on the disposal of shares except shares in companies holding immovable property in South Africa. More specifically, under paragraph 2(2), 80% of the market value of the equity shares at the time of

disposal must be attributable directly or indirectly to immovable property in South Africa held otherwise than as trading stock. In addition the person holding the shares, together with any connected person in relation to that person, must hold at least 20% of the equity shares in the company. If these criteria are not met, the non-resident will not be liable for CGT on disposal of the shares. This guide will therefore have limited application to non-residents.

11. DRAFT GUIDES

11.1. VAT 404 – Guide for vendors

This guide has been updated to provide for the following textual changes relating to operational requirements:

- **Chapter 10 – Forms of payment of VAT**

  With effect from 1 April 2016, manual forms of payment are no longer accepted by SARS branches, including payment by cheques sent by post or via SARS drop boxes. Payments have to be made via e-Filing, electronic fund transfer (EFT) or at a bank.

- **Chapter 11 – Penalties and Interest**

  With effect from 14 October 2016, remission of penalties and interest can only be made via e-Filing or by visiting a SARS branch to have the request captured.

- **Chapter 14 – Objections and Appeals**

  With effect from 14 October 2016, objections and appeals for can only be made via e-Filing or by visiting a SARS branch to have the request captured. While ADR 1 and ADR 2 forms are still accepted for disputes relating to PAYE, Trusts and other taxes, these forms are no longer accepted for VAT purposes.

12. INDEMNITY

Whilst every reasonable care has gone into the preparation and production of this update, no responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update will be accepted.