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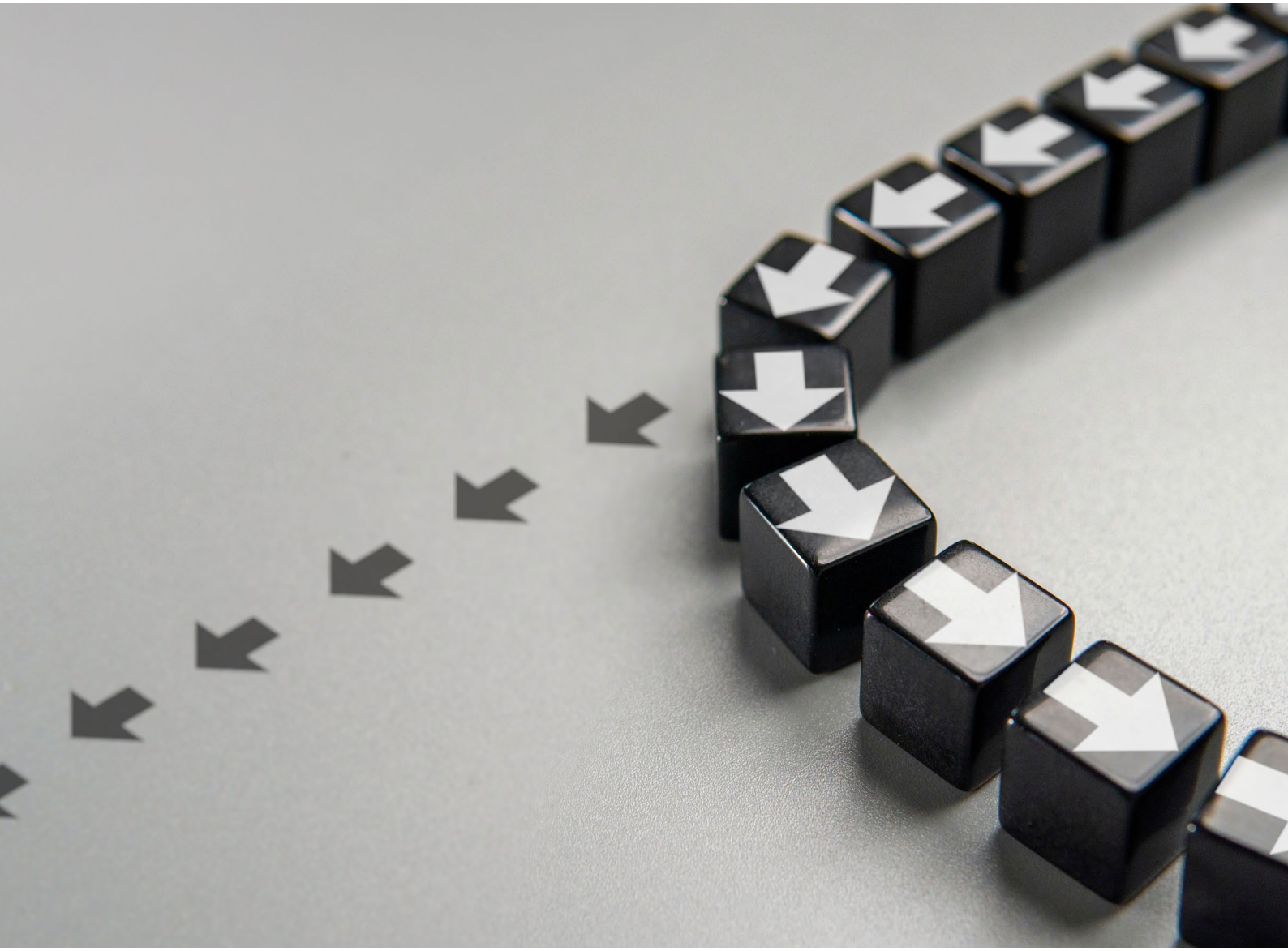

DEDUCTIONS AND ALLOWANCES
ELECTRIC VEHICLE TAX INCENTIVES

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RING-FENCING ASSESSED LOSSES UNDER SECTION 20A

Expenditure and losses incurred by individual taxpayers are generally deductible against their income under section 11(a) of the Income Tax Act, 1962 (the Act), read with section 23(g), provided certain requirements are met.

In other words, tax policy allows such expenses when they are, amongst other things, considered to produce income and are incurred pursuant to a trade. A taxpayer could also theoretically find themselves in a loss-making position in respect of a trade for more than one year.

Generally, these losses realised by individuals can be set off against other income in later years and irrespective of the source of that revenue. Said differently, an individual could make a loss in respect of one trade and offset that loss against income from another trade. However, there are certain limitations, exceptions and exclusions to that general rule.

Section 20A of the Income Tax Act, 1962 (the Act), is one of those rules. It comes into play when assessed losses from a trade were allowed in earlier years of assessment and it determines whether or not a trade loss should be set off against other income, thereby reducing taxable income. In other words, it "ring-fences" certain losses from specific trades in that those losses can then only be offset against income from that same trade. Importantly, a "ring-fenced" loss is not "lost" or "disallowed", but merely carried forward to the next year of assessment and is available for set-off against any income derived from that specific trade in that year.

WHEN DOES THE RING-FENCING OF LOSSES UNDER SECTION 20A APPLY?

Firstly and importantly, section 20A only applies to natural persons (ie, individuals) and not to companies, trusts or other juristic persons, which is somewhat ironic because it is quite a complex and intricate section. The South African Revenue Service's (SARS') *Guide on the Ring-Fencing of Assessed Losses Arising from Certain Trades Conducted by Individuals* (the SARS Guide), lists four factors that need to be determined when considering if the section is triggered, namely:

1. The "maximum marginal rate of tax requirement".
2. The "three-out-of-five-years" requirement or alternatively, the "suspect trade requirement".
3. The "facts and circumstances" test (the escape clause).
4. The "six-out-of-ten-years" requirement (the "catch all" provision).

Step 1 was the subject of Government's displeasure in the recent tax policy pronouncements in the 2025 Budget. Before considering that, it is worth looking at the other requirements first.

In this context, step 2 enquires into whether the taxpayer has made a loss from a specific trade in three out of the last five years or, alternatively, if the trade is a "suspect trade". The suspect trade list contains eight different trades including:

- sport practised by taxpayers;
- dealing in collectibles (eg, art or coins or wine);
- renting of residential accommodation where at least 80% of the accommodation is used by relatives of the taxpayer who occupy the residence for at least half of the year of assessment;
- rental of movables such as aircraft, boats or vehicles where 80% of the use is by relatives of the taxpayer who use the asset for at least half of the year of assessment;
- animal showing;
- part-time farming or animal breeding, unless that person carries on farming, animal breeding or activities of a similar nature on a full-time basis;
- creative arts performances; and

- buying or selling of any crypto asset.

Step 3 of the test allows a taxpayer to not be caught by the provisions where, for example, they can show that there is at least a reasonable prospect of earning a profit within a reasonable period. This test is not always easy to apply as it is a "facts and circumstances" based test and even if a taxpayer believes it may make a profit, SARS does not always necessarily agree. The SARS Guide provides a list of factors to consider and apply when considering this leg of the test and this is indicative of the fact that it is not simple. In this context, this step is often the subject of much debate between taxpayers and SARS.

Step 4 then provides that one cannot escape the claws of section 20A (ie, that losses must be ring-fenced) if there has been a loss in at least six out of the last ten years, including the current year. The assessed loss will be permanently ring-fenced in the year of assessment in which the rule applies. Said differently, one does not consider the "facts and circumstances" based test (step 3) if there have been losses in the past six out of ten years.

GOVERNMENT'S PROPOSAL TO REMOVE THE MARGINAL INCOME TAX RATE CARVE OUT

Notably, as already mentioned, the section does not come into play at all if the natural person in question is not taxed at the highest marginal income tax bracket. Moreover, if a person's taxable income is below the threshold for the highest marginal income tax bracket (currently R1 817 000 per annum), the assessed loss may not be ring-fenced under section 20A. This is irrespective of the number of years in which losses have been incurred and of the nature of the trade being carried on.

However, the Minister of Finance announced in the Budget Review Documents 2025 that the current application of section 20A of the Act allegedly enables taxpayers below the maximum marginal rate threshold to exploit the tax system by continuously offsetting losses from certain trades against other sources of income.

According to the Review, this creates a loophole that leads to substantial revenue losses for the fiscus, as taxpayers receive full refunds of their employees' tax when those losses are allowed. It has therefore been proposed that the threshold at which ring-fencing rules apply be reviewed and amended.

OBSERVATIONS

It is interesting to note the proposal and it is expected that there will be a robust public consultation process on it. This is especially the case against the background of Government also proposing not to adjust the personal marginal income tax brackets. In other words, given that Government removed the proposals regarding the 2% and later the 1% value-added tax (VAT) increase, it needed to find the money elsewhere (instead of cutting costs) and, amongst other things, has chosen to target individuals through an indirect personal income tax increase by not adjusting the personal income tax brackets (for a second year running) and targeting amendments to section 20A.

It is further noticeable that the proposed amendments to section 20A stand at odds with the initial, 2004, rationale behind the introduction of section 20A in its current form. The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003 (which introduced section 20A in its current form), was at pains to state that:

> "... private consumption can be masqueraded as a trade (i.e., a hobby) so that individuals can set-off these expenditures and losses against other income (usually salary or professional income). This attempt to deduct hobby-like expenses undermines the ability to pay principle of the Income Tax system because **wealthier individuals** have more means to **disguise hobby expenses** as a trade. Hence, a more stringent 'facts and circumstances' test will be introduced as a means to uncover these artificially labelled trades." *[Our emphasis]*

The explanatory memorandum states further that limiting the ring-fencing rule to high earners was important because "this aspect of the threshold ensures that section 20A ring-fencing is targeted solely at higher income individuals who have the means for disguising hobbies as trades".

It is accepted that 2004 is now over 20 years ago and "facts and circumstances" change. However, it is expected that there will be public pushback on this in the absence of evidence that supports the intentions given in the Review. The reality is that many of these trades conducted by individuals are making losses because the South African economy is not growing. Hitting those taxpayers with an indirect "additional tax" will certainly not help to stimulate the economy.

Jerome Brink

Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 11*(a)*, 20A & 23*(g)*;
- Revenue Laws Amendment Bill 71 of 2003.

Other documents

- The SARS *Guide on the Ring-Fencing of Assessed Losses Arising from Certain Trades Conducted by Individuals* (October 2010 – the guide reflects the law as at 30 September 2009, as amended by the Taxation Laws Amendment Act 17 of 2009);
- Budget Review Documents 2025;
- Explanatory Memorandum on the Revenue Laws Amendment Bill, 2003.

Tags: assessed losses from a trade; a ring-fenced loss; juristic persons; rental of movables.

PERSONAL USE ASSETS

The categorisation of an asset held by an individual as a "personal use asset" is important as the disposal of such an asset attracts no tax at all. The question is: what falls into this category?

On first reading, the capital gains tax (CGT) provision that deals with "personal use assets" (PUA) (paragraph 53 of the Eighth Schedule to the Income Tax Act, 1962 (the Act)) seems fairly simple, but a consideration of some real-life situations will show that it really is not.

But first, what does the provision say?

It starts off by stating that the capital gain or capital loss realised by a natural person or a special trust on disposal of such assets must be disregarded. It then "defines" such assets as those assets that are held by natural persons or a special trust and that are used mainly for purposes other than trade. Finally, it provides a list of assets which will specifically not qualify as "personal use assets".

The list of non-qualifying assets is not long and comprises the following, as well as any right or interest in any of them:

- A gold or platinum coin where the market value is largely attributable to the gold or platinum, for instance, Krugerrands;
- Immovable property – sadly, one's home or holiday home is thus excluded as a PUA and thus their disposal will give rise to a tax implication. Bear in mind, however, that R2 million of any capital gain on the disposal of a personal residence is exempt from CGT, so it is not all bad news. At this stage in the list of exclusions, one might initially think an "interest in immovable property" – where the property is held in a company – might qualify as a PUA, but since "financial instruments" are also excluded as PUAs this is not the case.

"Of note is that if the use of the asset is clear and it is used for both personal and for trade purposes, an apportionment has to be made. In addition, if there is a change in the use of the asset from trade purposes to PUA, tax will be payable."

"Even though assets that fall into the disregarded assets list may be used only for personal use (and not trading) capital gains tax will be payable if those assets are sold for more than their base cost."

- The financial instrument category will thus ensure that the disposal of shares, unit trusts, crypto assets and so on, does not fall into the PUA exemption.
- The fact that an aircraft, the empty mass of which exceeds 450 kilograms, is excluded means that any aircraft that must be licensed is not a PUA. Microlites, hang-gliders and drones may, however, qualify as PUAs;
- Similarly, a boat exceeding ten metres in length is excluded as a PUA. Thus, small sailing craft, ski boats, rubber ducks and so on used for personal purposes will be PUAs;
- Fiduciary, usufructuary or similar rights (for example, lease rights), the value of which decreases over time, do not qualify as PUAs;
- Similarly, insurance and reinsurance policies, including short-term policies that do not cover PUAs, will not qualify as PUAs. In other words, short-term insurance policies that do cover PUAs may be treated as PUAs.
- Where an allowance has been received for tax purposes in respect of any asset (for example, a motor vehicle allowance) which might, based on the definition, ordinarily be viewed as a PUA, the asset is specifically treated as a trading asset and, thus, not a PUA (paragraph 53(4)).

Even though assets that fall into the disregarded assets list may be used only for personal use (and not trading) capital gains tax will be payable if those assets are sold for more than their base cost. However, if they are sold for less than their base cost, the individual is prevented from claiming a CGT loss in respect of aircraft, boats, fiduciary and usufructuary interests, leases of immovable property, and fixed lifetime share and share block rights which decrease in value over time or any rights therein (paragraph 15).

According to the South African Revenue Service (SARS) Comprehensive Guide to CGT (Issue 9) the reason for this prohibition is that the assets are likely to deteriorate in value because they are used for personal consumption and, in line with other countries, rather than require a calculation which includes a notional wear and tear, the gains are determined based on an unadjusted base cost (ie, the actual costs). The corresponding loss prohibition thus saves both the taxpayer and SARS administrative effort and costs.

Similarly, any CGT losses that arise on the disposal of options over most PUAs are not claimable (paragraph 18). Such losses may, however, be claimed if the loss arises for a reason other than the exercise of the option in respect of immoveable property (except a personal residence), a gold or platinum coin, financial instruments or rights in these assets.

Of note is that if the use of the asset is clear and it is used for both personal and for trade purposes, an apportionment has to be made. In addition, if there is a change in the use of the asset from trade purposes to PUA, tax will be payable.

Although this sounds simple enough, the question that must always be asked is: Is the asset really a PUA or is it being used in a trade? Some examples can illustrate this problem:

When John retired from his day job he started collecting vintage cars as a hobby. He buys old cars and he spends many hours in his garage restoring them. Once restored he keeps them in a warehouse he owns, which he originally bought to rent to third parties to supplement his income. However, after three years he had eight cars and had to use the warehouse to store them. At that time, he was working on two more cars and was wondering where he would keep them.

John likes to alternately take each of the cars out on a Sunday and enjoys driving them. He is part of a vintage car club and he enjoys the camaraderie. Other collectors saw his cars and he is regularly approached to sell his cars. Initially, he did not want to sell any of the cars – he becomes attached to them through the restoration process. But he realised that he did not have the space to keep more than nine cars. Restoration is also an expensive exercise and, since John enjoys the restoration process, he realised that he needed to sell one or two of the cars to make space and generate some cash to keep his hobby going.

John has not changed his approach to his hobby, but now sells a car each time he has more than nine. He is hoping to use the money so that he can buy a further warehouse to store more cars.

The question that arises is: Are these vintage cars John's PUAs

or has he crossed over into the realm of trading? Have the cars and the parts he buys for their restoration become his trading stock, that is, are they acquired for the purposes of ultimate sale?

The answer will depend on having much more information and reviewing that information against the tests for "trade" – in simple terms: has John embarked on a "venture" as contemplated, amongst others, in the 1993 Appellate Division case of *Burgess v Commissioner for Inland Revenue* [1993] with a view to profit-making (although the profit motive is not essential to the trade test, it is an important determinant)? A detailed investigation into John's stated purpose looked at against the level of his activities regarding the purchase, restoration and sale of the cars would be needed.

One can imagine that if John is deriving significant profits, SARS may try to argue that he is conducting a trade and that such profits are taxable. But what if he is making losses? In that event, John might try to assert that he is trading, and in that instance SARS may assert that the cars are PUAs. The true position would need to be determined.

Let us look at another example.

Josh is in his early 20s and has a job in sales, earning commission. He loves sailing and, for a year, saved a portion of his commission each month so that in August 2023 he could buy his own 4 metre sailing boat. He loved the boat and sailed it every weekend until November 2023 when Josh exceeded his sales targets and received an unexpected bonus from his employer. He immediately sold this first sailboat and bought another, better one (still less than 10 metres). Again, he sailed it every week. In January 2024 Josh "dropped" a large client and his commission shot up. He sold the sailboat he had and bought an even better one. Then, at the end of February 2024 Josh sold that sailboat and bought a further, even better one (also less than 10 metres) as the new client had been consistently buying his employer's products. Josh made a profit each time he sold a sailboat.

Josh would consider each of the sailboats to be a PUA – he used them to follow his passion for sailing – with no tax consequence when he sold them. But would SARS see it that way? Again, a much more detailed investigation of the facts would be needed.

Ida is an art collector and had an admirable art collection, which she spent many years collecting. She never sold any of the pieces. Unfortunately, however, her family has fallen on hard times and her art collection has had to be sold in order to help them. She engaged an art dealer who held a number of art events with a view to procuring buyers. The proceeds were significant and far exceeded Ida's original expenditure. Is she merely realising her PUAs to best advantage or has she crossed over to trading, such that the PUA disregarding no longer applies?

There is no clear answer to any of the above scenarios as much more information would be needed to reach a firm decision. However, the scenarios each illustrate just how fine the line can sometimes be. Tax practitioners thus need to be aware that their clients may be crossing that line and ensure that they are accounting for the income and expenditure in the tax returns accordingly, so as to ensure that their clients will not be exposed to penalties and interest.

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Acts and Bills

- Income Tax Act 58 of 1962: Eighth Schedule: Paragraphs 15, 18 & 53 (specific reference to subparagraph (4)).

Other documents:

- *South African Revenue Service Comprehensive Guide to Capital Gains Tax* (Issue 9).

Cases

- *Burgess v Commissioner for Inland Revenue* [1993] (4) SA 161 (A); 55 SATC 185.

Tags: personal use asset; financial instruments; insurance and reinsurance policies; trading asset; notional wear and tear.

TREASURY COMPANIES

The term "treasury company" is used here to refer to a subsidiary of a holding company that holds its holding company's shares.

This arrangement has some tax advantages but there are also some pitfalls that need to be borne in mind. References in this article to paragraphs are to paragraphs of the Eighth Schedule to the Income Tax Act, 1962 (the Act).

In South Africa it is not possible for a company to hold its own shares as an asset on its balance sheet. The moment it acquires them, they are extinguished through merger [see *Grootchwaing Salt Works Ltd v Van Tonder* 1920 AD 492] and restored to the status of authorised capital. [See section 35(5) of the Companies Act, 2008.] The extinction of the shares in this way is a non-disposal under paragraph 11(2)*(b)*. There has been some debate in academic circles whether a company actually acquires its shares as an asset but SARS accepts that the shares are an asset for an instant before being disposed of for no consideration, and hence the reason for paragraph 11(2)*(b)* to prevent capital losses.

Using an employee share incentive trust for this purpose is one way to prevent the shares from disappearing. The use of a treasury company is another way.

THE DOWNSIDE OF A SHARE BUY-BACK FOR NATURAL PERSONS

One of the downsides of a share buy-back is that natural person shareholders will often receive the bulk of the consideration in the form of a dividend, with a relatively small portion comprising contributed tax capital (CTC). The CTC will comprise proceeds under paragraph 35, while the dividend, which is included in gross income under paragraph *(k)* of the definition of that term, is excluded from proceeds under paragraph 35(3)*(a)*. [*Note*: Paragraph 35(3)*(a)* excludes from proceeds any amount included in gross income or which must be or was taken into account in determining taxable income before the inclusion of any taxable capital gain.] The dividend is subject to dividends tax at 20%. Often, a capital loss will result on disposal of the shares because the CTC may be insufficient to cover the base cost of the shares.

When shares are issued in tranches over a long period, later shareholders tend to be prejudiced because their proportionate share of CTC is diluted by earlier shareholders. For example, if the first shareholder had 100 shares acquired for R100 and a later shareholder subscribes for 100 shares at R500, the later shareholder's share of the CTC pool will be only R300 [(R100 + R500) × 100/200]. This dilution means that the later shareholder has immediately lost R200 of CTC which will be replaced by a dividend of R200 attracting dividends tax at 20% upon distribution or a share buy-back.

A capital loss resulting from a share buy-back, even assuming it is not clogged under paragraph 39, can be carried forward indefinitely for set-off against a capital gain. However, the time value of money will erode its value the longer it is unused. [*Note*: Paragraph 39 limits the set-off of a capital loss arising from a disposal to a connected person to capital gains from disposals to the same connected person.]

As suggested above, there is an additional downside to a share buy-back for an individual and that is that dividends tax is imposed at 20% while the maximum CGT effective rate is 18% (40% inclusion rate × 45% marginal tax rate).

This differential of 2% means that a natural person shareholder would achieve a better tax outcome if their shares were sold to a fellow shareholder instead of being sold to the company.

Example 1 – Share buy-back v sale to third party with nominal base cost

Facts:

John acquired 100 shares in ABC Ltd on start up at a cost of R100. Many years later the shares are now worth R10 million. The company offers to buy back his shares at market value and the entire consideration will be a dividend. John is on the maximum marginal rate of 45%.

Result:

If John accepts the company's offer, he will receive a dividend of R10 million and the company will withhold dividends tax of R2 million leaving him with R8 million after tax. For CGT purposes, his proceeds under paragraph 35 will be nil because the dividend is excluded under paragraph 35(3)*(a)*. He would therefore be left with a small capital loss of R100, representing his base cost.

If he is able to sell his shares to a fellow shareholder or a treasury company, he will have proceeds of R10 million, less his base cost of R100 and the annual exclusion of R40 000, leaving him with a capital gain of R9 959 900. He would pay CGT of R1 792 782 (R9 959 900 × 18%), thus saving R207 218.

Example 2 – Share buy-back v sale to third party with substantial base cost

Facts:

The facts are the same as in Example 1, but John acquired his shares from a former shareholder for R4 million.

Result:

Should the company buy back his shares, he will pay dividends tax of R2 million as in Example 1 and be left with a capital loss of R4 million less the annual exclusion of R40 000 = R3 960 000. Unless he has another capital gain against which the capital loss can be offset, it will be of no immediate benefit to him.

However, if he can sell his shares to a fellow shareholder or treasury company, he will have a capital gain of R10 million proceeds – R4 million base cost = R6 million capital gain less R40 000 annual exclusion = R5 960 000. The CGT will be R5 960 000 × 18% = R1 072 800 and the tax saving a substantial R927 200.

These examples illustrate that selling shares back to a company can have serious tax disadvantages for a natural person shareholder, particularly when the base cost of the shares is significant.

The use of a treasury company can level the playing field.

OPERATION OF THE TREASURY COMPANY

Under section 48(2)*(b)* of the Companies Act, 2008, and subject to the solvency and liquidity requirements in section 46, a subsidiary can acquire its holding company's shares but

- not more than 10%, in aggregate, of the number of issued shares of any class of shares of a company may be held by, or for the benefit of, all of the subsidiaries of that company, taken together; and
- no voting rights attached to those shares may be exercised while the shares are held by the subsidiary, and it remains a subsidiary of the company whose shares it holds.

The treasury company will have a base cost for the shares acquired under paragraph 20(1)*(a)*, including any securities transfer tax under paragraph 20(1)*(c)*(iii). These acquisitions would typically be funded by the holding company on loan account.

If the shares can be disposed of within a reasonably short time to new shareholders, capital gains or income tax can be avoided in the treasury company.

Since the purpose of acquiring such shares is simply to acquire them from departing shareholders and then to dispose of them to qualifying directors and employees, there is no intention to trade in such shares. Any capital gains realised on such shares will simply be fortuitous and an incidental by-product. See in this regard *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust* [1992]; 54 SATC 271, in which the court cited the following extract from *Meyerowitz and Spiro on Income Tax* in paragraph 299 [at SATC 280]:

> "[t]he rather clumsy phrase: 'Operation of business in carrying out a scheme of profit-making' in plain language really means that receipts or accruals bear the imprint of revenue if they are not fortuitous, but designedly sought for and worked for".

DEDUCTIBILITY OF EXPENSES IN THE TREASURY COMPANY

The main sources of revenue for the treasury company are likely to be exempt dividend income from its holding company and interest income on the investment of the dividends it derives. It may also receive management fees for managing the share scheme. If it is carrying on a trade, its expenses are likely to be disallowed under section 23*(f)* to the extent that they are incurred in the production

of exempt dividend income. Nevertheless, to the extent that it derives taxable income, an apportionment may result in some deductible expenses. [See *Commissioner, South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd* [2014].] One should not lose sight of Practice Note 31 and section 11G, which is due to replace the practice note in 2026. [*Note*: Section 67 of the Taxation Laws Amendment Act, 2024 extends by one year the effective date of section 11G to years of assessment commencing on or after 1 January 2026.]

USING THE CORPORATE RULES

Transferring the shares by way of a section 45 intra-group transaction to the holding company is barred under section 45(6)*(f)*.

However, liquidating the treasury company using section 47 is possible.

In BPR 336 [*"Liquidation Distribution"* – dated 6 December 2019] a listed holding company owned 100% of the shares in a treasury company. The sole asset of the treasury company comprised shares in the holding company which were funded by a loan from the holding company.

It was proposed that the holding company would waive the loan and the treasury company would distribute the shares to the holding company as a liquidation distribution under section 47. The shares were then to be cancelled in the holding company and the treasury company deregistered. The ruling held that

- The distribution of shares by the treasury company to the holding company will constitute a "liquidation distribution" as defined in paragraph *(a)* of the definition in section 47(1).
- The treasury company will be deemed to have disposed of the shares at their base cost and the holding company will be deemed to have acquired them at the same base cost and no capital gains tax consequences will result for the holding company and the treasury company from the transfer of the equity shares.
- Section 47(5) will apply to the proposed transaction. The holding company must disregard the disposal or any return of capital for purposes of determining its taxable income, assessed loss, aggregate capital gain or aggregate capital loss.
- The liquidation distribution will constitute a dividend and must be included in the gross income of the holding company.
- The dividend will be exempt under the provisions of section 10(1)*(k)*(i).
- Section 64G(2)*(b)* will apply to the dividend. The treasury company must not withhold any dividends tax.
- Paragraphs 77 and 43A will not apply to the proposed transaction.
- Paragraph 11(2)*(b)*(i) will apply. The cancellation of the shares received by the holding company will not constitute a disposal.
- Section 8(1)*(a)*(v) of the Securities Transfer Tax Act, 2007 (the STT Act) will apply. No STT will arise on the transfer of shares from the treasury company to the holding company.
- Paragraph 12A(6)*(e)* will apply to the loan which will be waived by the holding company (and thus no tax will arise in the treasury company as a consequence of the waiver).

The outcome was thus that there was no capital gain on the distribution of the shares and no adverse CGT consequences from the waiver of the loan. Similarly, there were no CGT consequences in the holding company and no STT on cancellation of the shares. It follows that unwinding one of these treasury companies can be done without tax consequences.

DISPOSING OF THE SHARES TO THE HOLDING COMPANY SHORTLY AFTER ACQUISITION

Disposing of the shares to the holding company by debiting the holding company's loan account soon after acquisition from a shareholder would avoid capital gains from arising in the treasury company. Such a transaction would be a share buy-back, and if made by way of dividend, there would be no dividends tax liability because the transaction would be between two resident companies. [Section 64F(1)*(a)*.]

Could the use of a treasury company in this way constitute an impermissible tax avoidance arrangement? [*See* sections 80A to 80L, falling under Part IIA of Chapter III of the Act.] It is beyond the scope of this article to investigate this issue fully. While this is a risk area, the arrangement does have a commercial purpose, which is to make it equally attractive to a shareholder to sell their shares to the holding company as compared to other shareholders and it is certainly not a sham. The use of treasury companies is recognised in the Companies Act, 2008, and they are in widespread commercial use. Under the choice principle, taxpayers are free to arrange their tax affairs in a tax-efficient manner and tax avoidance is not per se impermissible. [*Commissioner, South African Revenue Service v Bosch and Another* [2015].] That said, the issue should be approached with caution.

Paragraph 43A of the Eighth Schedule must also be considered. It applies when a company holds a qualifying interest in a target company, disposes of any of the target company shares and receives an extraordinary exempt dividend within 18 months before the disposal or as part of the disposal. Its effect is to deem a portion of the extraordinary dividend to comprise proceeds for CGT purposes. It would apply to a share buy-back by the holding company from a treasury company if the treasury company held the required qualifying interest.

"These examples illustrate that selling shares back to a company can have serious tax disadvantages for a natural person shareholder, particularly when the base cost of the shares is significant."

Now, while a treasury company cannot under the Companies Act hold more than 10% of its holding company's equity shares, the definition of "qualifying interest" in paragraph 43A(1) requires the percentage interest to be determined "whether alone or together with any connected persons in relation to that company". Assuming an unlisted holding company holds 100% of the treasury company's equity shares, if a shareholder of the holding company, other than a company, holds, say, together with connected persons, 20% of the holding company's equity shares, it will indirectly hold 20% of the treasury company's equity shares. Such an indirect holding would make it a connected person in relation to the treasury company under paragraph *(d)*(iv) of the definition of "connected person" in section 1(1). Thus, even if the treasury company held only 1% of the holding company's equity shares, it would together with the 20% shareholder, hold at least 20% of the holding company's shares, which would give it a qualifying interest in the holding company assuming no other shareholder held a majority interest in the holding company together with connected persons. [*See* paragraph *(a)* (ii) of the definition of "qualifying interest" in paragraph 43A(1), which would apply to an unlisted holding company.] Determining whether the treasury company holds a qualifying interest can be a mind-boggling task, particularly when considering whether shareholders in the holding company are connected persons in relation to one another and a trust is involved.

An interesting point is that if a treasury company distributes its holding company's shares to the holding company, the transaction will be a distribution under paragraph 75 for proceeds equal to market value. No part of the deemed consideration under paragraph 75 received by or accrued to the treasury company will comprise a dividend because the holding company is not paying any consideration for the shares and the paragraph 75 deemed consideration does not apply in the opposite direction.

SECURITIES TRANSFER TAX (STT)

STT is imposed under the STT Act, 2007. Section 2 of that Act imposes the tax on every transfer of a security issued by a company incorporated, established or formed in South Africa at the rate of 0,25% of the taxable amount of the security.

The treasury company will be liable for STT on any shares acquired from shareholders of the holding company. However, the issue of new shares by the holding company does not attract STT. [*See* paragraph *(b)* of the definition of "transfer" in section 1 of the STT Act.] Shares transferred to the holding company by the treasury company which meet the requirements of the definition of "intra-group transaction" in section 45(1), even if the transaction itself is excluded under section 45(6)*(f)*, are exempt from STT under section 8(1)*(a)*(iii) of the STT Act. The reason is that section 8(1)*(a)* refers only to the definitions in the various corporate rules and does not require compliance with all the requirements of the various sections. [*Note*: STT is not payable in respect of the transfer of a security "in terms of an intra-group transaction *referred to* in section 45 ...". *See* BPR 195, dated 26 June 2015, in which SARS confirmed that the exemption in section 8(1)*(a)*(i) applied to an asset-for-share transaction in which the applicant had elected out of section 42.]

CONCLUSION

The use of a treasury company to hold its holding company's shares offers benefits for the company and its shareholders. But as with any tax-planning arrangement, awareness of all the tax implications is essential.

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Duncan McAllister

Webber Wentzel

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "connected person" (paragraph *(d)*(iv)) & "gross income" (paragraph *(k)*), 10(1)*(k)*(i), 11G; 23*(f)*, 42, 45 (specific reference to subsections (1) (definition of "intra-group transaction") & (6)*(f)*, 46, 47 (specific reference to paragraph *(a)* of definition of "liquidation distribution" in subsection (1) and to subsection (5)), 64F(1)*(a)*, 64G(2)*(b)* & 80A to 80L (Part IIA of Chapter III); Eighth Schedule: Paragraphs 11(2)*(b)*(i), 12A(6)*(e)*, 20(1)*(a)* & *(c)*(iii), 35 (specific reference to subparagraph (3)*(a)*), 39, 43A (emphasis on subparagraph (1): paragraph *(a)*(ii) of definition of "qualifying interest", 75 & 77;

- Companies Act 71 of 2008: Section 35(5) & 48(2)*(b)*;

- Securities Transfer Tax Act 25 of 2007: Sections 1 (definition of "transfer": paragraph *(b)*), 2 & 8(1)*(a)*(iii) & (v);

- Taxation Laws Amendment Act 42 of 2024: Section 67 (extends by one year the effective date of section 11G to years of assessment commencing on or after 1 January 2026).

Other documents:

- *Meyerowitz and Spiro on Income Tax* [in paragraph 299];

- Practice Note 31: *Interest paid on moneys borrowed* (3 October 1994) (due to be replaced by section 11G of the Income Tax Act in 2026);

- Binding Private Ruling 336: *Liquidation Distribution* (dated 6 December 2019);

- Binding Private Ruling 195: *Securities transfer tax exemption where election has been made that section 42 of the Act will not apply* (dated 26 June 2015).

Cases

- *Grootchwaing Salt Works Ltd v Van Tonder* 1920 AD 492;

- *Commissioner for Inland Revenue v Pick 'n Pay Employee Share Purchase Trust* [1992] (4) SA 39 (A), 54 SATC 271 [at 280];

- *Commissioner, South African Revenue Service v Mobile Telephone Networks Holdings (Pty) Ltd* [2014] (5) SA 366 (SCA), 76 SATC 205;

- *Commissioner, South African Revenue Service v Bosch and Another* [2015] (2) SA 174 (SCA), 77 SATC 61 [at 80].

Tags: treasury company; share buy-back; natural person shareholders; contributed tax capital (CTC); exempt dividend income; section 45 intra-group transaction; liquidation distribution; impermissible tax avoidance arrangement; connected person; qualifying interest; asset-for-share transaction.

ELECTRIC VEHICLE TAX INCENTIVES

On 24 December 2024, Cyril Ramaphosa, the President of the Republic of South Africa, signed the Taxation Laws Amendment Bill, 2024, into law.

The Taxation Laws Amendment Act, 2024, introduces a significant tax incentive aimed at promoting the production of battery electric and hydrogen-powered vehicles in South Africa. This incentive reflects the South African Government's commitment to transform the automotive manufacturing industry from the production of primarily internal combustion engine vehicles to include the production of battery electric and hydrogen-powered vehicles as envisaged in the *Electric Vehicles White Paper*, published in November 2023.

ELECTRIC VEHICLE TAX INCENTIVES IN OTHER AFRICAN COUNTRIES

Various African countries, like the Togolese Republic, Republic of Ghana, Republic of Benin, Republic of Uganda, United Republic of Tanzania and the Republic of Zambia, have already introduced tax incentives for battery electric vehicles, not only to lower the cost of such vehicles to the consumer, but also to boost investments in the local manufacture of electric vehicles. [See *Government Removes Tax on Electric Vehicles*, 12 December 2024, available on https://zanis.gov.zm/index.php/2024/12/12/government-removes-tax-on-electric-vehicles/#:~:text=Government%20says%20it%20has%20removed,of%20EVs%20in%20the%20country. (accessed on 14 January 2025).] South Africa joins a laundry list of African countries that have adopted tax incentives; however, battery electric and hydrogen-powered vehicle manufacturers need to be aware of the manner in which the South African Revenue Service (SARS) will apply this tax incentive.

DETAILS OF THE ELECTRIC VEHICLE TAX INCENTIVE

The incentive allows a person that is a motor vehicle manufacturer to claim income tax allowances in terms of section 12V of 150% of the cost of any –

- building (and improvements);
- new and unused machinery, plant, implement, utensil or article (including the cost of installation of any foundations or supporting structures designed for the machinery, plant, implement, utensil or article); and
- improvement to machinery, plant, implement, utensil or article acquired by the taxpayer,

that are used mainly in the production of battery electric or hydrogen-powered vehicles in South Africa.

PREVENTING ELECTRIC VEHICLE TAX INCENTIVE ABUSE

The incentive will apply for 10 years, to assets brought into use on or after 1 March 2026 and before 1 March 2036.

SARS has also introduced in section 12V(3) anti-abuse rules. These rules prevent taxpayers from inflating the cost of the asset or improvement and from claiming the allowance for assets that the taxpayer has sold in terms of an instalment credit agreement.

If the taxpayer sells an asset or ceases to use that asset mainly in the production of battery electric or hydrogen-powered vehicles within five years, there will, in terms of section 8(4)*(n*B*)*, be a 50% recoupment of the cost of the asset. If the asset has been sold, the recoupment will be in addition to the normal recoupments as provided for in section 8(4)*(a)* of the Income Tax Act, 1962, but not exceeding the allowances claimed in respect of that asset.

WILL MULTINATIONAL ENTITIES BENEFIT FROM THE INCENTIVE?

The full extent to which multinationals benefit from the incentives remains uncertain following the enactment of the Global Minimum Tax Act, 2024, which introduces a minimum tax rate of 15%, through a domestic minimum top-up tax (DMTT), for companies forming part of a multinational group with revenues exceeding EUR750 million. The rules involve complex calculations, which allow for a level of exclusion from the DMTT based on the taxpayer's eligible payroll costs and tangible asset values. The effects of the section 12V allowance and the DMTT will have to be carefully modelled to ensure that taxpayers investing in the production of battery electric or hydrogen-powered vehicles obtain the full benefit of the section 12V allowance.

"SARS has also introduced in section 12V(3) anti-abuse rules. These rules prevent taxpayers from inflating the cost of the asset or improvement and from claiming the allowance for assets that the taxpayer has sold in terms of an instalment credit agreement."

THE REALITY OF ELECTRIC VEHICLE MANUFACTURING

Even though this tax incentive is a leap in the right direction for battery electric and hydrogen-powered vehicle manufacturers, the sustainability challenges that South Africa faces may dilute the benefits that the tax incentive aims to achieve. South Africa is heavily reliant on fossil fuel-based electricity, with approximately 80–85% of South Africa's electricity being generated via coal-fired power stations, [*South Africa Country Commercial Guide*, available on https://www.trade.gov/country-commercial-guides/south-africa-energy (accessed on 20 January 2025)] which ranks South Africa as one of the most carbon-intensive nations globally.

Although electric vehicles are marketed as having "zero tailpipe emissions" and are optically favoured, the reality is that charging these vehicles will add to the load already borne by the carbon-heavy and buckling electricity grid [*Zero emissions vehicles*, available on https://www.energy.vic.gov.au/renewable-energy/zero-emission-vehicles (accessed on 21 January 2025)] and potentially offer only marginally less greenhouse gas emissions, when measured from a supply-chain perspective. Vehicle manufacturers should, therefore, consider a concurrent shift to renewable energy sources such as "off-grid solar-powered battery charging infrastructure" that can be made available to consumers to reduce reliance on the national electricity grid. [*See* media statement: *Zero Carbon Charge (CHARGE) welcomes EV tax incentive, but more regulatory action needed for EV charging*, available on https://charge.co.za/media-statement-charge-welcomes-ev-tax-incentive-but-more-regulatory-action-needed-for-ev-charging/ (accessed 22 January 2025).]

The manufacturing process for electric and hydrogen-powered vehicles, particularly their batteries, is energy-intensive and involves the extraction of rare earth metals like lithium, cobalt, and nickel. [*The harmful effects of our lithium batteries*, available on https://greenly.earth/en-us/blog/ecology-news/the-harmful-effects-of-our-lithium-batteries (accessed on 24 January 2025).] The mining of these materials often has significant environmental and social consequences, raising questions about the sustainability of scaling up electric and hydrogen-powered vehicles under this incentive. In addition, the disposal and recycling of electric vehicle batteries at the end of their life-cycle is frequently an overlooked issue. South Africa currently has limited infrastructure to handle the safe recycling of lithium-ion batteries; these batteries pose environmental risks if not properly managed. [eWASA: *New battery recycling plant opens in Gauteng*, available on https://ewasa.org/new-battery-recycling-plant-opens-in-gauteng/#:~:text=Unfortunately%2C%20battery%20recycling%20is%20a,its%20facility%20in%20Germiston%2C%20Gauteng. (accessed on 24 January 2025).]

IN CONCLUSION

South Africa's 150% tax incentive for electric vehicle manufacturers is a bold move toward modernising the country's automotive sector and aligning with global climate goals. However, the tax incentive is undermined by systemic challenges, including a coal-dependent national grid, the environmental impact of electric vehicle manufacturing, limited adoption and sustainable waste management processes. For this incentive to deliver tangible sustainability benefits, it must be paired with investments in renewable energy, equitable electric vehicle adoption strategies, sustainable manufacturing and recycling practices and emissions control throughout the supply chain process. Only then can South Africa truly drive towards a greener automotive future.

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 8(4)*(a)* & 12V;
- Taxation Laws Amendment Act 42 of 2024;
- Taxation Laws Amendment Bill 16 of 2024;
- Global Minimum Tax Act 46 of 2024.

Other documents:

- *Electric Vehicles White Paper* (published by Department of Trade, Industry and Competition in November 2023);
- *Government Removes Tax on Electric Vehicles*, 12 December 2024 [available on https://zanis.gov.zm/index.php/2024/12/12/government-removes-tax-on-electric-vehicles/#:~:text=Government%20says%20it%20has%20removed,of%20EVs%20in%20the%20country]. (accessed on 14 January 2025)];
- *South Africa Country Commercial Guide* [https://www.trade.gov/country-commercial-guides/south-africa-energy (accessed on 20 January 2025)];
- *Zero emissions vehicles* [https://www.energy.vic.gov.au/renewable-energy/zero-emission-vehicles (accessed on 21 January 2025)];
- Media statement: *Zero Carbon Charge (CHARGE) welcomes EV tax incentive, but more regulatory action needed for EV charging* [https://charge.co.za/media-statement-charge-welcomes-ev-tax-incentive-but-more-regulatory-action-needed-for-ev-charging/ (accessed 22 January 2025)];
- *The harmful effects of our lithium batteries* [https://greenly.earth/en-us/blog/ecology-news/the-harmful-effects-of-our-lithium-batteries (accessed on 24 January 2025)];
- eWASA: *New battery recycling plant opens in Gauteng* [https://ewasa.org/new-battery-recycling-plant-opens-in-gauteng/#:~:text=Unfortunately%2C%20battery%20recycling%20is%20a,its%20facility%20in%20Germiston%2C%20Gauteng. (accessed on 24 January 2025)].

Tags: battery electric vehicles; hydrogen-powered vehicle manufacturers; domestic minimum top-up tax (DMTT).

INTERPRETATION NOTE 137: TRADING STOCK

On 26 March 2025, the South African Revenue Service (SARS) issued Interpretation Note 137, providing guidance on the tax implications of section 8(4)(k)*(iv) of the Income Tax Act, 1962 (the Act), which deals with the scenario where a depreciable asset (that was not previously held as trading stock) is converted into trading stock. This is effective for assets commencing to be held as trading stock on or after 15 January 2020.*

This article aims to give a concise overview of the key aspects of this interpretation note and its potential impact on businesses. The key aspects and impact of the interpretation note are of crucial importance for businesses.

BACKGROUND

Generally, when a company has claimed deductions or allowances on an asset (like wear-and-tear or depreciation) and then disposes of that asset for more than its tax value, the difference is "recouped" and taxed as income. However, the rules are more nuanced when a depreciable asset is not sold, but instead, its purpose changes, and it becomes trading stock.

Prior to the amendment of section 8(4)*(k)*, the Act did not specifically address the situation where a depreciable asset, on which deductions or allowances had been claimed, was subsequently reclassified as trading stock. This created a potential loophole where previously claimed allowances were not recouped for normal tax purposes when the asset's usage changed.

KEY PROVISIONS OF SECTION 8(4)*(K)*(IV) AND INTERPRETATION NOTE 137

Deemed disposal: The core of the interpretation note revolves around section 8(4)*(k)*(iv). This section addresses the situation where a depreciable asset (not originally held as trading stock) *commences* to be held as trading stock. In this case, SARS will consider that the asset has been disposed of at market value. This means that, for tax purposes, the asset is treated as if it were sold at its market value on the date of the change in usage.

Recoupment of allowances: This deemed disposal triggers a recoupment of any deductions or allowances previously claimed on the asset under specific sections of the Act. This recoupment is included in the taxpayer's gross income for the year of assessment in which the change occurs.

Capital gains tax (CGT) implications: In addition to the income tax implications of the recoupment, the deemed disposal also has CGT implications. A capital gain or loss is calculated based on the difference between the market value at the time of the deemed disposal and the asset's base cost (original cost less any capital allowances claimed).

Trading stock valuation: The market value of the asset at the date it becomes trading stock is used as its cost for trading stock purposes. This value is then used to determine the opening stock value in the year of assessment following the change in usage. The interpretation note emphasises that determining when an asset "commenced" to be held as trading stock is a factual question. SARS will consider factors such as:

- The nature of the asset;
- The nature of the taxpayer's business;
- Internal policies and procedures of the taxpayer's business; and
- Evidence of a change in intention.

Market value determination: The market value of the asset at the date it becomes trading stock is critical for determining both the recoupment amount and the CGT implications. The interpretation note emphasises that "market value" is the price determined between a willing buyer and a willing seller in an open market, negotiating at arm's length. The taxpayer bears the burden of proving the market value.

Interaction with section 8(4)*(a)*: The interpretation note clarifies the interaction between section 8(4)*(k)*(iv) and section 8(4)*(a)*, which is the general recoupment provision. Section 8(4)*(k)*(iv) deems the asset to be sold at market value but does not regulate the recoupment or its amount. The latter is regulated under section 8(4)*(a)*.

Exclusions: The interpretation note also highlights specific exclusions where the recoupment rules **do not** apply. The most relevant exclusion is for assets contemplated in paragraph *(j*A*)* of the definition of "gross income" in section 1(1) of the Act. These are assets manufactured, produced, constructed, or assembled by a person, and is similar to other assets they manufacture for sale. These assets are treated as trading stock from creation, preventing the application of section 8(4)*(k)*(iv) and paragraph 12(2)*(c)*.

PRACTICAL IMPLICATIONS

Record keeping: Accurate records of the original cost, capital allowances claimed, and the market value of depreciable assets are crucial.

Timing: The timing of the change in usage can have significant tax implications.

Professional valuation: Obtaining a professional valuation of the asset at the time it becomes trading stock is strongly recommended to support the market value determination.

"The market value of the asset at the date it becomes trading stock is critical for determining both the recoupment amount and the CGT implications."

EXAMPLES

The interpretation note includes examples illustrating the application of these principles. These examples demonstrate how to calculate the recoupment and CGT implications in different scenarios.

Example 1

Illustrates the tax treatment where an allowance asset commences to be held as trading stock *before* 15 January 2020. In this case, the allowances are *not* recouped under section 8(4)*(k)*(iv) but are factored into the capital gain calculation when the asset became trading stock.

Example 2

Demonstrates the tax treatment where an asset commences to be held as trading stock *on or after* 15 January 2020. Here, the allowances *are* recouped under section 8(4)*(k)*(iv), and this recoupment reduces the proceeds for CGT purposes, preventing double taxation.

Example 3

Deals with assets excluded from recoupment under paragraph (*j*A) of the definition of "gross income" (ie, manufactured goods). Paragraph *(j*A*)* treats the assets as trading stock from its creation until its disposal.

IMPACT AND RECOMMENDATIONS

Interpretation Note 137 provides welcome clarity on a complex area of tax law. It is essential for businesses to carefully consider the implications of this interpretation note when reclassifying allowance assets as trading stock.

The following recommendations are made:

- Businesses should review their current asset holdings and identify any allowance assets that may be considered for reclassification as trading stock. Accurate records of the original cost, deductions claimed, and market value of such assets should be maintained.
- Professional advice to determine the specific tax implications of any proposed reclassification should be sought.

Mansoor Parker

ENS

Acts and Bills

- Income Tax Act 58 of 1962: Sections; sections 1(1) (paragraph *(j*A*)* of the definition of "gross income") & 8(4)*(a)* & *(k)* (emphasis on item (iv)); Eighth Schedule: Paragraph 12(2)*(c)*.

Other documents:

- Interpretation Note 137: *Recoupment of amounts deducted or set off when an asset commences to be held as trading stock* (26 March 2025).

Tags: depreciable asset; trading stock; recoupment rules; gross income; capital allowances; allowance assets.

THE IMPACT OF DEEMED DONATIONS ON SECTION 42 TRANSACTIONS

In the dynamic world of corporate taxation, section 42 of the Income Tax Act, 1962 (the Act), stands as a beacon for persons looking to restructure without immediate tax consequences.

This provision provides a mechanism for tax-neutral "asset-for-share" transactions in terms of which a person can transfer an asset to a resident company in exchange for shares in that company without immediate tax consequences, provided certain conditions are met.

One such condition is that the market value of the asset being transferred (on the date of disposal) must be equal to or exceed the tax (base) cost. In other words, the "asset-for-share" provisions are not available where the disposal would give rise to a loss.

It is interesting to note that this is the only express requirement (in section 42 at least) regarding the value of the asset being transferred. In other words, for purposes of section 42 itself, any contractual consideration for the asset is not determinative of whether the section applies, provided that the market value of the asset being transferred equals or exceeds its base cost.

However, it is a mistake to think that if section 42 applies, no further analysis is required as there could (for example) be latent tax consequences that arise where the value of the shares received as consideration pursuant to the "asset-for-share" transaction is not commensurate with the value of the asset. This article considers those consequences.

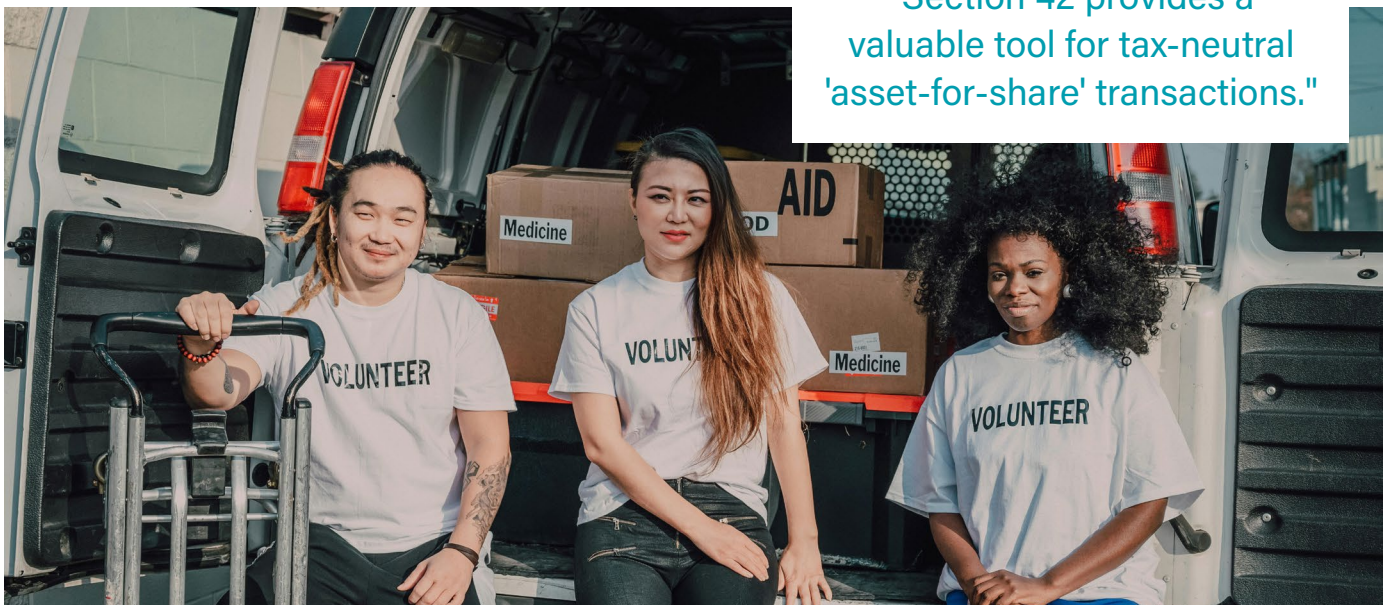
DEEMED DONATION

At common law, a disposition qualifies as a donation if it is motivated by pure liberality or disinterested benevolence, in other words, without the donor receiving any consideration in return. Therefore, where the recipient gives some consideration, the disposition cannot arguably be regarded as a donation.

For purposes of donations tax, section 55(1) of the Act defines a donation as "any gratuitous disposal of property including any gratuitous waiver or renunciation of a right".

On the other hand, where property is disposed of for a consideration that, in the opinion of the Commissioner for the South African Revenue Service (SARS) (Commissioner), is not "an adequate consideration", it will be deemed to have been disposed of under a donation as contemplated in section 58(1). The court in *Welch's Estate v Commissioner, South African Revenue Service* [2005] confirmed that the definition of "donation" in section 55(1) plays no role in interpreting or giving effect to the provision in section 58.

"Section 42 provides a valuable tool for tax-neutral 'asset-for-share' transactions."



Section 58(1) provides that:

> "where property has been disposed of for a consideration which, in the opinion of the Commissioner, is not an adequate consideration, that property shall … be deemed to have been disposed of under a donation; provided that, in determining the value of such property, a reduction shall be made of an amount equal to the value of that consideration."

Therefore, and notwithstanding what constitutes a donation at common law, section 58 deems a disposition in return for a *quid pro quo* but for inadequate consideration as a donation that is (potentially) subject to donations tax as contemplated in section 54. This means that even if something has been done for non-gratuitous reasons (eg, has a commercial purpose), it can still be a donation under section 58 if SARS is of the view that property was disposed of for inadequate consideration.

Given the wording of section 58(1), the Commissioner may invoke the section whenever the consideration for an asset is (in SARS' opinion) inadequate, irrespective of whether there is an intention to donate. However, important distinctions exist in the context of group company transactions. Section 24BA, which addresses value mismatches in asset-for-share transactions, does not apply to transactions between companies in the same "group of companies", as defined in section 41. While section 41 does not explicitly state that corporate rules do not override donations tax, even if donations tax could apply, in practice, if the transaction occurs between group companies, a deemed donation is unlikely to arise. In contrast, for transactions between companies that are not in the same group, the Commissioner may still apply section 24BA to assess whether the consideration is adequate.

In practice, the Commissioner considers that the term "adequate consideration" does not necessarily mean "fair market value"; the Commissioner will have regard to all the circumstances surrounding a particular transaction and the objectives of donations tax in determining whether the consideration is adequate. As such, the consideration can qualify as "adequate" depending on the circumstances and the requirements of the particular transaction (*see* SARS Interpretation Note 91 (Issue 2)).

On this basis, there is a view that SARS does not usually challenge transfers of assets at less than market value between companies and their sole beneficial shareholders or between associated companies with the same shareholders, provided that there is no enrichment of any particular person under section 58(1) – or, conversely, impoverishment. Therefore, if, as a result of any transfer of assets at less than market value between a company and its shareholders, a shareholder is no better or worse off financially, SARS may be less likely to invoke section 58(1).

CONCLUSION

Section 42 provides a valuable tool for tax-neutral "asset-for-share" transactions. While it may be less likely that SARS will impose donations tax on the transferor where the value of the consideration shares is not commensurate with the value of the asset in circumstances where the transferor is no better or worse off financially and/or economically, the interplay between section 42 and the deemed donation provisions highlights the need for careful consideration of the tax implications of any transaction.

It should also be noted that the above does not consider the application of other provisions, such as section 24BA or paragraph 38 of the Eighth Schedule to the Act, which could potentially apply where there is a value mismatch between the asset transferred and the shares issued in consideration. Therefore, if a taxpayer or their professional adviser is not *au fait* with the technical tax aspects of the transaction they are contemplating, costly mistakes can occur.

"It should also be noted that the above does not consider the application of other provisions, such as section 24BA or paragraph 38 of the Eighth Schedule to the Act, which could potentially apply where there is a value mismatch between the asset transferred and the shares issued in consideration."

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Cliffe Dekker Hofmeyr

Acts and Bills

- Income Tax Act 58 of 1962: Sections 24BA, 42 (specific reference to "asset-for-share-transaction", which is defined in subsection (1)), 54, 55(1) (definition of "donation") & 58(1); Eighth Schedule: Paragraph 38.

Other documents:

- Interpretation Note 91 (Issue 2): "*Concession or compromise of a debt*" (20 July 2022).

Cases

- *Welch's Estate v Commissioner, South African Revenue Service* [2005] (4) SA 173 (SCA).

Tags: asset-for-share transactions; donation; non-gratuitous reasons; group company transactions; group of companies; adequate consideration.

EXEMPTION OF FOREIGN PENSIONS TO BE REVIEWED

Section 10(1)(gC) of the Income Tax Act, 1962 (the Act), currently exempts, among other things, foreign sourced lump sums, pensions and annuities that are received by or accrue to a resident for past employment outside South Africa, except amounts from South African retirement funds or resident long-term insurers.

This exemption was introduced into the Act when South Africa moved to a worldwide basis of taxation for residents in 2001.

In Chapter 4 of the 2025 Budget Review (on page 42), National Treasury states that

> "[t]he current treatment of cross-border retirement funds may result in double non-taxation, particularly where South Africa is granted the taxing right by treaty. It is proposed that changes be made to the rules that currently exempt lump sums, pensions and annuities received by South African residents from foreign retirement funds for previous employment outside South Africa, with amendments in the current legislative cycle."

The Explanatory Memorandum on the Revenue Laws Amendment Bill, 2000, which introduced section 10(1)*(gC)* into the Act, noted at the time (on page 6 of the EM):

> *"Foreign pension payments*

The issue of the taxation of foreign pensions has raised some controversy. Currently foreign pensions and social security payments are exempt from income tax.

It is, however, international practice for a country of residence to tax foreign pensions. Many reasons have been put forward as to why foreign pensions should not be taxable once the Republic moves to a worldwide basis of taxation. It is argued that this may discourage foreigners from retiring in the Republic. Furthermore, it is argued that the income from a pension is static and that any tax imposed thereon will effectively reduce the pensioners' income. This argument is not necessarily correct as in most instances the country of source in any event taxes the pension if it is not taxed in the country of residence.

Various other problems such as the deductibility of contributions to foreign pension funds and the taxation of lump sum payments from these funds will have to be addressed. Foreign funds would also have to be approved by the Commissioner based on whether the rules of the fund

comply with the requirements of the Act and this may place a significant administrative burden on SARS.

From a practical point of view, it is, therefore, proposed that foreign pensions not be taxed at this stage. It must, however, be noted that this is merely an interim measure and that the issue of the taxation of foreign pensions will be revisited over the next three years. This should provide sufficient time to determine how contributions to these funds and the taxation of payments from foreign funds should be dealt with and to determine what the economic impact of taxing foreign pensions may be.

It is proposed that social security payments by foreign governments not be taxed as such an exemption is encountered in comparable jurisdictions." (*Own emphasis.*)

The rather cryptic wording in the Budget review makes it unclear whether the proposal would be merely to change the rules such that the exemption would no longer apply only in cases of double non-taxation. It seems more likely that it will be to simply remove the exemption insofar as it applies to lump sums, pensions and annuities, whether or not double non-taxation applies.

Assuming it is the latter, the question arises how wise this proposal would be, given that the exemption regime is certainly one of the benefits offered by South Africa to non-residents who wish to retire here. It would almost certainly have the effect of encouraging such previously non-resident retirees to emigrate and those considering retirement in South Africa to reconsider their options. Most such persons are wealthy and contribute positively to the economy.

As the Explanatory Memorandum indicated, another issue is the fairness of such an amendment, given that South Africa would be taxing the withdrawal of amounts from foreign retirement funds under circumstances which, unlike withdrawals from South African retirement funds, no deduction for South African income tax was given when contributions were made to the foreign fund. So, unlike the case of contributions to a South African retirement fund, in the case of a foreign retirement fund there was no direct loss to the fiscus at the point when the contributions were made.

An example of a jurisdiction that would fall into the apparent target of the proposal is the United Kingdom (the UK). There are many expatriates from the UK who have chosen to retire in South Africa. Article 17 of the double taxation agreement between South Africa and the UK grants the sole taxation rights for pension and similar remuneration to the individual's jurisdiction of residence. Therefore, a retiree from the UK who receives a UK pension and who has become exclusively South African tax resident is currently not subject to tax on their pension either in the UK or South Africa.

If the above amendment is promulgated, it would likely have a material effect on the financial position of many retirees with foreign pensions who have become exclusively South African tax resident and it may well cause them to emigrate to a jurisdiction that does grant a similar exemption. Although there is an argument that the capital portion of a retirement fund payout is not taxable, National Treasury needs to tread carefully here – the potential loss of current and potential retirees to the economy must be carefully considered.

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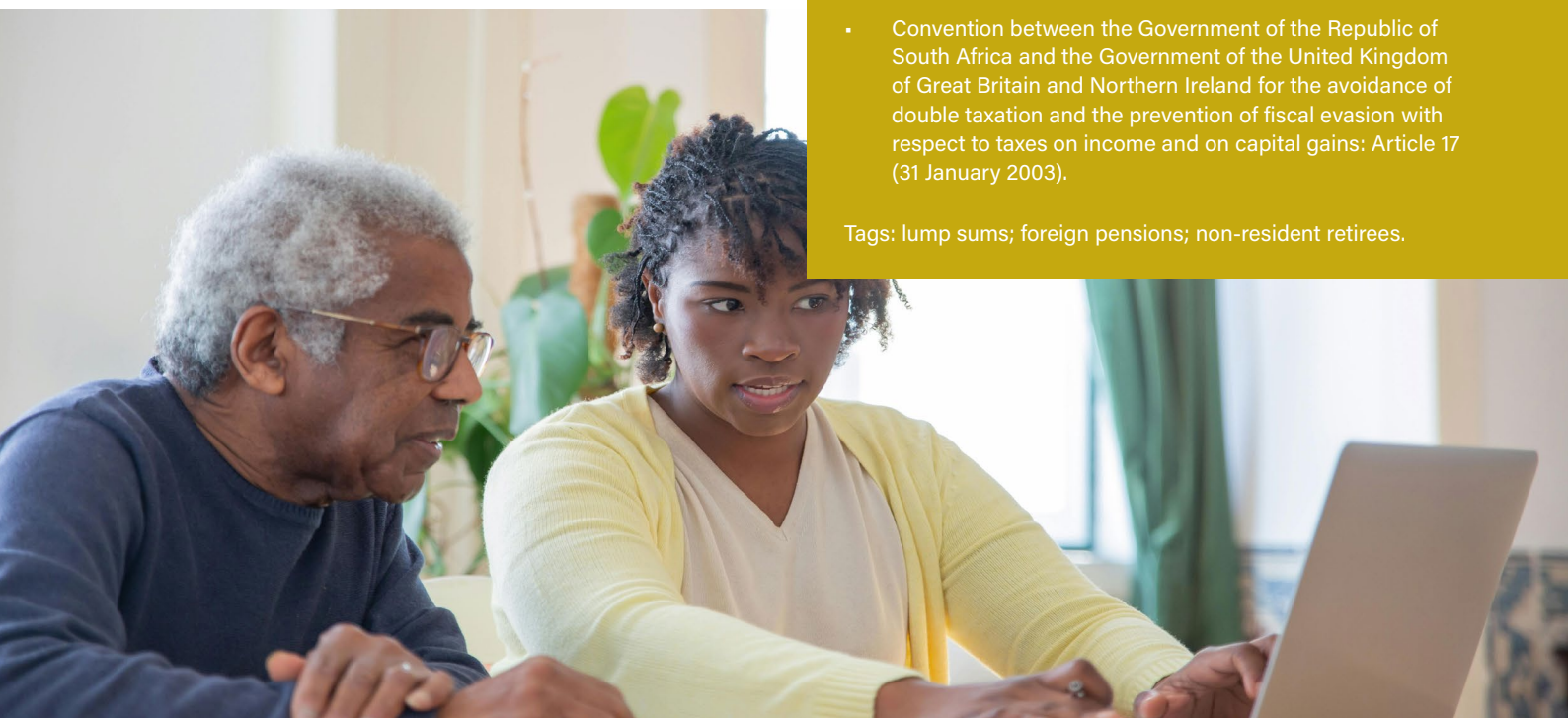
Acts and Bills

- Income Tax Act 58 of 1962: Section 10(1)*(gC)*;
- Revenue Laws Amendment Bill, 2000.

Other documents:

- 2025 Budget Review: Chapter 4 (page 42);
- Explanatory Memorandum on the Revenue Laws Amendment Bill, 2000 (page 6);
- Convention between the Government of the Republic of South Africa and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains: Article 17 (31 January 2003).

Tags: lump sums; foreign pensions; non-resident retirees.



TAXATION OF COLLECTIVE INVESTMENT SCHEMES

On 13 November 2024, National Treasury issued a discussion document setting out various proposals regarding a revised tax regime for collective investment schemes (CISs).

Public comment was called for by 13 December 2024, whereafter a workshop with relevant stakeholders was held on 17 January 2025.

In the Budget Reviews, issued with the 2025 Budgets, National Treasury acknowledged the concerns raised during this workshop, and that consultations with key stakeholders on this topic will continue during 2025. In addition to this positive commentary, Treasury has confirmed "…that it does not intend to tax all CIS returns as revenue". This is a helpful clarification, and provides some hope for the future of the taxation of these investment vehicles.

Less helpfully, Treasury has made clear the need for the tax-neutral provisions relating to asset-for-share transactions and amalgamation transactions, and for their application to a CIS in particular, to "be reviewed". Treasury apparently sees a "mischief" at play here, in the form of potential tax avoidance.

A summary of the key issues in relation to these items follows below.

A BRIEF OVERVIEW OF THE CURRENT CIS TAX REGIME IN SOUTH AFRICA

While there are many different types of CISs available to investors, these are generally subject to the same income tax rules, with the exception of a CIS in property. In essence, a CIS is regarded as a conduit (flow-through) insofar as amounts of income are distributed within 12 months of their accrual [as per section 25BA of the Income Tax Act, 1962 (the Act)]. Such distributions are then taxed in the hands of the unitholders (investors) in accordance with their own specific tax profiles.

Capital gains and capital losses are exempt in the hands of a CIS [again, with the exception of a CIS in property, in terms of paragraph 61(3) of the Eighth Schedule to the Act]. Unitholders in a CIS will be subject to tax on the ultimate disposal of their units in a CIS on either a revenue or capital basis, dependent on whether they acquired those units as capital assets, or as part of a scheme of profit-making. In certain instances, units held for at least three years in a CIS in securities or a hedge fund CIS will be deemed to be of a capital nature [in terms of section 9C of the Act].

It is worth emphasising that there are no clear definitions of "capital" or "revenue" in South Africa's tax legislation, and the principles laid down in case law are generally quite archaic, needing to be applied on a case-by-case basis. This can make practical application of these principles a significant challenge, especially in the complex financial services environment of a CIS.

National Treasury expressed some concern in 2018 over certain CISs which, in its view, were "…generating profits from the active frequent trading of shares and other financial instruments" [Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill, 2018], and allegedly abusing the capital gains exemption through incorrect classification of these "profits" as capital, and not revenue. Treasury accordingly proposed a legislative change to address this perceived mischief, to the effect that any gains or losses derived from the disposal of a financial instrument within 12 months of the acquisition thereof would be deemed to be revenue in nature.

This proposal was met with vehement opposition from the CIS industry, professional advisers, and certain industry bodies, resulting in National Treasury abandoning it.

NEW CIS TAX PROPOSALS SET OUT IN THE DISCUSSION DOCUMENT

The key tax proposals set out in the discussion document are summarised below [Note: A link to the discussion document is provided at the end of the article]. National Treasury made it clear in the workshop held in January 2025 that its main goal with these proposals is to provide certainty on the treatment of income. It stated repeatedly that the goal is not increased revenue collection – however, industry remains sceptical, especially as there is consensus that the current CIS tax regime works effectively and does not result in any permanent loss to the fiscus (given that tax is ultimately paid whenever unitholders dispose of their units).

As stated above, and based on the feedback provided during the workshop, National Treasury has made it clear in the 2025 Budget documentation that consultations on these proposals will continue in 2025.

1. Treat all income in the CIS as being revenue in nature

In the workshop held in January 2025, the proposal to treat all income in the CIS as being revenue in nature was unanimously opposed by industry and other stakeholders, on the basis that a similar proposal had already been put forward and withdrawn in 2018/2019.

Treasury acknowledged this, making it clear in the Budget Speech documentation that it does not intend to tax all CIS returns as revenue. Accordingly, it only cited the remaining three options in that documentation, removing this as a viable alternative.

2. Amend section 25BA to make CIS fully transparent

In essence, this proposal pushes the capital versus revenue question away from the CIS (being fully transparent for tax purposes), and on to the investor. This proposal presents a number of challenges, including the following:

- Treasury proposes that the capital or revenue nature of income in the investor's hands will be determined from the perspective and activities of CISs. This is likely to have unintended consequences for long-term investors that are invested into a CIS. These investors would expect to be taxed on a capital basis but, because the CIS is seen by SARS to be "trading", they would be taxed on a revenue basis.

- A number of stakeholders submitted comments that current IT systems simply cannot handle the complexities of determining daily amounts at an individual investor level. This proposal would therefore require significant and costly infrastructure and reporting upgrades and investment by each CIS.

- This proposal also presents potential cashflow and liquidity issues for investors where tax may be due, but where the investor's units in the CIS remain unsold.

- Individual investors would also need to apply for and claim any double tax treaty benefits on their own, rather than this being done on their behalf by the CIS (as is currently done).

For the reasons cited above, this proposal was largely opposed by industry during the workshop held in January 2025.

3. Using a turnover ratio to create a safe harbour

In this proposal, one would consider annual trade volumes compared to the total portfolio size in order to determine how actively trading occurred in that portfolio. If those trades are within a specified ratio, they would be taxed on a capital basis (ie, tax-exempt). For trades in excess of the specified ratio, the cumbersome existing capital or revenue principles would need to be applied, based on relevant facts and circumstances.

Treasury itself stated in the discussion document that any turnover rate proposed would be arbitrary, given the vast diversity of CISs within the industry, and proposes 33%, aligned to the 3-year capital rule currently set out in section 9C of the Act.

Stakeholders emphasised that trade volume is only one measure of determining trading activity, and that frequency of trading is not necessarily an indication of greater profits, but could be for investment mandate reasons, hedging, etc. It was also proposed by certain stakeholders that a list of investment transactions that are not considered trading activities be published by Treasury, similar to the UK's "White List" [https://www.gov.uk/government/publications/investment-manager-exemption-and-collective-investment-schemes-expanding-the-white-list].

The safe harbour proposal also has the potential to force fund managers to retain underperforming or overvalued assets, or to avoid rebalancing their portfolios when required, in order to avoid exceeding the prescribed ratio.

Stakeholders generally welcomed further discussions with National Treasury on this proposal, recognising that significant changes and further considerations are required in order to arrive at a workable solution.

4. Take hedge funds out of the CIS tax definition

In 2015, after a multi-year process of engagement between the industry, Treasury and the FSB [Financial Services Board, now replaced by the Prudential Authority and the Financial Sector Conduct Authority], hedge funds were included within the CIS legislation. This inclusion provided hedge fund investors with protection, through robust and transparent regulation and compliance. It has also resulted in hedge funds becoming accessible to the public through Retail Investor Hedge Funds (RIHFs) with financial advisor support, better liquidity, and lower minimum contributions.

"In this light, the proposal to remove hedge funds from the CIS regulation and tax framework was met with opposition from the industry during the Treasury workshop."

In this light, the proposal to remove hedge funds from the CIS regulation and tax framework was met with opposition from the industry during the Treasury workshop. The discussion document does not propose how hedge funds would be taxed if they were removed from the CIS framework but, given their complexities and the journey to regularise them in 2015, it is submitted that it would likely take a significant amount of time to develop hedge fund-specific tax legislation.

Stakeholders were vocal in opposing this proposal and were of the view that the hedge fund industry had been unfairly painted in a poor light throughout the discussion document. In reality, many fund managers manage both hedge funds and traditional CISs, with hedge funds often being marketed as the less risky of these two options.

There was general agreement in the workshop that further discussions are required on this proposal, and that simply removing hedge funds from the CIS framework will only create further uncertainty.

OTHER PROPOSALS

1. Asset-for-share and amalgamation transactions

As a separate item in the discussion document, National Treasury also proposed that a CIS be removed from the "corporate rules" tax relief set out in sections 41 to 47, and specifically the "asset-for-share" transaction relief in section 42 of the Act. Practically, this would be achieved through the removal of a CIS from the definition of "company", and a unit in a CIS from the definition of "equity share", both as defined in section 41. Definitions of "asset-for-share transaction" and "qualifying interest" in section 42(1) are proposed to be amended accordingly.

National Treasury reiterated this intention in the 2025 Budget documentation, widening the application of this removal to amalgamation transactions as well, as set out in section 44.

Per the discussion document, Treasury's perceived "mischief" here is an apparent avoidance of tax. These provisions are applied to transactions in which a person transfers shares to a CIS in exchange for units (participatory interests) in that CIS. Where the requirements are met, such transfer of shares occurs tax-neutrally, as with any section 42 transaction. In addition, the CIS itself is exempt from capital gains tax (CGT) on the ultimate disposal of those shares [in terms of paragraph 61(3) of the Eighth Schedule, assuming the shares were held by the person on capital account].

The person who transferred the shares will only suffer CGT when the units in the CIS are disposed, on the difference between the proceeds on that sale, and the base cost of the shares initially transferred to the CIS.

This proposal was also met with strong opposition from stakeholders during the workshop with Treasury in January 2025.

2. Anomaly in the Act relating to capital distributions

South Africa's tax legislation currently does not provide rules for the treatment of a capital distribution by a CIS to a unitholder. Given that such distribution is permitted by the CIS legislation, Treasury has seen fit to propose potential tax legislation to address this scenario.

The proposal in this regard (set out in the discussion document) is that the unitholder would reduce its CGT base cost of the units (participatory interest) held in that CIS by the amount of the capital distribution so received. To the extent that the capital distribution exceeds the base cost of the unitholder's units in the CIS, that excess would be regarded as a capital gain.

While this clarity is welcomed, in practice, it is rare that a CIS would make a capital distribution, which would generally only occur on liquidation of the CIS.

CONCLUSION

While stakeholders welcomed the engagement with Treasury during the workshop held in January 2025, the proposals in the discussion document were generally met with opposition. That being said, stakeholders are eager to continue to engage with and assist National Treasury in establishing certainty on the tax treatment of the CIS industry. While the proposals are a starting point, there is much further engagement with stakeholders required to develop a workable solution, especially in light of the diversity and complexity within the CIS industry. Treasury's indication in the 2025 Budget documentation that these consultations will continue in 2025 is therefore an encouraging development.

Finally, Treasury has also recognised that the CIS industry is a critical one to the South African economy, both in terms of investment and retirement savings, as well as market liquidity in general. As such, stakeholders cautioned Treasury to take its time in making any changes to the existing tax regime, given the significant impact this may have on the South African economy, and its population's dire savings culture.

For reference, the discussion document can be accessed here.

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Forvis Mazars

Acts and Bills

- Income Tax Act 58 of 1962: Sections 9C, 25BA, 41, 42 (definitions of "asset-for-share transaction" and "qualifying interest" in subsection (1)) & 44; Eighth Schedule: Paragraph 61(3).

Other documents:

- Discussion document setting out various proposals regarding a revised tax regime for collective investment schemes – issued by National Treasury on 13 November 2024;
- Draft Explanatory Memorandum on the Draft Taxation Laws Amendment Bill, 2018;
- "White List" (a UK list) [https://www.gov.uk/government/publications/investment-manager-exemption-and-collective-investment-schemes-expanding-the-white-list];
- 2025 Budget documentation.

Tags: collective investment schemes (CISs); asset-for-share transactions; amalgamation transactions; hedge funds; equity share; qualifying interest; capital distribution.

INVALID OBJECTION NOTICE DUE TO NON-COMPLIANCE

In X and Another v Commissioner for the South African Revenue Service *[2024], the Tax Court of South Africa on 2 December 2024 dismissed an application made to the court seeking validation of the objection submitted to SARS.*

BACKGROUND

SARS initiated audit proceedings on Dr X. While gathering information from the taxpayer as part of the audit, SARS also initiated audit proceedings on Dr X Inc.

As part of the audit proceedings SARS requested direct access to the electronic accounting records of the taxpayers, to be accessed by an appointed SARS Electronic Forensic Services Department (EFS) specialist as part of their audit process. For purposes of the audit proceedings SARS would not accept printouts or downloads of records not directly accessed by their appointed EFS specialist, who needed to be present at the taxpayers' offices to download the material directly, retaining the authenticity of the data to be analysed.

There was lengthy communication between the taxpayers, the company appointed to assist with the audit and SARS to gather information for the audit. During this process, the taxpayers were not forthcoming with providing SARS with the specific documentation requested in the manner it was requested. This included access to the electronic data. SARS, therefore, relied on copies of the taxpayers' bank statements, which SARS obtained directly from the bank.

As a result of the above, SARS raised additional assessments in terms of section 92 of the Tax Administration Act, 2011 (the TAA). Where SARS received no explanation from the taxpayers regarding deposits made into the taxpayers' bank accounts, SARS issued estimated assessments in terms of section 95 of the TAA.

Detailed letters of audit findings were presented to Dr X and Dr X Inc setting out the amounts that SARS included in the additional assessments, based on the information available to SARS as part of the audit.

THE PROCEDURES TO BE FOLLOWED IN LODGING AN OBJECTION AND APPEAL

When following the rules governing the alternative dispute resolution process, a taxpayer needs to follow the rules promulgated under section 103 of the TAA (the Rules).

In terms of Rule 7(2)*(b)*, in the grounds of the objection submitted to SARS, the taxpayer must –

(i) specify the part or specific amount of the disputed assessment objected to;

(ii) specify which of the grounds of assessment are disputed; and

(iii) submit the documents required to substantiate the grounds of objection that the taxpayer has not previously delivered to SARS for purposes of the disputed assessment.

In terms of Rule 7(4), where a taxpayer delivers an objection that does not comply with the above, SARS may regard the objection as invalid and issue a notice to the taxpayer stating the grounds for invalidity.

The taxpayer then has the right to resubmit the objection to SARS within the timeframe set out by SARS, effectively giving the taxpayer another opportunity to provide SARS with adequate grounds to support the taxpayer's grounds of objection.

THE PROCEDURE FOLLOWED BY THE TAXPAYERS

In this tax court case, following the submission of their first objection to SARS, SARS issued a formal notice to the taxpayers stating that their objections were invalid as they did not comply with Rule 7(2)*(b)*.

The taxpayers lodged a second objection, only slightly amending the grounds of the first objection, without providing any additional supporting documentation or making reference to the SARS audit findings. Due to the level of detail required by Rule 7(2)*(b)* not being evident, these objections were also rejected by SARS as being invalid.

Detailed reasons were provided to the taxpayers by SARS as to why the objections were regarded as invalid.

THE COURT'S ANALYSIS

The court examined whether the applicants' second objection met the requirements stipulated in Rule 7(2)*(b)* and found that the objections lacked the sufficient details needed to be valid.

Some of the reasons in support of the invalid notice were as follows:

- SARS were not given access to the electronic accounting records after numerous attempts as part of the audit process and thereafter, resulting in the information required by SARS to make a final assessment being incomplete.
- The taxpayers did not make reference to any specific amounts referred to in SARS' letters of audit findings, to which the taxpayers were objecting and did not support their grounds with the necessary supporting documentation.
- The taxpayers adopted a general argument as to why they disagreed with the additional assessments issued by SARS without being able to back up these statements with supporting evidence.
- Although SARS tried to access the electronic information requested as part of the audit again, the taxpayers were found to be obstructive and showed no co-operation to share this information.

The courts highlighted that SARS had acted reasonably in both instances by informing the applicants of their procedural deficiencies and granting them an opportunity to address these issues that were repeatedly not complied with by the taxpayer.

The court also observed that the second objection mirrored the deficiencies of the first, reflecting a continued disregard for procedural requirements. This non-compliance further compounded the applicants' position and undermined their argument for procedural fairness.

The court dismissed the application, concluding that the applicants' second objection did not comply with the validity requirements of Rule 7(2)*(b)*. It held that SARS had acted within the confines of the law by invalidating both objections. The applicants were ordered to pay SARS' costs, including the costs of two counsel that were employed.

Although not directly related to the outcome of the case, not being co-operative with SARS as part of an audit process, and purposely not providing SARS with the documentation requested as part of an audit, resulted in SARS levying an understatement penalty of 200% on the additional taxes due to SARS.

CONCLUSION

When lodging an objection with SARS, a taxpayer must ensure that the grounds of objection are detailed and can be supported with all necessary substantiating documents. Failure to comply with these requirements can result in an invalid objection.

Furthermore, the judgment also addressed the importance of a taxpayer's full co-operation with SARS during audits, as the lack of co-operation could have adverse consequences, resulting in additional tax and penalties being imposed by SARS, based on the information available to SARS. It is essential for taxpayers to approach audits and objections with diligence and professionalism to safeguard their interests effectively.

"The court examined whether the applicants' second objection met the requirements stipulated in Rule 7(2)*(b)* and found that the objections lacked the sufficient details needed to be valid."

Jessica Brown & Sharon MacHutchon

Forvis Mazars

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 92, 95 & 103.

Other documents

- Rules promulgated under section 103 of the TAA (dispute-resolution rules): Rule 7(2)*(b)* & (4).

Cases

- *X and Another v Commissioner for the South African Revenue Service* (52/2023) [2024] ZATC 12 (2 December 2024).

Tags: additional assessments; alternative dispute resolution process; understatement penalty.

SARS' REPATRIATION AND COLLECTION POWERS CONFIRMED

Sections 180, 184(2) and 186(3) of the Tax Administration Act, 2011 (the TAA) grant the South African Revenue Service (SARS) significant powers to recover tax debts from third parties responsible for a taxpayer's failure to pay outstanding tax debts.

In the case of *Greyvensteyn v Commissioner for the South African Revenue Service and Others* [2025] (judgment on 12 February 2025), the applicant unsuccessfully challenged the constitutionality of these provisions. The High Court dismissed the application and emphasised that, while SARS' powers and duties of recovery of taxes are not absolute, the recovery of taxes is crucial to ensure that the public benefit and public interest are served.

AT A GLANCE

- Persons in control or regularly involved in the management of the overall financial affairs of a taxpayer are responsible for ensuring that the taxpayer pays its outstanding tax debts. When the South African Revenue Service (SARS) determines that such a person (a third party) has negligently or fraudulently failed to do so, the third party becomes personally liable for those tax debts in terms of section 180 of the TAA.
- In *Greyvensteyn* the applicant argued that by allowing SARS to determine a third party's liability for the tax debts of a taxpayer, sections 180 and 184(2) violate the right to access to courts under section 34 of the Constitution. The applicant also argued that the repatriation and travel restriction powers in section 186(3) violate the rights to freedom of movement and freedom of trade under sections 21 and 22 of the Constitution.
- The court dismissed the application with costs, finding, firstly, that sections 180 and 184(2) do not infringe on the right to access to court, and, secondly, that section 186(3) does limit the rights in sections 21 and 22 of the Constitution but that this limitation is reasonable and justifiable and passes the test for constitutionality in section 36 of the Constitution.

BACKGROUND

SARS sought to hold the applicant, Mr Greyvensteyn, personally liable for approximately R3 billion of tax debts of Gold Kid Trading (Pty) Ltd (Gold Kid). This was on the basis of section 180 of the TAA and the applicant's control and/or regular involvement in the management of the overall financial affairs of Gold Kid.

In February 2023, SARS obtained an order against the applicant and Gold Kid for the preservation and repatriation of their assets in terms of sections 163 and 186 of the TAA (the order). The order also required the applicant to surrender his passport to the *curator bonis* appointed to preserve the assets.

Although the applicant disputed SARS' claims against him, his application in this case pertained not to the dispute but to the constitutionality of sections 180, 184(2) and 186(3) of the TAA.

CONSTITUTIONALITY OF SARS' POWERS TO DETERMINE A THIRD PARTY'S LIABILITY

The applicant contended that section 180, read with section 184(2), allows SARS to resort to self-help, as SARS is tasked both with investigating and making a finding on whether a third party is personally liable for a taxpayer's tax debts. This, according to the applicant, undermines the right to access court, as the jurisdiction of the tax court is excluded, since liability under section 180 does not arise from an assessment, and SARS' finding can only be reviewed and not appealed.

The court rejected the applicant's argument and emphasised that SARS' decisions under sections 180 and 184(2) of the TAA amounted to administrative action for purposes of the Promotion of Administrative Justice Act, 2000 (PAJA). Not only must SARS provide a third party with an opportunity to make representations prior to making a decision (protecting the third party's *audi alteram partem* right), but the decision itself is subject to judicial review of both its process and substance, and potentially also to appeal.

Accordingly, the court found that section 180 read with section 184(2) does not oust the jurisdiction of a court and does not infringe on section 34 of the Constitution.

CONSTITUTIONALITY OF THE REPATRIATION AND TRAVEL RESTRICTION PROVISIONS

Regarding the challenge to section 186(3), the court noted that the effect of the order was to limit the applicant's ability to travel outside South Africa, and to prevent him from dealing with his assets. This limited the applicant's rights in sections 21 and 22 of the Constitution.

"Persons in control or regularly involved in the management of the overall financial affairs of a taxpayer are responsible for ensuring that the taxpayer pays its outstanding tax debts."

While recognising that the rights to freedom of movement and freedom of trade hold an important place in our constitutional order, the court emphasised that the effective and efficient recovery of taxes (by restricting persons from dealing with assets and leaving South Africa to escape tax liabilities) is vital to maintain the fiscus in South Africa and ultimately to serve the public interest.

Having regard to the safeguards accompanying the order, such as the appointment of a *curator bonis*, and the fact that less restrictive means were not likely to have been effective in this case, the court found that the limitation of sections 21 and 22 of the Constitution by section 186(3) of the TAA was reasonable and justifiable in an open and democratic society based on human dignity, equality and freedom, and therefore passed the test in section 36(1) of the Constitution.

CONCLUSION

This judgment confirms that while SARS' powers and duties of recovery of taxes are not absolute, the third-party liability and repatriation provisions of sections 180, 184(2) and 186(3) are lawful and constitutional.

Heinrich Louw & Theodore Pauw

Cliffe Dekker Hofmeyr

Acts and Bills

- Tax Administration Act 28 of 2011: Sections 163, 180, 184(2) and 186 (specific emphasis on subsection (3));
- Constitution of the Republic of South Africa, 1996: Sections 21, 22, 34 & 36;
- Promotion of Administrative Justice Act 3 of 2000.

Cases

- *Greyvensteyn v Commissioner for the South African Revenue Service and Others* (B2495/2023); [2025] ZAGPPHC 128; [2025] JDR 0802 (GP).

Tags: tax debts; *audi alteram partem* right.

DONATIONS RECEIVED BY ASSOCIATIONS NOT FOR GAIN

The term "association not for gain" is defined in section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act). In essence, the definition includes religious and educational institutions of a public character as well as other societies, associations and organisations that are carried out otherwise than for purposes of gain to any proprietor, member or shareholder.

Associations not for gain are largely dependent on fund-raising initiatives and donations received from donors.

The cash flow of most associations not for gain is not infinite and has to be managed very carefully. Any unforeseen or unplanned expenditure like a tax liability (including penalties and interest) could have a detrimental impact on the existence of the association not for gain.

It is therefore crucial that the association not for gain understands the VAT implications of funding and donations received.

In this article the VAT implications of donations received by an association not for gain are considered. A "donation" is defined under section 1(1) of the VAT Act as a voluntary payment, whether in cash or kind, made to any "association not for gain" for its operational purposes. These payments do not provide any "identifiable direct valuable benefit" to the donor or anyone connected to them, and they exclude payments from public authorities or municipalities. Donations play a vital role in social responsibility initiatives. To comply with the provisions of the VAT Act, it is essential to classify donations correctly.

WHAT QUALIFIES AS A DONATION?

For a payment in cash or otherwise to be considered a "donation", it must be completely gratuitous. This means it should be given out of genuine kindness, with no expectation of anything in return other than perhaps a simple acknowledgement (a thank you) or a small token of appreciation.

WHAT DOES NOT QUALIFY AS A DONATION?

If a payment in cash or otherwise is made with the expectation of receiving something in return or if the recipient gives the donor a valuable benefit, it may thus be treated as a taxable supply for VAT purposes. Such a transaction, whether in cash or in kind, counts as "consideration" as defined in section 1(1), and is subject to VAT.

In simple terms, "consideration" refers to anything received in exchange for the supply of goods or services. "Consideration" is deemed to include VAT, meaning that any payment for a taxable supply is deemed to contain a VAT component. Donations made to an association not for gain are expressly excluded from the definition of "consideration" for VAT purposes provided that the donations are a "donation" as defined in section 1(1). A payment that is not a "donation" as defined will be treated as "consideration" if it can be linked to a supply and VAT will need to be charged at the standard rate thereon, unless the supply is zero-rated (including if it is a "grant" as defined) or exempt. It is also important to note that the VAT treatment is best determined by having regard to the substance, ie the true nature of the payment, rather than the label used to describe it in documents such as a deed of donation.

In the case of payment that is partly gratuitous and partly for goods or services, it is necessary to consider whether the payment should be apportioned between the amount attributable to the goods and services and the amount offered as a donation. The Constitutional Court, in *Capitec Bank Limited v Commissioner, South African Revenue Service* [2024], held that "the fact that the Act makes no explicit provision for apportionment in this situation is not dispositive against apportionment" and that "the scheme of the Act, in circumstances such as the present, itself suggests an apportionment". This finding by the court applied in a very different context, but there may be a rational basis to apply it in this context.

The facts, circumstances and the wording of the funding agreement may result in apportionment being appropriate and the basis for the apportionment will depend on what is fair and reasonable in the circumstances.

If the payment is a "donation" as defined, it will not have any VAT implications because donations are not subject to VAT. This means the association not for gain does not need to account for VAT nor issue a tax invoice to the donor.

If a payment is not considered a "donation" but is "consideration" for the supply of goods or services, the association not for gain must account for output tax in terms of section 7(1)*(a)* of the VAT Act unless an exception (zero-rating) or an exemption applies. In terms of section 64 of the VAT Act, the amount received from the donor will be deemed to be a VAT-inclusive amount. This would mean that the association not for gain would not ultimately retain the full payment received to fulfil its charitable activities but will instead only retain the donation less the tax fraction (the portion of the amount that constitutes VAT). As an illustrative example, a payment of R100 will be reduced by R13 (R100 less the tax fraction of 15/115) and the R13 will have to be paid to SARS by the association not for gain as output tax.

Where VAT is attributable to the payment, the association not for gain also needs to provide a valid tax invoice as specified in section 20(4) and (5) of the VAT Act. Additionally, the person making the payment may be entitled, when accounting to SARS, to deduct input tax if the supply is used or consumed for purposes of making taxable supplies. Failing to correctly determine the true nature of the payment can result in SARS raising assessments and imposing interest and penalties.

WHAT CONSTITUTES AN IDENTIFIABLE DIRECT VALUABLE BENEFIT?

Whether there is an "identifiable direct valuable benefit" to the donor varies from situation to situation. For instance, if the recipient must provide advertising or promotional services in exchange for the payment, this would usually create an identifiable direct valuable benefit for the donor. The success or otherwise of the advertising would be irrelevant; the mere requirement that those services must be rendered by the association not for gain would mean that the payment would not be gratuitous and cannot be classified as a "donation". However, an agreement stipulating exposure (ie, publicity) could still be properly interpreted as a donation if the payment was subject to conditions that require it be used for the objectives of the association not for gain.

The receipt of tangible benefits, such as merchandise or gifts from the association not for gain or services rendered by the association, such as invitations to exclusive events, regardless of the monetary value, may be an identifiable direct valuable benefit and potentially subject the donation to VAT.

Associations not for gain can consult their advisors to structure their agreements with donors in a way that part of the funding received is a consideration for a supply of a good or service and the other part is for the donation (if this is their intention). This approach will help the association not for gain to clearly allocate the funding between the consideration for the goods or services and the donation, ensuring that VAT is applied correctly to the appropriate portion of the funding.

As discussed above, on the base of *Capitec* it may be possible to argue that the funding received by an association not for gain can be apportioned to distinguish between the consideration for goods or services and the donation, even if no explicit wording is included.

Of course, taxpayers and ultimately courts could arrive at different conclusions based on the wording of the law as properly interpreted, and SARS is not the authority that exclusively decides on a reasonable interpretation.

By clearly understanding what constitutes a benefit, associations not for gain can ensure the appropriate VAT treatment of donations and compliance with the VAT Act. Here are some examples to help clarify what qualifies as a donation.

Example 1

Bright Futures Initiative, an association not for gain and a VAT vendor, hosts a sponsored walk and run event in which participants raise funds to support its mission of providing warm blankets to persons in need. All contributions are made voluntarily, with no expectation of receiving anything in return.

Bright Futures is not obligated to account for output tax on the contributions received, as the donors do not anticipate any benefits in exchange. In other words, the contributions made by the donors are entirely voluntary and gratuitous.

Example 2

Bright Futures Initiative organises a "giving day" event where individuals provide funding of any amount within a 24-hour period. This funding is made unconditionally by the funders. Bright Futures publicly recognises funders who contribute over R5 000 on its website.

Although it may be argued that a benefit is created for the funders, the funding itself is unconditional and not connected to any specific, tangible benefits received by the funders. Therefore, it is submitted that these payments should be seen as donations as defined and Bright Futures is not required to account for output tax on them.

Example 3

Unity Bank (a VAT vendor) provides financial contributions worth R500 000 to Bright Futures Initiative to help fund its efforts in supplying blankets to persons in need. In return, Unity Bank requests that Bright Futures promote their services by displaying branded materials with a market value of R50 000 on Bright Futures' website.

Unity Bank may be seen as receiving advertising and promotional services from Bright Futures. However, the full amount of R500 000 does not relate to the advertisement, only R50 000 of the R500 000 amount relates to the advertisement. Therefore, the amount of R500 000 can be apportioned to reflect the consideration of R50 000, which relates to a supply of a service, being advertising, and VAT will need to be charged on this portion. Then the rest of the amount, being R450 000, will be a donation as there is no identifiable direct valuable benefit associated with it. In these circumstances, Bright Futures Initiative must issue a tax invoice of R50 000 to the bank for the services provided, being advertising, and account for output tax.

CONCLUSION

Understanding the VAT implications of donations is vital for both donors and associations not for gain. After all, the association bears the burden of proving which amounts are taxable and which are not. All funding and contributions received must be properly interpreted to determine if they constitute "donations" as defined. By prioritising these aspects, associations not for gain can navigate VAT complexities effectively while staying focused on their mission and maintaining community trust.

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Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 1(1) (definitions of "association not for gain", "consideration" & "donation"), 7(1)*(a)*, 20(4) & (5) & 64.

Cases

- *Capitec Ltd v Commissioner, South African Revenue Service* [2024] ZACC 1 (CCT 209/22); [2024] (4) SA 361 (CC).

Tags: associations not for gain; donation; taxable supply; consideration; grant; identifiable direct valuable benefit.

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