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CAPITAL GAINS TAX
THISTLE TRUST AND THE CONDUIT PRINCIPLE

CORPORATE TAX
COMPANY TAX RETURNS

TRUSTS
NON-RESIDENT BENEFICIARIES OF RESIDENT TRUSTS

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THISTLE TRUST AND THE CONDUIT PRINCIPLE

BACKGROUND

The Thistle Trust is a beneficiary of ten *vesting trusts*. These trusts conducted business as property owners and developers for the tax years 2014 to 2016. The difference between a vesting trust and a discretionary trust is that the trustees in a vesting trust attend to the trust on behalf of the owners of the assets. With a discretionary trust the trustees decide whether to vest capital or income in a beneficiary.

The Thistle Trust was a discretionary trust, and its trustees were entitled to the rights to the income and capital of the vesting trusts. The income or capital or capital gains could thus be distributed by the Thistle Trust trustees to the beneficiaries. The tax effect of the distribution was such that untaxed capital gains or income fell to be taxed in the beneficiaries' hands if the beneficiaries were awarded those capital gains or income within the same tax year that it was earned.

The distribution of income or capital gain in a tax year in which it arises and the classification of the income or gain in the hands of the beneficiaries as being the same as that earned by the trust is referred to as the conduit or conduit pipe principle. This principle was well articulated in the matter of *Secretary for Inland Revenue v Rosen* [1971].

By contrast, if capital gains are received within a discretionary trust, or if income is so received and the funds are held and not distributed before the tax year end, then the funds must perforce be taxed in the trust. In that case the beneficiaries thus receive the after-tax money tax-free in a subsequent year. The challenge, however, is that trusts are taxed upon taxable income at a very high flat rate of 45%.

The "inclusion rate" is the amount of a capital gain that must be included in the taxable income of the trust. A trust inclusion rate is 80% of the gain. By contrast, a natural person's inclusion rate is only 40% of the gain. What is more, natural persons have a threshold of R40 000 per year below which the gain is not taxed. Thus, gains of R40 000 accruing to a natural person in a tax year are free of tax. Only gains above the amount of R40 000 per annum are subject to the inclusion rate and then 40% of such amount is included in the individual's taxable income in terms of section 26A of the Income Tax Act, 1962 (the Act).

The Thistle Trust was assessed to tax for the 2014 to 2016 tax years on the capital gains that arose on the disposal of assets by the trustees of the vesting trusts. In the view of SARS these gains were to be assessed in the Thistle Trust and not in the hands of the beneficiaries to whom the Thistle Trust had distributed the amounts during the years in question. The gains were thus taxed at a higher rate than if they were taxed in the hands of the beneficiaries. The additional assessments were raised in September 2018.

Again, section 26A of the Act provides that capital gains must be included in taxable income and be taxed at the rate of the entity in which the gain accrues. Dissatisfied with the assessments, the Thistle Trust trustees objected. The objection was to the effect that

> "having regard to the provisions of section 25B of the ITA and paragraph 80(2) of the Eighth Schedule to the ITA . . . the capital gains . . . ought not to have been taxed as our client derived no taxable income in this regard, and such gains were properly taxable in the hands of our client's beneficiaries under those provisions of the ITA. . ."

GAUTENG TAX COURT

The objection was declined. The matter was then placed before the Gauteng Tax Court early in 2021. Wright J was the presiding officer. The additional assessments raised by SARS in 2021 included understatement penalties as well as interest upon the tax liabilities that had been imposed.

The findings of the tax court (*IT 24918* [2021]) were that the vesting trusts, the Tier 1 trusts, had disposed of assets and made capital gains. These gains were distributed to the Thistle Trust and passed on to the Thistle Trust beneficiaries. The Thistle trust was thus a conduit between the Tier 1 trusts and the Thistle Trust beneficiaries. The trust beneficiaries were all South African residents.

The gains constituted "amounts" within the ambit of section 25B(1) and (2) and paragraph 80(2) of the Eighth Schedule. Importantly, section 25B(1) was amended by section 28*(b)* of the Taxation Laws Amendment Act, 2020 (with effect from 20 January 2021), and the assessments were raised in 2018 in respect of the tax years 2014 to 2016.

Before the 2021 amendment, section 25B(1) provided that any amount received by or accrued to a person in their capacity as trustee of a trust, shall be deemed to be an amount which has been received by or accrued to a beneficiary who has a vested right to that amount, to the extent that the amount has been derived for the immediate or future benefit of that beneficiary. Section 25B(2) provides that the rule at section 25B(1) finds application if a beneficiary has acquired a vested right to an amount as a consequence of the exercise of discretion by the trustees of the trust.

The amendment to section 25B(1) specifically excludes capital gains. The relevant parts of section 25B now read – with the 2021 amendment underlined:

> **"Taxation of trusts and beneficiaries of trusts**
>
> (1) Any amount (<u>other than an amount of a capital nature which is not included in gross income, or an amount contemplated in paragraph 3B of the Second Schedule</u>) received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall.... to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.
>
> (2) Where a beneficiary has acquired a vested right to any amount referred to in subsection (1) in consequence of the exercise by the trustee of a discretion vested in him or her in terms of the relevant deed of trust, agreement or will of a deceased person, that amount shall for the purposes of that subsection be deemed to have been derived for the benefit of that beneficiary."

The tax court held that the distributions that flowed through the Thistle Trust to the beneficiaries consisted of capital gains which were taxable in the hands of those beneficiaries. The tax court thus set aside the additional assessments. The tax court held that the amended wording of section 25B could not be read retrospectively to inform the proper interpretation of the section during the 2014 to 2016 tax years. It emphasised the wide and unqualified meaning of the words "any amount" in subsections (1) and (2) of section 25B in its form during the 2014 to 2016 tax years.

SARS then appealed to the Supreme Court of Appeal, with leave of the tax court.

SUPREME COURT OF APPEAL

The SCA reasoned that the main issue for consideration was whether the amounts representing the capital gains that accrued to the Thistle Trust beneficiaries are taxable in the hands of the Thistle Trust or its beneficiaries who received the gain in the tax year that the gains were realised.

The second issue was the imposition of an understatement penalty. This penalty arises in the event that it is found that the gains are taxable in the hands of the Thistle Trust. If that finding were made, do the circumstances giving rise to the tax treatment by the Thistle Trust warrant the imposition of an understatement penalty?

On appeal, the Commissioner's arguments were upheld. The SCA judges held that appropriate circumstances did not exist in the *Thistle* matter for the application of the conduit principle.

The SCA relied upon its ruling in *Milnerton Estates Ltd v Commissioner, South African Revenue Service* [2019]. In *Milnerton Estates* the following was stated:

> ". . . capital gains, the determination of the amount of any capital gain falling to be included in the taxpayer's taxable income is a matter dealt with in the Eighth Schedule to the Act . . . and on its face the Schedule seems to provide a self-contained method for determining whether a capital gain or loss has arisen."

It confirmed that the Eighth Schedule was to be treated as providing a self-contained method for determining capital gains tax that had to be included in a taxpayer's taxable income.

SARS argued that paragraph 80(2) of the Eighth Schedule applies exclusively and that section 25B does not apply. The full bench of the SCA agreed. According to the SCA, the treatment of Thistle's tax liability was to be determined only in accordance with paragraph 80(2), because at the time of the introduction of section 25B capital gains tax did not yet exist in South Africa. Therefore, the words "any amount", so it held, could not include capital gains.

So, the SCA upheld SARS' argument that the capital gains realised by the disposal of properties were taxable in the hands of the Thistle trustees, not in the hands of their beneficiaries. Thistle trust had not itself disposed of any capital asset. It only distributed moneys that were vested in it from the sale by Zenprop. It thus held that the conduit principle did not apply by virtue of paragraph 80(2) of the Eighth Schedule.

Section 222(1) of the Tax Administration Act, 2011 provides:

> "In the event of an 'understatement' by the taxpayer, the taxpayer must pay, in addition to the 'tax' payable for the relevant tax period, the understatement penalty determined under subsection (2) unless the 'understatement' results from a *bona fide* inadvertent error."

SARS' initial stance was that it should be concluded that the Thistle Trust had consciously and deliberately adopted the position it took when it elected to distribute the amounts of the capital gains as it did. It had relied upon an old tax opinion that had been furnished to another trust (the opinion had been penned by the esteemed late Dr David Meyerowitz).

However, during argument, it was conceded by SARS – stated in the ruling to have been correctly conceded – that the understatement by the Thistle Trust was a *bona fide* and inadvertent error as it had believed that section 25B was applicable to its case. Though the Thistle Trust erred, it did so in good faith and acted unintentionally. In the circumstances, SARS was not entitled to levy the understatement penalty. Thus, SARS was held by the SCA to have correctly assessed Thistle to tax, but it was not entitled to penalties. This concession was to limit SARS from arguing for penalties in the Constitutional Court.

CONSTITUTIONAL COURT

The Thistle Trust then launched an appeal to the Constitutional Court. The constitutional issue upon which Thistle relied to allow its case to be heard by the Constitutional Court was an issue of retrospectivity as it impacted upon the rule of law. Its stance was that the SCA retrospectively applied the 2020 amendment to section 25B to the tax dispute, which concerned the 2014 to 2016 tax years.

During argument, Thistle counsel contended that this case raises an arguable point of law of general public importance. This point concerned the interpretation of section 25B and paragraph 80(2) and their effect upon the conduit principle. Thistle counsel submitted that the general public importance lay in the fact that the SCA ruling affected the capital gains tax liability of all trusts in tiered trust structures before the 2021 amendment of section 25B.

Before the Constitutional Court (the Court) Thistle's counsel argued that the correct interpretation of the statutes in question was that even though "any amount" was the wording utilised prior to the introduction of capital gains tax, these words are still clear.

Furthermore, gains are included in taxable income in any event by virtue of section 26A. Thistle counsel argued that, if section 25B were to be disregarded, paragraph 80(2) entitles it not to be taxed on the relevant capital gains, because paragraph 80(2) must be interpreted as an attempt to codify the conduit principle.

SARS contended that the Explanatory Memorandum on the Revenue Laws Amendment Bill, 2008 indicated that the purpose of the amendment to paragraph 80(2) by the Revenue Laws Amendment Act, 2008 was to ensure that second-level trusts could not avoid liability for capital gains tax on the proceeds of a capital gain it received from its vesting trust, by distributing the relevant amount to its beneficiaries.

The Court held that Thistle's application for leave to appeal should be upheld as the Court had general jurisdiction in terms of section 167(3)*(b)*(ii) of the Constitution, because arguable points of law of general public importance were raised. These concerned the interpretation of section 25B and paragraph 80(2) and the application of the common law conduit principle.

The Court went on to point out that the conduit principle had found its way into our law from the English common law. A lengthy exogenesis of the conduit principle was then set out.

The position before the year 2008, however, was that the introductory wording of paragraph 80(2) had stated "where a capital gain arises in a trust". The 2008 amendment replaced this wording with "where a capital gain is determined in respect of the disposal of an asset by a trust".

At the time of the years of assessment relevant to the present case, paragraph 10(1)*(a)* and paragraph 10(1)*(c)* had been amended so that natural persons were taxed on 33.3% of their net capital gains whereas *inter vivos* trusts were taxed on 66.6% of their net capital gains. These percentages are currently 40% and 80%, respectively.

Considering section 26A, it is patent that it provides for the taxation of gains in terms of the Eighth Schedule.

It provides:

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

The judges then held that if the Eighth Schedule said nothing about liability for the taxation of capital gains arising out of the disposal of assets by trusts, it would have been arguable that section 25B (as a specific provision addressing the conduit principle and the taxation of trusts) should govern the application of the conduit principle to the taxation of capital gains realised by the sale of assets by a trust.

However, paragraph 80 specifically applies to the conduit principle. It governs the liability for taxation on capital gains realised by the sale of trust assets. It governs how the conduit principle is to be applied to establish which taxpayer is liable for taxation on the capital gains realised by the sale of assets by a trust.

The Court held that paragraph 80 must be read in conjunction with section 26A.

Furthermore, paragraph 80 is a provision that goes beyond questions of quantification. Patently, the paragraph serves to identify the taxpayer liable for capital gains tax on a trust's capital gain distributed to a beneficiary in the same year of assessment in which the disposal took place.

For the tax years 2014 to 2018 paragraph 80(2) provided:

> "(2) . . . where a capital gain is determined in respect of the disposal of an asset by a trust in a year of assessment during which a trust beneficiary . . . has a vested interest or acquires a vested interest (including an interest caused by the exercise of a discretion) in that capital gain but not in the asset, the disposal of which gave rise to the capital gain, the whole or the portion of the capital gain so vested –
>
> *(a)* must be disregarded for the purpose of calculating the aggregate capital gain or aggregate capital loss of the trust; and
>
> *(b)* must be taken into account for the purpose of calculating the aggregate capital gain or aggregate capital loss of the beneficiary in whom the gain vests."

In this instance, Thistle vested the amount of the capital gain in its beneficiaries. However, it must be appreciated that Thistle had not realised the capital gain by disposing of an asset; Zenprop had disposed of the asset.

The upshot is that Thistle could not be "the trust" referred to in item *(a)* of paragraph 80(2).

"At the time of the years of assessment relevant to the present case, paragraph 10(1)*(a)* and paragraph 10(1)*(c)* had been amended so that natural persons were taxed on 33.3% of their net capital gains whereas *inter vivos* trusts were taxed on 66.6% of their net capital gains. These percentages are currently 40% and 80%, respectively."

Zenprop was the only trust that could be "the trust" contemplated in item *(a)*. As a result, Thistle could not receive the benefit of having the capital gain disregarded for the purposes of the determination of its aggregate capital gain. The gain was vested in Thistle and was subject to tax in its hands. This ruling was accepted by the majority of the Constitutional Court judges.

Regarding the understatement penalties, the Court held that the phrase "*bona fide* inadvertent error" in section 222 of the TAA is open to different plausible interpretations.

Therefore, the dispute over the correct interpretation raised an arguable point of law of obvious public importance. The interpretation will affect how the question of the imposition of understatement penalties is dealt with in future. The Court stated that, as the tax court had not ruled upon the understatement penalties and that SARS had conceded before the SCA that the understatement penalties were unwarranted, it had to act as court of first and last instance, which was not really desirable.

One of the criteria upon which SARS pinned its understatement penalties was item (iii), alternatively item (ii), of the table in section 223 of the TAA. These are the categories of "no reasonable grounds for 'tax position' taken" and "reasonable care not taken in completing return". SARS bears the onus of proving the facts that would bring the understatement of Thistle within either of these categories. [See section 129(3) of the TAA.]

However, the Court considered the stance of SARS. SARS had held a contrary view to the view of the tax advice received from their tax specialist by Thistle and had advised Thistle of this difference of opinion. Thus, so their argument went, Thistle's adoption of their position was unreasonable.

In other words, SARS argued that if Thistle had taken reasonable care in completing its return, it would have ignored the advice given to it and followed the stated SARS position which that advice had expressly considered and rejected.

The Court held that to elevate SARS' disagreement to the status of an authority that can decree the only reasonable interpretations of tax legislation, is an untenable argument. In *Marshall NO v Commissioner, South African Revenue Service* [2019], SARS advanced a similar argument in relation to the relevance of an interpretation note it had issued to explain its view on an issue of VAT law. The Constitutional Court had rejected that argument.

The penalties were thus held to be inapplicable in this case.

The dissenting judge, ruling upon the merits of the matter, suggested that SARS had failed to offer an explanation for the distinction between the operation of the conduit principle under paragraph 80(2) in relation to capital gains distributed through multi-tiered trust structures and the operation of the conduit principle under section 25B in relation to all other forms of income distributed through multi-tiered trust structures to the ultimate beneficiary that receives the income in the year of assessment. He held that "the construction of the provision proposed by [SARS] would render the provision irrational and arbitrary".

Regrettably, it is submitted, this issue was not canvassed fully during the trials. Thistle did not allege that if paragraph 80(2) was interpreted to apply the conduit principle to capital gains differently to the manner in which section 25B applied the conduit principle to all other forms of income, this differential treatment would be irrational or otherwise unconstitutional.

The majority view was that the differential treatment was not unconstitutional. The majority further held that to speculate upon why such differentiation existed would not advance the matter.

The result is that the findings of the SCA were upheld in the Constitutional Court.

Adv Peter O'Halloran

Acts and Bills

- Income Tax Act 58 of 1962: Sections 25B & 26A; Eighth Schedule: Paragraphs 10(1)*(a)* & *(c)*, & 80(2)*(a)*;
- Taxation Laws Amendment Act 23 of 2020: Section 28*(b)*;
- Tax Administration Act 28 of 2011: Sections 129(3), 222(1) & (2) & 223 (table: items (ii) & (iii));
- Revenue Laws Amendment Act 60 of 2008;
- Constitution of the Republic of South Africa, 1996: Section 167(3)*(b)*(ii).

Other documents

- Explanatory Memorandum on the Revenue Laws Amendment Bill 2008.

Cases

- *IT 24918* [2021];
- *Secretary for Inland Revenue v Rosen* [1971] (1) SA 172 (A);
- *Milnerton Estates Ltd v Commissioner, South African Revenue Service* [2019] (2) SA 386 (SCA);
- *Marshall NO v Commissioner, South African Revenue Service* [2019] (6) SA 246 (CC).

Tags: vesting trust; discretionary trust; conduit pipe principle; additional assessments; taxable income; understatement penalty; common law conduit principle; natural persons.

CAPITAL ALLOWANCES IN TAX-DEFERRED TRANSACTIONS

A capital allowance represents the portion of capital investment costs that a business can deduct from its income under the Income Tax Act, 1962 (the Act). In South Africa, as in many other jurisdictions, capital investments are usually not immediately deductible in the year that the expense is incurred. Instead, these investments are written off over a specified period. By the end of this write-off period, the business would have deducted the full cost of the asset.

Taxpayers should be aware of certain nuances when transferring these allowance assets under the corporate roll-over provisions in sections 41 to 47 of the Act. This can be illustrated with an example: Suppose a transferor company sells a business as a going concern to a transferee company. Both companies are South African tax residents and belong to the same group of companies, with a 31 December year-end. The transferor company transfers its assets to the transferee company on 31 August 2023 as part of an intra-group transaction. These assets include those on which the transferor company claimed various allowances, such as section 12C (for assets used by manufacturers) and section 13*quin* (for commercial buildings).

The question arises whether the transferor company can claim these allowances for the eight months from 1 January to 31 August 2023 and whether the transferee company can claim them for the remaining four months from 1 September to 31 December 2023. Alternatively, only one of the companies may qualify for these allowances.

On 16 August 2023, SARS published Issue 2 of Interpretation Note 107 (IN 107), which provides guidance on section 13*quin*. According to IN 107, if the transferor company meets the requirements for claiming the section 13*quin* allowance before the transfer, it will claim the full section 13*quin* allowance for that year in which it transfers the allowance asset to the transferee company, even if the transferee company also meets the requirements. The transferee company cannot claim the allowance for the same period, as the two companies are deemed to be one and the same person for determining the allowance. Thus, in the example mentioned above, the transferor company would claim the section 13*quin* allowance for the entire 2023 tax year, despite owning the assets for only eight months. The transferee company is unable to claim the section 13*quin* allowance in the 2023 tax year even though it acquired the assets for the remaining four months.

This tax treatment is predictable when the asset purchase agreement is not subject to any suspensive conditions, as the disposal date is considered the agreement's conclusion date. The contracting parties are able to determine the date on which the asset purchase agreement will be concluded. However, if the agreement includes a suspensive condition, the disposal date is when the condition is satisfied. As this is outside the control of the parties, there is a risk that if the suspensive conditions are fulfilled in February 2024, the transferor company would be entitled to the capital allowance for the full 2024 tax year. According to IN 107, the capital allowance cannot be apportioned, potentially causing a mismatch in income and expenses, as the transferee will start deriving income from the business in 2024 while the transferor continues to claim the allowance for the full 2024 tax year.

IN 107 explicitly states that section 13*quin* is a non-apportionable allowance in the context of a section 45 intra-group transaction. This approach also applies to transfers under section 42 (Asset-for-share transactions), section 44 (Amalgamation transactions) and section 47 (Transactions relating to liquidation, winding-up and deregistration) as these provisions contain similar "one and same person" deeming provisions.

"On 16 August 2023, SARS published Issue 2 of Interpretation Note 107 (IN 107), which provides guidance on section 13*quin*."

The issue is whether SARS' approach to non-apportionable allowances is limited to the section 13*quin* allowance or whether it extends to other capital allowances. Other potentially non-apportionable allowances may include those in section 12C (assets used by manufacturers or hotel keepers, and for aircraft and ships) and section 12D (pipelines, transmission lines, and railway lines). The SARS approach in IN 107 would not apply to section 11*(e)* wear-and-tear allowances.

Taxpayers are urged to exercise caution in apportioning allowances when transferring allowance assets under the corporate roll-over provisions.

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 11*(e)*, 12C (*Deduction in respect of assets used by manufacturers or hotel keepers and in respect of aircraft and ships, and in respect of assets used for storage and packing of agricultural products*), 12D (*Deduction in respect of certain pipelines, transmission lines and railway lines*), 13*quin* (*Deduction in respect of commercial buildings*), 41 to 47 (*specific references to sections 42 (Asset-for-share transactions*), 44 (*Amalgamation transactions*) and 47 (*Transactions relating to liquidation, winding-up and deregistration*)).

Other documents

- Interpretation Note 107 (Issue 2) (*"Deduction in respect of commercial buildings"*) – 16 August 2023.

Tags: corporate roll-over provisions; transferor company; transferee company; section 13*quin* allowance; wear-and-tear allowances.

WAIVER OF INTRA-GROUP LOANS

The Taxation Laws Amendment Act, 2023, which was promulgated on 22 December 2023, contains two almost identical amendments to (i) section 19 of the Income Tax Act, 1962 (the Act), and (ii) paragraph 12A of the Eighth Schedule to the Act, both of which deal with the concession or compromise of a debt. These amendments modify exclusions from the exemptions in section 19(8)(d) *and paragraph 12A(6)*(d) *when the group-funded asset is disposed of under section 42, 44, 45 or 47. For the sake of simplicity and avoiding duplication only paragraph 12A(6)*(d) *will be dealt with in this article.*

"If the debt benefit occurs in a year subsequent to the disposal, paragraph 12A(4) will apply and the debtor will have to redetermine the capital gain or loss and compare it with the previously determined capital gain or loss (likely to be nil because of section 42, 44, 45 or 47)."

BACKGROUND

Paragraph 12A deals with the concession or compromise of a debt and replaced the problematic paragraph 12(5), which applied to years of assessment commencing before 1 January 2013. Paragraph 12A was not without its problems and underwent substantial amendment for years of assessment commencing on or after 1 January 2018. Paragraph 12A in its present guise provides that when a creditor waives a debt, the debtor is required to reduce the base cost of the asset funded by that debt under paragraph 12A(3) if the asset has not been disposed of in a year of assessment prior to that in which the debt is waived. If the debt is waived and the debtor disposed of the asset in an earlier year of assessment, paragraph 12A(4) requires the capital gain or loss originally determined to be redetermined assuming the debt had been waived in that year. The absolute difference between the capital gain or loss originally determined and the redetermined capital gain or loss is then brought to account as a capital gain in the year in which the debt is waived.

For example, assume a capital asset with a base cost of R100 was funded by a loan of R100 in tax year 1. The asset is sold in tax year 3 for R120. If the debt of R100 is waived in tax year 3 (before or after the sale, the base cost of the asset will be reduced to nil under paragraph 12A(3) and the capital gain will be R120 (R120 proceeds less nil base cost). *Note*: The base cost must be reduced even if the debt benefit arises after the sale but before the end of the year of assessment, since a capital gain or loss is determined for a year of assessment under paragraph 3*(a)* or 4*(b)* and not only up to the date of sale. If the debt is waived in tax year 5, the original capital gain would have been R20 (R120 proceeds less R100 base cost). The redetermined capital gain would be R120 (R120 proceeds less nil base cost). The absolute difference between R120 (capital gain after applying paragraph 12A(3)) and R20 (capital gain originally determined) is R100, which must be recognised as a capital gain in tax year 5.

EXEMPTIONS

Paragraph 12A(6) contains a number of exemptions from paragraph 12A, and most of these exemptions contain exceptions. Paragraph 12A(6)*(d)* provides that paragraph 12A must not apply to a debt benefit in respect of any debt owed by a person:

"*(d)* to another person where the person that owes that debt is a company, if –

(i) that company owes that debt to a company that forms part of the same group of companies as that company; and

(ii) that company has not carried on any trade,

during the year of assessment during which that debt benefit arises and the immediately preceding year of assessment: Provided that this subitem must not apply in respect of any debt –

(aa) incurred, directly or indirectly by that company to fund expenditure incurred in respect of any asset that is disposed of by that company, before or after that debt benefit arises, by way of an asset-for-share, intra-group or amalgamation transaction or a liquidation distribution in respect of which the provisions of section 42, 44, 45 or 47, as the case may be, applied: Provided further that, for purposes of this paragraph, where a debt benefit arises prior to the disposal of an asset, that debt benefit must be treated as a debt benefit that arose immediately before that disposal; or …".

Thus, generally, intra-group debts funding assets will not have base cost reduction consequences for the debtor under paragraph 12A(3) or capital gains tax consequences under paragraph 12A(4) as long as the debtor company has not traded in the current and immediately preceding years of assessment.

But paragraph 12A will apply if the group-funded asset is disposed of under section 42, 44, 45 or 47 and the group debt is waived before or after that disposal.

The words "before or after that debt benefit arises" were substituted for the words "was subsequently" by section 41(1)*(a)* of the Taxation Laws Amendment Act, 2023, and came into effect on 1 January 2024 and apply in respect of any disposal of an asset on or after that date. The further proviso was added by section 41(1)*(b)* of the same amending Act with the same effective date.

In other words, before the 2023 amendment, the exclusion applied only when the debt benefit arose and then the asset was disposed of under section 42, 44, 45 or 47. Now it will also apply when the group-funded asset is disposed of under section 42, 44, 45 or 47 and then the debt benefit arises.

DEBT BENEFIT ARISING BEFORE THE DISPOSAL UNDER SECTION 42, 44, 45 OR 47?

Neither the *Comprehensive Guide to Capital Gains Tax (Issue 9)* nor Interpretation Note 91 (Issue 2) contains any examples on the application of the subsequent disposal of the asset following the debt benefit. This seems hardly surprising as the previous wording made little sense. How is a debtor expected to apply a provision that is dependent on a future event? The debtor does not have a crystal ball and applying the rule retrospectively would offend the principle that there should be finality in the raising of assessments. Botha JA in *Caltex Oil (SA) Ltd v Secretary of Inland Revenue* [1975] summed up the position as follows:

> "What is clear, I think, is that events which may have an effect upon a taxpayer's liability to normal tax are relevant only in determining his tax liability in respect of the fiscal year in which they occur, and cannot be relied upon to redetermine such liability in respect of a fiscal year in the past."

This problem has now been addressed by the introduction of the further proviso to paragraph 12A(6)*(d)*.

Its effect is to change the time when the debt benefit arises from the time when the actual debt benefit arose and when the exemption applied, to immediately before the disposal of the group-funded asset. Thus, paragraph 12A(3) will be triggered, with the result that the debtor company must reduce the base cost of the asset before the section 42, 44, 45 or 47 transaction. The effect on the transferee under that transaction will be that it will acquire the asset at its reduced base cost. Unfortunately, the creditor, which would have been denied a capital loss under paragraph 56(1) when the actual debt benefit arose, will not be entitled to a capital loss immediately before the disposal of the asset because the further proviso applies "for the purposes of this paragraph", which restricts its application to paragraph 12A.

Paragraph 56(1) requires a creditor that is a connected person in relation to a debtor to disregard a capital loss on disposal of the debt owed by the debtor. The creditor would not have been entitled to the capital loss at the time of disposal of the debt under paragraph 56(2) because the debtor was not required to reduce the base cost of the asset under paragraph 12A(3) as a result of the exemption under paragraph 12A(6)*(d)*.

Example 1 – Debt benefit arising before disposal of group-funded asset under section 42, 44, 45 or 47

Facts:

Holdco owns all the shares in Subco 1 and Subco 2. All these companies are residents with years of assessment ending on the last day of February.

Subco 1 acquired an asset from Holdco at a cost of R1 million on loan account on 28 February of year 1 after which it immediately ceased trading. On 28 February of year 3, Holdco waived the debt of R1 million owed by Subco 1. On 28 February of year 4, Subco 1 disposed of the asset to Subco 2 under section 45.

Result:

On 28 February of year 3 there was a concession or compromise of the debt of R1 million but it was excluded from paragraph 12A under paragraph 12A(6)*(d)* as Subco 1 had not traded in the current or immediately preceding year of assessment. Holdco was precluded from claiming a capital loss under paragraph 56(1) because Subco 1 did not suffer any of the consequences listed in paragraph 56(2), for example, a base cost reduction under paragraph 12A(3).

However, as a result of Subco 1 subsequently disposing of the asset to Subco 2 under section 45, Subco 1 is treated for purposes of paragraph 12A under the further proviso to paragraph 12A(6)*(d)* as having a debt benefit immediately before the section 45 transaction. Subco 1 must therefore reduce the base cost of the asset by R1 million. The effect will be that Subco 2 will acquire the asset at the reduced base cost of nil. Holdco is, however, unable to claim a capital loss despite the base cost reduction imposed on Subco 1, since the time of the disposal of the debt by Holdco under paragraph 56(1) is not carried forward by the further proviso.

DEBT BENEFIT ARISING AFTER THE DISPOSAL UNDER SECTION 42, 44, 45 OR 47?

Strangely, the effect of the debt benefit arising after the disposal seems to be the same under both paragraph 12A(3) and (4).

Paragraph 12A(3)

If the asset is disposed of in the earlier part of a year of assessment under, say, section 45, and the debt that funded that asset is later waived in the same year of assessment, the base cost of the asset will need to be reduced when determining the capital gain or loss for the year of assessment. However, for purposes of section 45, the base cost of the asset which will equal the proceeds for the transferor and base cost for the transferee, must be determined on the date of the section 45 transaction (that is, before the debt benefit). The effect will be to trigger a capital gain for the transferor. The creditor should be able to claim a capital loss under paragraph 56(2).

Example 2 – Debt benefit arising after disposal of group-funded asset under section 42, 44, 45 or 47 in the same year of assessment

Facts:

Holdco owns all the shares in Subco 1 and Subco 2. All these companies are residents with years of assessment ending on the last day of February.

Subco 1 acquired an asset from Holdco at a cost of R1 million on loan account on 28 February of year 1 after which it immediately ceased trading. On 1 March of year 3, Subco 1 disposed of the asset to Subco 2 under section 45. On 1 August of year 3, Holdco waived the debt of R1 million owed by Subco 1.

Result:

Subco 1 does not qualify for the exemption under paragraph 12A(6)*(d)* for the debt benefit arising as a result of Holdco's waiver of the debt because it disposed of the group-funded asset under section 45 to Subco 2 on 1 March of year 3.

Under section 45 Subco 1 is treated as having disposed of the asset to Subco 2 on 1 March of year 3 for proceeds of R1 million and Subco 2 is treated as having acquired the asset on the same date for the same amount.

Under paragraph 12A(3) Subco 1 must reduce the base cost of the asset to nil as a result of the debt benefit occurring in the same year of assessment. Subco 1 will therefore have a capital gain of R1 million.

Holdco will have a capital loss of R1 million under paragraph 56(2)*(a)*(i) because Subco 1 has had to reduce the base cost of its asset under paragraph 12A(3).

Paragraph 12A(4)

If the debt benefit occurs in a year subsequent to the disposal, paragraph 12A(4) will apply and the debtor will have to redetermine the capital gain or loss and compare it with the previously determined capital gain or loss (likely to be nil because of section 42, 44, 45 or 47). The absolute difference must then be recognised as a capital gain in the year when the debt benefit arises.

The creditor should be able to secure a capital loss under paragraph 56(2)*(a)*(ii) because the debtor has a corresponding capital gain under paragraph 12A(4).

The transferee company will acquire the asset before any base cost reduction.

Example 3 – Debt benefit arising after disposal of group-funded asset under section 42, 44, 45 or 47 in a subsequent year of assessment

Facts:

Holdco owns all the shares in Subco 1 and Subco 2. All these companies are residents with years of assessment ending on the last day of February.

Subco 1 acquired an asset from Holdco at a cost of R1 million on loan account on 28 February of year 1 after which it immediately ceased trading. On 1 March of year 3, Subco 1 disposed of the asset to Subco 2 under section 45. On 1 March of year 4, Holdco waived the debt of R1 million owed by Subco 1.

Result:

Subco 1 does not qualify for the exemption under paragraph 12A(6)*(d)* for the debt benefit arising as a result of Holdco's waiver of the debt on 1 March of year 4 because it disposed of the group-funded asset under section 45 to Subco 2 on 1 March of year 3.

Under paragraph 12A(4) Subco 1 must redetermine the capital gain or loss and account for the absolute difference between the redetermined gain or loss and any capital gain or loss arising at the time of disposal (in this instance there was neither a capital gain nor a capital loss at the time of disposal on 1 March of year 3 because of section 45). The redetermined base cost, after applying paragraph 12A(3) is nil (R1 million – R1 million). Since the proceeds were R1 million under section 45, the redetermined capital gain is R1 million (R1 million proceeds less nil base cost), which Subco 1 must account for when the debt benefit arises on 1 March of year 4. Holdco will be entitled to a capital loss of R1 million under paragraph 56(2)*(a)*(ii) because Subco 1 has had to account for a capital gain of R1 million under paragraph 12A(4). Subco 2 has a base cost of R1 million under section 45 on 1 March of year 3.

CONCLUSION

The results achieved by the provisos to paragraph 12A(6)*(d)* are not consistent when the debt benefit arises before and after the disposal of the asset under section 42, 44, 45 or 47. Whether the provisos serve any purpose besides inflicting unnecessary complexity on SARS and taxpayers can be questioned. Surely, as long as the creditor is denied a capital loss, there is no need to inflict a base cost reduction or capital gain on the debtor even if it has disposed of the asset under one of the corporate rules.

This article was first published in ASA April 2024

Duncan McAllister

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 19 (references to subsections (8)*(d)*), 42, 44, 45 & 47; Eighth Schedule: Paragraphs 12, 12A (subsections (3), (4), (5) & (6)*(d)* – article concentrates on subsection (6)*(d)* – specific reference to the provisos to item *(d)*) & 56(1) & (2));
- Taxation Laws Amendment Act 17 of 2023 (promulgated on 22 December 2023): Sections 23 & 41 (specific reference to subsection (1)*(a)* and *(b)*).

Other documents

- *Comprehensive Guide to Capital Gains Tax* (Issue 9);
- Interpretation Note 91 (Issue 2) (*"Concession or compromise of a debt"*) (20 July 2022).

Cases

- *Caltex Oil (SA) Ltd v Secretary of Inland Revenue* [1975] (1) SA 665 (A); 37 SATC 1 at 15.

Tags: concession or compromise of a debt; redetermined capital gain; debt benefit; group-funded asset; transferee company.

COMPANY TAX RETURNS

On 16 September 2024 SARS released an enhanced Corporate Income Tax Return (ITR14) on its website. This new version of the ITR14 must be submitted by all companies with effect from this date.

Amongst a number of changes to the ITR14 is that all companies must now provide detailed information of the individuals that are regarded as their beneficial owners. Failure to comply with these requirements can result in penalties and compliance notices.

The aim is to enhance transparency and combat illicit activities such as money laundering and terrorism financing by ensuring the identity of ultimate beneficial owners is known.

The concept of beneficial ownership has been integrated into the corporate income tax return process.

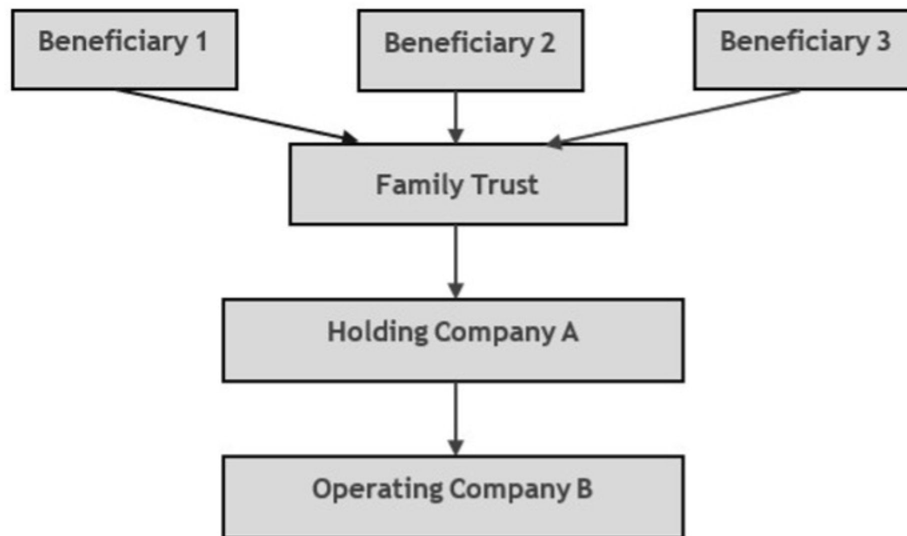
The following key points should be noted:

a. Definition – Beneficial ownership in respect of a company means an individual who, directly or indirectly, ultimately owns that company or exercises effective control over that company. A beneficial ownership control below 5% need not be declared.

b. Mandatory disclosure – As of 11 December 2023, filing beneficial ownership information with the Companies and Intellectual Property Commission (CIPC) has become mandatory for companies completing their annual returns. This ensures that the true owners of companies are known, even if ownership is hidden behind layers of other entities.

c. Complex ownership structures – The CIPC's system now accommodates complex ownership structures, allowing companies to report ownership even when the first layer of ownership is another company, a trust, or a nominee shareholder.

In practice, this could be problematic. Consider the following very common shareholding structure:



If the tax return of Operating Company B is completed, not only the details of Holding Company A and the Family Trust must be provided but also the personal details of Beneficiaries 1 – 3 will have to be supplied although this information might not be readily available.

Previously, SARS only required the details of Company B's shareholder, namely Holding Company A.

SARS is of the view that beneficial ownership information will help to ensure transparency and accuracy in the reporting of ownership structures within companies. This could prevent potential tax evasion, money laundering and other illicit activities by ensuring that the ownership details are consistent and verified. Detailed share register information could aid in detecting and preventing abusive tax practices or schemes designed to manipulate ownership structures to exploit tax loopholes.

Beneficial ownership information could be used for data matching and verification purposes, allowing SARS to cross-reference the information provided in corporate tax returns with other sources of information to identify discrepancies or potential inaccuracies.

It is submitted that, while all of the objectives are reasonable, it is unacceptable that SARS now places a further burden of disclosure on companies for information that it should be able to access through its on-line interfaces with the CIPC and the various Masters' offices. Some of the information requested will, however, not be held by CIPC or the Masters' offices and in many of these cases, it will also not be held by the company.

Completing the beneficial ownership details on the ITR14 can present several challenges. The following considerations should be taken into account:

a. Complex ownership structures – Identifying all beneficial owners can be difficult, especially in companies with complex ownership structures. This includes tracking ownership percentages and control mechanisms.

b. Data accuracy – Ensuring the accuracy of the information reported is crucial. Inaccurate or incomplete data can lead to significant penalties, including fines and imprisonment for wilful violations.

c. Compliance awareness – Many companies may not be fully aware of the new requirements or the extent of the information needed. This lack of awareness can lead to delays, additional costs and non-compliance.

d. Administrative burden – The process of gathering and verifying beneficial ownership information can be time-consuming and resource-intensive, particularly for small businesses.

"It is submitted that, while all of the objectives are reasonable, it is unacceptable that SARS now places a further burden of disclosure on companies for information that it should be able to access through its on-line interfaces with the CIPC and the various Masters' offices."

e. Legal and regulatory understanding – Companies need to understand the legal definitions and requirements related to beneficial ownership, which can be complex and subject to change.

Some tips to help complete the beneficial ownership details on the new enhanced corporate income tax return:

a. Understanding the requirements – One should familiarise oneself with the legal definitions and requirements for beneficial ownership. This includes knowing who qualifies as a beneficial owner and the specific information that needs to be reported.

b. Gathering accurate information – One should ensure that one has accurate and up-to-date information about all beneficial owners. This includes their full names, identification numbers and the nature and extent of their ownership or control.

c. Use reliable sources – Verify the information from reliable sources such as official company records, shareholder agreements and other legal documents.

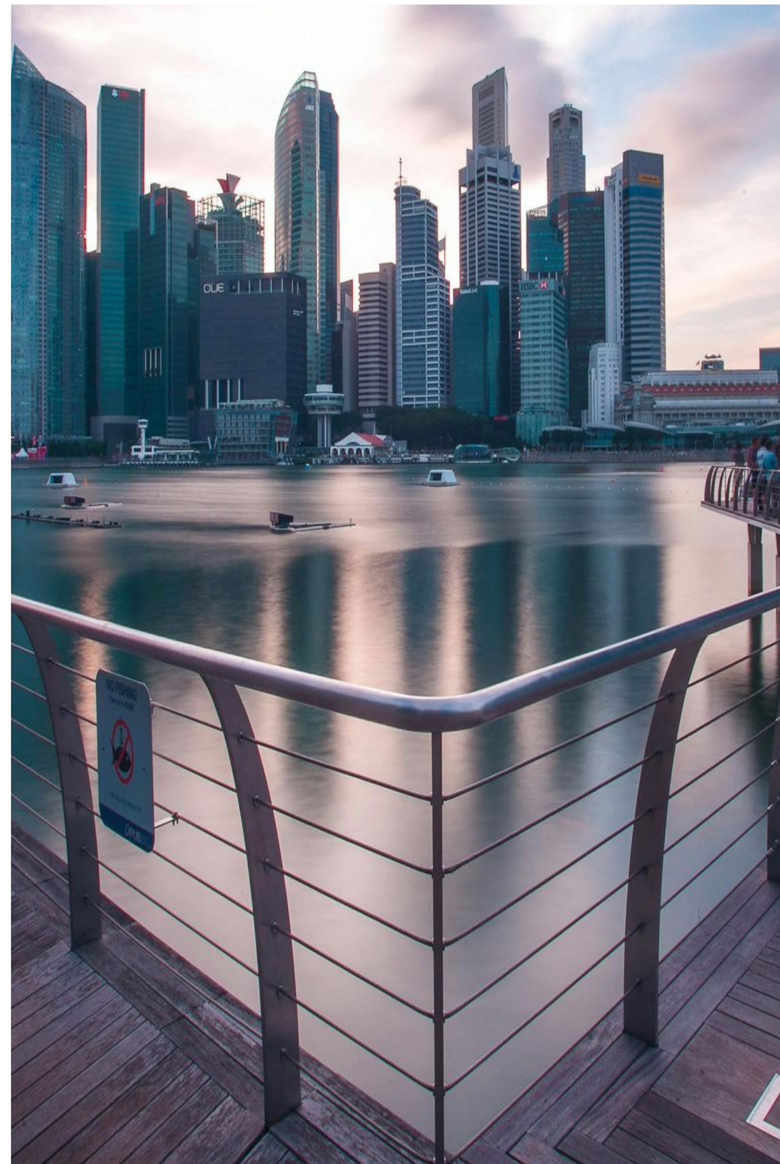
d. Maintain records – Keep detailed records of the information collected and the sources used. This will help in case of any audits and compliance checks.

e. Consult professionals – If one is unsure about any aspect of the reporting requirements, consider consulting with legal or tax professionals who specialise in corporate tax compliance.

f. Stay updated – Regulations can change, so stay informed about any updates or changes to the reporting requirements. Regularly check the CIPC website and other official sources for the latest information.

In conclusion, the new requirements regarding companies' beneficial ownership are important and care should be taken that the correct information is submitted to SARS. There is a view that SARS' approach in shifting the burden of disclosure of information, much of which should already be accessible to it through the CIPC and the various offices of the Master of the High Court to corporate taxpayers, is unacceptable. The gathering and recording of information that SARS should be able to access will result in additional unproductive costs for companies that they can ill afford, given South Africa's constrained economic environment.

"Amongst a number of changes to the ITR14 is that all companies must now provide detailed information of the individuals that are regarded as their beneficial owners."



James Language & Johann Benadé

BDO

Acts and Bills

- General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act 22 of 2022: Section 55 (inserts definition of "beneficial owner" in section 1 of the Companies Act 71 of 2008);
- Companies Act 71 of 2008: Section 1 (definition of "beneficial owner").

Other documents

- Corporate Income Tax Return (ITR14) (new version released on 16 September 2024 by SARS).

Tags: beneficial owners; money laundering; terrorism financing; tax evasion.

THE FINAL ENERGY INCENTIVE LEGISLATION

On 22 December 2023 the Taxation Laws Amendment Act, 2023, was promulgated. It contained the final versions of the renewable energy incentive legislation.

Happily, the final legislation has ironed out many of the gremlins that were in the draft legislation and will be important for individual tax returns that are still to be submitted for the 2024 year of assessment and corporate tax returns.

THE SOLAR ENERGY TAX CREDIT (SECTION 6C)

Section 6C of the Income Tax Act, 1962 (the Act), grants individuals a tax credit (rebate) against their normal tax payable equal to 25% of the cost actually incurred by them in acquiring any new and unused solar photovoltaic panels having a generation capacity of not less than 275W. The panels must be brought into use by the person who acquired them on or after 1 March 2023 and before 1 March 2024. Interestingly, a person acquiring panels in February 2023 would qualify for the tax credit as long as the panels were brought into use during the 2024 year of assessment. The panels must be new and unused at the time of acquisition. The exact meaning of "new" in this context probably means "not second-hand". Another meaning could be "not old". If a person bought panels from a supplier that had been holding them in stock for five years, they may be regarded as not "new", although it is submitted that such an interpretation would defeat the purpose of the legislation. As long as the panels produce at least 275W, why should it matter how long they have been in stock?

The panels are the type that convert sunlight to electricity (photovoltaic), and not the solar thermal collector type that heats water. The position with hybrid panels that both heat water and produce electricity is unclear but presumably as long as they produce at least 275W of electricity, they should qualify.

The credit is limited to R15 000 in aggregate (R60 000 × 25%), that is, one would need to spend more than R60 000 before the R15 000 limit applied. The limit is per person, so if more than one person living in the residence contributed to the cost of the panels, each would be subject to a R15 000 limit. The words "in aggregate" relate to the total cost of all panels acquired and brought into use during the year of assessment by each person.

The tax credit will be allowed only if –

- the solar panels are installed and mounted on or affixed to a residence mainly used for domestic purposes by the natural person who incurred the cost of acquiring them and brought them into use ["mainly" means more than 50% per *Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk* [1966]];
- the installation is connected to the distribution board of the residence; and
- an electrical certificate of compliance issued under the Electrical Installation Regulations, 2009, is issued to the natural person in respect of the installation.

A person would therefore be unable to obtain a credit for financing the cost of an installation at the home of a relative where they do not reside, since they would not be using the panels for their own domestic purposes.

When more than one person in the residence contributes to the cost of the panels, the amount spent by each such person will qualify that person for the credit.

There is no longer any provision in section 6C which results in a reversal of the tax credit if the person disposes of the panels before 1 March 2025. In practice, however, it is highly unlikely that anyone would go through the cost of installing panels only to remove them within the same year of assessment. The abandonment of this clause, which was in the draft Bill, also solves the concern that a person who is not the owner of the residence would be disposing of the panels through the principle of *accessio* as soon as they are attached to the residence (the panels may well accede to the residence and become the property of the owner of the residence).

Section 6C makes no provision for the tax credit to apply when the home owner hires a solar system and incurs a monthly rental. A portion of such rental expense may, however, qualify under section 11*(a)*. read with section 23*(b)* and 23*(m)*(iv) of the Act, to the extent that it is incurred for the purposes of trade.

No tax credit will be allowed to the extent that a deduction has been granted on a panel under section 12B or 12BA of the Act (section 6C(4)).

Section 6C is deemed to have come into operation on 1 March 2023 and applies to years of assessment commencing on or after that date.

There is nothing to prevent the cost of panels from being added to the base cost of a residence. Paragraph 20(3)*(a)* of the Eighth Schedule to the Act does not prevent the inclusion in base cost as it deals only with amounts allowed in determining taxable income before the inclusion of any taxable capital gain. Section 23B of the Act is likewise not applicable as it deals only with double deductions in the determination of taxable income.

On 8 March 2024, SARS issued a guide on section 6C.

ENHANCED DEDUCTION FOR ASSETS USED IN THE PRODUCTION OF RENEWABLE ENERGY (SECTION 12BA)

Like section 6C, section 12BA is a temporary measure which provides an enhanced incentive compared to the existing allowance under section 12B(1)*(h)* for assets used in the production of renewable energy.

It applies to any new and unused machinery, plant, implement, utensil, or article (particular thing or item) owned by the taxpayer or acquired by the taxpayer as a purchaser under an agreement contemplated in paragraph *(a)* of the definition of "instalment credit agreement" in section 1(1) of the Value-Added Tax Act, 1991 (the VAT Act), and which was or is brought into use for the first time by that taxpayer for the purpose of that taxpayer's trade on or after 1 March 2023 and before 1 March 2025.

The asset must have been acquired to be used by that taxpayer or the lessee of that taxpayer *in* the generation of electricity from –

- wind power;
- photovoltaic solar energy;
- concentrated solar energy;
- hydropower; or
- biomass comprising organic wastes, landfill gas or plant material.

The restrictions on lessors being able to take advantage of section 12BA that were in the draft legislation have been removed. National Treasury notes that under a finance lease the lessee will take ownership of the assets only at the end of the lease, thus enabling a lessor to potentially qualify for the allowance. Unfortunately, section 23A has been amended to ring-fence the section 12BA allowance against the rental income. This has caused many *en commandite* partnerships to structure their agreements as power purchase agreements (PPAs). Under such PPAs the partnership does not let the equipment but rather charges a fee for the electricity produced by it. Some of these partnerships make use of borrowings to boost the section 12BA allowance. Under section 24H(3) of the Act the section 12BA allowance is limited to the taxpayer's contribution plus any amount for which the taxpayer may be held liable to any creditor of the partnership and any income received by or accrued to the taxpayer from the trade or business (with the excess carried forward to the following year). [*Author's note*: See Binding Class Ruling 85, dated 9 December 2022, and BCR 88, dated 22 February 2024, for rulings involving *en commandite* partnerships.] Given that the allowance is 125% of the cost of the asset, the taxpayer will have to be liable for an additional R25 over and above a contribution of R100, which makes little sense because the R25 does not involve any outlay. National Treasury declined to exclude the additional 25% portion of the allowance from section 24H(3). Before 2002, section 24H(3) excluded the now repealed section 11*bis* marketing allowance, which also involved a deduction that exceeded cost.

Questions have been asked whether the cost of inverters and batteries qualify on the basis that they do not actually generate electricity. In an FAQ document released by National Treasury on 20 November 2023, it was confirmed that storage and conversion assets would qualify for the incentive as long as they were part of a system that produced electricity. Installations that simply used inverters and batteries to store power from the grid and release it during load shedding would not qualify.

Unlike section 12B, section 12BA has no electricity generation limits.

Taxpayers embarking on massive energy projects may find it difficult to bring such projects into use before 1 March 2025, as they can take several years to complete. These taxpayers will have to avail themselves of section 12B.

Supporting foundations or structures will qualify for the allowance if the asset or improvement qualifies for the allowance and they are mounted on or affixed to any concrete or other foundation or supporting structure and –

- the foundation or supporting structure is designed for such asset or improvement and constructed in such manner that it is or should be regarded as being integrated with the asset or improvement;
- the useful life of the foundation or supporting structure is or will be limited to the useful life of the asset or improvement mounted on or affixed to it.

In the above circumstances, the foundation or supporting structure is deemed to be part of the asset or improvement mounted on or affixed to it. The purpose of this deeming provision is no doubt to ensure that the foundation does not become part of the immovable property to which it is affixed, thus losing its character as a separate asset qualifying for the allowance under section 12BA.

Under section 12BA(2) the deduction is 125% of the cost incurred for acquiring the asset. Thus, if the asset cost R1 million, the taxpayer would be entitled to a deduction of R1 250 000. For an individual on the maximum marginal rate of 45%, this amounts to a total tax saving of R562 500. For a company on the 27% flat rate, the saving will be R337 500.

Under section 12BA(3), for the purposes of section 12BA, the cost to a taxpayer of any asset acquired by that taxpayer is deemed to be the lesser of –

- the actual cost to the taxpayer; or
- the cost which the taxpayer would, if that person had acquired the asset under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the asset was in fact concluded, have incurred in respect of the direct cost of acquisition of the asset, including the direct cost of its installation or erection.

The purpose of this rule is to prevent interest incurred from forming part of the cost of the asset. Interest would usually be claimed under section 24J on a yield-to-maturity basis.

The deduction does not apply to any asset the ownership of which is retained by the taxpayer as a seller under an agreement contemplated in paragraph (a) of the definition of "instalment credit agreement" in section 1(1) of the VAT Act (section 12BA(4)*(a)* of the Act). This rule prevents the seller from claiming the deduction, since it is the acquirer who would claim it (see section 12BA(1)).

It also does not apply to any asset brought into use on or after 28 February 2025 (section 12BA(4)*(b)*).

A person is not entitled to a deduction under section 12B if that person has claimed a deduction for the relevant asset under section 6C or section 12BA (section 12B(4)*(h)*). Taxpayers can choose under which provision they wish to claim a deduction (section 12B or section 12BA). Given that section 12BA offers the superior deduction, it is unlikely that a taxpayer would choose section 12B over section 12BA unless there was a concern that the asset could not be brought into use before 1 March 2025.

RECOUPMENT OF THE SECTION 12BA ALLOWANCE

A special recoupment rule, contained in section 8(4)*(n*A*)* of the Act, applies when a section 12BA asset is disposed of before 1 March 2026. It provides that in such circumstances the taxpayer must include in income 25% of the cost of that asset, which has been recouped during the current year of assessment, in addition to the inclusion of amounts under section 8(4)*(a)*, but limited to the total amount allowed to be deducted under section 12BA. It seems unlikely that a taxpayer would go to the trouble of installing solar equipment in, say, 2023, only to dispose of it two years later. The most likely scenario in which this could occur seems to be when the building itself is disposed of together with the equipment attached to it.

The table below illustrates various scenarios illustrating the interaction between section 8(4)*(a)* and 8(4)*(n*A*)* when an asset is disposed of before 1 March 2026. The table assumes that the person paid R100 for the section 12BA asset and obtained an allowance of R125.

Proceeds	**Section 8(4)*(a)***	**Section 8(4)*(n*A*)***	**Capital gain**	**Workings for section 8(4)*(n*A*)***
100	100	25	0	R100 × 25%
110	110	15	0	R100 × 25%, limited to 15
130	125	0	5	R100 × 25% limited to nil
80	80	20	0	R80 × 25%

On or after 1 March 2026 the position is as follows:

Proceeds	**Section 8(4)*(a)***	**Section 8(4)*(n*A*)***	**Capital gain**
100	100	-	0
110	110	-	0
130	125	-	5
80	80	-	0

CAN THE SECTION 12BA ALLOWANCE BE CLAIMED ON A PORTION OF A RESIDENCE USED FOR TRADE?

Employees other than persons deriving more than 50% of their remuneration from commission are prevented from claiming the allowance under section 23*(m)*.

A sole trader or commission agent may be able to claim the section 12BA allowance on the cost of installation of energy generation equipment at domestic premises that is attributable to the part of the premises used for the purposes of trade, provided they comply with section 23*(b)*. That provision requires that "such part is specifically equipped for purposes of the taxpayer's trade and regularly and exclusively used for such purposes". Commission agents must not perform their duties mainly in an employer-supplied office in order to qualify for the allowance. SARS indicates in Interpretation Note 28 (Issue 3) dated 4 March 2022 in paragraph 4.6.1 that it accepts that the correct method for apportioning expenses is one based on floor area. However, an apportionment based on power consumption attributable to the part used for trade divided by the total power consumption would seem to be more appropriate.

A sole trader or commission agent who claims a tax credit for solar panels under section 6C would be unable to claim the cost of inverters and batteries under section 12BA, since the batteries and inverters would no longer be part of a group of assets used in the generation of electricity. To qualify, the person must claim section 12BA on the panels together with the inverters and batteries.

On 23 November 2024 SARS published a section 12BA guide, the "*Guide on the Allowances and Deductions Relating to Assets Used in the Generation of Electricity from Specified Sources of Renewable Energy*".

CONCLUSION

In the 2024 Budget, presented on 21 February 2024, no extensions were announced to section 6C or section 12BA.

[*Editorial comment*: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear. Furthermore, *a binding class ruling* applies only to *SARS and the class referred to in the ruling*, and is published for general information. It does not constitute a practice prevailing. A third party may not rely on a binding class ruling under any circumstances. In addition, published binding class rulings may not be cited in any dispute with SARS, other than a dispute involving the class identified therein.]

This article was first published in ASA May 2024

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 6C (specific reference to subsection (4)), 8(4)*(a)* & *(n*A), 11*(a)*, 11*bis*, 12B (specific reference to subsection (1)*(h)*), 12BA (specific reference to subsections (1), (2), (3) & (4)*(a)*,) 23*(b)* & *(m)*(iv), 23A, 23B, 24H(3), 24J; Eighth Schedule: Paragraph 20(3)*(a)*;
- Value-Added Tax Act: Section 1(1) (definition of "instalment credit agreement");
- Taxation Laws Amendment Act 17 of 2023.

Other documents

- Electrical Installation Regulations, 2009;
- Binding Class Ruling 85 (*En commandite* partnerships investing in photovoltaic solar energy plants) – 9 December 2022;
- Binding Class Ruling 88 (*En commandite* partners investing in solar assets) – 22 February 2024;
- Interpretation Note 28 (Issue 3) ("*Deductions of home office expenses incurred by persons in employment or persons holding an office*": Paragraph 4.6.1) – 4 March 2022;
- 2024 Budget;
- *Guide on the Allowances and Deductions Relating to Assets Used in the Generation of Electricity from Specified Sources of Renewable Energy* – issued on 23 November 2024.

Cases

- *Sekretaris van Binnelandse Inkomste v Lourens Erasmus (Eiendoms) Bpk* [1966] (4) SA 434 (A); 28 SATC 233 at 245.

Tags: renewable energy incentive legislation; taxable capital gain; instalment credit agreement; maximum marginal rate.

BINDING PRIVATE RULING 410 – CFC DISPOSES OF EQUITY SHARES

The South African Revenue Service (SARS) issued Binding Private Ruling 410 (BPR 410), providing insights into a technical aspect of South African income tax law concerning controlled foreign companies (CFCs) and their interaction with various sections of the South African Income Tax Act, 1962 (the Act).

Released on 11 September 2024, this ruling clarified the income tax and capital gains tax consequences associated with the disposal of equity shares in a foreign company by a CFC.

UNDERSTANDING THE LEGISLATIVE CONTEXT

The ruling referenced several critical sections of the Act. Specifically, it discussed the implications of section 9H(3)*(b)* and 9H(5), along with paragraph 64B of the Eighth Schedule, all of which played crucial roles in determining the tax outcomes of the transaction in question.

PARTIES INVOLVED

The ruling involved multiple parties:

- **The Applicant:** A company incorporated outside South Africa but classified as a tax resident in South Africa.
- **Company A:** A CFC as defined in section 9D(1) of the Act, associated with the Applicant.
- **Company B:** A foreign company involved in the transaction.

DETAILS OF THE PROPOSED TRANSACTION

The proposed transaction involved Company A's participation in shares of Company B, which were considered "equity shares" as defined in section 1(1) of the Act. Notably, the value of any assets in Company B was not linked to assets directly or indirectly located, issued, or registered in South Africa. As a result, the shares held by Company A did not constitute an interest as contemplated in paragraph 2(2) of the Eighth Schedule. The Applicant's group intended to dispose of its interest in Company B.

"It is clear that the cessation of CFC provisions and their interaction with various sections of the Act remains a complex area, which prompted the taxpayer to seek a ruling from SARS."

STEPS OF THE PROPOSED TRANSACTION

The steps of the proposed transaction were complex, but essentially structured as a merger governed by foreign law. Company A, along with third-party shareholders, planned to dispose of their shares in Company B to a third-party purchaser (the Purchaser) in exchange for a combination of cash and shares. The Purchaser owned 100% of the shares in Merger Sub 1 (MS1) and Merger Sub 2 (MS2). Structuring the transaction as a merger provided the buyer with certainty regarding the acquisition of all issued shares in the target company.

"The steps of the proposed transaction were complex, but essentially structured as a merger governed by foreign law."

The steps outlined in the ruling can be summarised as follows:

Step 1 – Merger 1: MS1 merged with Company B.

- Company B became the surviving entity, with MS1 being automatically terminated, thus becoming a wholly owned subsidiary of the Purchaser.
- Company B shares held by Company A and the third parties were cancelled by Company B following their conversion to the right to receive the per-share merger consideration (a combination of cash and shares to be issued by the Purchaser).

Step 2 – Merger 2: Company B merged with MS2.

Company B merged with MS2, with MS2 as the surviving company, leading to the automatic termination of Company B.

Step 3 – Payment of consideration

The Purchaser paid the per-share merger consideration to Company A and the third parties (in the form of cash and shares in the Purchaser).

As a result of these steps, Company B (and its subsidiaries) ceased to be regarded as CFCs in relation to the Applicant.

SARS RULING

SARS ruled as follows:

- Company A was regarded as having disposed of its shares in Company B to the Purchaser for the purposes of paragraph 64B(1)*(b)* of the Eighth Schedule.
- Immediately after the proposed transaction, the shareholders of the Purchaser and any company in Company A's group were not "substantially the same" for purposes of paragraph 64B(1)*(b)*(iii) of the Eighth Schedule.
- The participation exemption in paragraph 64B(1) applied to Company A's disposal of its shares held in Company B to the Purchaser, resulting in any capital gain (or capital loss) arising from the disposal to the Purchaser being disregarded.
- Section 9H(5) of the Act applied to the transaction and had the effect of removing the effects of section 9H(3)*(b)*. This meant that the deemed disposal of all Company B's assets was not applicable when Company B ceased to be a CFC.

It is clear that the cessation of CFC provisions and their interaction with various sections of the Act remains a complex area, which prompted the taxpayer to seek a ruling from SARS.

The favourable stance taken by SARS is a positive sign for taxpayers entering into similar types of transactions, as there were no adverse tax consequences from a South African perspective.

[*Editorial comment*: Published SARS rulings are necessarily redacted summaries of the facts and circumstances. Consequently, they and articles discussing them should be treated with care and not simply relied on as they appear. Furthermore, a *binding private ruling* has a binding effect bet*ween SARS and the applicant only*, and is published for general information. It does not constitute a practice generally prevailing. A third party may not rely upon a binding private ruling under any circumstances. In addition, published binding private rulings may not be cited in any dispute with SARS, other than a dispute involving the applicant or any co-applicant(s) identified therein.]

Jessica Brown & Tertius Troost

Forvis Mazars in South Africa

Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definition of "equity share"), 9D(1) & 9H(3)*(b)* & 9H(5); Eighth Schedule: Paragraphs 2(2) & 64B (specific reference to subparagraph (1)*(b)*(iii)).

Other documents

- Binding Private Ruling 410 ("*Disposal by a controlled foreign company of equity shares in a foreign company*") (11 September 2024).

Tags: controlled foreign companies (CFCs); third-party shareholders; third-party purchaser; wholly owned subsidiary.

DIGITAL NOMAD VISA

Like takes in cinematography, many iterations of the amendments to the Immigration Regulations (Regulations) have been seen in 2024. One of the concepts that has required a few takes, is the remote working, or what is commonly referred to as the "digital nomad", visa.

The current Minister of Home Affairs, Dr Leon Schreiber, has, in terms of section 7 of the Immigration Act, 2002, further amended the criteria and conditions of the digital nomad visa in the Third Amendment of the Immigration Regulations, published on 9 October 2024 (the Third Amendment). This article outlines the changes.

Most notably, the income threshold to qualify for the visa has been reduced from the equivalent of ZAR 1 million per annum to the equivalent of ZAR 650 976 per annum. The Minister has also reverted to the previous version of the amendments in some respects, that is, the version that was published prematurely, on 28 March 2024 ("Second Amendment of the Immigration Regulations, 2014"), and was withdrawn on 12 April 2024.

In particular, the somewhat clumsy reference to "foreign source income" concerning the nature of the work conducted by the foreign applicant that was included in the republished version of the amendments (republished on 20 May 2024), has been removed. So too has the reference to compliance with legislation governing the employment of workers in South Africa.

Concerns have been raised about apparent inconsistencies between the digital nomad rules and the provisions of the Income Tax Act, 1962 (the Act), relating to the income tax liability of the digital nomad, and about the fact that Government has not addressed the tax risks for foreign employers, namely the risk that a foreign employer may be required to register as a taxpayer and as an employer with the South African Revenue Service (SARS) if permitting an employee to work in South Africa on a remote basis. The latest changes address the first concern, but not the second.

Initially, the amendments provided for foreign remote workers to be exempt from registering with SARS if their visas were issued for a period of less than six months in a 12-month period. This period was then tightened to less than six months in a 36-month period; and rather than an automatic exemption, the regulations entitled the employee to apply to be exempted by SARS from registering as a taxpayer.

One of the concerns with these provisions was that, while the exemption relates to compliance obligations, it effectively provided an exemption from income tax which is not provided in the Act. While foreign remote workers who are tax residents in a country that has concluded a double taxation agreement (DTA) with South Africa should qualify for tax relief, this does not apply to foreign remote workers who cannot rely on a DTA.

The Third Amendment now provides that foreign remote workers who are tax resident in a country that has concluded a DTA with South Africa will be required to register with SARS if they are present in the Republic for longer than an aggregate period of 183 days during any 12-month period (which aligns with the terms of most DTAs). Digital nomads from countries that do not have DTAs with South Africa will be required to register with SARS regardless of how long they remain in South Africa.

As indicated above, the Third Amendment also no longer refers to "foreign source income", which in the context of tax means something completely different to what its presumed intention was in the previous version of the Regulations.

Unfortunately, while the changes in the Third Amendment are to be welcomed, the legislature has not yet addressed the main tax concerns for foreign employers, namely the risk that the remote worker will create a permanent establishment for the foreign employer (and thus trigger both an obligation to register as an employer and potentially also a corporate tax liability). It is also still unclear what the position will be when it comes to the payment of skills development levies and unemployment insurance contributions relating to digital nomads.

Finally, despite the removal in the Third Amendment of the specific reference to South African employment legislation, foreign employers would still be well-advised to consider the possible employment law implications of "digital nomad" remote working arrangements.

Aneria Bouwer & Chloë Loubser

Bowmans

Acts and Bills

- Income Tax Act 58 of 1962;
- Immigration Act 13 of 2002: Section 7.

Other documents

- Immigration Regulations, 2014 (published in terms of section 7 of the Immigration Act 13 of 2002);
- Second Amendment of the Immigration Regulations published in *Government Gazette* on 28 March 2024 and withdrawn on 12 April 2024;
- Second Amendment of the Immigration Regulations republished in *Government Gazette* 50675 on 20 May 2024;
- Third Amendment of the Immigration Regulations, published in *Government Gazette* 51366 on 9 October 2024.

Tags: "digital nomad" visa; double taxation agreement (DTA); permanent establishment; skills development levies; unemployment insurance contributions.

THE RISK OF INCURRING A LIABILITY FOR ANOTHER PARTY'S TAX DEBTS

In the case of Christoffel Hendrik Wiese and Others *[the Appellants]* v CSARS *(1307/2022) [2024] ZASCA 111 (judgment delivered on 12 July 2024), one of the questions before the Supreme Court of Appeal (SCA) was whether a "tax debt", (defined in section 1 of the Tax Administration Act, 2011 (the TAA)), existed for purposes of section 183 of the TAA even where an assessment for the amount in question had not yet been raised by SARS.*

The import of the question was that, if the answer to this question was in the affirmative and if the other requirements of section 183 were met (which was not decided), the Appellants could have been held jointly and severally liable for the tax debts of another taxpayer in terms of this section.

The facts were that in January 2007, Energy Africa (Pty) Ltd (the taxpayer) disposed of shares and claims held in Energy Africa Holdings (Pty) Ltd (EAH), which resulted in a capital gain that was not disclosed in the taxpayer's 2007 income tax return. Following an audit of the transaction that gave rise to the disposal, the South African Revenue Service (SARS) notified the taxpayer of its intention to raise an additional assessment for income tax to reflect the capital gain and also to raise an assessment to give effect to a liability for secondary tax on companies (STC) relating to the transaction.

In April 2013, the taxpayer disputed SARS' audit findings and thereafter disposed of its sole asset, a loan account claim, to its holding company through the distribution of a dividend *in specie*. SARS finalised its audit and raised assessments that reflected tax liabilities relating to income tax (for capital gains tax) and STC, during August 2013. The taxpayer objected against these assessments, which objections SARS allowed in part. The taxpayer chose not to appeal the disallowance of the objections, and thereafter SARS issued a final demand in respect of both assessments but was informed that the taxpayer was dormant.

In July 2015, SARS lodged an inquiry in terms of Part C of Chapter 5 of the TAA at which the Appellants testified. SARS contended that the Appellants had knowingly assisted the taxpayer to part with its sole asset with the intention of obstructing the collection of a tax debt owed by the taxpayer to SARS. SARS issued notices of personal liability to the Appellants in terms of section 183 of the TAA. Section 183 imposes an individual and joint liability on a person for a taxpayer's tax debt, to the extent that such a person knowingly assists a taxpayer in dissipating its assets in order to obstruct the collection of a tax debt. The Appellants maintained that, since the distribution of the dividend *in specie* preceded the date of issuance of the additional assessments, no "tax debt" as defined in the TAA existed at the date of the distribution.

The matter proceeded to the Western Cape High Court, which ruled in favour of SARS. The High Court found, among other things, that section 183 of the TAA did not require of SARS to have issued an assessment for a tax debt to have been in existence at the time of the distribution. The court found, among other things, that the taxpayer's tax debt relating to capital gains tax and STC existed prior to the assessments being issued by SARS. The taxpayer then proceeded with an appeal to the SCA against the High Court's decision.

The SCA had to decide, among other things, whether the term "tax debt", as contemplated in section 183 of the TAA, requires that an assessed tax debt should have existed at the date that the dissipation of assets occurs. It was noted that, in considering the definition of "taxable event" in section 1 of the TAA, the occurrence of an event, such as the disposal of a capital asset for CGT purposes, triggers a taxpayer's liability for tax. The SCA pointed out that a "tax debt" represents an amount of tax payable by a taxpayer to SARS. Although the amount of tax due to SARS is established in terms of an assessment, the assessment itself does not impose a liability for tax; instead, a liability for tax is imposed through the operation of law regardless of whether an assessment exists.

Therefore, the SCA held that a tax debt was in existence at the time the dissipation of the taxpayer's assets by the distribution of the dividend *in specie* occurred, despite the absence of assessments quantifying the amount of the tax debt at that stage. The question whether the remaining requirements of section 183 of the TAA are met such that the Appellants, or some of them, may be held jointly and severally liable for the tax debt of the taxpayer, was not considered by the SCA and doubtless will form the subject of subsequent court proceedings.

Besides the existence of a "tax debt" at the time dissipation of a taxpayer's assets occurs, section 183 requires that –

(a) the third person should "knowingly assist in the dissipation of a taxpayer's assets";

(b) the dissipation should be undertaken "in order to obstruct the collection of a tax debt"; and

(c) the assistance should have rendered the taxpayer unable to discharge the tax debt.

Apart from section 183, which imposes a liability on a third party for the purposeful obstruction of the collection of a tax debt owed by a taxpayer to SARS, the SCA considered other specific provisions in the TAA which provide for the collection or recovery of a tax debt owed by a taxpayer from other persons. These sections are briefly discussed below.

Section 169(2) of the TAA authorises SARS to recover a tax debt from a representative taxpayer who is not personally liable under section 155, by confiscating any assets belonging to the taxpayer that are in possession of the representative taxpayer or under such person's management or control. A representative taxpayer includes, among other persons, the public officer of a company.

An alternative avenue for the collection of an outstanding tax debt owed by a taxpayer is in terms of section 179 of the TAA. This

"Section 169(2) of the TAA authorises SARS to recover a tax debt from a representative taxpayer who is not personally liable under section 155, by confiscating any assets belonging to the taxpayer that are in possession of the representative taxpayer or under such person's management or control."

provision allows for a senior SARS official to issue a notice to a so-called agent who would be required to settle the taxpayer's "outstanding tax debt" from an amount of money that is or will be held for or owed by such a person to the taxpayer. The term "outstanding tax debt" is defined in section 1 of the TAA and the SCA found that, in the context of section 179, this pre-supposes that SARS must have issued an assessment for the amount of the outstanding tax. In this manner, section 179 of the TAA authorises SARS to collect the outstanding tax debt from money, including a pension, salary, wage or other remuneration, due to a taxpayer from a third-party agent. Such recovery may occur regardless of whether the tax debt in question is under dispute.

Under section 180, a person that controls or is regularly involved in the management of the overall financial affairs of a taxpayer may also face personal liability for the outstanding tax debt of a taxpayer. This would be the case if a senior SARS official is satisfied that such person's negligence or fraud resulted in the failure to pay such debt. Once again, this provision uses the term "outstanding tax debt", which the SCA found in this context implies that SARS must have issued an assessment for the amount of the outstanding tax.

If a company is wound up without settling any "outstanding tax debt" owed by that company, including its liability as a responsible third party, section 181 of the TAA may impose a liability to settle the tax debt on the company's shareholders. Persons who were shareholders of the company within one year prior to its winding up, are jointly and individually liable to settle the company's tax debt to the extent that they received assets of the company in their capacity as shareholders within one year prior to its winding up. This only applies if the tax debt existed or would have existed at the time of receipt of such assets, had the company complied with its obligations under a tax Act. Notwithstanding the use of the term "outstanding tax debt" in section 181(1), in its judgment the SCA concluded that because section 181(2) refers to tax debt that existed or would have existed at the time of receipt of the assets, the provision could apply even if the tax debt in question had not been determined by SARS in an assessment at the time the shareholder had received the assets of the company. However, it should be noted that listed companies are expressly excluded from the scope of section 181.

Finally, section 182 provides that where a person receives an asset from a taxpayer (not necessarily a company) who is a "connected person" in relation to such taxpayer without consideration or for consideration below the fair market value of the asset, that person is liable for the "outstanding tax debt" of such taxpayer. Similar to section 181, the liability of the connected person is limited to the lesser of the tax debt that existed or would have existed at the time of receipt of the assets, had such taxpayer complied with its obligations under a tax Act, and the fair market value of the asset at the time of the transfer, reduced by the fair market value of any consideration paid for the asset. In commenting on this provision, the SCA also concluded that notwithstanding the use of the term "outstanding tax debt", because it refers to tax debt that existed or would have existed at the time of receipt of such assets, the provision could apply even if the tax debt in question had not been determined by SARS in an assessment at the time the shareholder had received the assets of such taxpayer.

In the present case, the provisions of section 183 were the focal point under consideration. The SCA held that the purpose of section 183 is to impose a liability to pay a taxpayer's tax debt on a third party where such party knowingly assisted the taxpayer to obstruct the collection of tax. The SCA reiterated that whether the other requirements of section 183 were met was not a consideration before the court. The court merely had to decide the question whether a tax debt existed at the time the dissipation of assets occurred, even though the dissipation of assets preceded the date of the assessments under which the quantum of the tax debt was determined and, as noted above, decided this question in the affirmative.

The case illustrates the importance for those involved in the affairs of other taxpayers to be aware of instances where they could potentially be held liable for the tax debts of the other taxpayer, either through their positive action or inaction.

Doria Cucciolillo & Adjunct Associate Professor David Warneke

BDO

Acts and Bills

- Tax Administration Act: Sections 1 (definitions of "outstanding tax debt" & "tax debt"), 50 to 58 (Part C of Chapter 5), 155, 169(2), 179, 180, 181(1) & (2), 182 & 183.

Cases

- *Christoffel Hendrik Wiese and Others v CSARS* (1307/2022) [2024] ZASCA 111 (judgment delivered on 12 July 2024).

Tags: tax debt; additional assessment; secondary tax on companies (STC); taxable event; dividend *in specie*; jointly and severally liable; collection of a tax debt; representative taxpayer; outstanding tax debt; senior SARS official; responsible third party.

NON-RESIDENT BENEFICIARIES OF RESIDENT TRUSTS

The Taxation Laws Amendment Act, 2023, made changes to section 25B(1) and (2) of the Income Tax Act, 1962 (the Act), that have profound tax implications for resident trusts with non-resident beneficiaries. The amendments apply to the 2025 and subsequent years of assessment and commenced on 1 March 2024.

Section 25B(1) and (2) now provide as follows:

> **"25B. Taxation of trusts and beneficiaries of trusts**
>
> (1) Any amount (other than an amount of a capital nature which is not included in gross income or an amount contemplated in paragraph 3B of the Second Schedule) received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust, shall, subject to the provisions of section 7, to the extent to which that amount has been derived for the immediate or future benefit of any ascertained beneficiary, <u>who is a resident</u> and has a vested right to that amount during that year, be deemed to be an amount which has accrued to that beneficiary, and to the extent to which that amount is not so derived, be deemed to be an amount which has accrued to that trust.
>
> (2) Where a beneficiary <u>who is a resident</u> has acquired a vested right to any amount referred to in subsection (1) in consequence of the exercise by the trustee of a discretion vested in him or her in terms of the relevant deed of trust, agreement or will of a deceased person, that amount shall for the purposes of that subsection be deemed to have been derived for the benefit of that beneficiary."

(Underlining indicates the 2023 amendments (insertions).)

The Explanatory Memorandum on the Taxation Laws Amendment Bill, 2023, notes that there has been an increase in applications to transfer money offshore. This activity has led to concern over the difference between the treatment of capital gains under paragraph 80 of the Eighth Schedule to the Act and section 25B. Under paragraph 80 attribution of a capital gain is possible only to a resident beneficiary, while section 25B does not contain such a limitation for income. The result is that –

- non-residents may not be taxable on foreign source amounts;
- tax recovery actions may be difficult; and
- SARS may not have the information necessary to identify the ultimate beneficiaries when the beneficiary of the resident trust is a non-resident trust.

THE COMMON LAW CONDUIT PRINCIPLE

In *Commissioner, South African Revenue Service v The Thistle Trust,* [2023], the appellant argued that despite paragraph 80 of the Eighth Schedule permitting attribution only to residents, a capital gain could flow through multiple trusts under the common law conduit principle. The Supreme Court of Appeal rejected this argument despite it being entertained in the tax court. [*ITC 1941* [2021] 83 SATC 387 (G).] That case was taken on appeal to the Constitutional Court and heard on 8 February 2024. At the time of writing, judgment was pending, but in my view, it would be surprising if the CC were to rule that the conduit principle had any role to play in section 25B or paragraph 80. If the conduit principle allowed income or capital gains to flow to non-resident beneficiaries, the clear legislative intent as expressed in the newly amended section 25B and paragraph 80 would be undermined. [*Editorial comment*: The judgment of the CC has since been delivered and the court ruled that the awards to the beneficiaries of Thistle Trust did not reduce the tax liability of the trust itself.]

VESTING TRUSTS

At an online webinar on 29 February 2024, SARS claimed that the amended section 25B also applied to vesting trusts. SARS claimed that the amended section 25B also applied to vesting trusts. But whether that view is correct seems questionable, and it would be helpful if SARS were to issue an Interpretation Note on this subject to clarify its formal position.

> "The purpose of section 25B(2) seems to be to clarify that when a trustee exercises a discretion over income that has been received by or accrued to the trust in a year of assessment, it will be treated as having accrued to the beneficiary and retain its character as income despite being vested after receipt or accrual by the trust."

Section 25B(1) begins by referring to any amount "received by or accrued to or in favour of any person during any year of assessment in his or her capacity as the trustee of a trust".

The definitions of "trust"' and "trustee" in section 1(1) refer to assets being administered by a person acting in a fiduciary capacity, which would encompass both discretionary and vesting trusts.

However, it is submitted that, whether or not vested rights are brought within section 25B(1) needs to be determined with reference to the words "received by or accrued to". In *Geldenhuys v Commissioner for Inland Revenue* [1947] the court stated that "received by" meant "received by the taxpayer on his own behalf for his own benefit".

And in *Lategan v Commissioner for Inland Revenue* [1926] the court stated that "accrued" meant "to which he has become entitled". [*Author's note*: The Lategan principle was upheld by the Appellate Division in *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* [1990].]

The next question is what is meant by "in his or her capacity as the trustee of a trust".

Could this mean not only amounts received by the trust as owner but also amounts to which the beneficiary has a vested right?

It is submitted that the words "received by or accrued to" refer to amounts that belong to the trust. Those amounts are derived by the trustee in his or her capacity as such. Amounts held by the trust on behalf of a beneficiary accrue to the beneficiary and are held by the trustee as a quasi-agent or administrator. Attempting to tax a trust on income which accrues to a beneficiary is tantamount to taxing a nominee or agent and there are a string of cases that reject that proposition. [*Geldenhuys* (above)*; Taxpayer v Commissioner of Taxes, Botswana* [1980] (director's fees ceded to holding company); *Secretary for Inland Revenue v Smant* [1973] (registered shareholder v beneficial shareholder).] In *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* [1955] the court stated:

> "If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income."

In addition, section 25B(1) is subject to section 7. Section 7(1) provides as follows:

> **"7. When income is deemed to have accrued or to have been received**
>
> (1) Income shall be deemed to have accrued to a person notwithstanding that such income has been invested, accumulated or otherwise capitalized by him or that such income has not been actually paid over to him but remains due and payable to him or has been credited in account or reinvested or accumulated or capitalized or otherwise dealt with in his name or on his behalf, and a complete statement of all such income shall be included by any person in the returns rendered by him under this Act."

When a beneficiary has a vested right to income under the trust deed and chooses to allow it to be accumulated in the trust on his or her behalf, that income clearly accrues to the beneficiary under the core rules and section 7. Such a vested right is an accrued right. [See *ITC 76* (1927) 3 SATC 68 (U) at 70.]

The view expressed above is consistent with the way SARS treats vested assets of non-residents for capital gains tax purposes. [See SARS *Comprehensive Guide to Capital Gains Tax (Issue 9)* in 14.9.4.] Once an asset has been vested in a non-resident beneficiary and any capital gain is taxed in the trust or hands of a resident donor, any further disposal of the vested asset by the trustee is an action on behalf of the beneficiary, and it is the beneficiary that must account for any further capital gain or loss, assuming that the asset falls within paragraph 2(1)*(b)* of the Eighth Schedule such as immovable property in South Africa. [*Author's note*: Paragraph 11(1)*(d)* of the Eighth Schedule states that the vesting of an interest in an asset of a trust is a disposal.]

DISCRETIONARY TRUSTS

The position with income accruing to a discretionary trust is, however, different. Despite such income having been received by or accrued to the trust, section 25B(1) overrides the principle that income cannot be disposed of after accrual and deems it to accrue to a resident beneficiary. [See *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* [1960].]The result is that when the trustees vest income in a non-resident beneficiary, there is no longer any mechanism to remove it from the trust and deem it to accrue to such a beneficiary.

Rather inconsistently, section 7(5) can still result in such income being attributed to a non-resident donor, while paragraph 70 of the Eighth Schedule does not permit a capital gain to be attributed to a non-resident donor.

The purpose of section 25B(2) seems to be to clarify that when a trustee exercises a discretion over income that has been received by or accrued to the trust in a year of assessment, it will be treated as having accrued to the beneficiary and retain its character as income despite being vested after receipt or accrual by the trust. Section 25B(2) also excludes non-resident beneficiaries from its ambit, so if income is vested after accrual in a non-resident beneficiary, it will remain taxable in the trust unless attributed to a donor under section 7.

> "The amendments to section 25B might result in more taxes for the fiscus in the short term. But the lawmakers should bear in mind that in raising taxes, for every action there is often an unequal and opposite reaction, which might result in less taxes being collected in the long run."

THE EFFECT OF THE AMENDMENTS TO SECTION 25B

The amendments to section 25B can have severe consequences. For example, under the previous wording of section 25B, income vested in a non-resident beneficiary would have been attributed to that beneficiary. The non-resident beneficiary was taxable on income vested in him or her from a South African source (for example, rental income from immovable property in South Africa) but interest income may well have been exempt from normal tax under section 10(1)*(h)*. Income from a non-South African source was not taxable in the hands of the non-resident beneficiary. There was also a chance that the non-resident beneficiary would have enjoyed a lower rate of tax ranging from 0% to 45% because of the sliding scale applicable to natural persons.

In other situations, the vested amount, such as a local dividend, royalty income or interest on a private company loan account, may have attracted a lower rate of withholding tax by virtue of a tax treaty.

Now, all income, regardless of its source, vested in a non-resident beneficiary, is subject to normal tax in the trust at 45% unless it can be attributed to a donor under section 7.

TAX TREATIES

In the final response document on the various 2023 amending Acts dated 2 February 2024, SARS and National Treasury addressed two issues concerning the amendments to section 25B and South Africa's tax treaties. The first comment was that the amendment may cause economic double taxation as the trust will pay tax in South Africa while the non-resident beneficiary may pay tax on the distributed amount in another country. Response: Article 1(2) of the 2017 OECD Model Treaty provides as follows:

> "2. For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State shall be considered to be income of a resident of a Contracting State but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State."

The words "considered to be income of a resident of a Contracting State" do not grant the foreign country an exclusive taxing right (see article 1(3)) but merely enable it to grant double tax relief.

For example, if the beneficiary of a South African resident trust is resident in Country X, and Country X regards the trust as fiscally transparent, Country X should provide tax relief under the equivalent of article 23A (exemption method) or 23B (credit method) for the normal tax paid by the trust on the income vested in the beneficiary. The relief Country X has to provide is limited under article 23B(1) to the tax it imposes on the income.

In addition, article 3(1) of the multilateral instrument (MLI) ratified and deposited by South Africa in 2022, became effective in South Africa on 1 January 2023, and contains similar wording to article 1(2). The response, however, drew attention to the OECD commentary in paragraph 5 which noted that

> "States should not be expected to grant the benefits of a bilateral tax convention in cases where they cannot verify whether a person is truly entitled to these benefits".

This qualification relates to the obtaining of adequate information from the entity concerned (that is, the resident South African trust).

The second comment was that the amendment resulted in a conflict with article 24(1) of the OECD Model Treaty relating to non-discrimination. Response: The proposed amendment does not provide different treatment based on nationality and therefore there is no discrimination.

Consequential amendments were made to sections 49D and 50D (exemption from withholding tax on royalties and interest, respectively) to exempt a distribution or a royalty or interest received by or accrued to a trust that is distributed to a beneficiary. Given that the amount was received by or accrued to the trust, one can question whether these amendments were necessary as they would represent a distribution of after-tax trust capital.

CONCLUSION

The amendments to section 25B might result in more taxes for the fiscus in the short term. But the lawmakers should bear in mind that in raising taxes, for every action there is often an unequal and opposite reaction, which might result in less taxes being collected in the long run. The amendments to section 25B have made resident trusts an expensive vehicle for housing assets for the benefit of non-residents.

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Acts and Bills

- Income Tax Act 58 of 1962: Sections 1(1) (definitions of "trust" and "trustee"), 7, 10(1)*(h)*, 25B(1) & (2), 49D & 50D; Second Schedule: Paragraphs 2(1)*(b)* & 3B; Eighth Schedule: Paragraphs 11(1)*(d)*, 70 & 80;
- Taxation Laws Amendment Act 17 of 2023.

Other documents

- Section 46 notices;
- 2017 OECD Model Treaty: Response: Article 1(2); Articles 1(3), 5, 23A (exemption method) & 23B (credit method) & 24(1);
- Multilateral instrument (MLI) (ratified and deposited by South Africa in 2022): Article 3(1);
- Explanatory Memorandum on the Taxation Laws Amendment Bill, 2023;
- SARS *Comprehensive Guide to Capital Gains Tax* (Issue 9) in 14.9.4;
- Final response document (of SARS and National Treasury) on the various 2023 amending Acts – dated 2 February 2024.

Cases

- *Commissioner, South African Revenue Service v The Thistle Trust* [2023] (2) SA 120 (SCA), 85 SATC 347;
- *ITC 1941* [2021] 83 SATC 387 (G);
- *Geldenhuys v Commissioner for Inland Revenue* [1947] (3) SA 256 (C), 14 SATC 419 at 430;
- *Lategan v Commissioner for Inland Revenue* [1926] CPD 203, 2 SATC 16 at 20;
- *Commissioner for Inland Revenue v People's Stores (Walvis Bay) (Pty) Ltd* [1990] (2) SA 353 (A), 52 SATC 9;
- *Taxpayer v Commissioner of Taxes, Botswana* [1980] 43 SATC 118;
- *Secretary for Inland Revenue v Smant* [1973] (1) SA 754 (A), 35 SATC 1;
- *Commissioner for Inland Revenue v Genn & Co (Pty) Ltd* [1955] (3) SA 293 (A), 20 SATC 113 at 123;
- *ITC 76* [1927] 3 SATC 68 (U) at 70;
- *Commissioner for Inland Revenue v Witwatersrand Association of Racing Clubs* [1960] (3) SA 291 (A), 23 SATC 380.

Tags: resident trust; non-resident trust; common law conduit principle; non-resident beneficiaries; vesting trusts; received by; accrued; exempt from normal tax; multilateral instrument (MLI).

THE SUPPLY OF SERVICES TO NON-RESIDENTS

With the increase in cross-border transactions, it is anticipated that the supply of goods and services to non-resident companies will increasingly be scrutinised by the South African Revenue Service [SARS].

Therefore, it is important that South African vendors familiarise themselves with the requirements of the value-added tax provisions relating specifically to supplies made to recipients that are not residents of South Africa.

GENERAL OUTPUT TAX PROVISIONS

Section 7(1)*(a)* of the Value-Added Tax, 1991 (the VAT Act), imposes value-added tax (VAT) on the supply of goods or services made by a vendor in the course or furtherance of the VAT enterprise carried on by the vendor.

Output tax is generally levied at the standard rate (currently 15%), unless the supply can be zero-rated in terms of section 11 of the VAT Act.

THE SUPPLY OF SERVICES TO NON-RESIDENTS

Output tax may be charged at the zero rate where services are supplied to non-residents, subject to certain limitations.

One of these limitations is contained in section 11(2)*(l)*(iii) of the VAT Act. This limitation determines that the zero-rating does not apply where the services are supplied directly to the non-resident or any other person, where the non-resident or the other person is in South Africa at the time that the services are rendered.

KEY REQUIREMENTS

Section 11(2)*(l)*(iii) of the VAT Act requires that:

- ***The services should be supplied to a non-resident***

A company will be regarded as a non-resident if the company is not a resident of South Africa. Where a company is incorporated / established or effectively managed in South Africa, the company is considered to be a resident of South Africa.

This means that if a company is incorporated / established or effectively managed in a foreign country, it will be regarded as a non-resident.

The Taxation Laws Amendment Bill, 2024, proposes to exclude those companies that are considered residents of South Africa as a result of being effectively managed in South Africa, only if such companies do not have a VAT enterprise in South Africa. This proposed change will greatly contribute to the facilitation of cross-border trade.

- ***The non-resident or other person must not be in South Africa at the time the supplying vendor renders the services***

SARS is of the view that if a foreign company's employee or director (hereinafter referred to as a "representative") is in South Africa at the time that the services are rendered, the services are rendered while the non-resident is in South Africa.

This would mean that the requirements of section 11(2)*(l)*(iii) of the VAT Act are not met, and that output tax cannot be charged at the zero rate. It is submitted, however, that the representative should be physically present in South Africa for reasons relating directly to the services rendered before the zero-rating of the supply is denied.

DOCUMENTARY REQUIREMENTS

Section 11(3) of the VAT Act provides that the correct documentation must be obtained in order to support the vendor's entitlement to apply the zero rate of VAT. The documentation that must be obtained and retained is set out in Interpretation Note 31 (Issue 4) (IN 31).

IN 31 determines that the following documentation must be obtained and retained to supply services at the zero rate:

- The tax invoice;
- Written confirmation from the recipient of the supply that it is not a resident of South Africa and not a VAT vendor;
- Written confirmation from the recipient that it or any other person to whom the supply is made, will not be present in South Africa at the time that the services are rendered; and
- Proof of payment.

CONCLUSION

Where output tax is incorrectly charged at the zero rate or where the supplying South African vendor does not meet the documentary requirements, SARS may impose a 10% late payment penalty, understatement penalties and interest.

Where a South African VAT vendor expects to regularly enter into transactions with non-residents, it is advisable to ensure that output tax is charged at the correct VAT rate and that the documentary requirements are met.

"Output tax is generally levied at the standard rate (currently 15%), unless the supply can be zero-rated in terms of section 11 of the VAT Act."

Evádne Bronkhorst

Forvis Mazars in South Africa

Acts and Bills

- Value-Added Tax Act 89 of 1991: Sections 7(1)*(a)* & 11 (specific reference to subsections (2)*(l)*(iii) & (3));
- Taxation Laws Amendment Bill 16 of 2024.

Other documents

- Interpretation Note 31 (Issue 4) (*"Documentary proof required for the zero-rating of goods or services"*) (9 March 2016).

Tags: non-resident companies; supply of goods or services; the zero rate; late payment penalty; understatement penalties.

South African Institute of Taxation