FUNDAMENTALS OF SOUTH AFRICAN INCOME TAX

2022

TWELFTH EDITION

Edited by

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Fundamentals of South African Income Tax

1.1. ORIGINS OF FUNDAMENTALS

This is the 12th edition of Fundamentals of South African Income Tax (Fundamentals). The book originally grew out of the recognition of the need for a textbook aimed specifically at foundational tax knowledge. At this foundational level it would be more appropriate to remove some of the complexity of the tax legislation and provide users with a basic understanding of the mechanics of the core tax computations. Once users establish a base of tax knowledge they will be better prepared to utilise the full-version "Notes on South African Income Tax" in more advanced tax courses.

1.2. SOURCE MATERIAL

While attempting to remain true to the source material, drawn largely from Notes on South African Income Tax, much of the complexity in the selected topics has been removed and the structure is less traditional than in the full version. Fundamentals continues to develop over time as legislation changes and as the curricula of the foundational tax courses that this book serves develop.

1.3. THE APPROACH OF THIS BOOK

Our experience has been that when students are immediately confronted with large volumes of detailed tax theory, they struggle to understand how the theory fits into the end goal of preparing a tax computation. The approach to this book is to develop a foundation of simple application upon which the complexities of taxation can be built at a later stage. The approach is predominantly practical rather than theoretical. Our hope is that after working through this book students will be able to deal with the basic tax returns of a variety of taxpayers and will then be ready to progress to the theoretical concepts underpinning the system of taxation in South Africa.

The book begins with the concept of the individual employee as a taxpayer. It is anticipated that this represents the most likely first exposure students may have to tax. Here we also cover the limited deductions available to employees.

The next few chapters expand the scope of sources of income to include the operating of a business and the earning of investment income with their associated tax implications. This also creates the opportunity to make the transition to companies as taxpayers. At this stage we introduce the concepts of exempt income and specific deductions.

Once the major taxpayers and their sources of income have been established, we begin to explore capital allowances and capital gains tax. These concepts are sufficiently demanding to require their own chapters, although, once again, the focus is on developing a basic understanding of the core principles. The book concludes with chapters on specific topics appropriate in a foundational tax course.

This book has been based on taxpayers with 2022 years of assessment. Amendments pertaining to 2023 years of assessment are therefore not fully considered in this edition.

We welcome comments as to the effectiveness of this book as a teaching resource and other feedback.

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1.1 INTRODUCTION

Income tax is a levy that is determined according to a taxpayer's taxable income. It is payable by South African resident taxpayers on their worldwide taxable income and by non-residents on their taxable income from a South African source.

These concepts will be explained in greater detail in this and further chapters, but at this point it is sufficient to compare taxable income to net profit before tax (the figure used for accounting purposes).

A very simple taxable income calculation for an individual would look similar to the following:

Gross income (s1)	XXX
Less: Exempt income (s10)	XXX
Income	XXX
Less: Deductions (mainly s11 to s20 & s23)	XXX
Add: Taxable portion of allowances per s8(1) and taxable portion of capital gains (s26A)	XXX
Taxable income	XXX

One can see that gross income is the starting point of the taxable income calculation. However, it would be better to start an introductory explanation of tax with all the inclusions of income for an individual whose only income is from employment and who has an uncomplicated tax calculation.

An individual earns income from many sources. As the calculation above suggests, the Income Tax Act allows certain exemptions and deductions against this income before arriving at taxable income. This chapter endeavours to explain how income from employment will be taxed. Detailed explanations provide guidance on the calculation of exemptions and deductions. Chapter 1 then collates this information and indicates how taxable income is calculated and demonstrates how the tax to be collected by the South African Revenue Service (SARS) is determined.

The chapter concludes with guidance on employees' tax, explaining that this is not a separate tax, but a method of tax collection, and how an employer will calculate the tax to withhold from their employees' salaries.

Learning Objectives

By the end of the chapter, you should be able to:

- Understand what is included in gross income for an employed individual.
- Understand the concepts of fringe benefits and allowances and where to include each in the taxable income calculation.
- Calculate the inclusion in the taxable income calculation of each fringe benefit and allowance discussed in this chapter and when (if applicable) the exclusions to each fringe benefit apply.
- Understand the concept of exempt income; how to include it in the taxable income calculation; and, how to calculate each exemption.
- Understand the concept of income and how it differs from gross income.
- Understand the concept of deductions; how it differs from a reduction (under fringe benefits and allowances); and, how to calculate each deduction.
- Determine taxable income for an employed individual, taking into account all the requirements of the fringe benefits, exemptions, deductions and allowances.
- Calculate the tax liability.
- Understand the concept of employees' tax and how it differs from total income tax / the final tax liability.
- Understand the concept of remuneration, how it differs from gross income and how to calculate it.
- Understand the concept of 'balance of remuneration' and how to calculate it.
- Determine the employees' tax withheld from an individual's monthly salary.

1.2 INCOME FROM EMPLOYMENT

The most important or common provisions of the Income Tax Act dealing with the taxation of employment and fringe benefits may be summarised as follows:

Income Tax Act reference	**Subject**
Section 1 - Gross income (paragraph (c))	Amounts for services rendered
- Gross income (paragraph (i))	Fringe benefits
- Gross income (paragraph (n))	Other amounts to include in gross income
Section 8(1)	Travel, subsistence and other allowances
Sections 10(1)(nA), (nB), (o), (p), (q)	Exemptions
Seventh Schedule	Fringe benefits (detail)

1.2.1 INCOME FROM SERVICES

Amounts can be included in gross income either through the general definition (see chapter 2), or through a special inclusion – such as paragraph (c) – because they do not necessarily meet the general definition criteria but should still be subject to tax.

Paragraph (c) of the gross income definition deems all amounts received in respect of services rendered or to be rendered, or in respect of (or by virtue of) employment, to be gross income (i.e. included in the starting figure of the taxable income calculation). A payment is in respect of services rendered if there is a causal link between the services and the payment. A payment for 'loss of office' for example, would not be for 'services rendered'. However it would be 'by virtue of' employment, if the person would not have received it had he not been employed.

For example, a taxpayer who receives a reward of R200 000 for providing the police with information regarding illegal dealings in diamonds receives such reward in respect of the information supplied (the service rendered).

The words 'in respect of' imply that the reason for the payment to the person must be because of the services he or she renders or will render. The link between the payment and the services need not be direct. It is submitted, however, that the payment must have as its motive a reward for the services rendered.

Example - Prize

Mr G, as sole proprietor, runs a business called ABC Insurance Brokers, selling insurance policies for a number of insurance companies. As he sold the most insurance policies for XYZ Insurance Company, XYZ gave Mr G a prize of R50 000 in cash, and a gold watch worth R25 000.

The total prize (of R75 000) is taxable in Mr G's hands even though he does not work for XYZ. He received it because of a service he rendered (he sold the most insurance policies).

1.2.2 NON-CASH REWARDS (FRINGE BENEFITS)

A fringe benefit is a benefit provided by an employer to an employee, other than cash. An employee is taxed on the 'value' of the fringe benefits he receives.

Paragraph (i) of the gross income definition includes fringe benefits in gross income. Paragraph (i) applies only to employees and office holders (directors) and refers to the *value* of any benefit. The 'value' of the fringe benefit is the value determined in the Seventh Schedule. This is an amount which is determined independently of the cost to the employer of providing the benefit.

If an amount is included in paragraph (i) it is excluded from paragraph (c) of the gross income definition. The taxpayer will not be taxed twice.

Examples of paragraph (i) income are:

(i) the use of an employer-owned car;

(ii) the use of residential accommodation;

(iii) schooling for children of employees paid for by the employer;

(iv) the use of any employer-owned asset;

(v) services provided by the employer to the employee;

(vi) low interest loans.

An employee may be offered the use of a company car in lieu of a portion of his cash salary. The employer will reduce the employee's cash salary by an amount equivalent to the cost of providing the car. From the employer's point of view offering employees fringe benefits instead of cash has no effect on the after tax cost to the business.

The fringe benefit may however be beneficial to the employee because the amount which is included in his income may be lower than additional cash salary and consequentially his after-tax position improves.

1.2.3 ALLOWANCES

Section 8(1) provides for certain amounts to be included in a person's 'taxable income'. Note that these amounts are not included in gross income and will be included further down in the taxable income calculation. This is important for the calculation of gross income and certain deductions. For the purposes of the section, the person is referred to as a 'recipient'.

The definition of 'taxable income' in section 1 states that it is the aggregate of:-

(a) income minus allowable deductions and set-offs; and

(b) all amounts to be included or deemed to be included in taxable income.

Section 8(1) deals with 3 categories of allowance or advances that have to be included in taxable income after certain portions of the allowance or advance are reduced. These are:

- Travel allowance
- Subsistence allowance
- Other allowances received by virtue of the recipient's office or duties (such as an entertainment allowance).

All other allowances are fully taxable.

Interpretation Note 14 (issue 5), issued on 30 March 2021, deals with the Commissioner's interpretation of the provisions dealing with allowances, advances and reimbursements. An interpretation note accompanies the

Income Tax Act and is generally considered to be a "practice generally prevailing" in terms of the Tax Administration Act, which binds SARS as to interpretation. Interpretation Note 14 provides that:

- an 'allowance' is typically an amount of money granted by an employer to an employee where the employer is certain that the employee will incur business related expenditure on behalf of the employer, but where the employee is not obliged to prove or account to the employer for the expenditure.
- where the amount is an 'advance' the employee has to prove the business expenditure and refund any excess to the employer.
- where the amount is a 'reimbursement' the employee has already incurred the business expenditure, paid for it out of his own pocket, and then recovers the expense from the employer. The employee usually has to provide the employer with the expense voucher showing that he incurred the expense on behalf of the employer.

1.3 FRINGE BENEFITS

1.3.1 GENERAL

Fringe benefits are included in gross income in terms of paragraph (i) and are valued in terms of the provisions of the Seventh Schedule. Fringe benefits differ from normal salary packages and allowances in that they are not paid in cash. It is for this reason that they are referred to as 'benefits' and not payments.

Paragraph (i) differs from paragraph (c) in that it refers to *value* rather than to an *amount*. Because of the difficulty of establishing the value of a benefit to a particular taxpayer, the Act (Seventh Schedule) contains valuation rules for the different types of fringe benefits. The amount which is subject to tax in the employee's hands is the value of the benefit less any amount paid by the employee for the benefit. Each of the paragraphs, from (5) to (13) in the Seventh Schedule, contains valuation provisions as well as certain exclusion provisions.

1.3.2 SEVENTH SCHEDULE - OVERVIEW

Taxable benefits

The Seventh Schedule deals with the valuation of benefits granted by an employer *or* associated institution to an employee.

Paragraph 2 of the Seventh Schedule defines the different types of benefits, which are then valued in terms of paragraphs (5) to (13). The following is a summary of the Seventh Schedule benefits.

Paragraph (2)	Fringe benefit	Valuation Paragraph
(a)	Acquisition of an asset (other than money) for no consideration or for an inadequate consideration	5
(b)	Right of use of an asset other than residential accommodation or a motor vehicle	6
(b)	Right of use of a motor vehicle	7
(c)	Meals and refreshments and meal and refreshment vouchers	8
(d)	Residential accommodation	9, 10A
(e)	Free or cheap services	10
(f)	Low interest loans	11
(g)	Housing subsidies	12
(gA)	Housing subsidy schemes	12
(h)	Payment of employee debts or release of an employee from an obligation to pay a debt	13
(i)	Medical aid fund contributions	12A
(j)	Medical expenses paid by employer	12B
(k)	Long-term insurance provided by employer	12C
(l)	Contributions to retirement funds by employer	12D
(m)	Contribution to bargaining council by employer (not discussed in this chapter)	12E

Excluded benefits

The following are specifically excluded from the definition of 'taxable benefit' in paragraph 1 of the Seventh Schedule:

(a) any benefit which is exempt from tax under section 10 of the Act;

(b) any benefit provided by any benefit fund in respect of medical, dental and similar services, hospital services, nursing services and medicines;

(c) any lump sum benefit payable by a benefit fund, pension or pension preservation fund, provident fund or provident preservation fund. (These are taxed in terms of paragraphs (d) and (e) of the gross income definition, and are not considered in this book);

(d) any benefit or privilege received by or accruing to any person (as contemplated in section 9(2)(g) or (h)), basically government employees, stationed outside the Republic (but the benefit must be attributable to that person's services outside of the Republic);

(e) any severance benefit.

1.3.3 ACQUISITION OF ASSET AT LESS THAN ACTUAL VALUE – PARAGRAPHS 2(a) & 5

Benefit - paragraph 2(a)

A taxable benefit arises whenever an asset (**other than money**) has been acquired by an employee from:

- his employer; or
- any other person by arrangement with his employer.

The benefit is the difference between the value (as determined in paragraph (5)) and the consideration/payment given by the employee. The following benefits are excluded from paragraph 2(a):

- meals, refreshments, vouchers, board, fuel, power or water as contemplated in paragraphs (c) or (d) (i.e. meals and residential accommodation);
- marketable securities and equity instruments per sections 8A, 8B and 8C (not considered in this book).

Cash equivalent - paragraph 5

The cash equivalent is the value prescribed by the Seventh Schedule. For this fringe benefit it is determined as follows:

- Market value at the time the asset is acquired by the employee,

OR

- cost to the employer if the asset is movable property (other than financial instruments or any asset which the *employer* had the use of prior to acquiring ownership thereof) which was acquired by the employer to give to the employee,

OR

- the lower of cost or market value if the asset is trading stock of the employer (other than financial instruments, e.g. shares) XXX

Less: Amount paid by the employee for the asset (XXX)

Amount taxed in employee's hands XXX

Examples – Assets acquired by employee

(a) An employer gives an old welding machine, which had cost it R5 000 (including VAT) to an employee. The machine was a fixed asset of the employer and has an open market value of R2 000 when it is given to the employee.
Fringe benefit (market value) R2 000

(b) A company purchases a television set to give to an employee. Market value is R3 000 but the company buys the set at a trade price of R2 600 (including VAT).
Fringe benefit R2 600

Note that it does not matter whether the employer can claim the VAT on the TV set as an input, the fringe benefit is the VAT inclusive amount.

(c) An employer gives an employee trading stock with an open market value of R6 000. The trading stock had cost the employer R10 000.
Fringe benefit (lower of cost or market value) R6 000

(d) An employer who is a share dealer gives an employee 100 shares (held as stock) which had cost R1 000. At the time that the shares are given to the employee their market value is R5 000.
Fringe benefit (market value) R5 000

Note: Even when the employer is registered as a vendor for VAT purposes, the cost of the asset for fringe benefits purposes is inclusive of VAT (i.e. even if an input is claimable).

Bravery and Long-service Awards

An employee might receive an asset from an employer as a bravery or long service award. A bravery award is for performing some form of heroic deed. Long service is defined as an initial unbroken period of service of not less than 15 years or any subsequent unbroken period of service of not less than 10 years.

Where an asset is given to an employee as a long service award or a bravery award the value of the benefit is the market value or cost to the employer of acquiring the asset (whichever is appropriate – as determined above by the cash equivalent), reduced by the lesser of R5 000 or the aggregate cost of all such awards given to the employee during the year.

Example – Bravery award

During the year ended 28 February 2022 an employer gives an employee three assets as bravery awards. The cost of the assets (including VAT) is R3 000, R2 500 and R7 000 respectively. The amounts included in the employee's income in respect of the three awards is:

1)	Cost to employer	R3 000
	reduced by the lesser of:	
	(i) R3 000 (cost)	
	(ii) R5 000	(R3 000)
	Taxable portion	nil
2)	Cost to employer	R2 500
	reduced by the lesser of:	
	(i) R5 500 (R3 000 + R2 500) (aggregate cost)	
	(ii) R5 000	(R5 000)
	Taxable portion	nil
3)	Cost to employer	R7 000
	reduced by the lesser of:	
	(i) R12 500 (aggregate cost)	
	(ii) R5 000	(5 000)
	Taxable portion	R2 000

The wording of the provision is misleading, because the employee has received a total reduction of more than R5 000 for the year.

1.3.4 RIGHT OF USE OF ANY ASSET (OTHER THAN RESIDENTIAL ACCOMMODATION OR ANY MOTOR VEHICLE – PARAGRAPHS 2(b) & 6

Benefit - paragraph 2(b)

In terms of paragraph 2(b) a taxable benefit arises whenever an employee is granted the right to use any asset (other than motor vehicles and residential accommodation) for his private or domestic purposes either free of charge or for a consideration that is lower than the value of his use. The value of the use of assets other than motor vehicles is determined under paragraph 6 while motor vehicles are dealt with in paragraph 7.

Cash equivalent - paragraph 6

(i) If the asset is leased by the employer:

Rental paid by employer for the period	XXX
Less: Amount paid by employee for the period	(XX)
Amount taxed in employee's hands	XXX

(ii) If the asset is owned by the employer:

Use the lower of
- market value (at the date of commencement of period of use by the employee) or
- cost to employer

multiplied by 15% per annum

multiplied by portion of the year asset is used by employee	XXX
Less: Amount paid by employee	(XX)
Amount taxed in employee's hands	XXX

(iii) Where the employee is granted the *sole* right of use of an asset for a major portion of its useful life, the value on which the employee will be taxed will not be determined as above but will be the cost of the asset to the employer. The benefit will be deemed to have accrued to the employee on the date that he was first granted the right of use of the asset.

Exclusions

This paragraph is not applicable if:

- the private or domestic use by the employee is incidental to the use of the asset for the purposes of the employer's business or the asset is provided by the employer as an amenity to be enjoyed by the employee at his place of work or for recreational purposes at that place or a place of recreation provided by the employer for the use of his employees in general, or
- the asset consists of any equipment or machine which the employee uses from time to time in short periods and the Commissioner is satisfied that the value of the private or domestic use is negligible, or
- the asset consists of telephone or computer equipment which the employee uses mainly for the purposes of the employer's business, or
- the asset consists of books, literature, recordings or works of art.

1.3.5 RIGHT OF USE OF MOTOR VEHICLE – PARAGRAPHS 2(b) & 7

The private use by an employee of an employer's motor vehicle is a taxable benefit and often referred to as the company car fringe benefit. The method used to calculate the taxable benefit is based on the 'determined value' of the motor vehicle. The monthly value of the benefit is 3.5% of the determined value of the car.

Where the vehicle is subject to a maintenance plan, the monthly fringe benefit is 3.25% of the determined value (because the cost of the maintenance plan pushes up the cost of the vehicle).

The 'determined value' is the cost (including VAT) but excluding finance charges. If the vehicle has no cost, the value is the market value (including VAT), when the employer first obtained the right of use.

If the employee is first granted the right to use the vehicle 12 months or more after the employer first acquired the vehicle or the right of use of the vehicle, the determined value is reduced. The reduction in the determined value is by means of a depreciation allowance of 15% for each completed 12 month period from the date on which the employer first obtained the vehicle or right of use to the date on which the employee is first granted the right of use. The depreciation allowance is calculated on the reducing balance method. This would happen, for example, where a vehicle is taken from one employee and given to another for his use. The depreciation allowance is not claimable where the vehicle (or its right of use) was acquired from an associated institution, and the employee had, prior to the acquisition, enjoyed the right of use of the vehicle.

Example – Reduction of determined value

An employer purchases a motor car for R200 000 in January 2020 and gives the use of the car to an employee A. In April 2021 employee A resigns and the employer gives the use of the car to employee B. The determined value for the purposes of calculating employee B's fringe benefit:

R200 000 x (100% - 15%) = R170 000

The employer owned the car for 15 months before giving the right of use to employee B. This is one completed 12 month period, and no further adjustment is made for the additional 3 months.

Cash equivalent - paragraph 7

The amount taxed in the employee's hands is set out in **paragraph 7(2)** as:

Value of private use (see below)	XXX
Less: Consideration paid by employee	(XX)
	XXX

Value of private use

The value is for each month or part of a month during which the employee was entitled to use the vehicle for private purposes. The monthly value is 3.5% (or 3.25% if there is a maintenance plan) of the determined value of the car.

Example – Use of motor vehicle

An employer purchases a motor car for R114 000 and gives the use of the car to an employee. The employer pays all costs relating to the car. The monthly fringe benefit is calculated as follows:

R114 000 x 3.5% = R3 990

If the employee is required to pay R300 per month for the use of the car the R3 990 is reduced to R3 690.

Temporary breaks in private use

The value of private use will not be reduced where the vehicle is temporarily not used by the employee for private purposes.

Reduction of fringe benefit due to business use

Where accurate records of distances travelled for business purposes are kept (i.e. a logbook), the value placed on private use for each vehicle may be reduced. The reduction is calculated as follows:

$$\text{Value of private use pre-reduction (i.e. determined value x 3.5\%)} \times \frac{\text{business kilometres}}{\text{total kilometres}}$$

Reduction of fringe benefit due to employee paying certain costs

In order to use this reduction, the employee must have paid all the costs relating to one (or more) of the following:

- Licence
- Insurance
- Maintenance

Once again, accurate records of distances travelled must be kept. This time, the records must relate to private distances. The value placed on private use for each vehicle may be reduced. The reduction is calculated as follows:

$$\text{Full cost of licence and/or insurance and/or maintenance} \times \frac{\text{private kilometres}}{\text{total kilometres}}$$

Reduction of fringe benefit due to employee paying private fuel cost

Where accurate records of private distances travelled are kept and where the employee bears the full cost of fuel for 'private' purposes, the fringe benefit is reduced by the rate for fuel which applies in the 'travel allowance' table in the *Government Gazette*. Refer to 1.4.1 Travel allowance. The reduction is calculated as follows:

Private kilometres travelled X rate per kilometre for fuel in the 'travel allowance' table

Example – Use of motor vehicle with reductions

InvestCo (Pty) Ltd provides Noah with a company car on 1 March 2021. The car cost InvestCo (Pty) Ltd R300 000 (including VAT) when purchased on 1 February 2020. Noah kept a logbook and travelled 40 000 kms with 10 000 kms being for business. He paid the licence of R600 in full and paid for all the private fuel of R27 000.

Calculate the value of the fringe benefit assuming

a) The car did not come with a maintenance plan and Noah makes no other payments.

b) The car did come with a maintenance plan and Noah makes no other payments.

c) The car did not come with a maintenance plan and Noah pays R700 per month to use the car.

a)	Initial inclusion (R300 000 x 3.5% x 12 months)	R126 000
	General business reduction (R126 000 x 10 000km/40 000km)	(R31 500)
	Licence reduction (R600 x 30 000km/40 000km)	(R450)
	Fuel reduction (30 000km x 135.8c per km)	(R40 740)
	Inclusion in gross income:	R53 310

b)	Initial inclusion (R300 000 x 3.25% (maint plan) x 12 months)	R117 000
	General business reduction (R117 000 x 10 000km/40 000km)	(R29 250)
	Licence reduction (R600 x 30 000km/40 000km)	(R450)
	Fuel reduction (30 000km x 135.8c per km)	(R40 740)
	Inclusion in gross income:	R46 560

c)	Initial inclusion (R300 000 x 3.5% x 12 months)	R126 000
	General business reduction (R126 000 x 10 000km/40 000km)	(R31 500)
	Licence reduction (R600 x 30 000km/40 000km)	(R450)
	Fuel reduction (30 000km x 135.8c per km)	(R40 740)
	Amount paid by Noah (R700 x 12 months)	(R8 400)
	Inclusion in gross income:	R44 910

No value – Pool cars and business vehicles

Paragraph 7(10) states that the private use of a motor vehicle by an employee will have no value if it is a pool car or if it has to be used after hours for business purposes and the private use is limited to travelling between the employee's home and his work.

- A pool car is one which is not kept at or near the residence of the employee outside of business hours. Generally, there is not a particular employee who is responsible for the pool car. It is usually kept at work and is used by all the employees in general during the day (running errands, etc). The motor vehicle may occasionally be taken home by an employee, but its private use must be infrequent or merely incidental to the business use.
- If the nature of the employee's duties are such that he is regularly required by his employer to use the motor vehicle outside of normal working hours to carry out his duties, then he is not taxed on a fringe benefit, provided that he is generally not permitted to use the vehicle for private purposes, other than travelling from his residence to his work and back. The only private use which is permitted is that which is infrequent or merely incidental to the business use.

Employer reimbursement

If the employer reimburses the employee for any costs, the amount of the reduction allowable to the taxpayer is reduced by that reimbursement.

1.3.6 MEALS, REFRESHMENTS AND MEAL AND REFRESHMENT VOUCHERS – PARAGRAPHS 2(c) & 8

Benefit - paragraph 2(c)

A benefit arises if an employee has been provided with any meal or refreshment or voucher entitling him to any meal or refreshment (other than as part of residential accommodation) for free or for a consideration that is lower than the value of the benefit.

Cash equivalent - paragraph 8

The employee is taxed as follows:

Cost to employer of providing the meal, refreshment or voucher	RXXX
Less: Amount paid by employee	(XX)
Amount included in employee's income	RXXX

Exclusions

The following are not taxed:

- meals or refreshments supplied in a canteen, cafeteria or dining room operated by or on behalf of the employer and patronised wholly or mainly by employees,
- meals and refreshments supplied during business hours or extended working hours or on a special occasion,
- meals enjoyed by an employee in the course of providing entertainment on behalf of the employer.

1.3.7 FREE OR CHEAP SERVICES – PARAGRAPHS 2(e) & 10

Benefit - paragraph 2(e)

Where any service has, at the expense of the employer, been rendered to an employee for his private use, the service is treated as a fringe benefit. The paragraph covers services rendered both by the employer and by any other person. The benefit arises if the employee has received the service for no consideration or has paid a consideration which is lower than the cost to the employer of having the service rendered (or the lowest full fare for a travel service).

Cash equivalent - paragraph 10

If a service is rendered to an employee, he is taxed as follows:

(a) Travel facility granted by an employer who is engaged in conveying passengers for reward by sea or by air -

If the employer enables the employee or the employee's relatives to travel to a destination outside the Republic for private or domestic purposes, the employee will be taxed on the lowest full fare, less the amount paid by the employee or his relative in respect of such facility.

(b) In the case of any other service the employee will be taxed on the cost of the service to the employer less any amount paid by the employee for the service.

Exclusions

No value will be placed under this paragraph on -

(a) Any travel facility granted by any employer who is engaged in the business of conveying passengers for reward by land, sea or air to enable any employee or the employee's spouse or minor child to travel -

(i) to any destination in the Republic or to travel overland to any destination outside the Republic, or

(ii) to any destination outside the Republic if such flight or voyage was made in the ordinary course of the employer's business and such employee, spouse or minor child was not permitted to make a firm advance reservation of a seat or berth.

(b) A transport service by the employer to convey employees between their home and work.

(bA) Any communication service provided to an employee if the service is used mainly for the purposes of the employer's business. This would include, for example, access to the internet and e-mail.

(c) Any service rendered by an employer at work to help employees perform their duties better, or any recreational facilities, or any service as a benefit to be enjoyed by employees at work.

(d) Travel facilities granted to the spouse or minor children of an employee where the employee is stationed more than 250 kilometres away from the usual place of residence for more than 183 days in a year of assessment (the exclusion applies to travel between the usual place of residence and the residence in which the employee is stationed). The exclusion will only apply if the person is more than 250 kilometres away from his or her usual place of residence in the Republic for the duration of his employment. The employee must be stationed in the Republic.

1.3.8 LOW INTEREST LOANS – PARAGRAPHS 2(f) & 11

Benefit - paragraph 2(f)

Where a loan has been granted to an employee by:

- his employer; or
- any other person by arrangement with the employer; or
- any associated institution in relation to the employer

and no interest is payable or interest is payable at a rate lower than the official rate the difference between the official rate and the interest paid is a fringe benefit.

Specifically excluded from this paragraph are subsidised loans which fall into paragraph 2(gA).

Official rate of interest

The value of certain fringe benefits is determined with reference to the official rate of interest. Two such benefits are low interest loans and subsidies. The official rate changes from time to time as commercial rates of interest change. The *Government Gazette* rates for loans denominated in Rands are set out in Appendix E at the back of this book. For loans denominated in any other currency, the relevant market related rate of interest for the currency is used.

The official rate of interest is defined as:

- Loan in Rands : 100 basis points above the repo (repurchase) rate
- Loan in foreign currency : 100 basis points above the equivalent of the South African repo rate for that currency

Where the repo rate changes, the official rate changes from the beginning of the next calendar month.

Cash equivalent - paragraph 11

The cash equivalent of a no-interest or low-interest loan is calculated as follows:

Interest payable at the official interest rate	RXXX
Less: Interest incurred by employee for the year	(XX)
Cash equivalent of taxable benefit	RXXX

However, the Commissioner may approve of a different method if it achieves substantially the same result. Note that if the official rate of interest is varied during the year, the old rate applies up to the date on which the new rate comes into operation.

No value

Paragraph 11(4) provides that the following are effectively exempted from tax under paragraph 11 -

- a casual loan or loans to an employee not exceeding R3 000 in total at any time; or
- a loan to an employee to enable him to further his studies; or
- a loan granted up to R450 000 to assist the employee to purchase a residential property, the value of which does not exceed R450 000 in the year of purchase or in that year, the remuneration proxy of the employee does not exceed R250,000. The employee may not be a connected person in relation to the employer.

Deduction

Paragraph 11(5) provides that if the employee had to pay interest on the loan, and such interest would have been in the production of his income - then, for the purposes of section 11(a) the taxable benefit included in the employee's taxable income will be deemed to be interest actually incurred by him.

1.3.9 SUBSIDIES – PARAGRAPHS 2(g), 2(gA) & 12

Benefit - paragraphs 2(g) and 2(gA)

In terms of paragraph 2(g) a benefit arises whenever an employer has paid any subsidy in respect of capital or interest on any loan. Paragraph 2(gA) applies in the situation where the employer pays a lender a subsidy in respect of a loan to an employee. If the amount paid by the employer together with the interest paid by the employee exceeds an amount determined by using the official interest rate (applied to the loan) the full amount paid by the employer is treated as a taxable subsidy. If the amount paid by the employer together with the interest paid by the employee is less than the official rate the loan is treated as a low interest loan.

Cash equivalent - paragraph 12

The cash equivalent of a subsidy referred to in paragraphs 2(g) or 2(gA) is the value of the subsidy. So, if for example, an employer pays an employee a housing subsidy of R1 000 per month, the value of the benefit (included in the employee's income) is R1 000 per month.

Example of paragraph 2(gA)

On 1 March 2021, Mr B's employer entered into an arrangement with Finance Ltd whereby Finance Ltd would lend Mr B R500 000 at the bond interest rate less 7%. Mr B's employer would pay the 7% as an administration fee to Finance Ltd. The capital is only repayable after 5 years.

For the period 1 March 2021 to 31 July 2021 assume that the bond interest rate was 12%. For the period 1 August 2021 to 31 August 2021 assume it was 8%, for the period 1 September 2021 to 30 September 2021 assume it was 11%, and for 1 October 2021 to 28 February 2022 assume that it was 12%. Assume that the official rate was 8,5% to 30 September 2021 and 10% for the remainder of the year of assessment.

Mr B's taxable benefit is as follows:

1/3/2021 – 31/7/2021

Bond rate 12%
Official rate 8.5%

Paragraph 12 subsidy: 500 000 x 7% x 153/365 R14 671

Note: Because the amount paid by the employer and employee (12%) exceeds the official rate (8,5%) the amount paid by the employer (7%) is taxed as a subsidy.

1/8/2021 - 31/8/2021

Bond rate 8%
Official rate 8.5%

Paragraph 11 loan: 500 000 x (8,5% - 1%) x 31/365 R3 185

1/9/2021 - 30/9/2021

Bond rate 11%
Official rate 10%

Paragraph 12 subsidy: 500 000 x 7% x 30/365 R2 877

1/10/2021 – 29/2/2021

Bond rate 12%
Official rate 10%

Paragraph 12 subsidy: 500 000 x 7% x 151/365 R14 479

1.3.10 PAYMENT OF EMPLOYEE'S DEBT OR RELEASE OF EMPLOYEE'S OBLIGATION TO PAY A DEBT – PARAGRAPHS 2(h) & 13

Benefit - paragraph 2(h)

A taxable benefit arises if:

- the employer has paid an amount owing by the employee to any third person without requiring the employee to reimburse him; or
- the employer has released the employee from an obligation to pay an amount owing by the employee to the employer.

An employer is deemed to have released an employee from an obligation to pay a debt if the debt prescribes. The proviso does not apply if the Commissioner is satisfied that prescription was not due to an intention on the part of the employer to confer a benefit on the employee.

Excluded from the scope of this paragraph are the amounts contemplated in paragraph 2(i) (medical aid contributions) and paragraph 2(j) (medical expenses paid by the employer).

Cash equivalent - paragraph 13

The cash equivalent of the benefit is either the debt paid by the employer or the debt owed by the employee to the employer which has been written off.

No value

The following is not taxable (i.e. is deemed to have no value as a taxable benefit)

- payment of the employee's subscriptions to a professional body, if membership of the body is a condition of the employee's employment;
- insurance premiums indemnifying an employee solely against claims arising from negligent acts or omissions in the rendering of the employee's services to the employer; or
- payment of any portion of the value of a benefit which is payable by a former member of a non-statutory force or service as defined in the Government Employees Pension Law, 1996 (Proclamation No. 21 of 1996), to the Government Employees' Pension Fund as contemplated in Rule 10(6)*(d)* or *(e)* of the Rules of the Government Employees Pension Fund contained in Schedule 1 to that Proclamation (in terms of a Revenue Laws Amendment, 2005).
- where in return for a bursary or study loan a person (employee) has assumed an obligation to render services for a certain period (to the person who has granted the bursary – the former employer); and
    - the employee becomes liable to pay an amount to his former employer because he has terminated his services without fulfilling his obligations, in order to take up employment with a new employer; and
    - the new employer has settled the obligation to the former employer; and
    - the employee has in consideration for the payment assumed an obligation to render services to the new employer for a period which is not shorter than the unexpired portion of the service due to the previous employer.

1.3.11 MEDICAL AID CONTRIBUTIONS – PARAGRAPHS 2(i) & 12A

Benefit - paragraph 2(i)

A fringe benefit arises when an employer has directly or indirectly made any contribution or payment to any medical aid scheme registered under the provisions of the Medical Schemes Act (Act No. 131 of 1998), for the benefit of an employee or the dependants of an employee.

Cash equivalent - paragraph 12A

The benefit to any employee in respect of contributions made by the employer to the medical aid fund is the amount contributed by the employer.

Where the portion relating to a specific employee cannot be determined, the above determination is no longer used. The employee's portion will be determined by taking the full contribution made by the employer and dividing by the number of employees (irrespective of the number of dependants that any one employee may have). The Commissioner has the power to alter this determination.

To the extent that the payments by the employer are taxable, the employee is deemed to have made the contributions to the medical aid fund himself or herself.

No value

No value shall be placed on the taxable benefit derived from an employer by -

- a person who by reason of superannuation, ill-health or other infirmity retired from the employ of such employer; or
- the dependants of an employee (who was employed at the date of death) after such employee's death; or
- the dependants of a deceased retired employee; or

Example – Medical scheme contributions paid by employer

Mr Good aged 50 is married and has one child aged 16. Mr Good is employed by Big Ltd and is a member of the Goodhealth Medical Scheme. Mrs Good and the child are dependants in terms of the scheme. The monthly contributions which are R2 000 are paid by Big Ltd.

Mr Average aged 65 is a widower and also works for Big Ltd, on a part-time basis (mornings only). He is also a member of the Goodhealth Medical Scheme. Big Ltd pays R800 per month to the scheme in respect of Mr Average's membership. The employees make no contributions to the scheme.

The amount to be included in Mr Good's gross income for the year is:

Contributions paid by employer	R24 000

The amount to be included in Mr Average's gross income for the year is:

Contributions paid by employer	R9 600

1.3.12 INCURRAL OF COSTS RELATING TO MEDICAL SERVICES – PARAGRAPHS 2(j) & 12B

Benefit - paragraph 2(j)

A benefit arises if the employer has directly or indirectly incurred any amount (by contribution or payment) in respect of any medical, dental or similar services, hospital, nursing services or medicines for the employee (including the employee's spouse, child, relative or dependant) as contemplated in paragraph 12B.

Cash equivalent - paragraph 12B

The amount incurred by the employer on behalf of the employee (including the employee's spouse, child, relative or dependant) will be the fringe benefit for that employee.

Where the portion relating to a specific employee cannot be determined, the employee's portion will be determined by taking the full expenses incurred by the employer and dividing by the number of employees entitled to make use of this facility (irrespective of the number of employees that have made use of the facility). The Commissioner has the power to alter this determination.

To the extent that the payments by the employer are taxable, the employee is deemed to have made the contributions to the medical aid fund himself or herself.

Exclusions

No value will be placed under this paragraph on medical expenditure paid by an employer in respect of any of the following:

- A medical scheme run by an employer for his employees (their spouses and children). This has to be approved by the Registrar of Medical Schemes. Certain employers view direct medical care of their employees as a core function. This exclusion is to help those employees. Treatments need to be as determined by the Minister of Health. This applies to schemes run by the employer in the same way as a medical scheme if the Registrar of Medical Schemes approves it. There are certain other requirements where the scheme is not run as the business of a medical scheme (see paragraph 12B(3)(a)(ii)).
- For the benefit of a person who by reason of superannuation, ill-health or other infirmity retired from the employ of such employer, or for the benefit of his dependants.
- For the benefit of the dependants of an employee (who was employed at the date of death) after such employee's death.
- Any benefit which consists of services rendered to the employees in general at the work place for the better performance of their duties.
- Any medical benefit where the services are rendered or the medicines supplied to comply with any law in the Republic.

1.3.13 CONTRIBUTIONS TO RETIREMENT FUNDS BY EMPLOYERS – PARAGRAPHS 2(*l*) & 12D

Benefit - paragraph 2(*l*)

A fringe benefit arises when an employer has made any contribution for the benefit of any employee to any pension fund, provident fund or retirement annuity fund.

Cash equivalent - paragraph 12D

The value of the benefit depends on the type of benefit from the fund:

- Where the benefit consists solely of "defined contribution components",

  The benefit value is then simply the amount contributed to the fund by the employer
- Where the benefit does not consist solely of "defined contribution components"

  The value of the fringe benefit is then determined in terms of a formula:

  X = (A x B) – C, where

  X = the fringe benefit

  A = the fund member category factor (which is based on the fund member category of which the employee is a member, and provided by the board of the fund)

  B = the retirement funding employment income of the employee for the year (which is the remuneration on which the employer's contribution to a pension or provident fund is based)

  C = the employee's contributions to the fund for that year of assessment

No value

No value shall be placed on the benefit derived from a contribution made by the employer to the fund -

- for the benefit of a member who has already retired from the fund, or
- in respect of the dependants or nominees of a deceased member of the fund.

Deduction by employee

The fringe benefit value per paragraph 12D is deemed to be a contribution of the employee to the retirement fund.

1.4 ALLOWANCES

Although similar in nature, allowances are not treated in the same way as fringe benefits in the taxable income calculation. Fringe benefits are included in gross income (the starting point of the calculation). Allowances are included in taxable income. Therefore, they should be included after deductions.

1.4.1 TRAVEL ALLOWANCE

Section 8(1)(b) deals with the travel allowance. There are two types of travel allowance, i.e.

(i) an allowance or advance in respect of transport expenses; and

(ii) an allowance or advance to be used by the recipient for paying expenses in respect of a motor vehicle used by the recipient for business purposes (the so-called 'motor car travel allowance').

There is a presumption under paragraph (ii) that the vehicle is owned by the recipient, but it need not be. However, if the employer owns the vehicle, the employee cannot deduct deemed expenditure per the tables from such travel allowance. He has to deduct his actual business travel costs (see below).

When an employee has been paid an allowance in respect of transport expenses any portion of such allowance which is expended for the purpose of private travel (i.e. not for business travel) will be included in his taxable income. Note that private travel includes travel between the employee's residence and his place of employment. For this reason, a travel allowance received by an office-based employee who only uses his car to travel between his home and place of work will be treated as normal salary, fully subject to income tax.

Example – Allowance for transport expenses – section 8(1)(b)(i)

Mr Brown is required to travel between two factories operated by his employer. Both factories are situated near a railway station and Mr Brown uses the train to commute between the two factories. He also commutes from his home to work by train. His employer pays him a travel allowance of R400 per month. During the year ended 28 February 2022 he spent R1 920 on travelling between his home and work and R2 800 on travelling between the two factories. In terms of section 8(1) the amount to be included in his income in respect of the travel allowance is as follows:

Allowance for transport expenses (400 x 12)	R4 800
Less: Business travel (travel between factories)	(2 800)
Include in taxable income	R2 000

The most common type of 'travel allowance' is one which is given to an employee who uses his own car for business purposes – section 8(1)(b)(ii). As discussed above, section 8(1) is not confined only to persons who use their own car and also not only to persons who are employees. All that is required is;

- that the person (not necessarily an employee) receives a travel allowance, and
- that the recipient uses the vehicle, in respect of which the allowance is received, for business purposes for all or part of the year.

In Interpretation Note 14, SARS states that the allowance must reflect the anticipated business expense of the employee. If the allowance is excessive, it will be regarded as normal salary. Employers will be liable for the deduction of employees' tax in these circumstances.

The amount which is deemed to be part of the recipient's taxable income is so much of any allowance or advance in respect of the expenses of any travelling on business as is not actually expended on business travel.

The application of the section therefore requires a determination of business travel expenditure. There are two ways in which this can be done, namely:

(i) Using actual figures. If a taxpayer can produce actual business expenditure figures which are acceptable to the Commissioner, such figures will be used. To do this a taxpayer would have to keep a detailed record of all of his business expenditure.

(ii) Using actual business kilometres travelled and a deemed cost per kilometre.

In each case a log book would have to be kept and all business travel would have to be recorded.

Deemed cost per kilometre

Government Gazette No 44229 of 5 March 2021, fixes the current rate per kilometre in respect of motor vehicles for the purposes of this section. The table of rates is set out in the appendices, and applies in respect of years of assessment commencing on or after 1 March 2021 (see Appendix A).

The schedule of rates states that the rate per kilometre shall be determined in accordance with the table, and will be the sum of:

(a) the fixed cost per the table, divided by the total distance in kilometres travelled during the year of assessment. (This includes kilometres for both private and business purposes).

If the vehicle is used for business purposes during a period which is less than a full year the fixed cost must be reduced proportionately. The apportionment is done on the basis of the ratio of the 'period of use for business purposes' to 365 days (366 in a leap year). This does not mean that you must compare the 'days' of business use to 365 days. Regard must be had to the 'period' in which the business use falls.

(b) the fuel cost per the table where the recipient of the allowance has borne the *full* cost of the fuel used in the vehicle; and

(c) the maintenance cost per the table where the recipient has borne the *full* maintenance cost of the vehicle.

The three costs referred to above vary depending on the value of the vehicle. The 'value' is defined in the schedule as follows:

(i) Where the motor vehicle was acquired by the recipient under a *bona fide* agreement of sale or exchange concluded by parties dealing at arm's length, the value is the original cost of the vehicle to him, *including* any VAT, but *excluding* any finance charges or interest. Note that this paragraph does not apply to motor vehicles acquired at the end of a lease.

(ii) Where the motor vehicle is held by the recipient under a lease (as contemplated in the definition of instalment credit agreement in the Value Added Tax Act) or was held by him under such a lease and acquired by him on the termination of the lease, the value will be;

- where the lessor is a banker or financier, the cost to the banker or financier of the motor vehicle, plus any VAT paid by the lessor under the financial lease,
- where the lessor is a dealer, the price at which the motor vehicle is normally sold by him for cash or may normally be acquired from him for cash, together with any sales tax or VAT paid by the lessor under such financial lease.

(iii) In any other case, the value is the market value of the motor vehicle at the time when such recipient first obtained the vehicle or the right of use thereof, plus an amount equal to the VAT which would have been payable at the time in respect of the purchase of the vehicle had it been purchased by the recipient at such time at a price equal to such market value.

Example – Travel allowance – deemed costs

Mr A uses his car for a full year for business and private purposes. The cost of the car is R105 000 (including VAT at 15%). Mr A's employer pays him a travel allowance of R2 500 per month. Mr A kept a log book of business travel.

Total kilometres travelled by Mr A during the year was 27 000, of which 7 000 were for business purposes.

The tax-free portion of the travel allowance is calculated as follows:

Deemed rate per kilometre is determined as follows:

Fixed cost (based on R105 000)	$\frac{52\,226}{27\,000} \times \frac{365}{365}$	193.43	cents
Fuel		116.20	cents
Maintenance		48.30	cents
		357.93	cents/km

Business expenditure: 7 000 km x 357.93 cents = R25 055.10

Mr A will include in his taxable income:

Travel allowance 12 x R2 500	R30 000,00	
Reduced by business expense	R25 055.10	R4 944.90

Actual costs

If the taxpayer is able to furnish an acceptable calculation based on accurate data, he can deduct the actual cost of his business travel for the year.

Where actual costs are being determined, the value of the vehicle is limited to R665 000. The wear and tear is limited to this value and must be determined over a period of 7 years. Note this determination of wear and tear is for the purposes of this calculation only. Furthermore, any finance charges must be limited as if the vehicle had a cash cost of a maximum of R665 000. Similarly, for a leased vehicle, the instalments for the year of assessment cannot exceed the fixed cost per the table issued by the Minister based on that vehicle's 'cash cost'.

Actual kilometres travelled for the year (if recorded)	XXX
Less: Actual private travel	(XXX)
Actual business travel (proved to the satisfaction of the Commissioner)	XXX

The ratio of actual business kilometres travelled to total kilometres travelled is applied to the total costs to calculate the business costs.

Example 1 – Travel allowance & actual costs

Mr A receives a travel allowance of R1 800 per month for a vehicle costing R319 200. For the year of assessment he travelled a total of 20 000 kilometres, of which 5 500 were for business purposes. He had paid cash for the vehicle.

Mr A's actual travel expenditure for the year is as follows:

- wear and tear (R319 200 / 7)	R45 600
- licence	500
- insurance	8 000
- fuel	10 000
- maintenance	2 000
	R66 100

The taxable portion of the travel allowance is:

Travel allowance received, R1 800 x 12 =	R21 600.00
Less: Business costs, R66 100 x 5 500/20 000 =	(18 177.50)
	R 3 422.50

Note that Mr A still has the option of using the deemed cost reduction and would do so if that reduction resulted in a figure greater than R18 178.

Example 2 – Travel allowance & actual costs – vehicle costing more than R665 000

Mr B uses his car, which he purchased for R700 000 (including VAT) on 1 March 2021, for business purposes. Finance charges incurred on this acquisition amounted to 3% simple interest per annum. He has kept an accurate record of expenses and paid R12 000 for fuel, R5 280 (including VAT) for maintenance, R800 for licence, and 2.0% based on the value of the car for insurance. Mr B is not a VAT vendor. He receives a travel allowance of R90 000 p.a. He travelled 40 000 kilometres in total with 21 000 being business kilometres.

Mr B

Travel allowance		R90 000
Total kms	40 000	
Private kms	(19 000)	
Business kms	21 000	
Actual expenditure:		
Finance charges R665 000 (max) x 3%	19 950	

Fuel	12 000	
Maintenance	5 280	
Licence	800	
Insurance R700 000 x 2%	14 000	
Wear & tear R665 000 (max)/7 years	95 000	
	R147 030	
Reduction from travel allowance (21 000/40 000 x R147 030)		(R77 191)
		R12 809

Note that Mr B still has the option to elect using the deemed cost reduction and would do so if that reduction resulted in a figure greater than that allowed under this method.

Note: The employee has a further option for their travel allowance reduction. If the allowance received is a reimbursive allowance, the employee has the option of deducting 382 cents per kilometre from his travel allowance if he so wishes. The 382 cents can only be used if the employee receives no other reimbursement or allowance.

A reimbursive allowance is an allowance based on kilometres travelled, not a set value per month.

Example 3 – Reimbursive travel allowance & actual costs

Mr A receives a travel allowance of R4.10 per business kilometre travelled for a vehicle costing R319 200. For the year of assessment he travelled a total of 20 000 kilometres, of which 5 500 were for business purposes. He had paid cash for the vehicle.

Mr A's actual travel expenditure for the year is as follows:

- wear and tear	R45 600
- licence	500
- insurance	8 000
- fuel	10 000
- maintenance	2 000
	R66 100

The taxable portion of the travel allowance is:

Travel allowance received, R4.10 x 5 500 =	R22 550.00
Less: Business costs, R66 100 x 5 500/20 000 =	(18 177.50)
	R 4 372.50

Note that Mr A still has the following options available to him:

1. To elect to use the deemed cost reduction method and would do so if that reduction resulted in a figure greater than R18 178.
2. As the travel allowance is reimbursive (i.e. based on kilometres travelled), he also has the option to use R3.82 x 5 500 = R21 010 as his reduction.
3. Mr A will elect whichever option grants the largest reduction to the travel allowance..

1.4.2 SUBSISTENCE ALLOWANCE

Section 8(1)(a)(i) requires all allowances or advances to be included in 'taxable income', excluding any amount actually expended by the recipient (employee) –

- on any
  - accommodation
  - meals and other incidental costs
- while the recipient is obliged
  - by reason of his duties (office or employment)
  - to spend at least one night away from his or her usual place of residence in the Republic.

Accommodation

The portion of the allowance or advance for accommodation which is included in the recipient's (employee's) taxable income is calculated as follows:

Amount of **allowance** for accommodation (say) 5 nights at R2 000 per night	R10 000
Amount which the employee can prove he spent (say)	(6 000)
Include in taxable income	R 4 000

Amount of **advance** for costs of accommodation (say)	R12 000
Amount for which employee has records of the accommodation expense (say)	(7 000)
Amount recovered by the employer (say)	(2 000)
Include in taxable income	R 3 000

Note: A loss cannot be created. Costs are limited to the advance or allowance.

The difference between an allowance and an advance is:

- Allowance – the employee can deduct his actual costs of accommodation for tax purposes and need not account to his employer for what he spent.
- Advance – the employee has to account to his employer for his actual costs of accommodation. He is taxed on any amount which he has not spent on accommodation and has not paid back to his employer.

The subsistence allowance tables do not apply to accommodation allowances, so usually an employer pays these costs directly.

Meals and other incidental costs

Where an advance or allowance is received by an employee for meals and other incidental costs, he or she can deduct either:

- the amount actually spent (limited to the advance or allowance), or
- the amount set by the Commissioner by way of notice in the *Government Gazette* for each day or part of a day that the employee is absent from his or her usual place of residence (provided that the employee is obliged to spend at least one night away).

The employee can choose between the two methods on a day-by-day basis.

Note that the allowance in this case is called a 'subsistence' allowance, and the amount allowed to be deducted per the *Government Gazette* applies to either of the following:

- an allowance for meals and other incidental costs
- an allowance for incidental costs only.

The allowance for incidental costs is to cover beverages, private telephone calls, gratuities (tips), and room service.

The amounts deductible from the subsistence allowance for the 2022 year of assessment (1 March 2021 – 28 February 2022) are as follows:

Meals and incidental costs in the Republic	R452 per day
Incidental costs only, in the Republic	R139 per day
Daily amount for travel outside the Republic	Varies per country – See Appendix B

Example – Subsistence allowance

Mr G is a sales representative for the KLJ Feed and Fertilizer Company (KLJ). His employer estimates that he will need to spend 10 nights away from home, visiting 10 customers. The employer agreed that it will pay the costs of accommodation and give Mr G an allowance for meals and incidental costs of R500 per day. Mr G was therefore paid an advance of R5 000 for the month of January.

By the end of the month, Mr G had only spent 8 nights away on business, visiting 8 customers. For the 9th customer, he travelled out to the customer in the morning, and went back home in the evening. He did not visit the 10th customer.

By the end of the following month Mr G had not refunded any part of the allowance to the employer.

Mr G's income for tax is as follows:

January (8 nights x R500)	R4 000
Tax-free portion (8 x R452)	(3 616)
Included per section 8(1)	R384
February (2 x R500)	R1 000

1.4.3 OTHER ALLOWANCES

Section 8(1)(a)(ii) is meant to deal with all other allowances, including the entertainment allowance. This provision was expanded to include expenditure allowed to be spent by the employer on meals and incidental costs while away for part of a day away from home. The rate was set in *Government Gazette* 44229 (5 March 2021) as being R139 per day. This is to be distinguished from the meals and incidentals covered by section 8(1)(a)(i)(bb).

The basic principle is that all allowances are included in taxable income, and where the recipient is an employee, he cannot deduct any expenses from such other allowances if section 23(m) applies (see later).

Note however that a reimbursement of actual business expenditure is not included in the recipient's taxable income. Where the amount is a reimbursement of or an advance for expenditure the amount must be:

- incurred or to be incurred,
- on the instruction of the employer,
- in the furtherance of the trade of the employer, and
- the employee must produce proof to the employer that the expenditure was wholly incurred, and
- the employee must account to the employer for the expenditure
- if an asset is bought, the ownership of the asset must be given to the employer.

The position is as follows:

- If an employee is given an allowance, for example an entertainment allowance, and he is not required to account (to his employer) for actual expenditure incurred, the amount is included in his taxable income.
- If an employee is given an amount, whether in advance or in arrears, to cover expenditure which he has, or will, incur on the instruction of his employer and for which he is accountable to his employer in terms of s8(1)(a)(ii), the amount does not fall into his taxable income (see above).

Example – Reimbursive allowance

Mr D is given an amount of R5 000 to buy a computer program for his employer. Mr D buys the program for R4 000. On the way back to office he meets a client and they decide to have lunch. The lunch costs R400 and Mr D offers to pay for it with part of the funds given to him by his employer.

On returning to office Mr D gives the program to his employer, as well as the invoice for the program and the invoice for the lunch. He also returns the R600 cash which he has left.

Mr D's inclusion in taxable income is calculated as follows:

Advance	R5 000
Amount spent on program	(4 000)
Amount returned to employer	(600)
Section 8(1) inclusion in taxable income	R400

Mr D is taxed on the R400 because the money was not spent on the instruction of his employer.

1.5 EXEMPTIONS

1.5.1 GENERAL

Having determined gross income from employment, the next step is to determine if any of this income is *exempt* from tax. If an amount is exempt it is deducted from gross income in order to arrive at income, as follows:

	GROSS INCOME	XXX
Less	EXEMPT INCOME	(XXX)
	INCOME	XXX

The exempt income provisions are set out in section 10 of the Act. Key exemptions relating specifically to income from employment (s10(1)(nA), (nB), (o), (p), (q), (qA)) are covered in detail in this chapter. Any other exemptions covered in this chapter are in less detail.

1.5.2 SPECIAL UNIFORMS EXEMPTION – SECTION 10(1)(nA)

Where an employee is required to wear a special uniform while he is on duty, he is exempt from tax on the value of such uniform given to him by his employer or on any allowance (to the extent considered reasonable by the Commissioner) paid to him for that purpose, provided that the uniform is clearly distinguishable from ordinary clothing.

1.5.3 TRANSFER OR RELOCATION COSTS EXEMPTION – SECTION 10(1)(nB)

Where an employee is

- appointed, or
- transferred, or
- dismissed

and moves at the insistence of his employer and the employer bears the cost thereof, the amount expended will not be taxed in the employee's hands.

The costs dealt with are

- transportation costs,
- settling-in costs,
- hiring of temporary accommodation for less than 183 days.

The employee will also not be taxed on any costs borne by the employer or reimbursed to the employee in respect of the sale of the employee's previous residence and in settling in permanent residential accommodation at his new place of residence.

The Commissioner has stated the following in this regard:

Reimbursement of actual expenses: The following items are exempt from tax if the employer *reimburses* the employee for the actual expenditure incurred and must be reflected under code 3714 on the IRP 5 certificate

- Bond registration and legal fees
- Transfer duty

} For new home

- Cancellation of bond
- Agent's commission on sale of previous residence

} For previous home

Settling-in costs include the following and must be reflected on the IRP 5 certificate under code 3714

- New school uniforms
- Replacement of curtains
- Motor vehicle registration fees
- Telephone, water and electricity connection

To simplify the administration, it will be acceptable and treated as tax free if an amount equal to one month's basic salary is paid to the employee to cover settling-in costs (excluding those related to transport, temporary accommodation and purchase and/or sale of residence).

Expenditure fully taxable: Should payments be made by the employer in respect of the following two items, these will constitute taxable benefits in the hands of the employee concerned and be subject to the deduction of employees' tax:

- Payments to reimburse the employee for loss on the sale of a previous residence during transfer.
- Architect's fees for the design or alteration of a new residence.

1.5.4 SHIPS CREW EXEMPTION – SECTION 10(1)(o)(i)

Section 10(1)(o)(i) exempts any remuneration (as defined in the Fourth Schedule) derived by any person as an officer or crew member of a ship engaged in international transportation for reward of passengers or goods is exempt if such person was outside the Republic for a period or periods exceeding 183 full days in aggregate during the year of assessment. The crew of ships used in the prospecting, exploration, mining or production (including surveys and other work of a similar nature) for any minerals (including natural oils) from the seabed outside the Republic, may also have their remuneration exempted under this provision where such officer or crew member is employed on board such ship solely for purposes of the 'passage' of such ship, as defined in the Marine Traffic Act, 1981, and the 'days' requirement is met. A full day runs from 00H00 to 24H00.

1.5.5 EMPLOYMENT OUTSIDE THE REPUBLIC EXEMPTION – SECTION 10(1)(o)(ii)

Section 10(1)(o)(ii) exempts the first R1,25 million of any remuneration received by or accrued to a person by way of any salary, leave pay, wage, overtime pay, bonus, gratuity, commission, fee, emolument, including an amount referred to in paragraph (i) of the definition of gross income (fringe benefits), is exempt if it is in respect of services rendered outside the Republic for, or on behalf of, any employer provided that person was outside the Republic of South Africa -

- for a period or periods exceeding 183 full days in aggregate during any 12 month period commencing or ending during that or any other year of assessment; and
- for a continuous period exceeding 60 full days during such period of 12 months; and
- such services were rendered during such periods worked outside the Republic.

The remuneration referred to in this subsection includes fringe benefits and benefits under employee share schemes.

Note:

1. The payment must relate to employment. Independent contractors (self-employed persons) may not claim the exemption.
2. The payment does not have to be received during the year that the employee was outside the Republic. It must merely relate to the work done outside South Africa.
3. Note that the provisions do not apply to any person contemplated in section 9(2)(g) (public office) or section 9(2)(h) (government employees).
4. If a person is in transit through the Republic and does not formally enter the Republic, he is deemed to be outside the Republic.
5. The services do not have to be rendered during the whole time that the employee is outside the Republic. If the employee is on holiday outside the Republic, the days on holiday count towards the days requirement.
6. Where remuneration is received by or accrues to any person during any year of assessment in respect of services rendered by that person in more than one year of assessment, the remuneration is deemed to have accrued evenly over the period that those services were rendered (s10(1)(o)(ii), proviso (C)).

Example – Exemption for employment outside South Africa

Mr K works for ABC Auditors, where he earns a salary of R240 000 per year. On 1 January 2021 he was sent on secondment to the UK, where he remained until 30 September 2021. He did not return home at any time during that period.

- Mr K has been outside South Africa for more than 183 days beginning in the 2021 year of assessment and ending in the 2022 year of assessment
- During that time Mr K has been outside South Africa for a continuous period exceeding 60 days
- Therefore Mr K qualifies for the s10(1)(o)(ii) exemption.

R40 000 of Mr K's salary will be exempt from tax for the year of assessment ending 28 February 2021 (R240 000 x 2/12).

R140 000 of Mr K's salary will be exempt from tax for the year of assessment ending 28 February 2022 (R240 000 x 7/12).

1.5.6 SERVICES FOR THE SOUTH AFRICAN GOVERNMENT EXEMPTION – SECTION 10(1)(p)

Section 9(2)(h) deems the income arising from certain services rendered to the South African Government or municipality to be from a South African source. This deeming provision applies to residents and non-residents alike.

Section 10(1)(p) exempts such amounts from South African tax in the hands of a non-resident if he is taxed in his home country on the amount and the tax is actually borne by him.

1.5.7 BURSARIES AND SCHOLARSHIPS EXEMPTION – SECTION 10(1)(q)

Section 10(1)(q) exempts any *bona fide* scholarship or bursary granted to assist or enable any person to study at a recognised educational or research institution.

The following additional rules apply if the scholarship or bursary has been granted by an employer (or an associated institution) to an employee or a relative of an employee:

- In the case of a bursary or scholarship granted to an employee the exemption will not apply unless the employee agrees to reimburse the employer for any scholarship or bursary if the employee fails to complete his or her studies for reasons other than death, ill-health or injury.
- In the case of a scholarship or bursary granted to a relative of an employee the exemption is limited to R20 000 per year for studies up to NQF level 4 (high school) and R60 000 per year for studies up to NQF level 10 (PhD), provided that the employee's remuneration does not exceed R600 000 for the year of assessment. If the employee's remuneration exceeds R600 000 during the year of assessment, the section 10(1)(q) exemption will not apply to the scholarship or bursary granted to assist the relative of the employee to study.

Interpretation note 66 deals with the taxation implications of bursaries and scholarships.

The interpretation note defines the following terms:

- 'Bona fide scholarship or bursary'
- 'A recognised educational or research institution'
- 'To study'
- 'Remuneration'

A *bona fide* bursary would include one which is in terms of a written agreement conditional on the fulfilment of stipulated requirements such as the requirement that the grantee is required to obtain a qualification or take up employment with the grantor on completion of his studies. It also includes a direct payment of fees.

'To study' relates to the formal process whereby the person to whom the grant is made, gains or enhances his knowledge, intellect or expertise. It is not a requirement that a degree, diploma or certificate be awarded on completion of the course of study. 'Study' does not include research undertaken for the benefit of another person, e.g. an employer, a business or sponsor. Also, a grant to a visiting academic for the purpose of lecturing students does not satisfy the study requirement. A reward or reimbursement of study expenses borne by a person after completion of his studies does not constitute a scholarship or bursary as the grant must have been made *to enable or assist the grantee to study.*

Where an employee obtains a loan to study, it is exempt from fringe benefits tax, but if the loan is waived, the employee will be taxed on the amount waived. The section 10(1)(q) exemption will not apply.

Similarly, where an employer rewards an employee for obtaining a qualification or successfully completing a course of study, or reimburses him for study expenses, the payment by the employer to the employee will be taxed in the employee's hands in terms of paragraph (c) of the gross income definition.

Specialised training courses

The interpretation note states that expenditure in connection with in-house or on-the-job training, or courses presented by other undertakings for or on behalf of employers, does not represent a taxable benefit, in the hands of the employees of the employer, if the training is job-related and ultimately for the employer's benefit.

1.5.8 BURSARIES AND SCHOLARSHIPS EXEMPTION FOR DISABLED PERSONS – SECTION 10(1)(qA)

Similar to the previous section, section 10(1)(qA) exempts any *bona fide* scholarship or bursary granted to assist or enable any person with a disability as defined in section 6B(1) to study at a recognised educational or research institution.

The following additional rules apply if the scholarship or bursary has been granted by an employer (or an associated institution) to an employee or family member of an employee:

- In the case of a bursary or scholarship granted to a disabled employee the exemption will not apply unless the employee agrees to reimburse the employer for any scholarship or bursary if the employee fails to complete his or her studies for reasons other than death, ill-health or injury.
- In the case of a scholarship or bursary granted to a family member of an employee the exemption is limited to R30 000 per year for studies up to NQF level 4 (high school) and R90 000 per year for studies up to NQF level 10 (PhD), provided that the employee's remuneration does not exceed R600 000 for the year of assessment. If the employee's remuneration exceeds R600 000 during the year of assessment, the section 10(1)(qA) exemption will not apply to the scholarship or bursary granted to assist the relative of the employee to study.

1.6 DEDUCTIONS

1.6.1 DEDUCTIONS AND ALLOWANCES

So far, we have looked at inclusions in gross income (with allowances being included in taxable income) and exemptions from this gross income. Now we will take a closer look at deductions, which are amounts that one subtracts from income to determine taxable income.

Most deductions are included under section 11. Section 11(a) allows the deduction of revenue expenditure incurred in the production of income from trade. Salaries, wages, etc are income from trade, because 'trade' is defined in section 1 of the Income Tax Act as including any 'employment'.

SARS has taken the view that expenditure incurred in the production of employment income is not incurred in the production of income in cases where the person would earn their wage or salary regardless of whether they incurred the expenditure.

In the past, therefore, employment contracts would be drafted to require employees to do certain things so that the related expense could be deducted, for example:

- Being on call (telephone at home and mobile phone)
- Working from home (home study)
- Belonging to a professional body (professional subscriptions)
- Keeping up to date (subscribe to trade journals)
- Having a notebook computer to work while away from office

The result has been that section 23 has been designed to prevent the deduction of certain expenses related to employment, i.e. –

- Section 23(b) disallows expenses related to a home study unless it is specifically equipped for the purposes of the employee's trade and regularly and *exclusively* used for that purpose and the following applies–

- the employee's income from employment is derived mainly from commission or other variable payments based on his or her work performance and the employee's duties are performed (mainly) outside any office provided to him or her by the employer; and
- the employee's duties are mainly performed in his study.

o Section 23(m) disallows any section 11 expenditure or loss relating to employment or the holding of office (if the remuneration is subject to employees tax in terms of the Fourth Schedule), except for:

- Deductions in respect of domestic premises which are not disallowed under section 23(b)
- Pension, provident or retirement annuity fund contributions – these are deductible in terms of section 11F
- A refund of the person's salary per section 11(nA) or of a restraint of trade payment under section 11(nB)
- Legal expenses per section 11(c)
- Wear and tear per section 11(e)
- Bad debts per section 11(i)
- Doubtful debts per section 11(j)
- Premiums paid in terms of an insurance policy to the extent that it covers the person against loss in income as a result of injury, illness, disability or unemployment - s11(a). (The proceeds from such policy must constitute income in the taxpayer's hands)

Furthermore, since deductions in respect of donations to public benefit organisations are governed by section 18A rather than section 11 they are not disallowed by section 23(m) and may therefore also be made against employment income.

The section 23(m) limitation does not apply to agents or representatives whose remuneration is *normally* derived mainly in the form of commissions based on his or her sales turnover.

1.6.2 PENSION, PROVIDENT AND RETIREMENT FUND CONTRIBUTIONS

Section 11F deals with the taxpayer's contributions to a pension fund, provident fund or retirement annuity fund. These contributions were previously deductible under sections 11(k) and 11(n).

Contributions to retirement funds – section 11F

A member's contributions to a pension, provident and retirement annuity fund are deductible under section 11F. These contributions consist of:

- contributions in the current year (including the contributions of the employer considered a fringe benefit for the purposes of the Seventh Schedule), and
- contributions in the past that were disallowed as a deduction under section 11F and the old sections 11(k) and 11(n).

The deduction under section 11F is limited to –

The lesser of:

- R350 000; or
- 27.5% of the higher of:
  - Remuneration as defined in paragraph 1 of the 4th Schedule (excluding retirement or severance lump sums), or
  - Taxable income (excluding retirement or severance lump sums), before the s11F or s18A deductions.
- Taxable income before s11F and including taxable capital gains under s26A.

Example

Mr R earns a salary of R300 000 per year. He also has other income, not related to employment, of R80 000. He contributes 8% of his salary to a pension fund and contributes R500 per month to a retirement annuity fund. Mr R

also contributes R12 000 to a provident fund. Mr R's employer contributed 5% of the salary to the pension fund. Mr R has previous non-deductible retirement fund contributions, brought forward from prior years of R4 000.

The section 11F deduction will be calculated as follows –

Contributions of (R300 000 x (8%+5%)) + (R500 x 12) + R12 000	R57 000

Limited to the lesser of:

- R350 000, or
- 27.5% of the higher of:

Remuneration (salary R300 000 + fringe benefit employer contribution R15 000)	R315 000
And taxable income (R300 000 + R15 000 + R80 000)	R395 000
Therefore 27.5% x R395 000	R108 625

Therefore, all contributions are deductible, and the deduction is R57 000.

1.6.3 DONATIONS TO PUBLIC BENEFIT ORGANISATIONS

In terms of s18A a deduction (subject to a 10% limit) is allowed in respect of the sum of *bona fide* donations of cash or property in kind made by a taxpayer, during the year of assessment, to:

- certain public benefit organisations (PBO) approved by the Commissioner under section 30 and certain other institutions and bodies. Not all donations are tax-deductible. The PBO or other institution has to be registered under Part II of the Ninth Schedule, and must issue a tax deduction certificate to the donor.
- The deduction is limited to an amount which does not exceed 10% of the taxable income of the taxpayer before the deductions under this section.

Example – Pension, RAF, Donations and Medical contributions

Mr G (under 65) earns a pensionable salary of R204 000 for the year ended 28 February 2022 and has other trading income of R130 000, and interest income of R43 300 (assume R22 800 of this interest is exempt). The following amounts have been paid by him for the year of assessment:

Deductible revenue expenditure in the production of trade income	R22 000
Provident fund contributions	7 500
Medical aid contributions	6 000
Donations to tax-exempt church fund	2 000
Donations to tax-exempt AIDS organisation (tax deduction certificate received)	1 800
Pension fund contributions	12 000
Retirement annuity fund contributions	18 000

Mr G's taxable income for the year is as follows:

Salary		R 204 000
Trading income	R130 000	
Deductible trading expenses	(22 000)	108 000
Interest income	R43 300	
Interest exemption	(23 800)	19 500
		R331 500
Pension, provident and retirement annuity fund contributions s11F	R37 500	
Ltd to lesser of R350 000,		
27.5% of the higher of		
Remuneration	R204 000	
And taxable income	R331 500	
Therefore 27.5% x R331 500,	R91 163	
And taxable income	R331 500	
All the contributions of R37 500 are deductible.		(37 500)
Donations to church (not deductible)		-

Donations to Aids organisation	(1 800)
Taxable income	R292 200

1.6.4 SEQUENCE OF DEDUCTIONS

The Act provides that the taxable portion of the capital gain must be included in the taxable income of the taxpayer (section 26A). The Act provides that the deduction of donations to certain organisations must not exceed 10% of the taxable income (excluding any retirement fund lump sum benefit and retirement fund lump sum withdrawal benefit) of the taxpayer as calculated before allowing any deduction under section 18A.

A specific sequence should be applied when a taxpayer's taxable income is calculated if he or she contributed to retirement funds (s11F), received a taxable allowance in respect of section 8(1)(a), made a taxable capital gain, made a deductible donation to an organisation under section 18A. This sequence is illustrated by the following example:

Example

Mr A is under 65 with no dependants and his income (non-retirement funding income) is R320 000 for the 2022 year of assessment, before the following taxable income and contributions and deductions for the year of assessment were taken into consideration:

Taxable travel allowance	R 24 000
Taxable portion of capital gain	120 000
Current contributions to a retirement annuity fund (not through the employer and no proof of payment was provided)	52 000
Medical aid fund contributions (by himself, not through the employer)	14 000
Medical expenses not refunded by his medical aid fund	45 000
Donations to public benefit organisations in the Republic which carry on public benefit activities as contemplated in Part II of the 9th Schedule	43 000

Calculation of Mr A's taxable income for the year of assessment ending 28 February 2022:

Non-retirement funding income		R320 000
Plus: Taxable travel allowance		24 000
Less: RAF contribution of R52 000		
Ltd to lesser of R350 000,		
27.5% of the higher of		
Remuneration (R320 000 + R24 000)	R344 000	
And taxable income (R344 000 + R120 000)	R464 000	
Therefore 27.5% x R464 000	R127 600	
And taxable income R464 000		
Therefore all the contributions are deductible		(R52 000)
Plus: Taxable capital gain		120 000
Taxable income before donations		412 000
Less: Donations of R43 000: Limited to 10% x R412 000		(41 200)
Taxable income		R370 800

Note: the taxpayer would also be entitled to medical rebates, as discussed in 1.7.4 and 1.7.5.

1.7 TAX LIABILITY AND TABLES

1.7.1 CALCULATION OF INDIVIDUAL'S TAX LIABILITY

So far, the calculation of taxable income includes the following:

Gross income (s1)	XXX
Less: Exempt income (s10)	(XX)
Income	XXX

Add: Taxable portion of allowances (s8(1))		XX
Less: Deductions (mainly s11 to s20 & s23)		
Retirement fund deductions (s11(F))	XX	(XX)
Add: Taxable portion of capital gains (s26A)		XX
Less: Donations deduction (s18A)		(XX)
Taxable income		XXX

Once the taxable income has been calculated, the tax payable must be determined. This is accomplished by using the tax table for each year of assessment and considering the rebates applicable.

Tax per the table, based on taxable income	XXX
Less: Rebates	XXX
Tax payable	XXX

1.7.2 TAX TABLE

The tax payable on a person's taxable income is set out in the tax table for each year of assessment.

The tax table for individuals (natural persons) is set out in Appendix A. It applies to all individuals as well as special trusts. The tax table provides rates of tax which increase progressively as taxable income increases. In other words, persons with low income pay tax at a lower rate than persons with high income.

Example – Tax table

Mrs Hay has a taxable income of R250 000 for the year ended 28 February 2022. Calculate her tax per the tax table.

Solution

Tax on R216 200	R38 916
Tax on R33 800 (R250 000 – R216 200) @ 26%	8 788
Total tax per the tax table	R47 704

Mrs Hay's average rate of tax is 47 704 / 250 000 x 100 = 19,08%. Her marginal rate of tax is 26%, being the rate of tax which Mrs Hay will pay on her next Rand of taxable income.

Note: The tax per the table is reduced by certain personal rebates which are discussed in 1.7.3.

1.7.3 NORMAL TAX REBATES

The normal tax rebates are fixed amounts deductible by a natural person from the tax calculated per the tax table.

The rebates for the year of assessment ended 28 February 2022 are as follows:

- Primary rebate - R15 714 (2021: R14 958)
- Secondary rebate - R 8 613 (2021: R8 199)
- Tertiary rebate - R 2 871 (2021: R2 736)

Notes: (1) The secondary rebate is claimable if the taxpayer is 65 years or older on the last day of the year of assessment

(2) The tertiary rebate is claimable if the taxpayer is 75 years or older on the last day of the year of assessment

(3) If the taxpayer dies during the year, but would have been over 65/75 at the end of the year of assessment had he lived, the secondary/tertiary rebate is still deducted from his tax, but would be apportioned as it would be in respect of a partial period of assessment.

(4) The total rebate for a person who is 65 or older is therefore R24 327 (15 714 + 8 613).

(5) The total rebate for a person who is 75 or older is therefore R27 198 (15 714 + 8 613 + 2 871).

1.7.4 MEDICAL SCHEME FEES TAX CREDIT

In addition to the normal tax rebates, a natural person contributing to a medical aid is entitled to an additional rebate – the medical scheme fees tax credit under section 6A.

In terms of section 6A, taxpayers who contribute to a medical aid scheme (in terms of the Medical Schemes Act) or to any similar scheme in another country, will receive a monthly tax rebate of R332 (for one member), R664 for the taxpayer and one dependant and R224 per each additional dependant.

The contributions must be in respect of the taxpayer, his spouse, any child and any dependant of the taxpayer who was admitted as a dependant under the medical scheme.

All taxpayers who are contributing to a medical aid qualify for this rebate. The rebates are only claimable for the months in which contributions are paid to the medical aid. The monthly tax rebate is a fixed amount, regardless of the actual contribution made by the taxpayer. The contribution to the fund can be larger or smaller than the credit.

Contributions by employers

The rules of a medical aid fund vary from fund to fund and may require half the medical aid contribution to be made by the employer and half by the employee. To the extent that the payments are made by an employer and are taxable as a fringe benefit, the employee is deemed to have made the contributions to the medical aid fund himself or herself.

1.7.5 ADDITIONAL MEDICAL EXPENSES TAX CREDIT

A natural person paying qualifying medical expenses is entitled to an additional rebate to be deducted from normal tax payable – the additional medical expenses tax credit under section 6B.

Qualifying medical expenses

These expenses include:

(a) Amounts paid by him or her:

- to a registered medical practitioner
- to a registered nursing home
- to a registered pharmacist

(b) Amounts paid by him or her in respect of expenditure incurred outside the Republic on services or medicine similar to those described above, and

(c) Expenditure that is prescribed by the Commissioner, necessarily incurred and paid by the taxpayer in consequence of any physical impairment or disability suffered by the taxpayer or any dependant.

Any expenses recovered from the medical aid scheme or under an insurance policy are not included as qualifying medical expenses.

The amounts paid must be in respect of the taxpayer, or any dependant as referred to below.

Dependant

Dependant means:

(a) A person's spouse,

(b) A person's child and the child of his or her spouse,

(c) Any other member of the person's family whom they are liable to support, and

(d) Any other person recognised as a dependant in terms of the rules of the medical aid scheme to which they contribute for the medical scheme fees tax credit.

Child for the purposes of the rebate

For the purposes of the section child means any child (including an adopted child) of the taxpayer or his spouse who was alive for at least part of the year and meets the following requirements:

- *Under 18 years of age*

The taxpayer will qualify for the rebate if the child is *under 18 years old* and is unmarried.

- *18 to under 21 years old*

The taxpayer will qualify for the deduction if the child is

- unmarried,
- wholly or partially dependent for his maintenance upon the taxpayer, and
- not liable for the payment of normal tax for the year in his own right.

- *21 to under 26 years old*

The taxpayer will qualify for the deduction if the child is:

- unmarried,
- wholly or partially dependent for his maintenance upon the taxpayer,
- not liable for the payment of normal tax for the year, and
- a full-time student at an educational institution of a public character.

- *Any age*

The taxpayer will qualify for the deduction if the child is:

- incapacitated by physical or mental infirmity from maintaining himself,
- wholly or partially dependent for his maintenance upon the taxpayer, and
- not liable for the payment of normal tax for the year.

Disability

A disability means a moderate to severe limitation of a person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if;

- the limitation has lasted or has a prognosis of lasting more than a year; and
- is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by the Commissioner.

1.7.6 LIMITATION OF THE MEDICAL EXPENSES TAX CREDIT

There are three categories of taxpayers to whom the rebate applies:

- Persons who are 65 years old and older,
- Persons with a disability, and
- Everyone else (persons younger than 65 without a disability)

Rebate for persons 65 years old and older, and persons with a disability

The calculations for the rebate for the first two categories are identical. The calculation is as follows:

(i) 33.3% of the medical aid contributions in excess of three times the medical scheme fees tax credit, plus

(ii) 33.3% of qualifying medical expenditure

Rebate for persons younger than 65 without a disability

The rebate is calculated as 25% of:

(i) medical aid contributions in excess of four times the medical scheme fees tax credit, plus

(ii) qualifying medical expenditure

to the extent that the sum of (i) and (ii) are in excess of 7.5% of taxable income.

Note: there can never be a negative excess.

Example – Medical scheme contributions and medical expenses

Mr X belongs to a medical aid scheme. His wife and daughter are listed as dependants. His employer contributes R1 500 per month to the medical aid in respect of his membership, and Mr X contributes R1 700 per month. For the 2022 year of assessment, Mr X incurs another R25 500 of qualifying medical expenditure, which was not covered by his medical aid. His taxable income is R300 000.

Calculate the final tax liability, assuming Mr X is:

a) 70 years old

b) 30 years old without a disability

a) 70 years old (working to the nearest Rand):

Taxable income		R300 000
Normal tax per the tables (R38 916 + 26% x (R300 000 – R216 200))		R60 704
Less: primary rebate		(R15 714)
Less: secondary rebate		(R8 613)
Less: s6A medical scheme fees tax credit (R664 + R224) x 12		(R10 656)
Less: s6B medical expenses tax credit		
Contributions (R1 500 + R1 700) x 12	R38 400	
3 times the s6A rebate (3 x R10 656)	(R31 968)	
	R6 432	
	x 33.3%	(R2 142)
Qualifying medical expenditure (R25 500 x 33.3%)		(R8 492)
Final tax liability		R15 087

b) 30 years old (working to the nearest Rand):

Taxable income		R300 000
Normal tax per the tables (R38 916 + 26% x (R300 000 – R216 200))		R60 704
Less: primary rebate (no secondary rebate as under 65)		(R15 714)
Less: s6A medical scheme fees tax credit		(R10 656)
Less: s6B medical expenses tax credit		
Contributions (R1 500 + R1 700) x 12	R38 400	
4 times the s6A rebate (4 x R10 236)	(R42 624)	
	Limited to R0	
Qualifying medical expenditure	R25 500	
	R25 500	
Less 7.5% of R300 000	(R22 500)	
	R3 000	
	x 25%	(R750)
Final tax liability		R33 584

1.7.7 TAX THRESHOLDS

The point at which tax becomes payable is known as the tax threshold.

As a result of the rebates, persons are not liable for tax if the tax per the table is equal to or less than the rebates to which they are entitled.

The tax thresholds for the 2022 year of assessment are as follows:

	Taxable income
- Persons under 65	R87 300 (2021 : R83 100)
- Persons over 65	R135 150 (2021 : R128 650)
- Persons over 75	R151 100 (2021 : R143 850)

1.7.8 TAX COLLECTION

Tax is collected by means of various withholding taxes (such as employees' tax), provisional tax which is paid six-monthly, and when an assessment is issued for the year.

Registration

Every person who becomes liable for income tax or becomes liable to submit a tax return must apply to the Commissioner to be registered as a taxpayer.

Employees tax

The Fourth Schedule to the Income Tax Act provides that where a person receives remuneration in respect of employment his or her employer must withhold tax from his or her remuneration and pay it to SARS. The employees' tax so withheld is determined by reference to tables issued by SARS.

Provisional Tax

Persons with non-remuneration income may be subject to provisional tax, which is an advance payment of tax, made in instalments during the year. A first payment is made on or before 31 August and a second not later than the last day of February. A topping-up provisional tax payment may be made 7 months after the year-end (see chapter 2).

Normally, persons who earn other income which is not subject to employees' tax have to register as provisional taxpayers and pay the tax on this other income on their provisional tax returns (see chapter 2).

Assessment

All persons who are liable for tax are required to render a return of their income and deductions every year. From this return SARS raises an assessment showing the tax due for the year. The amount due is reduced by any employees' tax and provisional tax, which has been paid to SARS in respect of the year.

1.7.9 PARTIAL PERIOD OF ASSESSMENT

A partial period of assessment is one which is less than 12 months.

In a partial period of assessment, the rebates (other than sections 6A and 6B) are reduced proportionately – section 6(4).

A partial period of assessment arises:

- in the year in which the taxpayer is born, if he is liable for tax;
- in the year in which the taxpayer dies;
- in the year in which the taxpayer ceases to be a resident due to emigration; or
- in the year in which the taxpayer goes insolvent.

Note that there is no partial period in the year in which a person starts working or stops working.

1.8 EMPLOYEES' TAX

1.8.1 GENERAL

Employees' tax is a withholding tax which is deducted from an employee's remuneration on a regular (usually monthly) basis. Its purpose is the advanced collection of normal tax. The deduction is made by the employer and is determined by using tables issued by SARS. Every employer who pays remuneration which is subject to employees' tax has to register with SARS as an employer for employees' tax purposes. The employees' tax deducted from an employee's remuneration by the employer must be paid to SARS within seven days after the end of the month. Should the seventh day be a weekend or a holiday, then the employees' tax is to be paid by the last business day before the seventh day. Failure to pay within seven days (or such last business day before the seventh day) will result in penalties and interest (see below) being levied by SARS on the amounts of tax that should have been paid.

1.8.2 DEFINITIONS

It is clear that the withholding of employees tax is only necessary where *remuneration* is paid by an *employer or representative employer* to an *employee*. The terms employer, employee, representative employer and remuneration are defined in paragraph 1 of the Fourth Schedule. The definition of remuneration is the most important because the other definitions are dependent on it.

Remuneration includes all payments and amounts payable, in cash or otherwise, whether or not for services rendered. Remuneration includes:

- salary and wages, leave pay, bonuses, gratuities, commissions, fees, overtime pay, emoluments, other amounts paid for services rendered
- allowances and advances (excluding the travel allowance and permissible subsistence allowances)
  - If a person has been paid a subsistence allowance to spend a night away from his usual residence and he has not (by the last day of the following month) spent the required nights away from his residence (and he has not refunded the allowance to his employer), the subsistence allowance is treated as a normal payment for services rendered and is subject to employees tax in that next month. It is deemed not to have been paid in the first month.
- 50% of allowances paid to a holder of public office
- 80% of any travel allowance, except where the employer is satisfied that 80% of the use of the vehicle is for business purposes. In this circumstance, the inclusion in remuneration is only 20%. This is to prevent a refund of employees' tax once the taxpayer has been assessed.
- Pensions, superannuation allowances, annuities
- restraint of trade receipts (gross income (cA))
- amounts paid for variation of office (gross income (d))
- any amount received or accrued in commutation of amounts due under any contract of employment or service (gross income (f))
- fringe benefits (gross income (i)). The amounts (after reductions) that are included in gross income, with the exception of:
  - Only 80% of the use of the motor vehicle (before any reductions), except where the employer is satisfied that 80% of the use of the vehicle is for business purposes. In this circumstance, the inclusion in remuneration is only 20%. This is to prevent a refund of employees' tax once the taxpayer has been assessed.

Remuneration does not include the following:

- Fees paid to a person for service he renders in the course of any trade carried on independently by him. Examples of such payments are fees paid to; auditors, medical practitioners, lawyers, independent businesses, etc. This is an important exclusion and is discussed in a separate chapter.

  Note that this exclusion does not apply in the case of persons who are not ordinarily resident in the Republic or persons such as labour brokers or personal service providers.

- Disability pensions in terms of certain Acts.
- Amounts paid to an employee to reimburse him for expenditure incurred in the course of his employment.
- Annuities under an order of divorce or similar separation.

Note that any subsistence allowance granted to an employee in a month, that is not either spent by the employee while away from home for at least one night or refunded to the employer, shall be deemed to be remuneration in the following month.

'**Employer**' is defined as a person who pays or is liable to pay remuneration to someone else.

Agents who pay the remuneration on behalf of another employer are not 'employers' in respect of that remuneration.

'**Employee**' is defined as a person (other than a company) who receives remuneration (or to whom remuneration accrues).

The other defined terms are dealt with separately in the rest of this chapter (employees' tax, employees' tax certificate, month, tax threshold).

1.8.3 DETERMINATION OF EMPLOYEES' TAX

The Fourth Schedule provides for the determination of the amount of employees tax to be withheld by an employer:

- The amount required to be withheld
- from any remuneration by way of employees' tax
- must be calculated on the balance of the remuneration remaining after deducting the following amounts:

(a) The contributions by the employee to any pension or provident fund (which the employer is required to deduct) (limited to the deduction permissible under section 11F).

(b) At the option of the employer, any contributions to a retirement annuity fund by the employee in respect of which proof of payment has been furnished (limited to the permissible deduction under section 11F).

(bA) The contributions made by the employer to a retirement annuity fund for an employee but limited to the permissible deduction for the employee in terms of section 11F.

(c) *deleted from 1 March 2015.*

(d) *deleted from 1 March 2014.*

(e) *deleted from 1 March 2012.*

(f) Donations made by the employer on behalf of the employee to institutions that issue the employer with a section 18A receipt. The deduction is limited to 5% of the employees' remuneration after deducting the amounts in (a) to (e) above.

Note: Where the employee contributes to a medical aid scheme, the employee's tax calculation will take into account the s6A medical aid rebate if either the medical aid scheme payment is withheld from the salary, or (at the option of the employer) the employee has furnished proof of payment.

Note: In the calculation of employees' tax, there is no provision for taking into account the s6B medical expenses rebate, unless the taxpayer is over the age of 65.

Example – Employees tax and normal tax

Mr X (aged 50) earns a salary of R15 000 per month for the year ended 28 February 2022. Assuming that he has other income of R40 000 for the year and is not entitled to any deductions his tax payments for the year will be as follows:

Employee's tax

Because he receives remuneration his employer will have to withhold employee's tax from his monthly salary. The employee's tax is calculated according to tables issued by SARS.

The monthly employee's tax is:	R1 391

This amount is withheld from Mr X's monthly salary (by his employer). The R1 391 withheld by the employer is paid to SARS which is credited to Mr X's account. By the end of the year the employer would have withheld and paid over an amount of R16 686.

Normal tax

Mr X will submit a tax return for the year ended 28/2/2022 in which he will reflect income of R220 000. His tax will then be computed as follows:

Gross income	R220 000
Less: Deductions	Nil
Taxable income	R220 000
Tax per the tables	R39 904
Less: Rebate	(15 714)
Normal tax	24 190
Less: Employees tax (advance payment)	(16 686)
Amount due on assessment	R7 504

1.8.4 FAILURE TO WITHHOLD EMPLOYEES' TAX

Any agreement between an employer and an employee in terms of which the employer undertakes not to withhold employees' tax is void (paragraph 7). Paragraph 5 of the Fourth Schedule deals with the situation where an employer fails to deduct or withhold the full amount of employees' tax as follows:

- The employer becomes personally liable for the payment of the tax to the Commissioner.
- When the Commissioner is satisfied that the failure was not due to an intent to postpone payment of the tax or to evade the employer's obligations he may, if he is satisfied that there is a reasonable prospect of recovery of the tax from the employee, absolve the employer from his liability.
- An employer who has not been absolved shall have a right of recovery against the employee. Until such time as the employee has repaid the tax to the employer he will not be entitled to receive a tax certificate from his employer.
- The tax which the employer is liable to pay is deemed to be a penalty. This means that the employer will not be permitted to claim a section 11(a) deduction in respect of the amount because s23(d) prohibits the deduction of any penalty.

1.8.5 ADDITIONAL TAX

Chapter 16 of the Tax Administration Act provides that if an employer fails to pay an amount of employees' tax with intent to evade the employer's or employee's obligations under the Act, SARS may levy a penalty of up to twice the amount of employees tax not paid. The penalty is deemed to be an additional tax for the purposes of collection and the calculation of interest on the amount owing.

1.8.6 PERSONAL LIABILITY OF REPRESENTATIVE EMPLOYERS, SHAREHOLDERS, AND DIRECTORS

A representative employer is a not an employer in the legal sense but is deemed to be an employer in terms of the Fourth Schedule for the purposes of collecting employees' tax. An example of a representative employer would be a pension fund, which is obliged to withhold employees' tax from the pensions that it pays to its members.

Chapter 10 of the Tax Administration Act provides that the representative employer pays the employees' tax in its representative capacity. If the representative employer becomes personally liable for the tax, additional tax, penalty, and/or interest, such amounts can be recovered from the employee.

Chapter 10 also states that the representative employer will become personally liable if, while the employees tax, etc. remains unpaid –

(a) it alienates, charges or disposes of any money 'received or accrued' in respect of which the tax is chargeable; or

(b) it disposes of or parts with any money belonging to the employer, which is in its possession after the tax has become payable, if the tax could legally have been paid from such money.

The Tax Administration Act also states that where the employer is a company (or close corporation) every shareholder and director who controls or is regularly involved in the management of the company's overall financial affairs shall be personally liable for the employees' tax, additional tax, penalty or interest for which the company is liable.

1.9 CONCLUSION

Chapter 1 is an introduction to the taxation of an employed individual, only considering that income received from their employer. If all the above is collated into one tax liability calculation, the result would look similar to:

Gross income s1		
Salary, commission, leave pay etc	XX	
Fringe benefits		
Acquisition of asset at less than actual market value	XX	
Right of use of asset	XX	
Right of use of motor vehicle	XX	
Meals, refreshments and vouchers	XX	
Free or cheap services	XX	
Low interest loans	XX	
Subsidies	XX	
Payment of employees' debt	XX	
Medical aid contributions	XX	
Medical costs incurred	XX	
Insurance premiums	XX	
Contributions to retirement funds	XX	XXX
Less: Exempt income s10		
Special uniform exemption s10(1)(nA)	XX	
Transfer/relocation costs exemption s10(1)(nB)	XX	
Ships crew exemption s10(1)(o)(i)	XX	
Employment outside SA exemption s10(1)(o)(ii)	XX	
SA government service exemption s10(1)(p)	XX	
Bursary exemption s10(1)(q)	XX	(XXX)
Income		XXX
Add: Taxable portion of allowances per s8(1)		
Travel allowance inclusion		XX
Subsistence allowance inclusion		XX
Other allowance inclusions (entertainment)		XX
Less: Deductions (mainly s11 to s20 & s23)		
Pension fund deduction s11F		(XX)
Add: Taxable portion of capital gains (s26A)		XX
Subtotal (needed for donations deduction - 10% excess)		XXX
Less: Donations deduction s18A		(XX)
Taxable income		XXX

Tax per the table, based on taxable income	XXX
Less: Rebates	XXX
Tax payable	XXX

1.10 INTEGRATED QUESTION

1.10.1 MR ROBERTSON (36 MARKS)

Mr Robertson, a South African resident, has worked for Leebya Pty (Ltd) ('Leebya' or 'the company') for an unbroken 35 years, since he was 25 years old. Due to his age, the company has decided to offer him an early retirement package with effect from 1 March 2022. Mr Robertson does not want to retire but knows he cannot pass up such a lucrative opportunity as is being offered by the company.

In order to ensure that he can still cover his expenses and keep the same living standards after retirement, Mr Robertson needs to know what the minimum value of a package is that he can accept from the company. He has therefore approached you to help him work out his tax issues, before he decides to accept or reject the early retirement package.

The following relates to his current employment package that he receives from Leebya:

Description of benefit	**Market value at date of use / acquisition**	**Cost to Leebya**
Monthly salary	N/A	R22 000
A gift of a fireman's outfit, hardhat and fake axe after successfully preventing a fire from breaking out in the factory.	R1 200	R1 400 (held as old trading stock)
A Tag Heuer watch as award for the last 10 years of service to Leebya	R27 000	R21 000 (specially designed for Mr Robertson)
A monthly allowance to cover transport expenses. Refer to **Note 1** below	N/A	R4 800
A R650 000 loan received from the bank on 31 March 2021. Mr Robertson owes interest at 5% p.a. below the prime interest rate. Leebya to pay an additional portion. (refer to **Note 2** right)	Prime interest rate: Up till 31/8/2021: 10% pa From 1/9/2021: 11% pa	**Note 2:** 3% pa of the loan capital

Note 1: Mr Robertson used the allowance to cover the purchase and running costs of an Audi A1. The car cost him R225 000. He paid R12 000 for running costs (which included fuel) during the year. This did not cover the servicing of the car, for which he does not pay. A detailed log book was kept, which indicated that 7 500km out of 25 500km in total was travelled for business purposes.

Additional information:

- Mr Robertson contributes 8% of his salary to a provident fund.
- Mr Robertson also contributes R1 200 monthly to a medical aid fund. An additional R9 500 was spent on medical costs not covered by the medical aid. Mr Robertson is a widower (i.e. his wife is dead) and has no dependants.
- He gave R55 000 to a local charity that provided him with a valid s18A certificate.
- The official rate of interest was 8.5% p.a. throughout the 2022 year of assessment.

YOU ARE REQUIRED TO:

1. Explain the relationship between fringe benefits, allowances and gross income with respect to:
   a) the calculation of taxable income, and **(2 marks)**
   b) the calculation of remuneration **(2 marks)**

2. With regards to the travel allowance, determine which reduction method Mr Robertson should use to obtain the greatest tax advantage. Provide detailed numerical support. **(9 marks)**

3. Calculate the cash equivalents of all the fringe benefits Mr Robertson receives. **(9 marks)**

4. Calculate Mr Robertson's taxable income for the year of assessment ended 28 February 2022. Your solution must also include an explanation for any items mentioned in the scenario of the question above that you have specifically excluded from your calculation. **(14 marks)**

SHOW ALL WORKINGS

1.10.2 MR ROBERTSON – SUGGESTED SOLUTION

1. a) Gross income includes fringe benefits as a special inclusion under paragraph (i). **1**
Allowances (net of reductions for business use) are included in taxable income. **1**
Gross income is the starting point of the calculation of taxable income. **1**

b) Remuneration does not include gross income *per se* but rather all gross income amounts related to services rendered. **1**
Remuneration includes fringe benefits, non-reimbursive allowances and 80% of the travel allowance. **1**
Max4

2. Which reduction method to use for the travel allowance

Actual mileage with actual expenditure

Total kms			25 500	
Private kms			(18 000)	
Business kms			7 500	
Actual expenditure:				
Running costs			12 000	**0.5**
Wear & tear	R225 000/7 years		32 143	**1**
Note that the wear & tear must be spread over 7 years			44 143	
Predicted reduction of allowance:	7 500/25 500 x R44 143 =		12 983	**1**

Cannot choose to use 382 cents/km
This is because the allowance is not a reimbursive allowance **2**

Actual mileage with deemed expenditure

Deemed expenditure:				
Fixed cost from table (based on R225 000)		75 039		**0.5**
Fixed cost in cents per km	75 039/25 500	294.27		**1**
No maintenance - not paid for by taxpayer		0.00		**0.5**
Fuel		126.30		**0.5**
Reduction in cents per km		420.57		
Projected reduction in travel allowance (7 500 x 420.57 cents)			31 543	**1**

	Therefore Mr Robertson should use actual kms with deemed expenditure method				1
3.	Fringe benefits cash equivalents				
	Fireman's clothing:				
	Lower cost / market value		1 200		1
	reduced by lesser of: (bravery award)	5 000			
	and aggregate costs of all bravery awards	1 200	(1 200)	0	0.5
	Watch:				
	Lower cost / market value		21 000		0.5
	reduced by lesser of: (long-service award)	5 000			1
	and aggregate costs of all long-serv. awards	21 000	(5 000)	16 000	
	Low interest loan / subsidy:				
	Loan: 1 April - 31 August				
	Employee 5% + Employer 3% < official rate 8.5%, therefore low interest loan				1
	Low interest loan (8.5% - 5%) x R650 000 x 153/365			9 536	2
	Loan: 1 September - 28 February				
	Employee 6% + Employer 3% > official rate 8.5%, therefore subsidy				1
	Subsidy 3% x R650 000 x 181/365			9 670	2
4.	Taxable Income				
	Salary	R22 000 x 12		264 000	1
	Fringe benefits	bravery	0		
		long-service award	16 000		
		low interest loan	9 536		
		subsidy	9 670	35 206	1
	Travel allowance R4 800 x 12		57 600		1
	Reduction (ltd to actual)		(31 543)	26 057	1
				325 263	
	s11F contributions to a provident fund	264 000 x 8%	21 120		
	Ltd to the lesser of:				
	350 000, and				
	27.5% of the greater of				
	Remuneration (264 000 + 35 206 + 80% x 57 600)		345 286		
	Taxable income		325 263		
		27.5%	94 953		
	Taxable income 325 263				
	Therefore all deductible			(21 120)	1
				304 143	
	s18A donations R55 000 ltd to				1
	10% x R304 143			(30 414)	1
	Taxable income			273 729	
	Normal tax per the tables (38 916 + 26% x (273 729 – 216 201)			53 873	1
	Less primary rebate			(15 714)	1
	Less s6A rebate	332 x 12		(3 984)	1
	Less s6B rebate				

Contributions	(1 200 x 12)	14 400		**1**
Less 4 x rebate	(4 x 3 984)	(15 936)		**1**
	Limited to	0		
Qualifying medical expenditure		9 500		**1**
Less 7.5% of taxable income		(20 530)	0	**1**
Tax liability			34 175	**35**

CHAPTER 2

PASSIVE INCOME, EXEMPTIONS AND DEDUCTIONS

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2.1 INTRODUCTION

Chapter 1 introduced income tax from the point of view of an individual who only earns income from employment. However, that is not the only income that a person can earn. What about investing the money that you save each month? There are many investments available that would all earn some form of return. A bank account earns interest; a share's return is both capital appreciation and dividend income. An annuity pays a monthly amount over a period of time.

Chapter 2 looks at this 'passive income' and illustrates how it will be taxed.

The chapter will look at the gross income definition: all the components and their application. While this area of tax is very reliant on case law, this book will not discuss each case in great detail. The conclusions reached by the courts on the application of the gross income definition will be highlighted and discussed.

SARS provides taxpayers with some concessions based on the type of investment income they earn. There are interest and dividend exemptions. Intellectual property that has been developed and that now earns income may also be exempt under certain circumstances. Purchasing an annuity that pays a set amount per period is also not necessarily all taxable.

Chapter 2 concludes with a detailed taxable income calculation indicating how the concepts taught in the chapter fit into the bigger picture of an individual's tax liability calculation.

Learning Objectives

By the end of the chapter, you should be able to:

- Understand all the components of the gross income definition and be able to apply the definition to different types of income.
- Calculate the non-residents' and natural persons' interest exemptions.
- Apply the dividend exemption.
- Understand the concept of an annuity and the impact on the interest and dividends exemptions when dividend and/or interest income is received in the form of an annuity.
- Understand the interaction between the royalties' exemption and the withholdings tax on that income.
- Calculate the exemption for both parts of a purchased annuity – the periodic amounts and the lump sum commutation.

2.2 GROSS INCOME

The starting point in the income tax calculation is gross income. The gross income definition is one of the most important definitions in the Act. Gross income is defined in section 1 as follows:

> **"Gross income",** in relation to any year or period of assessment, means –
>
> (i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
>
> (ii) in the case of any person other than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within or deemed to be within the Republic,
>
> during such year or period of assessment, excluding receipts or accruals of a capital nature, […]

The definition then goes on to list certain specific inclusions (some of which are discussed in the relevant chapters).

In this section we analyse and explain the components of this definition, i.e.

- the total amount
- in cash or otherwise
- received by or accrued to, or in favour of, a person
- from anywhere, in the case of a person who is a resident
- from a South African source, in the case of a non-resident
- other than receipts or accruals of a capital nature.

All of these criteria must be present before an amount can be treated as gross income in the hands of a person. So, for example, while the proceeds from the sale of a domestic dwelling constitute 'an amount received or accrued in cash or otherwise' such a receipt would normally be of a capital nature and, therefore, would not fall into gross income. (The taxable capital gain, however, may be included in "taxable income" – see Chapter 6 on capital gains tax).

Except for "resident" and "year of assessment", the various terms in the gross income definition are not defined. For this reason the courts have been called upon, on numerous occasions, to interpret their meaning. In deciding whether or not a particular amount constitutes gross income it is important to be familiar with the principles attaching to these undefined terms.

As a "resident" is defined and the "source" concept is only applicable to non-residents (in the context of gross income), these terms are left to the end of this section on gross income.

2.2.1 TOTAL AMOUNT

There must be an actual amount received or accrued before gross income arises. If the taxpayer receives something, which is an asset, and this asset has a value, then there is an amount for the purposes of the gross income definition. This principle comes from a 1926 case, *Lategan v CIR*.

The mere fact that the amount is difficult to determine does not necessarily mean that there is no amount.

There must be an actual amount. This means that notional amounts cannot constitute gross income. For example, if a person has money in his possession which does not earn interest, he cannot be subjected to tax on the notional interest which he could have earned had he invested his money in an interest-bearing investment. Merely holding money does not give one a right to interest. The amount received or accrued either has to be in the form of cash, or in the form of an asset.

2.2.2 IN CASH OR OTHERWISE

The second element of the gross income definition is that the amount received or accrued must be in cash or otherwise.

In other words it is not only receipts and accruals of money that could fall into gross income. Barter transactions could give rise to gross income, as long as the asset received is capable of being valued in money terms.

Example – Cash or otherwise

Mr C, an architect, designed all the houses in a golf course development, as well as the golf course and the golf clubhouse, in return for being given one of the houses once it was built. Assume that the accrual takes place when Mr C receives transfer of the house and that the value of the house at the date of transfer is R2,8 million.

Mr C's gross income is R2,8 million.

Note that where a receipt is in a form other than money it has to be valued at the earlier of the date of receipt or accrual.

The general principle, therefore, is that in situations where an amount is received or is to be received in a form other than money (or a money debt), the amount of gross income is established by ascertaining the market value of the taxpayer's right, at the date the taxpayer becomes entitled to the asset to be received.

2.2.3 RECEIVED BY OR ACCRUED TO

The third component of the gross income definition is the receipt or accrual of the amount.

Unlike the first two criteria, this is mainly related to time, and establishes the particular tax year in which the gross income arises. As the words suggest, there are two ways in which income may arise in a taxpayer's hands; it may be received by him or it may accrue to him (i.e. be due to him).

In many instances, the receipt and accrual of an amount will happen at the same time. In other situations the amount may accrue to the taxpayer prior to receipt. In the third type of transaction receipt may precede accrual. This situation is less common than the previous two and would occur, for instance, when, in terms of a contract, an amount is received by the taxpayer as an advance payment in respect of services to be rendered by him at some time after the payment, or a deposit is received in advance of the sale of a good or the supply of a service.

In terms of the wording in the Act, the Commissioner must include an amount in the taxpayer's gross income either when it is received, or when it accrues, but he may not include it both when it accrues and when it is received. In practice, gross income arises at the earlier of:

- the date of receipt; or
- the date of accrual.

An amount is received by a taxpayer only if it is received by him on his own behalf for his own benefit. In *Geldenhuys v CIR* (1947 CPD), the taxpayer, who had a right to use a flock of sheep, sold the sheep. As the taxpayer did not own the sheep, the amount received was not for the taxpayer's own benefit and hence was not included in gross income. This can be contrasted against *CIR v Witwatersrand Association of Racing Clubs* (1960 AD) where the Association held a charity event for the benefit of charities. As the Association had no obligation to pay the charities the amounts they received, the court decided that the amount was received for their own benefit and must be included in gross income.

It is important to note that an amount which is received by a person for his own benefit falls into his gross income, notwithstanding the fact that the amount has not yet accrued to him. Amounts which are stolen do not constitute a receipt, being a unilateral taking which confers no right on the thief. However, where a shop owner overcharges a customer, such amount overcharged does constitute an amount received. The situation in which a person steals money can be distinguished from the situation in which a person, in the course of his trading activities, fraudulently overcharges his customers. In the first case the amount is not received by the taxpayer and does not fall into his gross income, because there is no transaction (contract). In the second case the amount is received and does fall into gross income, as it has been received by virtue of a contract (agreement). In our law the term 'receipt' does not envisage a unilateral receipt. There have to be two parties, a giver and a recipient.

It is important to distinguish between a receipt for tax purposes and a receipt on loan account, which is traditionally seen as capital. If, upon receiving money, a taxpayer immediately comes under an obligation to repay it (whether then or in the future), the amount is not a receipt for tax purposes. This is different from a prepayment, however. Upon receiving an amount in advance, the taxpayer does not have to repay it, but has to deliver the goods or supply the services in respect of which the amount has been received. Therefore, an amount received in advance (i.e. before it accrues) is a receipt for tax purposes. It is only if the goods are never supplied, or the service is never rendered, that the obligation to repay the money arises.

From *Mooi v SIR* (1972 AD), an amount "accrues" to a taxpayer once he becomes unconditionally entitled to receive it.

Section 7(1) of the Act states that 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.

Example of accrual

Note: In both cases the taxpayers have February year ends.

(1) The sale and delivery of goods, by a person, in terms of a credit sale, takes place on 1 February 2022, with payment to be made on 30 March 2022.

Because a valid contract of sale has been concluded on 1 February 2022 and delivery has taken place the seller becomes entitled to the payment at that date. Accrual, therefore takes place on 1 February 2022 and not on 30 March 2022, and the amount will be taxed in the year ended 28 February 2022.

(2) The sale of goods on credit on 1 February 2022 with delivery to take place on 1 March 2022 and payment on 30 March 2022. The agreement is that the seller has to perform first (he must deliver the goods before he becomes entitled to the selling price).

Here the seller does not become entitled to the purchase consideration until delivery takes place on 1 March 2022. Accrual date will therefore be 1 March 2022, and the amount will be included in the taxpayer's tax return for the year ended at the end of February 2023.

The value of an accrual is the market value of the asset received, or the face value of the debt.

The proviso to the gross income definition states that if the taxpayer becomes entitled to any amount payable at a future date, that amount is to be treated as the value of the accrual. This means that the taxpayer may not calculate a discounted value of the debt and include that discounted present value of the future receipt in his gross income.

Example – Proviso to gross income definition

Mr Jones renders a service to ABX (Pty) Ltd on 15 February 2022. ABX agrees to pay Mr Jones R10 000 for the service, but the amount is only payable on 15 February 2028 (10 years later). The present value of R10 000 to be received in 10 years' time is, say, R4 000. This means that if Mr Jones had to sell the debt to a bank today, he would only be paid R4 000 for it.

Notwithstanding the fact that the commercial value of the accrual is R4 000, Mr Jones must include the full R10 000 (face value) in gross income for his year of assessment ended 28 February 2022.

2.2.4 CAPITAL

The final component (excluding residence and source) of the general definition of gross income is the exclusion of receipts or accruals of a capital nature. For example, if Mr A sells his house in Cape Town for R500 000, the amount received will, under normal circumstances, not fall into his gross income because it is a receipt of a capital nature.

Receipts or accruals of a capital nature are specifically excluded from the gross income definition and are therefore not subject to normal tax, unless a specific inclusion requires a particular type of capital receipt to be included in gross income (see other chapters).

If a capital receipt is not included in gross income, it is dealt with under the capital gains tax provisions contained in the Eighth Schedule (capital gains tax is dealt with in Chapter 6).

Example – Capital receipt

Mrs Black purchased shares for R10 000 on 1 October 2019. On 31 August 2021 she sells the shares for R36 000.

(i) If Mrs Black purchased the shares to use as trading stock, the receipt or accrual is not of a capital nature and the full selling price of R36 000 falls into Mrs Black's gross income. She will be allowed a deduction of the cost of the shares (R10 000) and will be taxed on R26 000.

(ii) If Mrs Black purchased the shares for investment purposes, the receipt or accrual is of a capital nature and the R36 000 will not be included in gross income. However, in terms of the provisions of the Eighth Schedule, a portion of the capital gain will be included in Mrs Black's taxable income (see Chapter 6).

The Act has not attempted to define the term ‘of a capital nature’ and in cases of uncertainty, it is left to the courts to decide whether or not a receipt or accrual is of a capital nature. The capital or revenue nature of receipts and accruals has probably been the subject of more case law than any other aspect of tax, which means that there is a substantial wealth of legal precedent on which to rely when making a decision as to the capital or revenue nature of income. The principles stemming from these decisions are outlined below.

Nature of the receipt

Income that is received by, or accrues to, a person is either of a capital nature or of a revenue nature. If it is capital it does not fall into gross income; if it is revenue it is included in gross income. It is normally not possible to have one amount of income which is partly capital and partly revenue (however, there are cases where apportionment is appropriate). In many instances very little difficulty is encountered in deciding the nature of income. For example, interest income or rental income is clearly income of a revenue nature. There are, however, situations where the classification becomes somewhat subjective.

Generally, a revenue receipt is the income that arises, in the context of passive income, from the employment of capital, either by using it or by letting it. If an amount is received every year, this would normally be an indication that it is income (revenue) and not capital. An exception would be where a capital amount is payable in instalments.

The decision as to whether an amount is capital or revenue usually arises when an asset is disposed of, or a right is given up or transferred. If the asset is a revenue asset (like trading stock) the amount received on its sale is revenue. If the asset is a capital asset (like a holiday house) the amount received on its sale is capital.

Sale of assets

How then do we distinguish capital receipts from revenue receipts in the case of sale? An analogy which is often used, and which serves to illustrate the principle very well, is that of a tree and its fruit. It is clear that income is inevitably generated by a capital asset, and that the income so generated is of a revenue nature. So, for example, when money (the tree) is invested in a bank, it gives rise to interest (the fruit). A person who places money in a financial institution will, therefore, be taxed on the interest he receives, because it is of a revenue nature, and will not be taxed on the withdrawals of his investment, because this represents his capital. The rule is thus fairly simple; namely that income is produced by an income-producing asset and that such income is of a revenue nature, while the income on the sale or redemption of the income-producing asset itself is of a capital nature.

The problem that arises is that it is often difficult to establish which is the income-producing asset and which is the income. This problem arises on the sale of an asset, because different people hold assets for different purposes.

Example – Capital v Trading stock

A vintage car owner rents his car to wedding parties. The rent is gross income, but the proceeds on sale, if he were to sell the car, would be capital.

Contrast the vintage car owner with the vintage motor dealer from whom the owner bought his car. To the dealer the cars are his trading stock. The motor dealer deals in such items to make a profit and the sale of a car will, therefore, result in a revenue receipt in his hands.

In the light of this example it should become apparent that the real problem lies not so much with the actual asset, but rather with the way in which the owner of the asset deals with it or perceives it. In other words, his intentions regarding the asset are important, since one person may intend to hold an asset as an income-producing asset (capital asset), while another may choose to be a dealer in the asset for the purposes of making a profit (revenue asset). In some cases a person may hold a number of a particular type of asset, some as capital and some as revenue.

Example – Capital and revenue

Mr X buys 10 houses to let and 11 houses for resale. The 10 houses are capital assets in Mr X's hands (because they will produce rental income), and the 11 houses are revenue assets (because they are held for resale).

Intention

The dominant intention with which a taxpayer acquires an asset determines whether it is capital or revenue. This is the primary test of the nature of the receipt.

The rule as it was developed in *CIR v Stott* (1928 AD) is firstly that the intention of the taxpayer at the date of acquisition must be established, and secondly that it is then possible to have a change of intention in the intervening period prior to the sale of the asset. The intention which the taxpayer may have at the time of acquisition may be one of the following:

- **Investment**

To acquire and hold the asset as an income-producing asset, i.e. to earn a flow of future income. An asset which is acquired with this intention is a capital asset and, in the absence of a change of intention, the disposal of such an asset will give rise to a receipt of a capital nature.

- **Speculation**

To acquire the asset for the purpose of making a gain by selling the asset in a scheme of profit-making. In other words, the intention is not to use the asset as an income-producing asset, but rather to realise the profit inherent in the asset. This is often referred to as having a 'speculative intention'. The asset is, therefore, acquired as trading stock with the intention of resale at a profit. The sale of such an asset will give rise to a receipt or accrual of a revenue nature. This principle was developed in *CIR v Pick 'n Pay Employee Share Purchase Trust* (1938 AD)

It is possible that at the time of acquisition the taxpayer may have mixed intentions, having contemplated both investment and speculation. In such cases it is necessary to establish the dominant intention. The taxpayer's actions vis-à-vis the asset subsequent to acquisition may indicate the dominant intention. If no intention is dominant, or the taxpayer has alternative intentions, the asset will be treated as a revenue asset.

Intention of a natural person

The intentions of a natural person are to be found in his or her state of mind at the time. It is therefore necessary to establish the state of mind of such a person in an attempt to establish intention. The only way in which this can be done is to ask the person what their intention was.

Unless other factors discredit the taxpayer's stated intention, it will be conclusive. Clearly, in situations where the actual facts of the case are in conflict with the taxpayer's evidence, little reliance will be placed on his statement.

Intention of a company

Where the taxpayer is a company it is normally easier to establish intention. The commercial activities of a company are more formally regulated than those of an individual. The intentions of a company are determined by its formal acts, i.e., the acts of the directors as evidenced by minutes of directors' meetings; the memorandum of association; the articles of association; and the resolutions of the members. The greatest weight is usually attached to the actions of the directors.

Caution should be exercised in placing too much reliance on the objects clause in the memorandum. The objects clause may give guidance, but is not in itself conclusive. If a company is empowered by its memorandum to engage in a particular type of transaction this does not necessarily mean that the income resulting from such a transaction is automatically taxable. The memorandum will merely be one of the additional factors relied on by the court to enable it to reach its decision.

Continuity

One of the major differences between a company and an individual lies in the question of the relevance of continuity. In the case of a company, the fact that a transaction is isolated will not necessarily indicate a capital intention, which it may do in the case of an individual; the reason being that there is a presumption that a company is formed for the purpose of carrying on business and that any act is, therefore, likely to be undertaken with a business motive. In the case of an individual the absence of continuity is accepted as one of the subsidiary tests which may add weight to the taxpayer's contention that his intention was capital. It should be noted, however, that where the intention of an individual is patently of a speculative nature the argument that it is an isolated transaction will not sway the court.

Change of intention

A change in the taxpayer's intention can lead to a change in the nature of an asset from capital to revenue and vice versa.

Having established the intention with which the asset was acquired, it is then necessary to determine whether there has been a change of intention prior to the disposal of the asset. A person may, for example, acquire land with the intention of using it for his domestic dwelling (a capital intention) and, if he does in fact use it for the original purpose envisaged, the subsequent sale will result in a capital accrual. It is, however, possible that, during the intervening period, he becomes aware of the economic potential of the property and, in an attempt to maximise this economic potential, sets about dealing with the property as a land dealer would. What has happened is that an asset, which was originally acquired as a fixed asset, has, by the actions of the taxpayer, been converted into trading stock. It should be noted, however, that the mere fact that a capital asset is sold at a profit does not in itself indicate a change of intention. The taxpayer is entitled to realise the asset to their best advantage – *CIR v Stott* (1928 AD). Something more is required to indicate that the owner is engaged in a scheme of profit-making. It is important, therefore, to establish whether it is the profit which motivates the sale or whether it is the sale which results in the profit. The former may constitute a change of intention, while the latter does not.

What is the 'something more' that must be done to bring about a change of intention? In the context of a company selling land the courts, including the judgment in the case of *Natal Estates Ltd v SIR* (1975 AD) have suggested consideration be given to the following, together with any other relevant factors:

- the activities of the owner in relation to his land up to the time of deciding to sell it in whole or in part
- whether such activities confirm or contradict the taxpayer's stated intention
- the planning, extent, duration, nature, degree, organisation and marketing operations undertaken.

A change of intention by the taxpayer has capital gains tax implications as well as gross income implications. Where, due to a change of intention, a capital asset is converted into a revenue asset, it must be valued, and this value must be treated as proceeds on the deemed disposal of the capital asset at the time of the change in intention. This value then becomes the cost of the taxpayer's trading stock.

2.2.5 RESIDENCE

South Africa has a 'residence' basis of tax. The residence basis of tax means that South African residents are taxable on their worldwide income, regardless of the source of that income.

A resident is defined in section 1 of the Income Tax Act as either:

- A person who is "ordinarily resident" in South Africa. In other words, South Africa is his or her true home.
- A non-resident who has spent a certain number of days in South Africa, i.e.
  - more than 91 days in total in each of the current and previous five tax years, and
  - more than 915 days in total during the previous five tax years.

  The days need not be consecutive.

Note that this "days test" or "physical presence test" only applies to persons who are not ordinarily resident at any time during the year of assessment. If a person ceases to be ordinarily resident in a particular year then the physical presence test cannot be applied to the remainder of that year.

If a person who is a resident in terms of the physical presence test leaves South Africa for a continuous period of 330 full days, he or she is deemed to be no longer resident from the first day of the 330-day period.

A juristic person (company, close corporation) or trust is deemed to be a resident of South Africa if it is incorporated, established, or formed in South Africa, or if it has its place of effective management in South Africa.

Ordinary residence

A person can be resident in more than one country at a time. Residence is a question of fact, and it involves a settled and enduring connection between a person and a place. Residence merely means that a person eats, sleeps, and works at a place with some degree of continuity or permanence. A person can be physically absent from a place from time to time and still be resident there. It is submitted, however, that a person can only be 'ordinarily resident' in one place at a time.

'Ordinary residence' requires an intention to live in a place at a particular point in time, for a significant period, with the place being his or her real home for that time. This intention also has to be carried out. It can mean the place that a person's lifestyle is centred and to which the person regularly returns, if his or her presence is not continuous, as was concluded in *Cohen v CIR* (1946 AD).

'Ordinary residence,' as was discussed in *CIR v Kuttel* (1992 AD), is the place where a person resides in the ordinary course of his or her day-to-day life. SARS Interpretation Note 3 (Issue 2 – 20 June 2018) deals with 'ordinary residence'.

A person does not lose his (or her) ordinary residence in a place by leaving for a temporary purpose. However a person could lose his ordinary residence in a place if he travels to another place to live and work indefinitely, even if he intends ultimately to return to the prior home.

It is important to note that the ordinarily residence test in the definition of resident applies regardless of how many days in the tax year the person is present in the Republic. In other words, ordinary residence is not determined by physical presence. It is in effect a state of mind. A person who is ordinarily resident in South Africa in terms of the principles set out above is a resident as defined, even though he may not be physically present in the Republic for the number of days required by the physical presence test.

Interpretation note 3 says that the following two requirements need to be present for a person to be 'ordinarily resident' in South Africa:

- an intention to become ordinarily resident in a country; and
- steps indicative of this intention having been or being carried out.

The practice note says that determining ordinary residence must be decided on the facts and based on the case law principles. It sets out a list of factors to consider, but adds that the list is not intended to be exhaustive or specific, merely a guideline:

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- An intention to be ordinarily resident in the Republic
- The natural person's most fixed and settled place of residence
- The natural person's habitual abode, that is, the place where that person stays most often, and his or her present habits and mode of life
- The place of business and personal interests of the natural person and his or her family
- Employment and economic factors

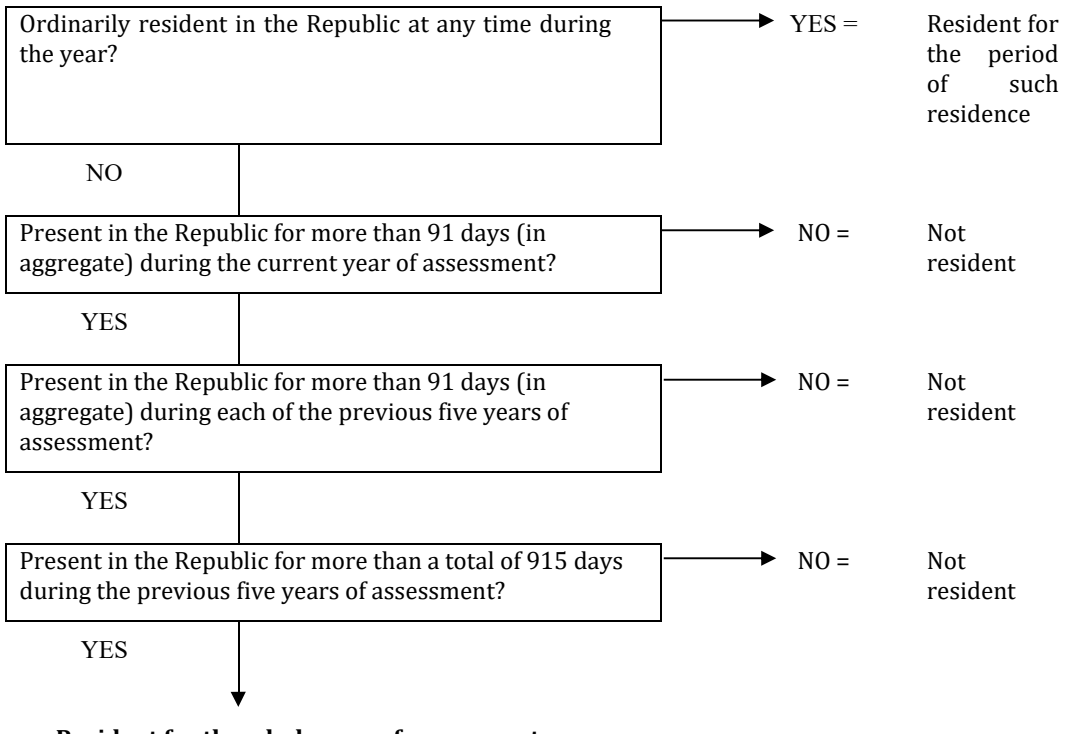
- The status of the individual in the Republic and in other countries, for example, whether he or she is an immigrant and what the work permit periods and conditions are
- The location of the natural person's personal belongings
- The natural person's nationality
- Family and social relations (for example, schools, places of worship and sports or social clubs)
- Political, cultural or other activities
- That natural person's application for permanent residence or citizenship
- Periods abroad, purpose and nature of visits
- Frequency of and reasons for visits

Physical presence

If a person is not ordinarily resident in the Republic at any point during a year of assessment, he will be treated as resident for tax purposes during that year if he spent a prescribed amount of time in the Republic.

> Such a person will fall within the definition of resident if the person is in the Republic for more than **91 days** in aggregate during the current year of assessment and was in total during the preceding five years of assessment physically present in the Republic for a period exceeding **915 days** and was physically present in the Republic for a period exceeding **91 days** in aggregate in each of such five preceding years.

The physical presence test of residence must be done each year, and may be represented as follows:



In the first year of assessment that a person fulfils the physical presence requirements, he or she is deemed to be a resident from the first day of that year of assessment.

A person who falls into the definition of resident because of physical presence in South Africa will cease to be a resident on the day that he leaves South Africa if he remains outside the Republic for a continuous period of at least 330 full days, counting from the day after he leaves the Republic. A full day runs from after midnight to the following midnight. It should be noted that the 330 days absence test does not apply to persons who are resident in the Republic because of the ordinarily resident test.

A day includes a part of a day. It does not include any day that a person is in transit through the Republic between two places outside the Republic and that person does not formally enter the Republic. (Through a "port of entry" as contemplated in section 9 (1) of the Immigration Act, 2002, or at any other place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs in terms of that Act.)

Example – Less than 91 days in current year

Mr V came to South Africa from Angola on 15 November 2015 to work temporarily for a mining equipment company. His wife and children stayed in Angola, and he returned to visit them for one month a year (July). Due to the nature of the work, his contract and his visa were extended and the only times he spent out of South Africa were for the month that he returned to Angola. His contract terminates on 15 April 2021. For what period will Mr V be deemed to be resident in South Africa on the basis of the physical presence test?

For each of the years of assessment, Mr V spent the following number of days in South Africa:

- 2016: 106 days
- 2017: 335 days
- 2018: 334 days
- 2019: 334 days
- 2020: 334 days
- 2021: 335 days
- 2022: 46 days

Mr V is therefore resident in South Africa from 1 March 2020 to 28 February 2021 because he was in South Africa for more than 91 days in that year and more than 91 days in each of the 2016 to 2020 years of assessment, and for more than 915 days in aggregate over the period of 5 years ending on 28 February 2021.

As Mr V was deemed a resident in the 2021 year of assessment, he will for future years remain resident in South Africa until such time as Mr V spends 330 full days outside of South Africa. In this case, Mr V left on 15 April 2021 and did not return. He will therefore be deemed to be non-resident from 16 April 2021 (the first full day outside of South Africa).

However, say that once he returns to Angola, he talks to his wife and children and they all decide to move to South Africa permanently. With this intention in mind, they return to South Africa on 1 November 2021 and settle here.

They would then become resident in South Africa from 1 November 2021 under the 'ordinary residence' test. As they would then be ordinarily resident for part of the 2022 year of assessment, the days test would not apply, so even though Mr V was physically present in South Africa for more than 91 days in the 2022 year of assessment, as well as in the previous 5 years of assessment, and he exceeded the 915 day rule for the previous 5 years, he will not be deemed to be resident in South Africa for the *whole* of the 2022 year of assessment, but only from 1 November 2021.

If Mr V had left South Africa on 10 June 2021, say, he would have spent more than 91 days in South Africa in the 2022 year of assessment and would be deemed to be resident in South Africa from the beginning of that year (i.e. from 1 March 2021). If, on leaving on 10 June 2021, he stays out of South Africa for a continuous period of 330 full days, he would be deemed not to be a resident from 11 June 2021 onwards.

SARS issued Interpretation Note 4 (Issue 5) on 3 August 2018, setting out its view on the physical presence test. In that note it states that a day begins at 00:00 and ends at 24:00. Therefore, a person who arrives in the Republic through a port of entry at 23:55 would be regarded as being physically present in the Republic for a day.

Example – More than 91 days in current year

Assume that Mr V (referred to in the example above) was in South Africa as a non-resident from 2017 to 2022, spending the following number of days in South Africa:

- 2017: 106 days
- 2018: 335 days
- 2019: 334 days
- 2020: 334 days
- 2021: 334 days
- 2022: 335 days

Mr V is therefore resident in South Africa from 1 March 2021 to 28 February 2022 because he was in South Africa for more than 91 days in that year and more than 91 days in each of the 2016 to 2021 years of assessment, and for more than 915 days in aggregate over the period of 5 years ending on 28 February 2021.

He then leaves South Africa on 10 June 2021. At that time he would have spent 102 days in South Africa, and if he did not leave for a continuous period of at least 330 full days (11 June 2021 to 6 May 2022) he remain as a deemed resident in South Africa for the whole 2022 year of assessment.

Companies and other non-natural persons

A company, etc. will be treated as resident in the Republic if it –

- is incorporated in the Republic; or
- is established in the Republic; or
- is formed in the Republic; or
- has its place of effective management in the Republic

The definition of resident in the case of persons other than natural persons is very wide, in that all of the requirements are alternatives. This means, for example, that a company which is incorporated in South Africa is a resident irrespective of where its place of effective management is. Conversely a company which has its place of effective management in South Africa is a resident irrespective of where it is incorporated.

2.2.6 SOURCE

Non-residents are taxed in South Africa on the source basis.

In the absence of a legislative rule for source, the source of income is where it has its origins. Although 'source' in such cases is a question of fact, it is not always easy to establish.

The principal test of source as formulated in *CIR v Lever Brothers and Unilever Ltd* (1946 AD), requires two factors to be established:

- the originating cause of the income, i.e. what gives rise to the income; and
- the location of that originating cause.

Example – Rendering of services

Mr A receives R1 000 for the services rendered in Johannesburg. The originating cause of the R1 000 accruing is the rendering of a service, and because the service was rendered in Johannesburg the income is from a Republic source. It can be seen that the conclusion as to the source of the income results from the answers to two questions -

(i) What gives rise to the income? - The rendering of the service.

(ii) Where was the service rendered? - Johannesburg.

Where there is more than one originating cause, it is necessary to establish which is the *dominant* cause. There is no apportionment of source in South African law.

2.2.7 SOURCE IN TERMS OF SECTION 9

Because of the subjectivity that is otherwise inherent in determining source, section 9 of the Act legislates rules for source.

The passive income source rules may be summarised as follows:

Dividends

A dividend is from a South African source if it is a 'dividend' as defined in section 1 of the Income Tax Act (section 9(2)(a)). Since this definition is limited to amounts paid by South African resident companies, only a dividend from a South African company is deemed to be from a South African source.

Foreign dividends (i.e. those that do not meet the Income Tax Act definition of 'dividend') are not from a South African source (section 9(4)(a)).

Interest

Interest is from a South African source if or to the extent that:

- the interest is incurred by a resident, or
- the interest is earned on funds invested or used in South Africa – section 9(2)(b).

If interest accrued does not meet either of the criteria above, it is not from a South African source – section 9(4)(b).

Sections 50A to 50H subjects interest that is earned on funds invested or used in South Africa to a 15% withholding tax if paid or accrued to a non-resident. Interest paid to a South African resident is not subject to the withholding tax, because they are taxed in full on their worldwide income.

Sections 50A to 50H are not applicable if:

- the interest is paid/accrued from the South African government or a bank in South Africa, or
- the non-resident is a natural person who was physically present in the Republic for more than 183 days during the 12 month period prior to the interest being paid, or
- the non-resident has earned interest as part of a permanent establishment and the non-resident is a taxpayer in the Republic.

Royalties

A royalty is from a South African source to if or to the extent that:

- the royalty is incurred by a resident – section 9(2)(c), or
- the royalty is received or accrued in respect of the use or right of use of any intellectual property within the Republic – section 9(2)(d).

If a royalty accrued or received does not meet either of the criteria above it is not from a South African source – section 9(4)(c).

Sections 49A to 49H subject royalties from a South African source and paid to a non-resident to a 15% withholdings tax. In terms of section 49B, the withholding tax is 15% if paid to a non-resident. Royalties paid to a South African resident are not subject to the withholding tax, because they are taxed in full on their worldwide income.

2.3 PASSIVE INCOME EXEMPTIONS

Having determined gross income, the next step is to determine if any of this income is exempt from tax. If an amount is exempt it is subtracted from gross income in order to arrive at income, as follows:

	GROSS INCOME	XXX
Less	EXEMPT INCOME	(XXX)
	INCOME	XXX

The exemptions are set out in sections 10 and 10A to 10C of the Act. It is important to note that section 10(3) provides that the exemptions granted in section 10(1) do not extend to the subsequent payments out of the exempt amounts (such as a salary paid out of exempt income), nor do the exemptions apply to any capital gains, as these are determined in terms of the 8th Schedule and included at the level of 'taxable income' (see Chapter 6). The exemptions also only apply in respect of normal tax. If an amount is exempt from tax, it cannot be subject to 'capital gains tax'. Once the exempt income is taken out of 'gross income' it has been accounted for and cannot be brought into account anywhere else in the calculation of normal tax.

Basically, there are two categories of exemptions:

- Income that is exempt from normal tax. This can be income that is totally exempt from normal tax, such as most South African dividends or South African interest earned by non-residents, subject to some conditions. There is also income that is partially exempt from normal tax, such as interest earned by natural persons up to the prescribed limit of the exemption. The tax-free savings regime for natural persons is not considered in this chapter.
- Entities that are exempt from normal tax, such as charities. Such entities are not considered in this book.

2.3.1 NON-RESIDENT'S INTEREST EXEMPTION

Section 10(1)(h) provides for an exemption in respect of South African source interest which is received by or accrued to a non-resident.

The section provides for an exemption of;

- interest received or accrued during any year of assessment
- by or to a person who is not a resident
- unless that person

(i) is a natural person who was physically present in the Republic for more than 183 days in aggregate during the 12-month period preceding the date on which the interest is received by or accrued to that person; or

(ii) the debt from which the interest arises is effectively connected to a permanent establishment in the Republic.

The exemption applies to all non-residents (individuals, companies, or trusts). It does not apply to interest which is paid by way of an annuity (section 10(2)) – for example, where a trust pays a non-resident beneficiary an annuity out of interest it earns, the annuity is taxed in the hands of the beneficiary, if it is from a South African source.

There is also the withholding tax of 15% on certain South African source interest paid to non-residents, in terms of s50A – s50H. As these provisions are outside of normal tax, the tax is applicable to this interest exempted from normal tax.

Example – Resident and non-resident

Mrs M was ordinarily resident in South Africa for part of the 2022 tax year. When she left South Africa, she settled in Brazil, becoming ordinarily resident in Brazil with effect from the day after she left South Africa. She received interest on a fixed deposit in South Africa for the whole year. The interest was paid at the end of each month, and amounted to R11 000 per month. Therefore, for the year of assessment ended 28 February 2022, she received interest of R132 000. This was her only income for the year.

Mrs M is 50 years old. Calculate her gross income and income assuming that she left South Africa

(a) on 4 November 2021; or

(b) on 31 May 2021.

(a) Gross income	R132 000
Basic interest exemption – s10(1)(i)	(R23 800)
(cannot use s10(1)(h) as inside for more than 183 days)	
Income	R108 200
(b) Gross income	R132 000
Section 10(1)(h) exemption (R11 000 x 9 months)	(99 000)
Section 10(1)(i) domestic interest exemption	(23 800)
Income	R9 200

2.3.2 NATURAL PERSON'S INTEREST EXEMPTION

Section 10(1)(i) provides for an exemption in respect of South African interest up to the following maximum amounts:

- In the case of a person who is 65 years or older R34 500
- In the case of a person who is under 65 years of age R23 800

Example

Mrs Rich, a South African resident who is 68, has the following investment income:

South African dividends (exempt in terms of s10(1)(k))	R40 000
South African interest	R60 000
Foreign interest	R200

Mrs Rich's gross income and exempt income are as follows:

Gross income:	**R**
SA dividends	40 000
SA interest	60 000
Foreign interest	200
	100 200
Exempt income	
SA dividends (s10(1)(k)(i))	(40 000)
SA interest exemption	(34 500)
Income	25 700

2.3.3 SOUTH AFRICAN DIVIDENDS – SECTION 10(1)(k)(i)

With some limited exceptions, South African dividends received by or accrued to or in favour of any person are generally fully exempt from normal tax.

2.3.4 DIVIDENDS AND INTEREST PAID AS AN ANNUITY

Section 10(2) states that the section 10(1)(h) exemption in respect of non-residents' interest, and the section 10(1)(k) exemption in respect of dividends do not apply if the interest or dividends are paid to the person as an annuity.

Example – dividends paid as an annuity

The ABC Trust receives tax-free dividends each year on its large investment portfolio. The trust has an obligation to pay an annuity of R6 000 per month to Mrs Xoli. The income statement of the trust for the year is as follows:

Exempt dividends received	R120 000
Less: Annuity to Mrs Xoli	(72 000)
Amount retained in the trust	R48 000

Mrs Xoli is taxed on the full amount of R72 000 per year, even though it is paid out of dividend income.

2.3.5 ROYALTIES PAID TO NON-RESIDENTS

Section 10(1)(*l*) exempts from normal tax any amount which has been subject to a withholding tax in terms of section 49A. Section 49A to 49H subjects royalties paid to non-residents to a withholding tax of 15%. The withholding tax is a final tax and it is therefore necessary to provide for an exemption to prevent the royalties being taxed a second time.

Section 10(1)(*l*) exempts any amount which has been subject to a withholding tax in terms of section 49A, unless that person

(i) is a natural person who was physically present in the Republic for more than 183 days in aggregate during the 12-month period preceding the date on which the royalty is received by or accrued to that person; or

(ii) at any time during 12-month period preceding the date of the royalty receipt or accrual the underlying intellectual property was effectively connected to a permanent establishment in the Republic.

2.3.6 PURCHASED ANNUITIES

Section 10A exempts a portion of an annuity amount where the annuity has been purchased from an insurer. An annuity amount is defined in the section as "an amount payable by way of annuity under an annuity contract and any amount payable in consequence of the commutation or termination of any such annuity contract".

An annuity contract is:

- an agreement concluded by an insurer and a purchaser in terms of which
  - the insurer agrees to pay to the purchaser (or his spouse or surviving spouse) an annuity (or annuities) until the death of the annuitant or the expiry of a specified term;

  - the purchaser agrees to pay the insurer a lump sum; and
  - no amount will be payable by the insurer other than by way of an annuity
- excluding any annuity payable under the rules of a pension fund, a provident fund or a retirement annuity fund.

A purchaser is:

- any natural person including such person's deceased or insolvent estate; or
- a *curator bonis* of, or a trust created solely for the benefit of, any natural person where the High Court has declared such person to be of unsound mind and incapable of managing his or her own affairs.

Annuities are included in gross income in terms of paragraph (a) of the gross income definition. Also included are amounts received when s10A annuities are terminated or commuted for a lump sum.

Section 10A only applies to individuals and not to companies. The exemption applies to any annuity amount payable to a purchaser or his deceased estate or insolvent estate or his spouse or surviving spouse, or to the deceased estate or insolvent estate of the spouse or surviving spouse. The effect of the section is to divide the annuity into a capital and an income portion. The capital portion or element is exempt, and the person receiving the annuity will only pay tax on the income portion.

The capital element that is exempt from tax is calculated as follows:

$$Y = \frac{A}{B} \times C$$

A = The lump sum paid by the insured for the annuity.
B = The total expected returns of all annuity amounts in terms of the contract.
C = The amount of the annuity. This can be expressed monthly, annually or in total, the capital portion being a fixed percentage of the total annuity.

Any amount payable in consequence of the commutation or termination of the annuity contract purchased from the insurance company is defined as an annuity amount and is included in gross income, paragraph (a). A portion of the lump sum resulting from the commutation or termination of the annuity contract is also exempted. The exemption is calculated using the following formula:

X = A - D
X = The exempt portion.
A = The amount originally paid for the annuity contract.
D = The total of the previously exempt portions of the annuities received under the contract.

Example – Exempt portion of annuity

Mr A, aged 62, purchased an annuity of R200 per month for the next 15 years. The capital sum paid for the annuity was R21 600. He received the first payment of R200 on 1 March 2021. His exemption is calculated as follows:

$$Y = \frac{\text{R21 600}}{\text{15 years x R200 x 12 months}} \times \text{R200} = \text{R120}$$

Therefore, R120 out of every R200 annuity received by Mr A is exempt from income tax.

Example – Termination of annuity

On 1 March 2019, Mr C purchased a 10-year annuity from the ABC Insurance Company. He paid R10 000 for the annuity and, from the end of March, received a monthly annuity of R173,80.

On 1 March 2021, Mr C terminated the annuity, and received a lumpsum of R9 044.

The tax-free portion of the lumpsum is calculated as follows:

1. Total expected receipts (R173,80 x 120 months) = R20 856
2. Capital portion (R10 000/R20 856) = 47,95%
3. Annuities received from 1 March 2019 to 1 March 2021 (R173,80 x 24 months) = R4 171
4. Exempt portion of annuities in (3)

R4 171 x 47,95% = R2 000 = **D**

5. Total originally paid = R10 000 = **A**

6. Exempt part of refund = **A - D** = R8 000 (R10 000 - R2 000)

The taxable portion of the refund is therefore, R9 044 - 8 000 = R1 044

2.3.7 FOREIGN DIVIDENDS

Section 10B provides certain specific exemptions and a general partial exemption in respect of foreign dividends received. The exempt portion of foreign dividends received that are subject to the general partial exemption rule is calculated as follows:

If the person is a company: Foreign dividend x $\frac{8}{28}$

If the person is an individual: Foreign received x $\frac{25}{45}$

The effect of this partial exemption is that the South African Income Tax paid on the foreign dividend will be 20%, which is the same rate as the Dividends Tax on South African dividends.

Example – Foreign dividend income

Investing Ltd is a South African company. On 1 March 2021 Investing purchased shares in a UK listed company, not listed on the JSE. Its total shareholding amounts to less than 10% of that company's issued shares. On 31 December 2021, the UK company declared a dividend equivalent to R2 800. Investing's taxable income in respect of the dividend received is therefore:

Dividend received		R2 800
Less: s10B exemption	R2 800 x $\frac{8}{28}$	(800)
Taxable portion		R2 000
Tax payable at 28%		R560

R560 is 20% of the total dividend originally received.

The s10B specific exemptions are beyond the scope of this book.

2.4 DEDUCTIONS

As the earning of passive income does not, generally, constitute a "trade" for the purposes of the Income Tax Act, most deductions are denied to this form of income. The rental of property does, however, constitute a trade, and therefore qualifies for deductions against the rental income. These deductions are considered in the context of trading deductions in Chapters 4 and 5.

2.5 CONCLUSION

Chapter 2 introduces the concept of gross income from other sources besides an employer. If one incorporates the gross income inclusions and exemptions learnt in this chapter into the tax liability calculation, the result would look similar to:

Gross income s1	
As per the definition, including, but not limited to:	
Salary, commission, leave pay etc	XX
Fringe benefits	
Acquisition of asset at less than actual market value	XX
Right of use of asset	XX
Right of use of motor vehicle	XX
Meals, refreshments and vouchers	XX

Free or cheap services	XX	
Low interest loans	XX	
Subsidies	XX	
Payment of employees' debt	XX	
Medical aid contributions	XX	
Medical costs incurred	XX	
Passive income		
Interest income	XX	
Dividend income	XX	
Royalty income	XX	
Purchased annuity receipts	XX	XXX
Less: Exempt income s10		
Non-resident interest exemption s10(1)(h)	XX	
Natural person interest exemption s10(1)(i)	XX	
Dividend exemption s10(1)(k)	XX	
Royalty exemption s10(1)(*l*)	XX	
Special uniform exemption s10(1)(nA)	XX	
Transfer/relocation costs exemption s10(1)(nB)	XX	
Ship's crew exemption s10(1)(o)(i)	XX	
Employment outside SA exemption s10(1)(o)(ii)	XX	
SA government service exemption s10(1)(p)	XX	
Bursary exemption s10(1)(q)	XX	
Purchased annuity exemption s10A	XX	
Foreign dividend exemption s10B	XX	(XXX)
Income		XXX
Add: Taxable portion of allowances per s8(1)		
Travel allowance inclusion		XX
Subsistence allowance inclusion		XX
Other allowance inclusions (entertainment)		XX
Less: Deductions (mainly s11 to s20 & s23)		
Pension fund deduction s11F		(XX)
Add: Taxable portion of capital gains (s26A)		XX
Subtotal (needed for donations deduction - 10% excess)		XXX
Less: Donations deduction s18A		(XX)
Taxable income		XXX
Tax per the table, based on taxable income		XXX
Less: Rebates		XXX
Tax payable		XXX

2.6 INTEGRATED QUESTIONS

2.6.1 INCLUSIONS IN INCOME (20 MARKS)

In each of the following scenarios, explain what amounts (if any) should be included in the taxpayer's gross income, and whether any exemptions apply.

a. Trading (Pty) Ltd sold trading stock to a customer, Mr Plumber. In return for the stock, Mr Plumber performed maintenance work on the plumbing at Trading's offices. If Trading had to pay for the plumbing it would have cost the company R5 000.

b. Credit (Pty) Ltd owns a chain of fashion retail stores. Customers belonging to the company's loyalty programme are entitled to 60 days' interest-free credit before having to pay for their purchases. At the end of its financial year, Credit has a debtors' balance of R420 000 in respect of customers who are only required to settle their accounts in the following year.

c. Property (Pty) Ltd owns a variety of commercial buildings from which it earns rental income. When the lease on one of its buildings came to an end, Property was unable to find a new tenant. Property therefore sold the building for R700 000.

d. Lending plc is a company based in the United Kingdom. Lending earned interest of R60 000 on a loan that it made to Property (Pty) Ltd to finance the purchase of a building.

e. Gimmick GmbH is a German company that develops new products and licences them to manufacturers. Gimmick licenced its top-selling product to a South African manufacturer for use in South Africa, in exchange for a royalty of 4% of sales. During the current year Gimmick earned royalties of R50 000 from the South African manufacturer, and a total of R2 000 000 from licensees around the world.

2.6.2 INCLUSIONS IN INCOME – SUGGESTED SOLUTION

a. Trading has received something during the year of assessment that is not of a capital nature. The gross income definition includes amounts received, whether in cash or otherwise, as long as a value can be attributed to what has been received. As what Trading has received is something other than cash, the market value of what it has received should be included in gross income. Trading therefore has gross income of R5 000. **3**

b. Credit has debtors of R420 000 due at year-end. It therefore has an amount, in cash or otherwise, that is not of a capital nature. These amounts have not yet been received; the question to be decided is therefore whether or not these amounts have accrued.

In order for an amount to have accrued, it does not have to be 'due and payable'; the taxpayer merely has to have an unconditional right to collect that amount in the future. As Credit has no further conditions to fulfil in respect of these debts, the amount has accrued.

According to the proviso of the gross income definition, this amount is deemed to accrue at its present value. **4**

c. Property has received an amount in cash or otherwise. The question to be decided is therefore whether or not the amount is of a capital nature.

Property's initial intention at the date the building was purchased was to use it to earn rental income. Property's decision to sell the building was not in order to earn a profit but because it could not find a new tenant. Therefore the decision to sell the building did not represent a change of intention to use the building as its trading stock. The amount received is therefore capital in nature and should be excluded from gross income.

Because the amount is capital in nature there may be capital gains tax consequences. **5**

d. Lending has received an amount that is not capital in nature. However, because Lending is not a South African tax resident, it must only include in its South African gross income amounts that have been received from a South African source.

The interest received is from a South African source because it was incurred by a South African resident (section 9(2)(b). Lending therefore has South African gross income of R60 000. **3**

Because Lending is not a South African resident, the interest received will be fully exempt in terms of section 10(1)(h) as long as the company is not carrying on business in South Africa.

In addition, in terms of section 50A, there is a withholdings tax of 15% on this R60 000. This is a final tax.

e. Gimmick has received an amount that is not capital in nature. However, because Gimmick is not a South African tax resident, it must only include in its South African gross income amounts that have been received from a South African source.

R50 000 has been received from a South African source, because it is a royalty that has been incurred by a South African resident (section 9(2)(c)), and because it has been received as a result of granting the right of use of intellectual property in South Africa (section 9(2)(d). Gimmick therefore has South African gross income of R50 000.

The remaining R1 950 000 is deemed not to be from a South African source, because it is neither from a South African resident not for the right of use of intellectual property in South African (section 9(4)(c)).

The amount of R50 000 is subject to a withholding tax of 15%, which must be withheld by the payer and given directly to SARS (section 49A).

Because the amount of R50 000 has been subject to section 49A withholding tax, it is exempt from any further tax in terms of section 10(1)(*l*). **5**

2.6.3 MR KOEBERG (32 MARKS)

Mr Koeberg (age 54, a South African resident and not a provisional taxpayer) is employed by Powerstation (Pty) Ltd ('Powerstation') in Cape Town, South Africa. He has worked for Powerstation for many years and was promoted to line manager in 2017. Mr Koeberg's cash salary, as contracted, is R350 000 for the 2022 year of assessment.

In addition to the salary, he receives the following benefits:

- The use of a mobile phone during work hours. Even though he is not supposed to, Mr Koeberg uses the phone after hours for limited personal use. On 1 March 2021, the market value of the phone is R5 000 and the cost to Powerstation is R4 000.
- An entertainment allowance (since being promoted to manager) of R2 000 per month. He does not have to account to Powerstation for any amounts spent. He had refunded R6 000 to the company by the end of February 2022 as this amount has not been used. The refunds occurred evenly over the year of assessment.
- Use of the company's golf clubs while playing golf with friends on weekends. Mr Koeberg used the golf clubs every month. The market value of the clubs is R750 and the cost to Powerstation was R600.

Powerstation also deducts 7% of Mr Koeberg's salary to pay over to a pension fund. Mr Koeberg was required to contribute an additional R1 500 as an arrear pension fund contribution. In order to adequately save for his retirement, Mr Koeberg also contributes R750 per month to a retirement annuity fund.

Mr Koeberg contributed an excess of R2 750 above the deductible amounts relating to pension fund contributions in the 2021 year of assessment.

Mr Koeberg has invested wisely over the course of his career and over the last year of assessment, he has earned the following additional income:

Description	**Amount R**
Interest from a bank account in the United Kingdom	1 200
Interest from a South African bank account	15 000
Dividends from a company situated in the USA (0,5% shareholding)	2 300
Dividends from South African investments	42 000
An annuity from a family trust. 40% relates to South African dividends and the remainder relates to South African interest	9 000

In order to supplement this additional income, Mr Koeberg purchased an annuity for R45 000 on 1 September 2021. The annuity pays out R650 per month for 10 years, starting on 30 September 2021. Unfortunately, he

required finance for home renovations and decided to terminate this annuity on 1 January 2022, for which he received R38 000 as a lump sum.

YOU ARE REQUIRED TO:

Assume all questions relate to the 2022 year of assessment (i.e. tax year ended 28 February 2022).

1. Calculate the contributions to retirement funds that will be considered for a s11F deduction. Your solution must also include an explanation for any items mentioned above that you have excluded from your calculation. **(2 marks)**

2. Determine Mr Koeberg's gross income (as defined). **(9 marks)**

3. Calculate the total s10A purchased annuity exemption. **(5 marks)**

4. Calculate Mr Koeberg's income (as defined). **(8 marks)**

5. Calculate the tax liability owing to SARS at the end of February 2022, assuming no employees' tax was withheld by Powerstation (Pty) Ltd. **(8 marks)**

SHOW ALL WORKINGS

2.6.4 MR KOEBERG – SUGGESTED SOLUTION

1.	Retirement fund contributions				
	Current pension (R350 000 x 7%)	24 500			**0.5**
	Arrear pension	1 500			**0.5**
	Current retirement annuity fund (R750 x 12)	9 000			**0.5**
	Excess prior year pension	2 750			**0.5**
		37 750			
2.	Gross Income				
	Salary			350 000	**0.5**
	Fringe benefits:				
	Use of mobile phone - telephonic therefore no fringe benefit				**1**
	Use of golf clubs - 15% per annum on lower of:	MV	750		
		Cost	600		
		Therefore	600 x 15%	90	**1**
	Interest from UK bank account			1 200	**0.5**
	Interest from SA bank account			15 000	**0.5**
	Dividends from USA company			2 300	**0.5**
	Dividends from SA investments			42 000	**0.5**
	Annuity - family trust			9 000	**1**
	Annuity - purchased (4 months)	4 x R650		2 600	**2**
	Annuity – lump sum			38 000	**1**
	Gross Income			460 190	**0.5**
3.	s10A exemption				
	s10A current annuity received				
	Y = A/B x C				
	A =	45 000			
	B = R650 x 12 x 10	78 000			
	A/B =	57.69%			
	C = R650 x 4 (from part 2 above)	2 600			
	therefore Y =			1 500	**2**

s10A lump sum received (A)		38 000		
X = A - D				
total exemptions received = D =		1 500		**1**
X = A - D		43 500		**1**
limited to actual			38 000	
Total s10A exemption			39 500	**1**
4. Income				
Gross income			460 190	**0.5**
less exemptions:				
s10A exemption (from part 3 above)			(39 500)	**0.5**
s10(1)(i) local interest	15 000			**0.5**
interest in annuity (60% x R9 000)	5 400			**1**
	20 400			
ltd to R23 800 (<65 years), limited to actual	(20 400)		(20 400)	**2**
s10(1)(k) local dividends	42 000			**1**
div in annuity denied exemption s10(2)(b)	-			**1**
	42 000		(42 000)	
S10B foreign dividends	2 300 x 25/45		(1 278)	**1**
Income			353 412	**0.5**
5. Tax liability				
Income			353 412	
Entertainment allowance (R2 000 x 12) - R6 000			18 000	**1.5**
			371 412	
less s11F retirement funds deduction				
Contributions		37 750		**0.5**
Limited to the lesser of:				
350 000,				
27.5% of the greater of:				
Remuneration (350 000 + 90 + 9 000 + 2 600 + 38 000 – 39 500)	399 690			**1**
Taxable income	371 412			**1**
	x 27.5%	109 915		
And taxable income R371 412				
Therefore all deductible			(37 750)	**1**
Taxable Income			333 662	
Normal tax per the tables	38 916	+ 30 540	69 456	**2**
less rebates (<65)			(15 714)	**1**
Normal tax payable			53 742	
				32

CHAPTER 3

BUSINESS ENTITIES

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3.1 INTRODUCTION

Chapters 1 and 2 have covered income tax from the point of view of an individual who earns income from employment and passive income. However, an individual could run a business (trade) earning active income. In addition, there are other types of business entities besides an individual.

Chapter 3 looks at the individual and their taxable income in the context of operating a business as a sole proprietor. The system of taxation for partnerships, companies, and close corporations is then explored.

Learning Objectives

By the end of the chapter, you should be able to:

- Understand the difference between an independent contractor and an employee and why there needs to be distinction between the two.
- Understand how trading income is incorporated into the taxable income calculation.
- Understand the concept of a company, how it is taxed and how this differs from the taxation of individuals.
- Understand the concept of a small business corporation and how it is taxed.
- Understand why there is provisional tax.
- Calculate the first, second and third provisional tax payments.
- Calculate the penalties and interest relating to provisional tax payments.

3.2 INDEPENDENT CONTRACTORS AND SOLE TRADERS

3.2.1 INDEPENDENT CONTRACTOR

As payments made to independent contractors are, generally, for services rendered, such amounts fall within the preamble to remuneration (as for employed individuals – see Chapter 1). In the absence of any further provisions this would mean that a person would have to withhold employees' tax from any amounts paid to another person for services rendered, whether independent or not. This would clearly be unmanageable – you could not be expected to withhold tax from the plumber who comes to your house to fix your drains. The definition of 'remuneration' in the Fourth Schedule therefore contains an exclusion for payments made to persons carrying on a separate trade from the person to whom the services are rendered.

The exclusion from the definition of remuneration requires that a person be carrying on an independent trade. The trade shall not be considered independent if it has to be performed mainly at the premises of the person from whom payment is received and is subject to his or her supervision either as to the way in which the work is performed or to the number of hours that are worked.

It is important to note that supervision and control is only a factor indicating employment if the person is supervised or controlled mainly at the premises of the employer. If a person is told when to start work and how long to work each week, this is control as to his hours of work and he would not be carrying on an independent trade if this was done at the premises of the employer. As an alternative to hours of work, if the employer controls the manner in which the employee has to work at the employer's premises this also means that the employee is not carrying on an independent trade. The control as to the manner of work usually means a close managing of the employee's time. Requiring a person to use the tools supplied by the employer could also be seen as a way of controlling that person's manner of working. The 'control or supervision' test is a difficult test to apply, because a professional or a skilled worker will need very little supervision, but could still be an employee. The 'Dominant Impression Test Grid' has been used by SARS to determine the extent to which a person is under an 'employer's control'. Note that in terms of the definition above, supervision or control does not have to come from the employer directly. An employer can, for example, hire a consultant for the specific purpose of providing supervision or control, and this will be sufficient to satisfy the requirements of the definition. SARS Interpretation Note 17 (Issue 5) of 5 March 2019 addresses the identification of independent contractors for the purpose of employees tax.

Where a person has three or more full-time employees who are not connected to him, however, he is deemed to carry on an independent trade. It is submitted that the determination of whether an employee is full-time depends on the employer's standards and practices. In other words, if the business hours of the employer total, say, 30 hours a week, then provided that the employee's contract is, normally, to work for the full 30 hours (except for leave taken in terms of a normal practice), such person is a full-time employee. It is submitted that the fact that the employee may have another job in the evenings or at night does not make that person a part-time employee of the company that employs him during the day.

Also, if the normal work week in relation to the business is 30 hours, and an employee works for 1 hour each morning, and has no other job, he is not a full-time employee. The reference to being engaged, on a full-time basis, in rendering the service referred to, means that the employee, in addition to being employed full-time by the company, must also spend all his or her time on that part of the business of the company of rendering the services.

It is important to distinguish an employee from an independent contractor, because it does not only affect the payer's responsibility to deduct employees' tax, but the payee may also be stopped (in terms of section 23(m)) from deducting most of his operating expenses from his income if he is a common law employee.

3.2.2 CASE STUDY – INDEPENDENT TRADE

Mr D carried on the business of manufacturing tables and employed a team of five carpenters, working under one foreman, in his factory. Except for the fact that one of the carpenters is the foreman's brother, and two carpenters are twins, none of the individuals are connected to each other. Mr D was near to retirement and was worried that if he retired and closed the business, his employees would not be able to work on their own. He therefore wanted to help the employees set up their own business so that they could develop entrepreneurial skills with his support, until such time as he was happy that they knew enough about all aspects of the business to go on their own. He had a meeting with the employees and they stated that they would prefer to keep on working for the foreman. They had no interest in acquiring equity in the business.

Mr D therefore entered into an agreement with the foreman in terms of which the foreman, as a sole proprietor, would employ the five carpenters and provide a service to Mr D on a labour-only basis, using the factory premises and the tools and equipment supplied by Mr D, as well as the raw materials supplied by Mr D, to manufacture tables. The foreman was free to dismiss any of the carpenters and hire different individuals without interference from Mr D.

Mr D would pay the foreman on a time basis and would not be involved at all in the day-to-day running of the manufacturing business. He would help the foreman, who would become an independent contractor, with the various back-office functions (accounting, tax, and payroll). Over time the foreman would acquire his own equipment and eventually rent the premises from Mr D. Mr D also intended to teach the foreman about designing and marketing the product, and dealing with customers. Until such time, however, Mr D designed the tables, advertised in the magazines and on the internet, and accepted orders. He then gave the specifications to the foreman who would employ his team to manufacture the tables on a labour-only basis. Mr D required the foreman to work on the factory premises so that he could keep a check on the quality of the work, and ensure that deadlines would be met. Mr D also required that the team be present from 8.25 a.m. to 5.15 p.m. each Monday to Friday, for at least 48 weeks per year, per individual.

The foreman was free to work for other people, but then he would pay Mr D for the use of the premises and equipment used in that part of the business, and would have to purchase his own raw materials. In the beginning, all of the work would come from Mr D, but over time it was hoped that the foreman would build up a large business with a wide customer base.

Initially it was agreed that Mr D would pay the foreman R70 000 (plus VAT) per month for the first 12 months, with the rate and method of payment to be renegotiated at the end of the 12-month period.

The question arises as to whether the payment to the ex-foreman, once this arrangement is entered into, is subject to employees' tax. If the amount is not 'remuneration' as defined, there will be no employees' tax leviable on the R70 000 per month.

Looking at the matter, the following is important:

1. The services are required to be performed at the premises of Mr D, therefore the first requirement of the provision set out above is met.
2. Mr D controls the hours of work as well (8:25 a.m. to 5:15 p.m.), so this requirement is met.
3. However, provided that the ex-foreman can keep at least three carpenters fully employed for the year (not counting his brother due to the connected person restriction), the further proviso would apply and the ex-foreman would be deemed to be carrying on an independent trade. The fact that two of the carpenters are twins does not matter as they are not connected to the ex-foreman.

3.2.3 SOLE TRADERS

Sole traders are, generally, those natural persons earning income from trading in their personal capacity. For example, the owner of a corner retail shop selling convenience foods would be a sole trader as the business is

not in the form of a legal entity and is not an independent contractor, as the owner is not rendering a service, but selling a product.

Sole traders, like independent contractors, are entitled to trading deductions and capital allowances against their trading income. Sole traders have the additional complication of separating their trading income and deductions from their passive income and personal expenses (see chapters 2 and 4).

3.2.4 MULTIPLE TRADES

Not only can sole traders have multiple trades, for example a retail trade and a rental trade, but sole traders and independent contractors may also be operating as employed individuals. Each of these trades must be separately considered and finally combined when determining the normal tax liability of such persons.

Example

Mr Jones runs a shop selling convenience foods. He is also employed by a large corporation as a food technologist. Assuming he is paid a salary of R30 000 per month, earns R60 000 monthly from selling convenience foods and qualifies for monthly deductions of R20 000, his taxable income for normal tax would be determined as follows:

Trade 1 – Employment	
His employment trade annual income is R30 000 x 12 =	R360 000
Trade 2 – Retail shop	
Gross income R60 000 x 12 =	R720 000
Less qualifying deductions R20 000 x 12 =	(R240 000)
Trade 2 taxable income	480 000
Total taxable income is R360 000 + R480 000 =	R840 000

3.3 PARTNERSHIPS

A partnership is a legal relationship arising from an agreement between two or more persons. It is not defined as a person in the Income Tax Act, and for income tax purposes it is therefore not regarded as a taxpaying entity.

The partners are taxable in their individual capacities. In terms of section 24H any income which has been received by or accrued to the partners in common (i.e. to the partnership) is deemed to accrue to the partners in their profit-sharing ratio on the same date on which it is received by or accrues to the partnership. Expenses and allowances relating to such amounts are also deemed to be those of the individual partners.

The purpose of this provision is to override a legal principle that the partner's share of profits only accrue to him at the end of the partnership's financial year, when the profits are brought to account.

Additional notes on partnerships

- The source of partnership profits is located where the services of each partner are rendered.
- Partners are taxed on their profits earned, irrespective of their drawings.
- When a partner resigns, dies or retires, the partnership comes to an end.
- When a new partner is admitted, the old partnership comes to an end and a new partnership comes into existence.
- If a partner sells his goodwill, the receipt is of a capital nature, whether paid in a lump sum or in instalments. If the goodwill is sold in return for an annuity, the seller is taxed on the annuity received in terms of paragraph (a) of the gross income definition, but the purchaser gets no deduction for the annuity paid because it is of a capital nature.

  However, s11(m) provides for a deduction of annuities paid to former partners if the following conditions are fulfilled,

  - the person had been a partner for at least 5 years;
  - retired on grounds of old age, ill health or infirmity; and
  - the Commissioner is satisfied that the amount is reasonable,

- in relation to the services rendered by the partner in the past,
- as well as in relation to the profits made in the partnership; and
- the payment is not a consideration in respect of some interest in the partnership, such as goodwill.

- Where a partner sells part of his share in the partnership, he recoups a proportionate share of the allowances on the assets held by the partnership.
- Paragraphs (d) (termination gratuities) and (i) (fringe benefits) of the gross income definition cannot apply to partners because they are neither the holders of an office nor employees of the partnership.
- If a debt owing to the partnership goes bad, the s11(i) deduction is only available to those partners who originally had the sale giving rise to the debt included in their income.

Example – New partner admitted

Black and Blue are partners sharing profits on an equal basis. Their debtors at 28 February 2021 amounted to R80 000. On 30 June 2021 one of these debtors, amounting to R15 000, went bad.

Brown was admitted into the partnership on 30 April 2021. The partners now each share in 1/3 of the profits. The s11(i) bad debt write-off which each partner may claim in respect of the R15 000, for the year ended 28 February 2022 is:

Black (R15 000 x 1/3)	R 5 000
Blue (R15 000 x 1/3)	R 5 000
Brown	-
	R10 000

Brown is not allowed a deduction in terms of s11(i) because the income from the transaction which gave rise to the debtor was never included in his income.

- Insurance premiums paid by the partnership on the lives of the partners cannot be claimed as a deduction in terms of section 11(w), which only applies to policies in respect of employees. However, if the partnership pays the premiums on individual life policies for the partner's own benefit, it is SARS practice to give the partnership a deduction and include the premium paid in the partner's taxable income. In effect such a premium is treated as the partner's share of profits.
- For Value-Added Tax (VAT) purposes, the partnership is treated as a person or vendor, separate from the partners, even though it is not a legal entity. A change in the composition of the partnership does not affect the VAT status of the vendor as long as one or more of the original partners carry on the business as a partnership.

3.4 COMPANIES

3.4.1 DEFINITION OF COMPANY

For income tax purposes the definition of 'company' is wider than the legal definition and includes:

- South African companies (any association, corporation or company incorporated in South Africa, registered as a company – paragraph (a) of the definition of 'company').
- South African public entities (any association, corporation or company established under any South African law – para (a) of the definition of 'company'). This would include universities, for example, and the South African Reserve Bank.
- Foreign companies (any association, corporation or company incorporated under the law of any other country – para (b) of the definition of 'company').
- Co-operatives – para (c) of the definition of 'company'.
- South African charities, etc. (any association, formed in South Africa, to serve a specified purpose beneficial to the public or a section of the public - this would include certain charities and foundations even if they were not registered as companies – para. (d) of the definition of 'company').

- Foreign collective investment schemes (an arrangement or scheme carried on outside South Africa, where members of the public invest in a collective investment scheme, i.e. the investors contribute to the scheme and hold a participatory interest – para (e)(ii) of the definition of 'company').
- A collective investment scheme qualifying as a REIT (Real Estate Investment Trust) on the JSE – para (e)(iii) of the definition of 'company').
- Close corporations – para (f) of the definition of 'company'.

An entity is incorporated when it is entered in a register and given juristic personality (in terms of the law of the country) so that it exists as a legal entity apart from its members or owners. A 'collective investment scheme' is one in which 2 or more people, companies, etc. (investors) contribute money or other assets to a company or trust and then hold a share or interest in that company or trust as a way of sharing in the investment. Collective investment schemes are often referred to as 'managed funds', 'mutual funds', or simply 'funds'. The Collective Investment Schemes Control Act deals with schemes in which the public are invited to invest.



When the term 'company' is used in the Income Tax Act, it must be read as referring to a close corporation and a co-operative as well. The definition specifically excludes a 'foreign partnership'.

3.4.2 FINANCIAL YEAR END AND YEAR OF ASSESSMENT

A company's year of assessment is the same as its financial year. Unlike individuals and trusts, a company's financial year end need not end on the last day of February.

Note: The Budget Speech is usually presented in February each year, while the detailed amendments are only tabled in Parliament towards the end of July and November. The amendments to the rates for the 2021/2022 tax year were tabled in February 2021, and the detailed amendments to the legislation were promulgated later in the year.

The new tax rates announced in the Budget Speech take effect immediately, that is, for individuals with effect from 1 March and for companies with year-ends falling within the period from 1 April of that year to 31 March of the next year. The amendments to the Act are generally only effective for year-ends from 1 January to 31 December of the *following* year (the 'general effective date' of the amendments), unless otherwise provided in the amending act.

Example

The financial year-end of a company falls in the period:	*Taxable income is calculated by referring to:*	*Tax rate used is that announced in:*
January to March 2021	2020 Act	2020 Budget
April to December 2021	2020 Act	2021 Budget
January to March 2022	2021 Act	2021 Budget

3.4.3 SPECIFIED DATE

This is the last day of the year of assessment of the company.

3.4.4 EQUITY SHARE CAPITAL

'Equity share' is defined in section 1. An equity share is:

- A share in a company
  - Excluding any share that does not carry a right to participate beyond a specified amount in a distribution.
- Note that the equity shares need not have voting rights.
- The definition covers shares in South African companies as well as shares in foreign companies.

Ordinary shares are equity shares. A member's interest in a close corporation is an 'equity share'. Any interest in the capital of a company is a share of that company or in that company.

Preference shares issued will only be equity shares if they are participating preference shares, i.e. -

- they participate in profits to an unlimited extent, or
- they participate in the distribution on liquidation.

Therefore, if a preference share does not participate in profits beyond a specified amount nor in capital beyond the nominal value of the share, it is not an equity share. These shares are usually referred to as 'non-participating preference shares'.

3.4.5 PUBLIC AND PRIVATE COMPANIES

The main reason for distinguishing between public and private companies, for tax purposes, is that public companies are exempt from donations tax.

Distinguishing between private and public companies

- If a company is registered as a private company under the Companies Act it is also a private company for tax purposes. Such a company can never be classified as a public company for tax purposes.
- A close corporation is a private company for tax purposes.
- If a company is registered as a public company under the Companies Act it may or may not be a public company for income tax purposes. Its tax classification will be determined in terms of section 38.

The Commissioner will (upon the request of a company) inform the company whether it is recognised as a public or private company for tax purposes. There is a list of which companies will be regarded as public companies. All companies which are not public in terms of section 38 will be regarded as private companies.

Public company quoted on a stock exchange

Any company having all classes of its equity shares quoted on a stock exchange on its specified date (year-end) shall be a public company, if the Commissioner is satisfied that;

- the stock exchange is a recognised one under adequate control,
- normal stock exchange rules apply to protect the interests of the public,
- the memorandum and articles of association/memorandum of incorporation of the company do not restrict the sale or transfer of any class of its shares to the general public, and
- the general public was, throughout the year of assessment, interested directly or indirectly, via shareholding in any other company, in more than 40% of every class of equity share issued by the company.

Public company not quoted on a stock exchange

Any company not being a private company under the Companies Act (nor a close corporation) shall be a public company, if the Commissioner is satisfied that:

- the general public was, throughout the year of assessment, interested directly or indirectly, via shareholding in any other company, in more than 50% of every class of equity share issued by the company, and
- no person enjoys benefits that he would not have enjoyed had the company been under the control of a board of directors acting in the best interests of all shareholders as if it was a quoted company.

Companies automatically classified as public companies

PBO: Any company which has been approved as a 'public benefit organisation' in terms of the provisions of section 30(3) of the Income Tax Act.

Co-op: Any co-operative registered under the Co-operatives Act.

Insurance: Any insurance company subject to tax under section 28, 29, or 29A (long-term and short-term insurance).

Any *public utility* company.

Gold and diamond mining: Any company whose sole or principal business in the Republic is gold or diamond mining.

Non-resident ships & aircraft companies: Any company to which the provisions of section 33 apply. These are owners or charterers of ships or aircraft neither ordinarily resident nor registered, managed or controlled in the Republic.

3.4.6 CALCULATION OF A COMPANY'S TAX LIABILITY

Companies pay normal income tax (usually at 28% - see Appendix D) on their taxable income.

The taxable income of a company is calculated in the same way as an individual's taxable income. There are certain provisions of the Act which apply only to companies, however, and certain provisions which apply only to individuals.

3.4.7 RATES OF NORMAL TAX

The rates of normal tax for companies are set out in Appendix A at the back of the book.

- Normal company or close corporation: 28%
- Small business corporation: 0%, 7%, 21%, 28%
- Long term insurer: 0%, 28%, 30%
- Micro business: taxed on turnover: 0%, 1%, 2%, 3%

3.5 SMALL BUSINESS CORPORATIONS

Special rates of tax apply to small business corporations (SBC's).

A small business corporation is defined as follows:

- any close corporation, co-operative or private company (in terms of the Companies Act)
- all the shareholders of which are natural persons (for the entire year of assessment)
- the gross income of which does not exceed R20 million for the year of assessment
- none of the shareholders or members of the SBC at any time during the year of assessment (of the SBC) holds any shares or has any interest in the equity of any other company other than certain 'permitted' shareholdings These 'permitted shareholdings' are holdings in:
  - a listed company;
  - any portfolio in a collective investment scheme or
  - any company contemplated in s10(1)(e)(i)(aa), (bb) or (cc) (sectional title body corporates, share block companies, and associations formed to manage the collective interests of its members);
  - less than 5% in a social or consumer co-operative or a co-operative burial society or any other similar co-operative if all of its income is solely derived from its members;
  - less than 5% in a primary savings co-operative bank or primary savings and loan co-operative bank;
  - any venture capital company as defined in section 12J
  - any friendly society (as defined in the Friendly Societies Act);
  - any company, close corporation, or co-operative if the company, CC, or co-op:
    - ~ has not during *any* year of assessment carried on any trade; *and*
    - ~ has not ever owned assets of more than R5 000 in value.
  - any company, close corporation or co-operative if the company, close corporation or co-operative has taken the steps contemplated in section 41(4) to liquidate, wind up or deregister (and the steps have not been withdrawn or invalidated).
- Investment income and income from a 'personal service' do not make up more than 20% x (revenue receipts & accruals + capital gains).

Investment income is defined as:

- dividends, royalties, rental from immovable property, annuities, similar income

- interest per section 24J (certain amounts are excluded, such as interest from a primary saving co-operative bank, and section 24K amounts)
- proceeds derived from investment or trading in financial instruments, marketable securities or immovable property

'Personal service' is defined as one of the following if it is rendered personally to clients by a person who holds an interest (shares or member's interest) in the company or close corporation:

- any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation, veterinary science.

Notes:

1. Small business corporations (SBC's) also qualify for the 100% section 12E allowance in respect of manufacturing plant and machinery, and a normal wear and tear allowance or a 50:30:20 write-off (i.e. over 3 years) in respect of other assets (see Chapter 5).
2. Personal service providers (as defined in the Fourth Schedule) cannot be SBC's.
3. Dividends paid by an SBC are subject to Dividends Tax in the normal way.

Example – Small Business Corporation (SBC)

Mr D owns all the members interest of ABC CC. It renders accounting services and sells computer programs. Mr D only has 'permitted' shareholdings in other entities.

The gross income of ABC CC for the year of assessment is as follows:

Sales of computer programs	R1 940 000
Accounting services rendered by Mr D	240 000
Accounting services rendered by Mrs D	700 000
Dividends	100 000
Interest income	200 000
	R3 180 000

In addition to the above, the CC made a capital gain of R900 000 on the sale of a building in which it ran its business. The building was sold for R2 million. The CC's tax deductible expenses for the year of assessment amounted to R2 430 000.

Calculate the tax payable by ABC CC. (ABC CC is not a 'personal service provider').

Step 1 – Is ABC CC a small business corporation?

- The member is a natural person (Mr D).
- The 'gross income' is not more than R20 million.
- It is not a personal service provider.
- The other shareholdings of the member are all permitted
- 20% of revenue receipts and capital gains is
  20% x (3 180 000 + 900 000) = R816 000
- Income from personal services and investment income:

- Mr D	R240 000
- Dividends	100 000
- Interest	200 000
	R540 000

This is less than the R816 000 calculated above. The proceeds from the sale of the building (R2 million) is not taken into account as investment income because it is capital in nature and is therefore not part of the total on which the 20% is based.

Conclusion: ABC CC is a SBC

Step 2 – calculate the taxable income

Gross income (as above)		R3 180 000
Less:	Exempt income (dividends)	(100 000)
	Income	R3 080 000
Less:	Deductions	(2 430 000)
		R 650 000
Add:	Taxable portion of capital gain: R900 000 x 80% =	720 000
	Taxable income	R1 370 000

Step 3 – calculate the tax per the table:

On first R87 300 =	0
R365 000 – 87 300 = R277 700 x 7%	19 439
R550 000 – 365 000 = R185 000 x 21%	38 850
R1 370 000 – 550 000 = R820 000 x 28%	229 600
	R287 889

Alternatively, this can be calculated as R58 289 + 28% x (R1 370 000 – R550 000)

3.6 CLOSE CORPORATIONS

A close corporation (CC) is a body corporate, registered in terms of the Close Corporations Act (69 of 1984). It is a separate legal entity which is therefore a taxpayer in its own right. It may have between 1 and 10 members and membership is restricted to natural persons and trusts.

Close corporations are falling away in South Africa. No new close corporations are allowed to be registered, but those currently registered can continue until an unspecified future date, when they will be required to convert to private companies.

3.6.1 TAX IMPLICATIONS OF CLOSE CORPORATIONS

A close corporation is a private company for income tax purposes, and is taxed as a company. A close corporation can also be classed as a small business corporation (SBC), or as an employment company (depending on the circumstances).

Any person who holds an office or performs functions similar to those of a director of a company is defined as a director. The Close Corporations Act provides that every member shall be entitled to participate in the carrying on of the business of the corporation. It is further provided that this rule may be varied in the association agreement. This means that unless the association agreement provides otherwise, every member of a close corporation is a director (for income tax purposes) in terms of the definition in the Income Tax Act.

Under certain circumstances, members (like directors of companies) can be held personally liable for the VAT and the employees' tax payable by the close corporation.

3.7 DIVIDENDS TAX

Dividends Tax is levied at the rate of 20% of the amount of 'any dividend paid by any company other than a headquarter company.' It is a withholdings tax that is withheld by the company before paying the net amount (dividend declared less dividends tax) over to the shareholder.

Example –Dividends Tax

Company A declares a dividend of R100 to its natural person and resident shareholders.

The shareholders of Company A will be charged Dividends Tax of R100 x 20% = R20. Company A must withhold this amount and pay it to SARS. The shareholders will receive R80, while the total cash outflow from Company A will be R100.

Close corporations are not specifically referred to in the definition of 'dividend' in section 1 of the Income Tax Act. This definition refers to any amount transferred or applied by a resident company for the benefit of any shareholder. However the definition of 'company' in section 1 includes a close corporation. Furthermore the definition of 'share' in section 1 effectively includes a member's interest in a close corporation. The result is that any distribution of profits by a close corporation to its members constitutes a dividend for the purposes of the Income Tax Act and will be subject to Dividends Tax. Such distributions, being a dividend as defined, are generally exempt from tax (per section 10(1)(k)) in the hands of the members of the close corporation.

Dividends Tax is beyond the scope of this book and will not be covered in further detail.

3.8 PROVISIONAL TAX

3.8.1 GENERAL

Provisional tax is a mechanism for the advanced collection of normal tax from taxpayers. All companies are subject to provisional tax. Because employees' tax is also an advanced collection of normal tax, only individuals who have income other than remuneration are subject to provisional tax. This would include independent contractors, sole traders and investors. Note that provisional tax is not a separate tax, but a method of tax collection.

A provisional taxpayer includes:

- Any person who derives income which is not remuneration (as defined) or an allowance or advance (contemplated in section 8(1)).
- Any company.
- Any person notified by the Commissioner that he is a provisional taxpayer.

Exemptions

The following persons (considered in this book) are exempt from the payment of provisional tax:

- Any approved tax-exempt Public Benefit Organisation;
- Any natural person who does not derive income from the carrying on of any business if:
  - (i) the taxable income of the person will not exceed the tax threshold (defined in para 1); or
  - (ii) the taxable income derived from interest, foreign dividends or the rental from the letting of fixed property does not exceed R30 000.

Remember that the 'tax threshold' is defined as follows: '*in relation to a natural person means the maximum amount of taxable income of that person in respect of a year of assessment which would result in no tax payable when the rates of tax contemplated in section 5 of this Act and the rebates contemplated in section 6 of this Act for that year of assessment are applied to the taxable income of that person*'

For the 2022 year the tax threshold for a person under 65 is R87 300 per year, for a person 65 years or older it is R135 150 and for a person 75 years or older it is R151 100.

Payment of provisional tax

Provisional taxpayers are required to make two compulsory provisional tax payments during the year of assessment based on their estimate of taxable income.

- The first is payable within the first six months of the year of assessment.
- The second is payable by no later than the end of the year of assessment. Provisional payments are merely advance payments in respect of the normal tax payable for the year. In certain cases, the taxpayer may make a third, voluntary, provisional tax payment, often referred to as a 'topping up payment'.

The provisional payments for any year will be reflected as a credit against the normal tax as finally assessed for that year. This means that if the provisional tax paid throughout the year is greater than the calculation of the tax as per the tables (and after rebates), then SARS will refund the taxpayer.

3.8.2 PROVISIONAL TAX PAYMENTS

The Fourth Schedule sets out the provisional tax calculation for both companies and individuals. The difference between the calculation of provisional tax for companies and individuals is in the tax rate (and rebates for individuals) and that the tax calculated for individuals (and personal service providers) must be reduced by any employees' tax paid in arriving at the provisional tax payable.

First Payment

The first provisional tax payment must be made six months before the year end of the taxpayer. In the case of a taxpayer with a February year end, this means that the first payment must be made not later than 31 August of the preceding year. For example, for the year ended 28 February 2022, the first 2022 provisional payment must be made no later than 31 August 2021.

The amount payable is computed by:

(1) estimating the total expected taxable income for the year,

(2) calculating the tax payable on this taxable income,

(3) deducting the rebates (in the case of individuals),

(4) dividing the tax payable by two,

(5) deducting any employees tax paid for the first six months of the tax year (in the case of individuals), and

(6) paying the resultant difference (if any) to SARS.

By default most taxpayers use the 'basic amount' to determine their estimated taxable income for their first provisional tax return. The 'basic amount' is the taxable income reflected in the most recent assessment received from SARS and usually appears on the provisional tax form. If the most recent assessment was received less than 14 days before the provisional payment is made, the basic amount is the taxable income reflected in the preceding assessment. Note that the basic amount must exclude any taxable capital gains, severance benefits and any retirement fund lump sums received or accrued in the year on which the basic amount is calculated.

This preceding assessment's taxable income must be increased by 8% per annum if more than 18 months have passed between the assessment date and the year of assessment of the provisional tax currently being calculated. The increased amount is then the 'basic amount' for the year. For example, if a 2021 assessment is used to calculate the amount for 2022 the taxable income from the assessment does not need to be increased (due to it being the previous year). However, if a 2019 assessment must be used for the first provisional payment, it will have to be increased by 24% (8% x 3 years).

An estimate of taxable income smaller than the basic amount may only be used with the consent of the Commissioner in the case of the first provisional payment. If the estimate is more than the basic amount, it is quite acceptable for the taxpayer to use the basic amount as the estimated taxable income.

If the taxpayer has not been previously assessed the basic amount is nil, but this will not be accepted by SARS. The Commissioner is allowed to increase any provisional tax estimate to an amount that he considers reasonable. He could do this, for example, where it is the taxpayer's first year of assessment. He can also do so if information indicates that the final taxable income is likely to be higher.

Notes:

1. Any taxable capital gain included in taxable income is excluded in determining the basic amount. For example, if a taxpayer's taxable income (as assessed) for the year ended February 2021 is R260 000 and included in such taxable income is a taxable capital gain of R30 000, the basic amount is R230 000.

2. Provisional taxpayers must request a provisional tax return form (IRP 6) from SARS, usually via e-filing. This form usually reflects the most recent assessed taxable income (the basic amount) at the time of the request.

Second Payment

The second payment must be made by the end of the year of assessment. This means that the second payment must be made by the end of February in the case of a taxpayer with a February year-end.

(1) Tax must be calculated on the total estimated taxable income (in the case of the second payment a two-tiered system is used – see below),

(2) rebates are deducted (in the case of individuals),

(3) employees' tax paid for the 12 months must be deducted (in the case of individuals),

(4) the first provisional tax payment must be deducted, and

(5) any remaining difference must be paid to the SARS.

3.8.3 TWO-TIER SYSTEM

The Fourth Schedule provides for a two-tiered system for provisional tax estimates by taxpayers.

- Where the actual taxable income for the year is R1 million or less, the estimate of taxable income can be based on the lower of:
  - the taxable income for the year (seriously calculated)
  - the basic amount (adjusted by the 8% per annum escalation if necessary)
- Where the actual taxable income for the year is more than R1 million, the estimate of taxable income must be based on a serious calculation of the taxable income for the year.

Example – Provisional tax of company

A company whose assessment for the year ended 30/6/2019 shows a taxable income of R1 100 000, provides the following information for the 2022 tax year:

- Estimated income for the 2022 year R900 000

1st 2022 Payment - 31 December 2021

The first payment will be determined using the basic amount which is R1 100 000, increased by 8% per year. Note that if this was the 2020 assessment, there would be no increase as the 18 month requirement would not have been fulfilled. There would also be no escalation if 2021 were the last year assessed.

Taxable income previously assessed = basic amount	R1 100 000
Increase by 8% for 3 years (24%)	264 000
Basic amount	R1 364 000
Tax on above (x 28%)	381 920
Divide by 2 for the first provisional tax payment	R190 960

2nd 2022 Payment - 30 June 2022

Tax on R900 000 (estimated income)	R252 000
Less: - 1st provisional payment	(190 960)
2nd provisional payment	R 61 040

If the company's tax return for the 2022 tax year shows a taxable income of R1 300 000 its assessment will be as follows:

Tax on R1 300 000 (x 28%)		R364 000
Less: - 1st Provisional	190 960	
- 2nd Provisional	61 040	(252 000)
Amount due		R112 000

Note: Because actual taxable income is greater than R1 million, and the second estimate of R900 000 is lower than 80% of the actual taxable income for the year (R1 300 000 x 80% = R1 040 000), an additional tax of 20% of the difference between the total tax paid and the tax on R1 040 000 is payable.

The tax on R1 040 000 is R291 200. Therefore the 'penalty' is 20% x (291 200 – 252 000) = R7 840

Example – Provisional tax of individual

A taxpayer (under the age of 65) whose assessment for the year ended 28/2/2020 shows a taxable income of R115 000, provides the following information for the 2022 tax year:

- employees' tax paid 1/3/2021 - 31/8/2021	R5 500
- employees' tax paid 1/9/2021 – 28/2/2022	R5 800
- Estimated income for the 2022 year	R110 000

1st 2022 Payment - 31 August 2021

The first payment will be determined using the basic amount which is R115 000 (not increased due to the 18 month requirement). Note that there would be no escalation if 2021 was the last year assessed.

Taxable income previously assessed = basic amount	R165 000
Tax on R115 000	29 700
Less: Rebate	(15 714)
	R 13 986
Divide by 2	R6 993
Deduct employees' tax	(5 500)
First provisional tax payment	R 1 493

2nd 2022 Payment - 28 February 2022

Tax on R110 000 (estimated income)	R19 800
Less: Rebate	(15 714)
	R4 086
Less: - Employees' tax for the year	(11 300)
- 1st payment	(1 493)
2nd provisional payment	R nil

If his tax return for the 2022 tax year shows a taxable income of R160 000 his assessment will be as follows:

Tax on R130 000		R28 800
Less: Rebate		(15 714)
		R13 086
Less: - Employees' tax	11 300	
- 1st Provisional	1 493	
- 2nd Provisional	nil	(12 793)
Amount due		R 293

Note: Because the second estimate of R110 000 is lower than 90% of the actual taxable income for the year (R160 000 x 90% = R144 000) and lower than the basic amount (R115 000), an additional tax of 20% of the difference between the total tax paid and the tax on R115 000 is payable.

The tax on R115 000 is R13 986. Therefore the 'penalty' is 20% x (13 986 – 11 300 – 1 493 – 0) = R239

The taxpayer's taxable income is not more than R1 million, so the 80% rule does not apply.

3.8.4 PENALTIES ON THE FIRST PROVISIONAL TAX PAYMENT

Underestimate

Although the first provisional tax payment cannot be based on a figure which is less than the basic amount, as adjusted if necessary, unless prior permission of the Commissioner is obtained, there does not appear to be any penalty in the Fourth Schedule if the tax is based on a figure which is less than the basic amount. Note, however, that if the Commissioner is not satisfied with the estimate he may request a revised estimate from the taxpayer.

Late submission

The Act does not provide for a penalty where the first provisional payment estimate is not submitted timeously.

Late Payment

The Fourth Schedule provides that if any provisional tax is not paid within the period allowed for payment, a penalty of 10% of the amount not paid will be levied on the taxpayer.

The term 'the amount not paid' refers to the amount of provisional tax which should have been paid. The penalty will therefore be calculated by determining the first payment which should have been made using the basic amount as an estimate.

If the Commissioner is satisfied that the failure to pay timeously was not due to an intent on the part of the taxpayer to evade or postpone the tax, he may remit all or part of this penalty.

In addition, section 89*bis* provides that interest at the prescribed rate will be payable for as long as the amount remains unpaid. In terms of section 23(d) (see chapter 4) such interest is not deductible for tax purposes.

3.8.5 PENALTIES ON THE SECOND PROVISIONAL TAX PAYMENT

Late submission and late payment

If the estimate of taxable income is not submitted before the last day of the year, a penalty will be imposed in terms of the Tax Administration Act. The Commissioner may remit all or part of the penalty in limited circumstances.

In addition, section 89*bis* provides that interest at the prescribed rate will be payable for as long as the amount remains unpaid and in terms of section 23(d) this interest is not deductible for tax purposes.

Underestimate – additional tax

Where the actual taxable income is R1 000 000 or less, in order to avoid the 20% 'additional tax' the second provisional tax payment must be at least equal to the tax on the lesser of:

- The basic amount
- 90% of the actual taxable income for the year

If it is less than both of these amounts, there is a 20% penalty of:

Tax on lower of the basic amount or 90% of taxable income	R XXX
Less: Employees' tax and provisional tax paid by end of the year	(XXX)
Amount subject to 20% penalty	R XXX

Example – Provisional tax 'additional tax'

Mr L, when making his second 2022 provisional tax payment on 28 February 2022, used an estimate of R400 000. His basic amount was R680 000. When he is finally assessed for 2022, his taxable income is R630 000. Calculate the 'additional tax' which Mr L will have to pay because his second provisional tax payment was too low.

Solution

Additional tax

Tax on lower of 90% of actual taxable income or basic amount,

i.e. tax on R567 000 (90% x R630 000) =		R146 559	
Rebate		(15 714)	
		R130 845	
Tax on actual estimate of R400 000 =	R89 814		
Rebate	(15 714)	(74 100)	(tax paid)
Difference		R56 745	
Additional tax at 20%		R11 349	

Where the actual taxable income for the year exceeds R1 000 000, the taxpayer must seriously calculate taxable income for the year (by the last day of the year of assessment), and make the provisional tax payment based on this calculation.

If the estimate is less than 80% of the actual taxable income, then the taxpayer will be liable for additional tax calculated as follows:

20% x (normal tax on 80% of actual taxable income – employees' tax and provisional tax paid by end of the year)

Therefore, if an individual's taxable income for the 2022 tax year is R1 500 000, and he estimated that his taxable income was R900 000, and such estimate was not seriously calculated, the additional tax is as follows:

Normal tax on 80% of taxable income of R1 500 000	R384 673
Normal tax paid on R900 000 (assuming no employees' tax paid and that the R900 000 is greater than the amount used for the first provisional tax payment)	(261 673)
Difference	R123 000
Additional tax at 20%	R24 600

And if a company's taxable income for the 2022 tax year is R1 500 000, and it estimated that its taxable income was R900 000, and such estimate was not seriously calculated, the additional tax is as follows:

Normal tax on 80% of taxable income of R1 500 000	R336 000
Normal tax paid on R900 000 (assuming the R900 000 is greater than the amount used for the first provisional tax payment i.e. the sum of the first and second provisional tax payments equals the tax on R900 000)	(252 000)
Difference	R84 000
Additional tax at 20%	R16 800

SARS can waive this penalty in whole or in part if satisfied that *both* of the following apply:

- The provisional tax was seriously calculated with due regard to the factors having a bearing on it, and
- The estimated taxable income or the tax was not deliberately or negligently understated.

SARS's discretion in this regard is subject to objection and appeal.

3.8.6 PENALTIES ON THE THIRD PROVISIONAL TAX PAYMENT

Section 89*quat* makes provision for the charging of interest at the prescribed rate if the total employees' tax and provisional tax payments for the year are less than the normal tax for the year as finally assessed. The interest is charged for a period starting seven months after the year end of individuals and companies with a February year end and six months after the year end for taxpayers with year ends other than February, and ending on the date of assessment.

So, for example, if the total employees' tax and provisional tax payments made by a taxpayer for the year ended 28 February 2022 amounts to R30 000 and the 2022 assessment which is dated 31 December 2022 reflects tax due of R50 000, interest will be charged on the shortfall of R20 000 for the period 1 October 2022 to 31 December 2022. In order to avoid the payment of interest, the taxpayer may make a third provisional payment of R20 000 on or before 30 September 2022.

The third payment is not a compulsory payment and there is, therefore, no provision for penalties if the payment is late or is underestimated.

Section 89*quat* only applies to:

- companies whose taxable income for the year exceeds R20 000 and
- individuals who are provisional taxpayers and whose taxable income exceeds R50 000.

With effect from a date still to be notified by the Minister of Finance, all taxpayers will become subject to the section 89*quat* interest. It will not be limited to provisional taxpayers.

Three terms are defined in the section:

(a) CREDIT AMOUNT

This is the sum of

- all provisional payments for the year
- any employees' tax paid during the year

(b) EFFECTIVE DATE

- A date falling 7 months after the last day of the year of assessment for taxpayers with February year ends.
- A date falling 6 months after the last day of the year of assessment for taxpayers with year ends other than the end of February.

(c) NORMAL TAX

This is the sum of

- assessed tax for the year
- any additional amount payable in terms of section 76, which has now been repealed, but s89*quat* still applies
- any penalty payable in terms of paragraphs 20 and 20A of the Fourth Schedule

The additional taxes referred to are:

- **Fourth schedule paragraph 20**

  This is a 20% additional tax resulting from an underestimate of the second provisional tax payment.

Where the normal tax exceeds the credit amount, the taxpayer is charged interest from the effective date i.e. interest is charged on any additional tax and provisional tax penalties.

Where the credit amount exceeds the normal tax for the year, interest at the prescribed rate will be paid to the taxpayer, on the difference, calculated from the effective date until the excess is refunded.

The Fourth Schedule also provides that any payments made after the effective date will be treated as late payments relating to the period prior to the effective date and will be subject to interest in terms of section 89*bis* and not section 89*quat*. For example, if the credit amount at the effective date is R100 000 and the normal tax for the year is R110 000, interest will be charged from the effective date to the date of assessment on the R10 000 difference in terms of section 89*quat*. If, however, the R10 000 is paid after the effective date but before the date of assessment, interest will only be charged from the effective date to the date of payment. If the taxpayer pays more than R10 000, say R12 000, after the effective date, the section 89*bis* interest will be charged on R12 000 at the prescribed rate from the effective date to the date of payment, whereas the overpayment of R2 000 will lead to SARS having to refund the R2 000, with interest, calculated from the effective date to the date the overpayment is refunded, at the prescribed rate. The interest paid by the taxpayer is not tax deductible, while the interest received is taxable.

Note that sections 187 to 189 of the Tax Administration Act deal with interest on the late payment of tax. However, these sections have not yet come into effect and section 89*bis* still applies.

Note further that if the taxable portion of a capital gain is not included in the calculation of the third provisional tax payment, the resultant shortfall is also subject to the section 89*quat* interest.

3.8.7 PRESCRIBED RATE OF INTEREST

The 'prescribed rate' is defined in section 1 of the Income Tax Act. Paragraph (a) of the definition deals with the rate payable by the Commissioner for the South African Revenue Service to the taxpayer, and paragraph (b) deals with the rate payable by the taxpayer.

Where an amount of tax is not paid on the date prescribed for payment (e.g. on the second date set out on the income tax assessment), interest is payable at the prescribed rate as set out in paragraph (b). Where a refund of tax that has been overpaid is due to the taxpayer by the Commissioner, interest is payable by the Commissioner at the prescribed rate as set out in paragraph (a).

The rates of interest are set out in Appendix E.

Where a taxpayer owes tax, additional tax, penalties, and interest, and he makes payment of part of the amount due by him, section 166 of the Tax Administration Act allows SARS to allocate that payment against any penalty, interest or oldest amount of tax.

3.8.8 PROVISIONAL TAX EXAMPLE

Example

For the 2020 tax year, Mr X (aged 50) was assessed on a taxable income of R150 000.

Mr X's employer withheld employees' tax of R1 560 for the period 1/3/2021 to 31/8/2021 and R1 560 for the period 1/9/2021 to 28/2/2022. Mr X has not yet received his assessment for the year ended 28 February 2021. In August 2021 Mr X calculated his first provisional tax payment for the 2022 year as follows:

Basic amount (2020 assessment not adjusted)	R150 000
Tax per table	R27 000
Less: Rebate	(15 714)
Tax payable	R11 286
Tax payable for 6 months (divided by 2)	R5 643
Employees' tax paid	(1 560)
First provisional payment (31/8/2021)	R4 083

In February 2022, Mr X feels that his taxable income will only be R120 000, so he calculates his second provisional payment as follows:

Tax payable on R120 000	R21 600
Rebate (as above)	(15 714)
	R 5 886
Employees' tax paid during the year	(3 120)
First provisional payment	(4 083)
Second provisional tax payment (28/2/2022)	R NIL

Mr X sends in his tax return for the year ended February 2022 in November 2022, and his actual taxable income for the year ended 28/2/2022 is R170 000. He is assessed on the R170 000 by 1 December 2022 and has to pay the following amounts:

Taxable income 2022 (Actual)		R170 000
Tax on R120 000		R30 600
Rebate		(15 714)
Tax Payable		R14 886
Already paid:		
Employees' tax	R3 120	
1st Provisional payment	R4 083	
2nd Provisional payment	Nil	(7 203)
Tax payable on assessment		R7 683

In addition, Mr X is liable for additional 'penalty' tax and interest.

Additional tax on underestimate

(i) First take 90% of the actual taxable income: R170 000 x 90% = R153 000

(ii) Compare this with the basic amount of R150 000

(iii) Calculate the normal tax on R150 000, i.e. R11 286

(iv) Deduct from R11 286 the employees' tax and provisional tax paid, i.e. R11 286 – R3 120 – R4 083 = R4 083.

(v) Multiply this difference by 20% to arrive at the penalty payable: R4 083 x 20% = R817

Note that if the Commissioner is satisfied that Mr X had genuinely calculated the R120 000 estimate, the Commissioner may, in his discretion, remit part or all of this additional tax.

Interest (s89quat)

Interest will be payable on the difference between the normal tax plus the additional tax (R14 886 + R817 = R15 703) and the credit amount of R7 203. The interest will be charged for the period 1/10/2022 to 1/12/2022 (date of assessment).

3.9 CONCLUSION

Chapter 3 introduces the concept of the sole trader and partnership and how the individual is taxed in their own name when transacting in a business environment on their own behalf and earning income other than from an employer or passive income.

Companies and close corporations were discussed and it was noted that they are separate legal entities and taxed in their own capacities.

Provisional tax is a method of tax collection that enables SARS to timeously receive tax owing to them.

If one incorporates the last 3 chapters into the tax liability calculation, the result would look similar to:

Gross income s1		
As per the definition, including, but not limited to:		
Salary, commission, leave pay etc *	XX	
Fringe benefits *		
Acquisition of asset at less than actual market value	XX	
Right of use of asset	XX	
Right of use of motor vehicle	XX	
Meals, refreshments and vouchers	XX	
Free or cheap services	XX	
Subsidies & low interest loans	XX	
Payment of employees' debt	XX	
Medical aid contributions	XX	
Medical costs incurred	XX	
Contributions to retirement funds	XX	
Trading Income		
Passive income		
Interest income	XX	
Dividend income	XX	
Royalty income	XX	
Purchased annuity receipts	XX	XXX
Less: Exempt income s10		
Non-resident interest exemption s10(1)(h)	XX	
Natural person interest exemption s10(1)(i) *	XX	
Dividend exemption s10(1)(k)	XX	
Royalty exemption s10(1)(*l*)	XX	
Special uniform exemption s10(1)(nA) *	XX	
Transfer/relocation costs exemption s10(1)(nB) *	XX	
Ships crew exemption s10(1)(o)(i) *	XX	
Employment outside SA exemption s10(1)(o)(ii) *	XX	
SA government service exemption s10(1)(p) *	XX	
Bursary exemption s10(1)(q) *	XX	

Purchased annuity exemption s10A	XX	(XXX)
Income		XXX
Add: Taxable portion of allowances per s8(1) *		
Travel allowance inclusion		XX
Subsistence allowance inclusion		XX
Other allowance inclusions (entertainment)		XX
Less: Deductions (mainly s11 to s20 & s23)		
Retirement fund deduction s11F *		(XX)
Add: Taxable portion of capital gains (s26A)		XX
Subtotal (needed for donations deduction - 10% excess)		XXX
Less: Donations deduction s18A		(XX)
Taxable income		XXX
Individuals and partnerships:		
Tax per the table, based on taxable income		XXX
Less: Rebates (normal and medical)		XXX
Tax payable		XXX
Companies:		
Taxable income x 28%		XXX

*Applicable only to natural persons

3.10 INTEGRATED QUESTION

3.10.1 THANDI GATSO (80 MARKS)

Mrs Thandi Gatso, a resident of Namibia (i.e. a non-resident of South Africa) aged 54, is an employee of Central (Pty) Ltd ('Central' or 'the company'). Central is a South African company, with a head office in Cape Town, where Thandi lives and works. She is also a widow (her husband passed away many years ago) with two children, who are dependants on her medical aid. Her son, after an unfortunate motor vehicle accident last year, is disabled and has a prosthetic limb.

Employment

Thandi receives a monthly salary of R22 000 and contributes 8% of her salary to a provident fund. The company contributes the same amount to the provident fund.

Thandi contributes R1 900 a month to a medical aid fund, which Central deducts from her gross salary and takes into account for employees' tax purposes. The company contributes the same amount to the medical aid fund.

The company provides all their employees with entertainment and travel allowances.

- Thandi receives an entertainment allowance of R2 500 per month. She is required to account to the company for all her expenditure. However, she discovered that all the invoices she had kept throughout the year had been thrown away during a house cleaning before being submitted to Central. Even though

Thandi was not able to prove the above invoiced amounts, she refunded R10 920 to the company, evenly over the course of the year of assessment.
- Thandi has a R2 000 a month travel allowance and has accurately calculated that 60% was used for private travel. This figure was obtained from a breakdown of her logbook.

In December 2021 the company decided to pay employees their annual bonuses. Thandi received a bonus of R80 000.

From January 2022, Thandi was given permission to use one of the company's Segways on weekends. Segways are two-wheel electronic personal transporters that are not classified as motor vehicles. The cost to Central when they were bought was R8 000 each, while the market value was R8 500. In January 2022, the cost of a new Segway was R6 000. Thandi paid Central R50 per month for the use thereof.

Fixed Property – Flat

Thandi saw a lucrative business opportunity arise when speaking to an estate agent friend. Thandi was told about a great deal about to go on the market: a two bedroom flat in Newlands was being sold for R550 000. In order to finance this purchase, Thandi entered into a loan agreement with Investing Bank Ltd. Central helped Thandi negotiate the loan agreement, which stated that interest was payable at prime plus one percent. Central does not pay any portion of the interest owing by Thandi.

The following are the interest rates applicable throughout the 2021 and 2022 years of assessment:

Interest Rate	**1 March 2020 – 30 June 2021**	**1 July 2021 – 28 February 2022**
Prime interest rate	7% p.a.	8% p.a.
Official interest rate	7.5% p.a.	7.5% p.a.

The flat was purchased on 1 July 2020, the same date on which the loan was obtained. It had to be renovated at a cost of R50 000, which Thandi was able to pay in cash. The flat was finally complete and let out to students at R7 500 a month from 1 April 2021. Renting is not considered a process of manufacture by the South African Revenue Service ('SARS').

Invention

While on holiday back in Namibia during February 2021, Thandi invented a type of waterproof, breathable material that can be manufactured a lot cheaper than Goretex (the name brand that first invented this type of material in the United States of America). Thandi registered a patent immediately in Namibia on 25 February 2021 for R5 000 and also in South Africa for R9 000 when she returned home on 1 March 2021.

Due to Thandi not being able to afford to manufacture and sell the product herself, she allows other companies to use her invention in their products in return for royalty payments. During the current year of assessment, she earned royalties of R129 600 from South African companies and R80 000 from Namibian companies. Both amounts were earned up until 31 December 2021. No royalties were earned in January or February 2022.

Other income and expenditure

Thandi received the following from investments in respect of the year of assessment ended 28 February 2022 (earned evenly over the year):

Annuity from a South African trust	R18 000 (**note 1**)
South African interest	R23 000
Namibian dividends	R3 200

Note 1: The annuity consists of 60% interest and the remainder as dividends.

Thandi also independently contributes R290 per month to a South African retirement annuity fund (which Central does not take into account for employees tax purposes).

She incurred additional medical expenses to the sum of R21 000 for the 2022 year of assessment.

Additional Information

Thandi submitted both her first and second provisional tax payments on time. She estimated for her first provisional tax payment that she would earn roughly R350 000 in total for the 2022 tax year.

The following table specifies when the last three years' assessments were received back from SARS, the taxable income reflected in those assessments and whether or not that taxable income included any taxable capital gains (i.e. the amounts included in the calculation of taxable income).

Assessment	Date Received	Taxable Income	Taxable Capital Gain
2019 Assessment	15 March 2021	R290 000	R25 000
2020 Assessment	5 September 2021	R302 000	R15 000
2021 Assessment	31 January 2022	R320 000	none

YOU ARE REQUIRED TO:

1. Explain briefly why Thandi Gatso is an 'employee' in terms of the Income Tax Act No. 58 of 1962. **(2 marks)**

2.
   a) Calculate the 'remuneration', as defined, for Thandi Gatso for December 2021. **(4 marks)**

   b) Determine the 'balance of remuneration' for December 2021. **(2 marks)**

   c) Determine the total employees' tax to be withheld by Central (Pty) Ltd in December 2021.
      - Your solution must include, but not be limited to, a calculation breakdown of the employees' tax related to the bonus received by Thandi Gatso. **(8 marks)**

   d) Determine the employees' tax to be withheld by Central (Pty) Ltd for the year of assessment ended 28 February 2022. **(5 marks)**

3. Explain, in detail, whether or not the acquisition price of the flat of R550 000 is deductible in terms of the Income Tax Act No. 58 of 1962. **(8 marks)**

4. Explain the income tax effects of Thandi Gatso's invention in terms of the Income Tax Act No. 58 of 1962. **(6 marks)**

5.
   a) Explain why Thandi Gatso is a provisional taxpayer. **(3 marks)**

   b) Indicate by what date Thandi Gatso is required to make her first provisional tax payment. **(1 mark)**

   c) Calculate the first provisional tax payment made by Thandi Gatso. **(9 marks)**

   d) Determine the taxable income of Thandi Gatso for the year of assessment ended 28 February 2022.
      - Your solution must also include an explanation for any items mentioned in the scenario of the question above that you have specifically excluded from your calculation.

- Your solution must clearly indicate a gross income subtotal, an income subtotal and taxable income.

Gross income	7 marks	
Income	4 marks	
Taxable Income	10 marks	**(21 marks)**

e) Determine the second provisional tax payment made (in accordance with the Income Tax Act No. 58 of 1962) by Thandi Gatso for the year of assessment ended 28 February 2022. Assume Thandi could accurately determine her taxable income at the end of February 2022, i.e. the figure from 5(d) above. **(4 marks)**

f) Calculate the tax liability or tax refund with respect to Thandi Gatso's tax affairs for the tax year ended 28 February 2022. **(4 marks)**

Overall: Presentation, Logic, Clarity and Neatness **(3 marks)**

3.10.2 THANDI GATSO – SUGGESTED SOLUTION

1) An employee is a person, other than a company, **1**
who receives remuneration **1**

2)

a) Remuneration for December

Salary		22 000	**0.5**
Contribution to provident fund by employer (22 000 x 8%)		1 760	
Medical aid contributions by employer - fringe benefit		1 900	**1**
Entertainment allowance	R2 500 - (R10 920 / 12)	1 590	**1**
Travel allowance	80% of R2 000	1 600	**1**
Bonus		80 000	**0.5**
		108 850	

b) Balance of Remuneration

Remuneration			108 850	**1**
less s11F – contributions to provident fund and retirement annuity fund				
Contributions (22 000 x 8% x 2)		3 520		
Limited to the lesser of:				
350 000, and				
27.5% of remuneration	108 850	29 994		
			(3 520)	
			105 330	

c) Employees' tax for December

Annual equivalent excluding bonus	(R105 330 - R80 000) x 12 =	303 960	**1**
Tax per tables = R38 916 + [26% x (R303 960 – R216 201)]		61 733	
Less Rebate		(15 714)	
Less Medical Rebate	(664+224) x 12	(10 656)	
Total employees' tax		35 363	**2**
Employees' tax for December (x1/12)		2 947	**1**
Annual equivalent including bonus	R303 960 + R80 000	383 960	**1**

Tax per tables = R70 532 + [31% x (R383 960 - R337 801)]			84 841	
Less Rebate			(15 714)	
Less Medical Rebate			(10 656)	
Total employees' tax on annual equivalent (including bonus)			58 471	**2**
Employees' tax on annual equivalent (excluding bonus)			35 363	
Employees' tax on the bonus (R58 471 – R35 363)			23 108	**0.5**
Total employees' tax withheld in December = R23 103 + R2 947			26 055	**0.5**

d) Total employees' tax for the year

Employees' tax up till November = R2 947 x 9 months			26 523	**0.5**
Employees' tax for December			26 055	**0.5**
Employees' tax for January and February				
Balance of Remuneration (excluding bonus)	R105 330 - R80 000	25 330		**1**
Use of Segway - 15% x (lower cost / MV) per annum	15% x R6 000 x 1/12	75		
less amount paid by Thandi		(50)		**1**
		25 355		
Annual equivalent	x12 =	304 260		**0.5**
Tax per tables = R38 916 + [26% x (R304 260 – R216 201)]		61 811		
Less Rebate		(15 714)		
Less Medical Rebate		(10 656)		
Employees tax		35 441		**1**
- for 2 months (x2/12)			5 907	**0.5**
Total Employees' Tax			58 485	

3) In order for an amount to be deductible, it must fall under either a special deduction or the general deduction formula. **1**

In this scenario, there is no special deduction under which the R550 000 falls. **0.5**

In the preamble (or beginning part) of s11, it requires the taxpayer to be carrying on a trade - Thandi is earning rental income (an activity included in the definition of trade). **1**

s11(a) requires the following:

> Expenditure or loss - The R550 000 that Thandi has paid for the flat. **1**

> Actually incurred - Thandi has already settled with the seller (i.e. paid out). **1**

> In the production of income - The flat is being purchased in order to earn rental income. **1**

> not of a capital nature

- the flat being purchased is creating an income earning structure (the flat is earning rentals). **1**
- the flat is creating an enduring benefit (being the ability to earn rentals in the future. **1**

Therefore the expenditure is of a capital nature. **0.5**

Hence it is submitted that R550 000 would NOT be deductible due to the cost being capital in nature. **1**

max 8

4) Thandi is a non-resident, and will be taxed on SA source income **1**

s9 deals with amounts that are from an SA source or not from an SA source **1**

In terms of s9(2)(d), the use of the invention in South Africa means that the royalties received for the use thereof is from a South African source. **1**

and hence R129 600 will be included in gross income **1**

Because the royalties are from a South African source, a s49A withholdings tax of 15% is applied to this income **1**

R129 600 x 15% = R19 440 will be withheld and paid over to SARS.

Due to the s49A withholdings tax applying (and because the withholdings tax is a final tax), s10(1)(l) applies to exempt this income from further tax. **1**

Therefore R129 600 will be exempt.

The registration costs of R9 000 should be deductible under s11(gB) **1**

However, as the costs are incurred in order to earn exempt income, the deduction is disallowed under s23(f). **1**

max 6

5)

a) Thandi is under the age of 65 **1**

and earns income from a business and taxable income is in excess of the tax threshold **1**

and taxable income from both interest and dividends exceed R20 000 **1**

b) 31 August 2021 **1**

c) First provisional tax payment

Taxable income estimate - R290 000 - R25 000 basic x 1.24		328 600	**1**
Being the 2019 assessment (as the basic amount) scaled up by 8% per annum for 3 years			
Tax per tables = R38 916 + [26% x (R328 600 – R216 201)]		68 140	
Less Rebate		(15 714)	
Less s6A Medical Rebate		(10 656)	
Less s6B Medical Rebate (disabled dependant)			
- medical aid	22 800		**1**
- employer contribution (deemed to be by Thandi)	22 800		**1**
- reduced by 3 times medical rebate (3 x 10 656)	(31 968)		**1**
- additional medical expenses	21 000		**1**
	34 632		
- Included at 33.3%		(11 532)	**1**
Normal tax on basic		30 237	**1**
First 6 months owing: R30 237 / 2		15 119	**1**
Less employees' tax for first 6 months: R2 947 x 6		(18 684)	**1**
First provisional tax payment		Nil	

d) Taxable income

Gross income

Salary		264 000	**0.5**

Provident fund contribution – fringe benefit				1 760	
Medical aid contribution by employer - fringe benefit				22 800	0.5
Bonus				80 000	0.5
Fringe benefit - Use of Segway (from 2(e) above)	R25 x 2			50	1
Rent income				82 500	1
Royalties – SA source	= 129 600			129 600	1
Royalties - Namibia - not SA source				0	1
Annuity	= 18 000			18 000	0.5
SA interest	= 23 000			23 000	0.5
Namibian Dividends - not SA source				0	0.5
			Gross income	**621 710**	
Less exemptions					
s10(1)(h) non-res interest exemption n/a as in SA for > 183 days				0	1
s10(1)(l) withholdings tax income exemption				(129 600)	1
s10(1)(i) interest exemption	18 000 x 60% =		10 800		1
			23 000		
limited to R23 800				(23 800)	
(s10(2)(b) prohibits exemptions under s10(1)(h) and (k))					1
			Income	468 310	
Add allowances					
travel allowance		Total	24 000		
		Business portion	(9 600)	14 400	1
entertainment allowance		Total	30 000		
		refunded	(10 920)	19 080	1
Less deductions					
s11A - pre-trade interest (rental a new trade)			550k x 8% x 273/365	(32 910)	1
s24J - interest once asset is being used			550k x 8% x 91/365	(10 970)	1
			550k x 9% x 243/365	(32 955)	1
s11(gB) - registration of patent - disallowed as exempt income				0	1
s13(1) - building - no deduction as not used in a process of manufacture				0	0.5
s13(*quin*) - building - no deduction as residential accommodation				0	0.5
Taxable income before s11F retirement deduction				424 955	
less s11F retirement contribution deductions					
Actual contributions (1 760 + 1 760 + 290x12)			7 000		
Limited to the lesser of:					
R 350 000, and					
27.5% of the greater of:					
i)Remuneration (108 850 – 80 000)x12 + 80 000 + (75–15)x2)			426 230		
ii)Taxable income 424 955		x 27.5%	117 213		1
iii)Taxable income			424 955		
Therefore s11F deduction is				(7 000)	1
Taxable income				417 955	

e) Second provisional tax payment

Lower of: Basic amount	320 000		
and estimate (use actual)	417 955		1
Tax per tables on basic = R38 916 + [26% x (R320 000 - R216 201)]		65 904	
Less Rebate		(15 714)	
Less s6A Medical Rebate		(10 656)	
Less s6B Medical Rebate		(11 532)	
Normal tax on basic		28 001	1
Less first provisional payment		Nil	0.5
Less total employees' tax for the year		(58 485)	0.5
		(30 484)	
Therefore second payment =		0	1

f) Tax liability / refund

Taxable Income		417 955	
Tax per tables		95 380	
Less Rebate		(15 714)	
Less Medical Rebates (s6A and s6B)		(22 188)	
Normal tax on basic		57 477	1
Less total employees' tax for the year		(58 485)	0.5
Less total provisional tax payments		nil	1
Normal tax refund due from SARS		(1 008)	0.5
s49A Withholdings Tax	R129 600 x 15%	19 440	1

OVERALL: neatness, coherence, logic, presentation **3**

CHAPTER 4

TRADING DEDUCTIONS AND TRADING STOCK

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4.1. INTRODUCTION

Having established the taxpayer's trading income (for both individuals and companies) by determining gross income and then deducting all exempt income as well certain deductions specific to individuals, the next step in the taxable income calculation is to deduct all other amounts allowed as tax deductions in terms of the Act.

Chapter 4 introduces the general deduction, under which most trading expenses are deductible. This is followed by the deductions that are specifically allowed, whether because they do not meet the general deduction or because the Income Tax Act has specifically included them.

Under certain circumstances, expenditure that might otherwise have been deductible will be disallowed or limited. This is governed by the provisions of section 23.

The last concept explained in this chapter is trading stock.

Learning Objectives

By the end of the chapter, you should be able to:

- Understand the general deduction – as a whole and in its components.
- Discuss whether or not expenditure is deductible under the general deduction.
- Understand all the specific deductions discussed and how to calculate them.
- Understand why section 23 exists and how it affects deductions.
- Understand trading stock from a tax perspective and how each section pertaining to trading stock fits into the taxable income calculation.

4.2. THE GENERAL DEDUCTION

4.2.1. INTRODUCTION

Taxable income (before including capital gains) is equal to 'income' minus 'deductions'. These deductions are allowed in terms of:

- The general deduction – section 11(a) read with section 23(g)
- Specific deductions – section 11 (mainly)

Section 11(a) is worded as follows (italics added):

> '11. General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from *carrying on any trade*, there shall be allowed as deductions from the income of such person so derived—
>
> (a) expenditure and losses *actually incurred* in the production of the *income*, provided such expenditure and losses are *not of a capital nature*;'

Section 23(g) is as follows:

> '23. Deductions not allowed in determination of taxable income.—No deductions shall in any case be made in respect of the following matters, namely—

… (g) any moneys, claimed as a deduction from income derived from trade, to the *extent* to which such moneys were not laid out or expended for the *purposes of trade*;'

The general deduction contained in section 11(a) and its limitation in section 23(g) are vitally important, for it is in terms of these sections that the majority of deductions are determined. The components of the general deduction can be set out as follows -

The preamble to section 11, which requires

- a trade to be carried on
- income to be derived from such trade

Section 11(a), which requires that there be

- expenditure and losses
- actually incurred
- during the year of assessment
- in the production of income
- not of a capital nature

Section 23(g), which prohibits the deduction of

- any moneys claimed as a deduction
- to the extent to which
- the moneys are not laid out or expended for the purposes of trade

Section 23H limits the deduction to a portion of the expenditure where the benefits from the expenditure are for a period which extends beyond the year of assessment. It is not part of the general deduction, but, as it has an important effect on the deduction, it is included in this chapter.

Example of section 11(a) read with section 23(g)

Mr X, a sole proprietor, goes on a business trip overseas and takes his wife with him. For almost half of the time he is on business, and for the rest of the time he takes a holiday with Mrs X. Mrs X does not work in the business. The costs related to his business are tax deductible, because they are incurred for the purposes of trade, and it is in the course of his trade that he earns income. However, as the costs are also incurred to have a holiday, this is a private expense, which is not tax deductible. To the extent that his costs relate to the private expenses, section 23(g) prevents the deduction. Assume that the costs are as follows:

	Mr X	*Mrs X*	*Both*
Airfares	R30 000	R30 000	
Hotel costs while on business (10 days)			R40 000
Hotel costs while on holiday (15 days)			R60 000

The costs deductible by Mr X under section 11(a), read with section 23(g) are as follows:	
Own airfare (R30 000 x 10/25)	R12 000
Hotel costs while on business (R40 000 x 50% - own half)	20 000
Hotel costs while on holiday (not deductible)	-
Total section 11(a) deduction	R32 000

Essentially, qualifying for a general deduction requires the consideration of two sections. Section 11(a) provides positively for what may be deducted, and section 23(g) is a general prohibition section that provides negatively for what may not be deducted. The deduction claimed must satisfy both sections.

Before examining paragraph (a) in detail, it is necessary first to examine the general introduction to section 11. The introduction contains two requirements, both of which must be satisfied before an amount qualifies as a deduction in terms of section 11 (unless a particular subsection specifically provides that one or the other need not apply, e.g. section 11(n)) -

- the first is that the taxpayer must be carrying on a trade
- the second is that income must be derived from that trade.

4.2.2. TRADE

The term ‘trade’ is defined in s1 and may be summarised as follows:

> 'Trade' includes every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of, or the grant of permission to use any patent, or any design or any trade mark, or any copyright, or any other property which is of a similar nature.

'Trade' implies an active occupation, as opposed to the passive earning of investment income. Note that, although rental earned from the letting of property might not require any active involvement on the part of the lessor, the letting of property is specifically included in the definition of trade. This is also the position in the case of income (royalties) arising from the use of patents, trademarks or copyrights, which is deemed to be income from a trade. The preamble to section 11(a) requires that a trade be ‘carried on’. This term implies that there must be some continuity. However, in certain circumstances even a single venture can amount to the ‘carrying on’ of a trade.

The court has ruled that ‘trade’ must be given the widest possible interpretation and includes any venture involving the taking of a risk in the pursuit of profit (*Burgess v CIR* (1993 AD)).

4.2.3. TAX VERSUS ACCOUNTING

The accounting treatment of expenditure is, to a large extent, irrelevant in deciding whether or not it is deductible for tax purposes. An expense or loss will only be allowed as a tax deduction if it meets all the requirements discussed below. A failure to meet any one of the requirements will result in a disallowance of the expenditure for tax purposes, irrespective of how correct its deduction may seem to be from an accounting point of view. Each of the components of section 11(a) will be examined in greater detail.

4.2.4. EXPENDITURE AND LOSS

The Act refers to both expenditure and losses in section 11(a). Whether or not there is any difference between the two terms is not clear. A possible difference is that losses may be expenditure of an involuntary nature. In any event, whether or not there is a difference between expenditure and losses does not appear to be a problem of any significance.

Expenditure and losses refer not only to cash outflows, but to liabilities, which may be settled in cash or otherwise. An example of expenditure in a form other than cash would be payment made by means of shares or land, in which case the cash equivalent of the value of the asset disposed would represent the expenditure.

4.2.5. ACTUALLY INCURRED

In deciding whether or not expenditure has actually been incurred, it is not essential to decide whether it was necessarily incurred. In other words, it is not for the tax authorities to decide whether or not the expenditure was prudent or otherwise. The mere fact that it has been actually incurred means that it passes this test. The deductibility of expenditure is not determined on a cash basis, that is, it is not necessary to have actually paid the expense before the deduction can be claimed. As long as the liability has been incurred (i.e. the money is owed), expenditure has arisen that may be claimed.

Whether or not an expense has been incurred is often determined by examining the obligations arising out of a contractual agreement. Where an expense incurred during the year cannot be quantified, the amount must be estimated, based on the information available. However, this must be distinguished from the case where it is not certain that a taxpayer will have to pay an expense. An expense is not actually incurred if there is a chance that the liability will not arise. In other words, the liability must be unconditional (see *Edgars Stores Ltd v CIR* (1988 AD).

- It is generally accepted that where an expense has been paid and the payer has no right to recover the funds, the expense has been incurred even if the payer has not yet received the goods or services for which he has paid.
- If an expense has not been paid, the liability will only be incurred once the taxpayer has received the goods or services from the supplier and owes him the money, because then the supplier will have performed and the purchaser is then bound to carry out his side of the agreement, i.e. to pay.

In *Nasionale Pers Bpk v KBI* (1986 AD) the court held that an accounting provision does not lead to the expense being actually incurred where no legal liability exists.

In *CIR v Golden Dumps (Pty) Ltd* (1993 AD), the court ruled that an amount is not 'actually incurred' for so long as it remains under dispute.

4.2.6. DURING THE YEAR OF ASSESSMENT

Although not specifically mentioned in section 11(a), the expenditure that the taxpayer seeks to claim as a deduction must be incurred during the year in which it is claimed. This means that the accounting principle of matching does not apply in the case of tax and that the expenditure must be claimed in the year in which it is incurred.

Prohibition of deductions in respect of prepaid expenses - Section 23H

Section 23H prohibits a section 11(a) deduction in situations where an expense is incurred in one tax year but the benefits (of the expenditure) are not enjoyed in full during the year. Subject to certain exceptions the deduction of such expenditure is deferred until the benefit is received. (See later).

4.2.7. IN THE PRODUCTION OF INCOME

This is probably the most onerous requirement of section 11(a). In terms of this requirement, any expenditure that has not been incurred for the purpose of producing income will not be allowed as a deduction. However, notwithstanding that the section refers to expenditure incurred in the production of income, it is clear that expenditure, in itself, does not produce income. Normally it is *actions* that produce income, and expenditure is merely a consequence of such actions. The expenditure attendant upon such actions is expenditure incurred in the production of income.

To identify expenditure incurred for the purpose of producing income, the courts (notably in *Port Elizabeth Electric Tramway Co Ltd v CIR* (1936 CPD), *Joffe and Co (Pty) Ltd v CIR* (1946 AD) and *COT v Rendle* (1965 (1) SA 59)) have ruled the following:

- Firstly, the act giving rise to the expenditure must have been performed for the purpose of producing income, and;
- Secondly, the expenditure in question must be closely linked to the performance of the act so identified.

Where the risk of having to incur the expenditure is an inevitable concomitant of the income-producing operations, it generally implies that the expenditure is incurred in the production of income. To say that the risk is an 'inevitable concomitant' means that the risk 'unavoidably comes with' the income-producing operations.

It may happen that an expense is incurred for a dual purpose (e.g. partly to earn income and partly to earn exempt income). In such a case the expense may have to be apportioned, and the portion incurred to produce exempt income cannot be deducted.

It should be noted that the term, '*in the production of income*', does not mean that the expenditure may only be deducted once the income has been produced (*Sub Nigel Ltd v CIR* (1948 AD)). As long as the purpose of the expense is to enable the taxpayer to earn income, the income may be earned in a later year. The expenditure is still deductible in the earlier year.

It is submitted that where an expense is incurred after the income is earned, it will be more difficult for the taxpayer to show that the expense was instrumental in producing the income if he was not bound before the income was earned to incur the expense. SARS could argue that, where the expense is voluntary, the taxpayer need not incur it, and this would not affect the production of the income that has already been earned.

4.2.8. NOT OF A CAPITAL NATURE

Just as capital receipts and accruals do not fall into gross income, capital expenses are not allowed as a deduction from income in terms of section 11(a). (Note: Allowances are granted in respect of certain capital expenditure in terms of specific provisions such as those contained in sections 11(e), 11(o), 12, 12B, 12C and 13, which are covered in Chapter 5. Furthermore, certain capital expenses are allowed against proceeds in determining capital gains for the purposes of 'capital gains tax' (see Chapter 6)).

As in the case of gross income, it is not always easy to decide whether an expense is of a capital or revenue nature. However, the tests for expenditure of a capital nature may be summarised as being where:

- it adds to the taxpayer's income-earning structure – *New State Areas Ltd v CIR* (1946 AD)
- it is a once-off expense from which future benefits (income) will flow. It is acquiring a source of profit, not the working of the source itself – *CIR v George Forest Timbers Co Ltd* (1924 AD)
- it creates an enduring benefit or advantage for the taxpayer – *Atherton v British Insulated and Helmsby Cables Ltd* (1926)

4.3. SPECIFIC DEDUCTIONS

The special deductions which are set out in sections 11(c) to 11(x) and sections 11A, 11D and 11E are generally meant to enlarge on the general deduction, not restrict it. Nevertheless, there are a number of special deductions that limit a deduction. Unless specifically otherwise provided, the special deductions under section 11 are subject to the trade requirement in the preamble to section 11. The objective here is to deal with the more common and important specific deductions.

4.3.1. DOUBLE DEDUCTIONS – SECTION 23B

Generally, expenses can only be deducted once, and a special deduction overrides the section 11(a) general deduction provision.

Section 23B provides that, where an amount qualifies for a deduction or allowance or may otherwise be taken into account in determining the taxable income of any person under more than one provision of the Act, such amount shall not be allowed to be taken into account more than once in the determination of taxable income (unless the Act specifically provides for a double deduction). The section furthermore provides that no deduction will be allowed under section 11(a) (the general deduction provision) if the deduction is dealt with under a specific section, even if the specific section limits the deduction or if the deduction under that section is granted in a different year of assessment.

4.3.2. VAT – SECTION 23C

Generally, Value-Added Tax (VAT) only has an income tax effect for non-vendors (persons not registered for VAT).

In terms of section 23C, VAT has the following effect on the cost or the market value of an asset or the amount of an expense for income tax purposes:

- If the taxpayer is registered as a vendor for VAT purposes, VAT paid by him as part of the cost of goods or services he acquires is excluded from the cost or the market value of an asset or the amount of an expense incurred by him if he is (or was in any previous year) entitled to claim back that VAT as an input. By claiming the VAT as an input, the vendor effectively obtains a refund of this VAT from SARS.
- If the taxpayer is not registered for VAT purposes, or if he is not entitled to claim an input, any VAT paid by him is part of his tax cost of the asset or expense (see Chapter 7).

Example – When VAT is part of the cost of an asset

Make (Pty) Ltd (a VAT vendor) purchases the following two assets:

– a motor car for R115 000

– a truck for R230 000

Because the VAT Act prohibits a deduction of an input in the case of a motor car, the cost of the motor car for income tax purposes is R115 000. Wear and tear will be claimed on R115 000.

In the case of the truck a VAT input of R30 000 will be claimed. It will either be set off against the VAT that the vendor owes to SARS or SARS will refund it to him. The cost of the truck for income tax purposes is therefore R200 000. Wear and tear will be claimed on R200 000.

Where regard is to be had to the market value of an asset acquired by a taxpayer, such market value must be reduced by any VAT that the taxpayer is entitled to claim as an input. It should be noted that the market value is reduced by the *actual* VAT input and not by the VAT fraction (15/115) of the market value.

Example – VAT deducted from market value

Make (Pty) Ltd purchases a manufacturing machine for R575 000 on 1 March 2021. At the time of the purchase the market value of the machine is R450 000. Being a VAT vendor, Make claims a VAT input of R75 000. In terms of section 12C of the Income Tax Act, an allowance is allowed on the lower of the cost of the asset or the market value. The allowance will therefore be based on R375 000 which is the market value (R450 000) reduced by the actual VAT input (R75 000).

4.3.3. LEGAL EXPENSES

Section 11(c) provides for the deduction of certain types of legal expenditure that would not otherwise be deductible under section 11(a).

Legal expenses which are not incurred in the production of income are not allowed as a deduction in terms of section 11(a). The section provides for a deduction of the following legal costs:

- fees for legal practitioners;
- expenses incurred in order to procure evidence or expert advice;
- court fees;
- taxing fees, witness fees and expenses;
- the costs of sheriffs and messengers of the court; and
- any other similar costs.

In order to qualify for a deduction the costs must be:

- actually incurred;
- in respect of any action, claim, dispute or action at law;
- in the course of, or by reason of, ordinary operations in carrying on trade; and
- not of a capital nature.

In addition, section 11(c) will only apply if the expenses are incurred in respect of a claim, dispute or action at law relating to such claim, by or against the taxpayer, and the amount being claimed by the taxpayer is an amount which would be taxable if the taxpayer wins or the amount claimed against the taxpayer would be deductible if he loses.

Example – Legal expenses

Sellit (Pty) Ltd hired an electrician to rewire its retail outlet at the Waterfront. However, the electrician reconnected the wires incorrectly, resulting in a fire. Sellit incurred legal expenses of R6 000 in suing the electrician for damages. In compensation it received R50 000 for the replacement of damaged shop fittings, and R10 000 for lost revenue during the time that the store had to be closed.

Sellit (Pty) Ltd can deduct legal expenses of R1 000 in terms of section 11(c), since R10 000 of the total compensation will be included in gross income. The remaining R50 000 received is capital in nature, and the legal expenses incurred to secure this amount are therefore not deductible.

4.3.4. RESTRAINT OF TRADE PAYMENTS

Restraint of trade payments are not deductible under section 11(a) because of their capital nature. However, section 11(cA) permits a deduction in respect of restraint of trade payments which are taxable in the hands of the recipient. The section provides for an allowance in respect of:

- any amount actually incurred by a person
- in the course of the carrying on of his trade
- as compensation in respect of any restraint of trade imposed on any natural person
- to the extent that the amount constitutes or will constitute income of the person to whom it is paid.

LIMIT

The deduction shall not exceed in any one year the lesser of -

- the amount incurred divided by the number of years (or part thereof) during which the restraint will apply; or
- one third of the amount incurred.

Note that the deduction is not apportioned if the expense is incurred part way through the tax year.

Example – Restraint of trade

On 1 June 2021 Tough (Pty) Ltd, which has a December year-end, incurs the following amounts in respect of restraint of trade payments to two employees:

(1) Mr X, a chemical engineer, is paid R5 million to restrain him from working for a competitor for a five-year period after he leaves the company.

(2) Mrs Y is paid R3 million to restrain her from working for 2 years and 6 months after she leaves the company.

Both Mr X and Mrs Y are taxed on the restraint payments.

Tough (Pty) Ltd may claim the following deductions in terms of section 11(cA)

Year ended 31/12/2021

Mr X	R5m ÷ 5	=	R1 m
Mrs Y	R3m ÷ 3	=	R1 m

The R1 million in respect of Mr X will be deducted in the years ended 31 December 2021 to 2024. The R1m in respect of Mrs Y will be deducted in the years ended 31 December 2021 to 2023.

4.3.5. REGISTRATION OF PATENTS, COPYRIGHTS, DESIGNS AND TRADEMARKS

Section 11(gB) allows a deduction in respect of expenditure actually incurred in:

- obtaining the grant of any patent,
- the restoration of any patent,
- the extension of the term of any patent,
- the registration of any design,
- the extension of the registration period of any design,
- the registration of any trade mark, or
- the renewal of the registration of any trade mark

if such patent, design or trade mark is used by the taxpayer in the production of his or her income.

Note that this section does not allow a deduction in respect of the actual cost of acquisition of the intellectual property (the patent, design or trade mark). The cost of acquisition is dealt with in section 11(gC).

4.3.6. ACQUISITION OF PATENTS, COPYRIGHTS AND DESIGNS

Section 11(gC) provides for an allowance in respect of expenditure actually incurred (in a year commencing on or after 1 January 2004).

The expenditure must be actually incurred to *acquire* (from someone else)

- any invention or patent (defined in the Patents Act)
- any design (defined in the Designs Act)
- any copyright (defined in the Copyright Act)
- any property of a similar nature (other than a trade mark)
- any knowledge connected with the use of such property or the right to have such knowledge imparted

The deduction does not apply to research and development costs.

The deduction is allowed in the year of assessment in which the property is brought into use for the first time by the taxpayer for the purposes of his trade.

If the expenditure is less than or equals R5 000 it is deducted in full in the year that the asset is brought into use for the first time.

If the expenditure exceeds R5 000 the allowance is

- 5% (per annum) of the expenditure, in the case of a patent, copyright or similar property (including knowledge and knowledge rights)
- 10% (per annum) of the expenditure, in the case of a design or similar property (including knowledge or knowledge rights)

Note Where assets of this nature (i.e. intellectual property) are *created* rather than acquired by the taxpayer from another person the provisions of section 11D (discussed below) will apply.

4.3.7. RESEARCH AND DEVELOPMENT EXPENDITURE

Section 11D applies to research and development expenditure undertaken on or after 1 January 2012.

Note that where an asset is immovable property, machinery, plant, implements, utensils or articles, the asset cannot obtain a deduction under section 11D, unless it is a prototype or pilot plant created solely for the purpose of the process of research and development and that prototype or pilot plant is not intended to be utilised or is not utilised for production purposes after that research and development is completed.

This means that section 11(e), 12C or 13 (amongst others) assets will not obtain a section 11D deduction, as there are specific subsections within those sections allowing a deduction for research purposes.

For example, new or unused machinery or plant acquired on or after 1 January 2012 and brought into use for the purposes of qualifying R&D will qualify for a section 12C allowance of 50% in the first year, 30% in the following year and 20% in the final year. This also applies to improvements to such machinery or plant.

Similarly the scope of section 13(1) includes buildings used wholly or mainly for carrying on research and development therein.

Research and development definition – section 11D(1)

R&D means systematic investigative or systematic experimental activities of which the result is uncertain, for the purpose of

(a) discovering new non-obvious scientific or technical knowledge;
(b) creating or developing
  i. an invention;
  ii. a functional design;
  iii. a computer programme;
  iv. knowledge essential to the use of such invention, functional design or computer program (other than operating or instruction manuals);
(c) making a significant and innovative improvement to any invention, functional design, computer program or knowledge for the purposes of new or improved function or improvement of performance, reliability or quality of that invention, functional design, computer program or knowledge;
(d) creating or developing a multisource pharmaceutical product; or
(e) conducting a clinical trial

Note that these costs can be capital or revenue in nature.

Actual deduction – section 11D(2)

The deduction is:

- 150% of research and development expenditure
- actually incurred
- directly and solely in respect of research and development undertaken in South Africa
- in the production of income
- and in the carrying on of any trade
- where the research and development is approved by the Minister of Science and Technology, and
- where the expenditure is incurred on or after the date the Department of Science and Technology receives the application for approval of the research and development.

No deduction may be allowed in respect of immovable property, machinery, plant, implements, utensils or articles, except for prototypes or pilots.

Note that the section 11D deduction is only available to taxpayers that are companies.

Research and development carried on by a third party – section 11D(4)

If the taxpayer incurs expenditure to fund the expenditure of another person carrying on research and development on behalf of the taxpayer, the taxpayer qualifies for the deduction of 150% of the research and development if:

- that research and development is approved by the Minister;
- the expenditure is incurred in respect of research and development carried on by the taxpayer; and
- the expenditure is incurred on or after the date of receipt of the application by the Department of Science and Technology for approval of that research and development.

The amount is allowed to the extent that the other person that carries on the research and development on behalf of the taxpayer is

- exempt from tax; or
- the Council for Scientific and Industrial Research (CSIR); or
- a company in the same group of companies, if
  - the company that carries on the research and development does not claim a 150% deduction
  - the taxpayer's deduction is limited to 150% of the *actual expenditure* incurred directly and solely in respect of that research and development carried on by the other group company

Categories of research and development – section 11D(6)

A person carries on research and development if that person is able to alter the methodology of the research. Notwithstanding this, if the Minister of Science and Technology designates certain categories of research and development in the Government Gazette, these are deemed to be the carrying on of research and development.

Government grant – section 11D(7)

No deduction is allowed, if funded by a government grant. The 150% may still be claimed on qualifying expenditure incurred in excess of the expenditure which is funded.

Non qualifying expenditure

The following are non-qualifying expenditure for section 11D:

a) routine testing, analysis, collection of information or quality control in the normal course of business;
b) development of internal business processes, unless those internal business processes are intended for sale or for granting the use or right of use or grant of permission to use thereof to persons who are not connected persons;
c) market research, testing or sales promotion;
d) social science research, including arts and humanities;
e) oil and gas or mineral exploration or prospecting, except research and development carried on to develop technology used for that exploration or prospecting;
f) the creation or development of financial instruments or financial products;
g) the creation or enhancement of trademarks or goodwill; and
h) any expenditure contemplated in section 11(gB) or (gC)

Even though the above expenditure is non-qualifying in terms of section 11D, it may still be deductible under section 11(a) if the requirements of that section are met.

No section 11D deduction is claimable for administration, financing, compliance or similar expenditure.

Approvals process – section 11D(11) to 11D(18)

Briefly, the applications for approval under section 11D must be made to the Department of Science and Technology, in a prescribed form, containing information prescribed by the Department for submission.

4.3.8. BAD DEBTS

A bad debts deduction is allowed in terms of section 11(i), in respect of debts which:

- are due to the taxpayer
- have during the year of assessment become bad, and
- are in respect of amounts which have been included in the taxpayer's income in the current or any previous year of assessment, i.e. the supply which gave rise to the debt which gave rise to gross income.

All three of the above conditions must be fulfilled in order for the debt to qualify for deduction. SARS will only treat a debt as bad if the taxpayer can show that it has ceased active recovery collection or handed the debt over to an attorney or debt collector, and has written the debt off in its books.

If for example a person disposes of his debtors to a finance house and guarantees that he will compensate the finance house for any debts that go bad, he will not be granted a bad debts allowance because the debts are no longer due to him (*Cooper v COT* (SR) 1952). The finance house will also not be entitled to a deduction because the debts were not previously included in its income. The situation is different, however, if the sale agreement provides that bad debts will revert to the seller. In such a case the bad debts allowance may be deducted by the seller.

Example – Bad debts

Sellit (Pty) Ltd (a VAT vendor) writes off the following debts as bad debts at 28 February 2022 (its year-end).

- Poor (Pty) Ltd R9 200

  In respect of sales made in March 2018, now considered irrecoverable

- Mr Weak R15 000

  The amount owing by Mr Weak, who was an employee, consists of a loan of R10 000 and accrued interest of R5 000. Mr Weak has disappeared and the debt is irrecoverable.

Solution

A section 11(i) bad debts allowance is deducted as follows:

Poor (Pty) Ltd	R8 000
Mr Weak	R5 000

Note (i) Poor's debt includes VAT of R1 200 (R9 200 x 15/115). The VAT portion may be claimed as a VAT input deduction. When the sales took place only R8 000 (R9 200 x 100/115) was included in income.

(ii) The loan of R10 000 was not included in Sellit's income and therefore cannot be claimed as a bad debt deduction. The interest on the loan would have been included in Sellit's income when it accrued and therefore is deductible in terms of section 11(i).

There is a difference between writing off a debt as bad and reversing a debt. A debt can be reversed by passing a credit note, because the sale was cancelled or the price was reduced. In such a case the debt is not bad, and the adjustment is made by claiming a section 11(a) deduction.

4.3.9. DOUBTFUL DEBTS

Section 11(j) provides for a deduction of debts that are doubtful. The allowance is only made in respect of debts that would have been allowed as a deduction had they become bad.

The allowance is calculated differently, depending on whether a specific accounting standard, IFRS 9, is being applied to the debt. In most circumstances IFRS 9 will only be applied by companies.

If IFRS 9 is being applied, the debtor's book must be stratified by risk:

- Where the risk of default has not changed since credit was granted, the taxpayer must make an assessment of expected losses in the next 12 months and provide for that. The tax deduction will be 25% of this provision.
- Where the risk of default has increased, the taxpayer must make an assessment of the lifetime expected credit losses and provide for that. The tax deduction in this circumstance will be 40% of the accounting provision.

If IFRS 9 is not being applied (i.e. for persons other than companies), the taxpayer can claim 40% of debt 120 days or more in arrears, and 25% of debt 60 days or more in arrears (excluding the debt 120 days or more in arrears).

The allowance under section 11(j) must be added back to the taxpayer's income in the following year of assessment. If the debt has gone bad in the following year, it will then be deducted under section 11(i) (if it meets the requirements of that section).

4.3.10. CONTRIBUTIONS BY AN EMPLOYER TO PENSION, PROVIDENT AND BENEFIT FUNDS

An employer may deduct contributions, made for the benefit of employees, to pension, provident and benefit funds (section 11(*l*)).

The section makes the following provisions for situations involving partnerships:

- For the purpose of determining the deduction, the partnership shall be treated as the employer. In the absence of this provision, each partner in the partnership would, in terms of the law of partnerships, be an employer. In terms of this provision only one deduction will be allowed to the partnership and individual partners will effectively deduct a portion based on their profit share.
- A partner who is a member of a pension, provident or benefit fund is deemed to be an employee of the partnership.

4.3.11. DONATIONS TO PUBLIC BENEFIT ORGANISATIONS

Donations to tax-exempt public benefit organisations (PBO's) are free of donations tax. However, this does not mean that such donations are deductible from a person's income for income tax purposes. Donations are only deductible if the PBO is registered in terms of Part II of the Ninth Schedule, so that it is able to issue tax deduction certificates for donations made to it.

In terms of s18A a deduction (subject to a 10% limit of taxable income – see below) is allowed in respect of the sum of *bona fide* donations of cash or property in kind made by a taxpayer, during the year of assessment, to:

- Certain public benefit organisations approved by the Commissioner under section 30. These are approved PBO's which carry on activities listed under Part II of the Ninth Schedule.
- Any institution, board or body contemplated in section 10(1)(cA)(i) which carries on any public benefit activity contemplated in Part II of the Ninth Schedule (or any other activity determined from time to time by the Minister) in the Republic.
- Any public benefit organisation approved by the Commissioner under section 30 which provides funds or assets to any other (section 18A) approved public benefit organisation, or to any (section 18A) institution, board or body contemplated in section 10(1)(cA)(i).
- Government, any provincial administration or municipality as contemplated in section 10(1)(a).
- Any Specialized Agency overseas (per Schedule 4 to the Diplomatic Immunities and Privileges Act) that carries on approved activities (per Part II of the Ninth Schedule or as determined by the Minister of Finance) and complies with certain requirements (it must comply with section 18A for example).

The donation deduction is available to all taxpayers (individuals, trusts, companies, and close corporations). The deduction is limited to an amount that does not exceed 10% of the taxable income of the taxpayer before the deductions under this section and excluding any taxable income from any retirement lump sum benefit. A deduction is only allowed if the donation is made to an organisation listed in Part II of the Ninth Schedule.

Any amount donated over the 'deductible' limit is carried forward to the next year of assessment.

A claim for a deduction in respect of any donation shall not be allowed unless supported by a receipt issued by the recipient of the donation. The following details must be reflected on the receipt:

- the reference number (issued by the Commissioner) of the public benefit organisation, institution or board;
- the date of the receipt of the donation;
- the name of the public benefit organisation, institution or board;
- the name and address of the donor;

- the amount of the donation or nature of the donation (if not in cash);
- a certification that the receipt is issued for the purposes of section 18A.

Note that subsection (18A(1C)) imposes restrictions in respect of the issuing of receipts by PBO's engaged in Conservation, Environment and Animal Welfare activities. Where the PBO fails to use the donated funds for carrying out its objects, the taxpayer's receipt becomes invalid and cannot be used to support a deduction.

4.3.12. ANNUITIES PAID TO FORMER EMPLOYEES ON RETIREMENT

Annuities paid by employers are dealt with in three situations as follows (section 11(m)):

(1) Annuities paid to former employees:

An employer may deduct (in full) an annuity for each year that it is paid to a former employee, provided that the employee retired on the grounds of old age, ill-health, or infirmity.

(2) Annuities paid to dependants of former employees or partners:

A deduction is also allowed in respect of annuities paid to the dependants of a former retired or deceased employee or partner. It is not a requirement for this deduction that the employee or partner retired on the grounds of old age, ill-health or infirmity. The person must be dependent upon an employee who is not deceased, or must have been dependent immediately prior to the former employee's death.

(3) Annuities paid to former partners:

A taxpayer may deduct an annuity paid to a person who was a partner in the taxpayer's business and who has retired on the grounds of old age, ill health or infirmity. However, the following must apply:

- The retired partner must have been a partner for at least 5 years;
- the amount of the annuity must be reasonable in the light of his services as a partner;
- the amount of the annuity must also be reasonable in the light of the profits earned by the partnership;
- the payment must not be in lieu of any other interest, such as goodwill; and
- it must be a genuine annuity.

Example – Annuity to employee and dependant

Mr Q retired from QB (Pty) Ltd at the age of 59, on the grounds of old age. As his pension was not enough to support him, the company decided, voluntarily, to pay him an amount of R1 000 per month. After 8 months Mr Q died, so the company decided to continue paying the annuity to his dependent widow. For the company's year of assessment ended 31 March 2022 the company had paid the following annuities:

Mr Q : 8 months x R1 000 =	R 8 000
Mrs Q : 4 months x R1 000 =	R 4 000
	R12 000

The section 11(m) deduction is -

Mr Q	R 8 000
Mrs Q	R 4 000
	R12 000

4.4. DEDUCTIONS SPECIFICALLY NOT ALLOWED IN DETERMINATION OF TAXABLE INCOME

Section 11(a) read with section 23(g) is the general deduction in the Income Tax Act, section 11(a) being the positive test and section 23(g) being the negative test. The reason that section 23(g) is looked at as being part of the 'general' deduction is that it is a general prohibition subsection. The specific prohibition provisions in the rest of section 23 must also be looked to as these prohibitions further limit the operation of the general deduction. This is the reason they are covered here, together with section 23(g).

4.4.1. PRIVATE AND DOMESTIC EXPENDITURE – SECTIONS 23(a) AND (b)

Private or domestic expenditure is not deductible. Section 23 prohibits the deduction of:

- the cost of maintenance of the taxpayer, his family or establishment (home) – section 23(a)
- domestic or private expenses – section 23(b). There are two exceptions to this (see below).

Expenditure such as bond interest, repairs to domestic dwellings, domestic worker's wages and costs of running a private motor vehicle are all disallowed under these two sub-sections. It should be noted, though, that subparagraph (a) of the proviso to section 23(b) does make provision for the deduction of expenditure incurred in respect of any portion of a private dwelling occupied *exclusively* and regularly for the purpose of trade (normally computed using floor area). That portion must be specifically equipped for the trade, however.

In terms of subparagraph (b) to the proviso to section 23(b), a full-time salaried employee will not be permitted a deduction in respect of a home office, unless it is specifically equipped for the purposes of the employee's trade and regularly and exclusively used for that purpose and one of the following applies–

- the employee's income from employment is derived mainly from commission or other variable payments based on his or her work performance and the employee's duties are performed (mainly) outside any office provided to him or her by the employer; or
- the employee's duties are mainly performed in his study.

It is submitted that if an employee also carries on some other trade he will still be entitled to a deduction if he uses his home office regularly and exclusively for the purposes of that trade and it is specifically equipped for trade (see, also, section 23(m) below).

4.4.2. INSURED LOSSES – SECTION 23(c)

If an expense is recoverable from someone else, there are logically two ways to deal with it,

- it should not be deductible in the first place; or
- it should be deducted and the amount recovered should be included in income

The correct treatment depends on the circumstances. Usually, the expense is first deducted and the recovery is included in income. In the case of insured losses, however, the position is different. The loss is not deducted and the amount recovered is not taxable if there is a direct link between the two. Section 23(c) disallows as a deduction of any loss or expenditure to the extent that it is recoverable under any contract of insurance, guarantee, security or indemnity.

For example, if a taxpayer suffers a loss, as a result of theft, which is deductible in terms of section 11(a), such loss will only be deductible to the extent that it is not recoverable under an insurance policy or any other form of indemnity.

4.4.3. TAX, PENALTIES AND INTEREST ON TAX – SECTION 23(d)

Section 23(d) prohibits the deduction of –

- income tax
- donations tax
- secondary tax on companies
- penalties on the above taxes
- penalties on Value-Added Tax
- penalties on any other tax administered by the Commissioner (customs duty, stamp duty, securities transfer tax, estate duty, transfer duty)
- penalties on the Regional Services levies
- interest on any tax administered by the Commissioner
- interest on the Regional Services levies
- penalties and interest on the Skills Development Levy paid in terms of the Skills Development Levies Act (No. 9 of 1999)

- penalties and interest on unemployment insurance contributions paid in terms of the Unemployment Insurance Contributions Act (Act 4 of 2002).

The following taxes may be claimed as a tax deduction to the extent that they are part of a deductible expense, or a tax allowance may be claimed on the cost of the article including these taxes, provided that in all cases the tax is not recoverable from the Revenue Service:

- Value-Added Tax
- Customs duty
- Stamp duty
- Securities transfer tax
- Transfer duty

Example – Deductible VAT

X (Pty) Ltd provides an employee with the use of a company owned motor car which cost R115 000 (including VAT). In terms of section 18(3) of the VAT Act the granting of the fringe benefit constitutes the supply (by X (Pty) Ltd) of a service. X (Pty) Ltd has to account for a monthly VAT output calculated as follows:

R115 000 x 100/115 x 0,3% x 15/115 = R39,13

Because this amount is a deemed output, X (Pty) Ltd does not actually recover it from the employee. In effect it is an expense incurred by X (Pty) Ltd in the production of its income. Because Value-Added Tax is not a prohibited deduction in terms of section 23(d), X (Pty) Ltd will be entitled to claim a section 11(a) deduction of R469,57 (R39,13 x 12) in the determination of its taxable income for the year.

4.4.4. PROVISIONS – SECTION 23(e)

Unless the Income Tax Act specifically provides for the deduction of a reserve (such as in section 24C, the provision for future expenditure, or section 11(j), the provision for doubtful debts), a taxpayer may not claim a deduction of a provision or amount transferred to a reserve.

This subsection supports the section 11(a) principle that expenditure may only be deducted once it has been actually incurred, unless specifically otherwise provided for in the Act.

4.4.5. EXPENSES TO PRODUCE EXEMPT INCOME – SECTION 23(f)

Section 23(f) specifically provides that an expense incurred for the purpose of earning any amount which is not income, is not deductible. In terms of the general deduction formula, such an expense would in any event not be deductible as it is not in the production of income.

Income is defined as gross income less exempt income. Any expenditure incurred in generating an amount that is exempt or which is not gross income is therefore not deductible. If, for example, a company borrows money to enable it to buy shares in another company for the purpose of earning exempt dividends, any interest that it pays on the borrowed money will not be allowed as a deduction because the dividends do not fall into its income. (South African dividends received are generally exempt in terms of section 10(1)(k)).

Although section 23(f) merely says that 'any expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in section one' of the Income Tax Act are not deductible, the practice of the Revenue Service has been to allow only a portion of expenditure where a taxpayer earns both exempt and 'taxable' income, and the expense relates to both sources of income.

Example – Apportionment of expenses based on income

XYZ (Pty) Ltd is the holding company of ABC (Pty) Ltd and DEF (Pty) Ltd. During the year it received dividends of R300 000 and royalties of R200 000 from its subsidiary companies (ABC and DEF). It acquired the shares in these companies both for the purpose of earning management fees and earning dividends. Its expenditure for the year that related to both sources of income was as follows:

- office rental	R30 000
- audit fees	R10 000
- bank charges	R5 000
- directors' fees	R20 000
- general office costs	R40 000

XYZ's taxable income for the year will be as follows:

Dividend income		R300 000
Royalty income		200 000
Gross income		R500 000
Less: Exempt income (dividends)		(300 000)
Income		R200 000
Less expenses:		
Office rental	R30 000	
Audit fees	10 000	
Bank charges	5 000	
Directors' fees	20 000	
General office costs	40 000	
	R105 000	
Deductible portion is R200 000/500 000 x 105 000		(42 000)
Taxable income		R158 000

4.4.6. NON-TRADE EXPENDITURE – SECTION 23(g)

Unless specifically provided for in the Act, a non-trade expense cannot be deducted. This is prohibited by the general provision contained in section 23(g) that prohibits the deduction of moneys paid to the extent that such moneys were not expended for the purposes of trade. The use of the word 'extent' in the section implies that if the expense is only partly for trade purposes, only part of it will be allowed as a deduction.

Section 23(g) is frequently used by SARS to either disallow the deduction of an expense or to limit such deduction. For example if a taxpayer incurs expenditure in respect of a holiday house which he uses for private use and for letting the expenditure will have to be apportioned and only that portion relating to trade (the letting) is allowed as a deduction in terms of section 11(a).

4.4.7. RESTRAINT OF TRADE PAYMENTS – SECTION 23(*l*)

Section 23(*l*) prohibits a deduction of restraint of trade payments except as provided for in section 11(cA). Section 11(cA) allows a restraint of trade payment to a natural person to be deducted over the period of the restraint agreement or three years, whichever is longer.

4.4.8. EXPENDITURE RELATING TO EMPLOYMENT – SECTION 23(m)

Section 23(m) prohibits a deduction of expenditure relating to employment or holding of office unless the deduction is specifically permitted in terms of this section. Any expenditure not included in the list of allowable deductions may not be deducted.

The section applies to:

- employees or holders of office
- who derive remuneration (as defined in the Fourth Schedule)

The section does not apply to:

- an agent or representative
- whose remuneration is normally derived mainly in the form of commission based on sales or turnover.

The allowable deductions under section 23(m) are considered in chapter 1.

The prohibition only applies to expenses incurred in the production of employment income. It does not prohibit expenditure incurred in the production of other income.

Example – employment and non-employment expenditure

Mr X works for the Municipality in the day as a Human Resources Manager. In the evening he runs a gardening website. Through the website he sells seeds, fertilizer, and gardening tools, and gives advice. He has an outside room at home specifically equipped for his gardening hobby, which is now a part-time business.

His income and expenses for the tax year are as follows:

Salary	R180 000
Sales of gardening stock (seeds, bulbs, fertilizer, etc.)	40 000
Costs of magazines on human resources that help him with his day job	(284)
Cost of computer on 1 March of the current year (he paid for this himself and uses it half of the time for work, and half for his business) - assume that a 3-year write-off is acceptable under section 11(e)	(9 000)
Cost of gardening stock sold	(25 000)
Running costs of outside room at home used for business - this consists of a portion of his bond interest, cleaning, electricity, telephone, water, rates, insurance, telephone, internet, stationery, wear and tear, repairs to the room, etc.	(9 000)
Revenue costs of room used as a study to catch up on his day work and read his human resources magazines and keep up to date	(2 000)

Mr X's taxable income is calculated as follows:

Salary		R180 000
Sales of gardening stock	R40 000	
Costs of magazines, not deductible (section 23(m))		-
Wear and tear on computer (R9 000/3) – section 11(e)	(1 500)	(1 500)
Cost of the gardening stock sold	(25 000)	
Running costs of outside room	(9 000)	
Revenue costs of study (not deductible)		-
Taxable income from each trade	R4 500	R178 500

Note: The cost of the study is not deductible because Mr X does not perform his duties as an employee mainly in his study, therefore, section 23(b) read with section 23(m) disallows the deduction of any costs related to the study (portion of bond interest, cleaning, electricity, rates, etc). Mr X may claim wear and tear on the computer to the extent that he uses it for his employment, because section 23(m) specifically does not prohibit this. As far as the costs of his gardening sales business are concerned, these expenses are deductible because they do not relate to employment, therefore section 23(m) does not apply.

4.4.9. FINES AND CORRUPT ACTIVITIES – SECTION 23(o)

Section 23(o) prevents the deduction of any payments resulting from an activity contemplated in Chapter 2 of the Prevention and Combating of Corrupt Activities Act No. 12 of 2004 ('PACCA'). This means that a person may not deduct bribes or unlawful kickbacks, whether such payments are to a State or a private institution or an individual.

The section also prohibits the deduction of any fine charged, or a penalty imposed as a result of an unlawful activity carried out in South Africa, or carried out in another country if that activity would be unlawful in South Africa.

4.5. PREPAID EXPENDITURE – SECTION 23H

Section 23H is aimed at deferring the deduction of certain expenditure where all or a portion of the goods, services, or benefits flowing from the expenditure will only be enjoyed at after the year-end. The section applies to allowances and deductions dealt with under sections 11(a), (c) or (d), section 11A, 11D(1) as covered in this book. Basically the section provides that the deduction may only be claimed when the goods or services (in respect of which the expenditure is incurred) are supplied or rendered. In the case of services or benefits, the deduction has to be spread over the number of months the service will be rendered or the benefit enjoyed. Where an apportionment on a monthly basis is considered by the Commissioner not to be a fair apportionment, he may direct that an apportionment be made in a way that appears fair and reasonable to him (section 23H(2)). This discretion is subject to objection and appeal. Note, for example, that if a person incurs legal fees in year 1 (in respect of a dispute in his business) for legal services rendered in year 1, but the dispute is only resolved

in year 2, the benefit of the legal services was still received in year 1 and so no spread is necessary. If an expense *has* to be claimed in year 1, and, by mistake, it is not claimed, it cannot be claimed in the later years.

The provisions of the section do not apply:

- where all the goods or services (which would be subject to the section) are supplied within six months of the year-end or the benefits are enjoyed within the same period; or
- where the aggregate of all amounts which would be subject to the section does not exceed R100 000; or
- to any expenditure to which the provisions of section 24K or 24L apply; or
- to expenditure actually paid in respect of any liability imposed by legislation.

Example – Prepaid expenditure

A taxpayer with a February year-end incurs a tax-deductible expense of R180 000 on 15 February 2021 for services to be rendered to him for the period 1 February 2021 to 31 July 2021. Also, on 1 January 2021 he paid his business insurance premium of R240 000 for the 2021 calendar year. The section 11(a) deductions that he may claim for the year of assessment ended 28 February 2021 and 28 February 2022 in respect of these amounts are as follows:

28 February 2021

Services cost *(As this expense relates to a period ending within 6 months of the year-end, the full amount is deductible)*	R180 000
Insurance premiums incurred (R240 000 x 2/12)	40 000
28 February 2022	
Insurance premiums (R240 000 x 10/12)	200 000

Where a taxpayer shows, during a year of assessment that the goods will not be received, or the service will not be rendered in the future, or that the benefit will not be enjoyed in the future, the expenditure already paid will be allowed as a deduction in that year of assessment to the extent that it has not already been deducted.

4.6. TRADING STOCK

Trading Stock is basically anything that is acquired or created for the purposes of sale, or which will be incorporated in another asset that will be sold. It is therefore a revenue asset.

The definition in section 1 expands this basic principle slightly to include consumable stores and spare parts, i.e.

'trading stock' includes -

(a) anything -

(i) produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by him or on his behalf,

(ii) the proceeds from the disposal of which forms or will form part of his gross income, otherwise than–

(aa) in terms of paragraph (j) or (m) of the definition of 'gross income';

(bb) in terms of paragraph 14(1) of the First Schedule; or

(cc) as a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph (n) of that definition; or

(iii) any consumable stores and spare parts acquired by him to be used or consumed in the course of his trade; but

(b) does not include–

(i) a foreign currency option contract; or

(ii) a forward exchange contract,

as defined in section 24I(1).

The second part of part (a) of the definition, namely the proceeds from the disposal of which forms or will form part of his gross income, refers only to things acquired with the intention of disposal, for income. In essence trading stock comprises anything acquired or held with a revenue intention i.e. for resale at a profit.

Examples of trading stock are:

- motor vehicles in a motor dealer business
- land and buildings held by a property dealer
- shares held by a share dealer
- clothing in an outfitters business
- consumable stores (sugar, cleaning materials, stationery)
- spare parts
- raw materials, work in progress and finished goods in a manufacturing business

> **Note:** SARS takes the view that packing materials are also trading stock.

Trading stock (except for consumable stores and spare parts) is by its very nature a revenue item, because its sale is the income-producing activity of the trader as opposed to an income-producing asset. As far as consumable stores are concerned, their use (consumption) is an integral part of the income-earning operations of the business.

The purchase of trading stock will, therefore, (apart from spare parts which are deducted under section 11(d)), result in an allowable deduction in terms of section 11(a), being an expense incurred in the production of income, not of a capital nature. The proceeds from the disposal of such trading stock will be included in gross income, being a receipt or accrual not of a capital nature.

4.6.1. SECTION 22

Section 22 has the effect of matching the cost of stock with the income from the sale of the stock.

Example – Opening and closing stock

A motor dealer purchases a motor vehicle in November 2020 for R80 000 and sells it in March 2021 for R120 000. The effect of the transaction on his taxable income for the years ended on the last day of February 2021 and 2022 will be as follows:

2021	Gross income - sales	Nil
	Section 11(a) deduction - purchases	(80 000)
	Closing stock – section 22(1) - add to income	80 000
	Taxable income	Nil
2022	Gross income - sales	120 000
	Section 11(a) deduction - purchases	Nil
	Opening stock – section 22(2) - deduct from income	(80 000)
	Taxable income	R40 000

It is clear, therefore, that the effect of section 22 is similar to the accounting treatment of trading stock in that it defers the deduction of the expenditure until the year in which the sale occurs, and matches the deduction with the income.

What is important is that section 22 has no bearing on stock acquired and wholly disposed of during the same year of assessment. Such transactions are relevant only for the purpose of section 11(a), the general deduction provision, and for the amount of profit or loss they contribute to taxable income. It is only where trading stock is on hand at the end of the year of assessment that section 22 can apply to it.

4.6.2. CLOSING STOCK

Section 22(1) provides that closing stock held and not disposed of at the year end must be accounted for at the lower of cost or market value, if the market value is lower than cost because of damage, deterioration or any other reason satisfactory to the Commissioner. NOTE: The discretion of the Commissioner is to be removed on a date determined by the Minister of Finance in the Government Gazette. The discretion will then be

replaced by a public notice setting out the conditions under which the value of closing stock may be reduced as at the year end of the taxpayer.)

Write-downs to market value

The section gives the Commissioner the power to allow a write-down of closing stock (other than financial instruments) where the market value is lower than the cost.

It must be noted that the write-down is not automatic, and will only be allowed when the Commissioner is satisfied that there has been a diminution in value. Practice Note 36 requires the following of the taxpayer:

- Where stock is valued below cost this fact must be disclosed to SARS.
- Reasons for using a value lower than cost must be given.
- The method of valuing the written down stock must be disclosed.

The practice note also provides that where stock has been written down on a fixed, variable or any other basis, not representing the actual value by which it has been diminished, the write-off will not be accepted without reasonable justification for such basis.

Finally the practice note warns taxpayers that if stock write-downs are not disclosed, such concealment will be viewed in a serious light and the Commissioner will consider the imposition of additional tax. The disclosure must be made in the annual return of income (i.e. the tax return).

The method of writing stock down has been presumed to be a method that complies with generally accepted accounting practice. International Financial Reporting Standard *IAS 2 – Inventory* provides in essence that inventories must be shown at the lower of cost or net realisable value.

Net realisable value is dealt with as follows:

- cost may not be recoverable by reason of damage, obsolescence, a decline in selling price, or if estimated costs of completion have increased;
- inventories are usually written down on an item by item basis;
- in some circumstances it is appropriate to group similar or related items; and
- estimates of net realisable value are based on the most reliable evidence available which may include post balance sheet events.

However, a recent judgment of the Supreme Court of Appeal (*CSARS v Volkswagen SA (Pty) Ltd* [2018] ZASCA 116) has indicated that applying IAS 2 is incorrect as the valuation is forward looking rather than determining a current diminution in value.

Spare parts

Spare parts are different from normal trading stock and consumable stores in that they are not sold or consumed in the ordinary sense. Because of their relative durability, they become integrated into the income-earning structure (such as plant and machinery) of the business. As such they are capital in nature.

Section 11(d), however, allows a deduction of

> sums expended for the repair of machinery, implements, utensils and other articles employed by the taxpayer for the purposes of his trade.

If we assume that the sums are expended when the spares are purchased, as opposed to when the repairs are effected, as we must if the definition of trading stock is to make sense, the position is as follows:

Spares purchased, section 11(d) (say)	R1 000
Spares on hand at year-end at cost, section 22(1) (say)	(800)
Amount effectively written off to repairs	R 200

If spares on hand are sold, the proceeds can only be included in gross income to the extent that they are a recoupment of the section 11(d) deduction. The fact that they are defined as trading stock does not, it is submitted, make them revenue in nature.

Work-in-progress

Work-in-progress at the end of the year is likely to be valued in terms of IAS 2 and included in closing stock.

Work-in-progress was described as stock in the process of production for sale. Its historical cost is the aggregate of the cost of purchase, cost of conversion, and other costs to bring it to its present location and condition.

The fact that work-in-progress may not be saleable in its present condition does not remove it from the definition of 'trading stock'. This is because the definition of trading stock includes anything acquired or produced 'for purposes of manufacture, sale or exchange'. The court held that as work-in-progress will be subject to a further process of manufacture, for ultimate inclusion as a product that will be sold, it falls into the definition of trading stock.

4.6.3. OPENING STOCK

Section 22(2) provides for two types of opening stock, namely:

- Section 22(2)(a) - Stock that was included in closing stock at the end of the previous year. Clearly stock which was held and not disposed of at the end of one year will still be held and not disposed of at the beginning of the next year. The amount reflected as opening stock will, therefore, be the same as the amount reflected as closing stock at the end of the preceding year.
- Section 22(2)(b) - The second type of opening stock deals with assets that were on hand at the beginning of the year but were not included in closing stock at the end of the previous year because they were held as capital assets. If in the current year the taxpayer changes its intention and the assets in question become trading stock the market value of such assets as at the date of the change is included in opening stock as a deemed cost.

  In terms of section 22(3) the cost of such stock is the market value on the date on which a capital asset changes to trading stock.

Example of section 22(2)(a)

For the year ended 31 December 2021 the XYZ trading company had closing stock with a value of R10 000. If this stock is sold for R12 000 during the year ended 31 December 2022, the effect on taxation is as follows:

Opening stock section 22(2)(a) (previous year's closing stock)	(10 000)
Sales - gross income	12 000
Taxable income	R2 000

Example of section 22(2)(b)

It should be noted that section 22(2)(b) deals only with assets 'held, and not disposed of, at the beginning of the year', and therefore does not cover the situation where stock is acquired during the current tax year. If, as an example of an asset 'held and not disposed of at the beginning of the year', a taxpayer owns an asset that he has held for a considerable time as a fixed asset, and then sells it in a way that suggests a change of intention (see Chapter 6), the proceeds on the sale will fall into gross income, being a receipt of a revenue nature. What has happened is that the asset, which was held as a capital asset at the end of the previous year, has become trading stock in the current year. It is this situation that is covered by section 22(2)(b). In a situation such as this the asset is treated as opening stock in the year in which the change of intention takes place. In terms of section 22(3) the amount to be included in opening stock is the market value of such asset on the date on which it ceases to be a capital asset and becomes trading stock. Note that in terms of paragraph 12 of the Eighth Schedule the capital asset is deemed to be disposed of for proceeds equal to its market value when it ceases to be a capital asset.

Example – Change of intention

On 1 November 2020 a company acquired vacant land as a capital asset at a cost of R1m. The company intended building a factory on the land.

In March 2021 the company changed its intention *vis-à-vis* the land and decided to embark on a subdivision and sale of the land in a scheme of profit-making. The market value of the land in March 2021 was R1,6m. The land was subdivided and sold for R2,8m by 31 December 2021. The company has a 31 December year-end.

The income tax effects for the relevant years are as follows:

Year ended 31/12/2020

No tax effects because the land is capital, and is therefore not subject to a tax deduction.

Year ended 31/12/2021

(i)	Eighth Schedule (capital gains)		
	Deemed disposal (paragraph 12) – market value	R1 600 000	
	Base cost – original cost	(1 000 000)	
	Capital gain	R 600 000	
	Include 80% of R600 000 in taxable income (see Chapter 6)		R480 000
(ii)	Sale of trading stock (gross income)		2 800 000
	Opening stock (section 22(2)(b) read with section 22(3))		(1 600 000)
	Taxable income		R1 680 000

4.6.4. COST FOR THE PURPOSES OF SECTION 22

The cost price of trading stock in terms of section 22(3) is the cost incurred plus costs as per International Financial Reporting Standards (IFRS) and International Accounting Standards (IAS) in getting the stock to its current condition and location.

IAS 2 provides that the cost of inventories should comprise:

- Cost of purchase, i.e.
  - the purchase price
  - import duties
  - other taxes (other than those which are recoverable)
  - transport and handling costs
  - other costs directly attributable to the acquisition
  - all costs are net of trade discounts, rebates and other similar items
- Costs of conversion, which include
  - costs directly related to units of production (e.g. labour)
  - allocation of fixed and variable production overheads (e.g. depreciation, maintenance, indirect labour)
  - other costs

These are costs incurred in bringing the inventories to their present location and condition

- Borrowing costs may, in certain circumstances, also be included in the cost of inventories in terms of generally accepted accounting practice.

If an asset is acquired during the year as a capital asset, and is then converted into trading stock, its cost is deemed to be the market value of the asset at the date of change.

4.6.5. STOCK ACQUIRED FOR NO CONSIDERATION

In terms of this sub-section where stock is acquired for no consideration, its cost is deemed to be its market value on the date on which it was acquired. Note however that stock acquired during the current year cannot be reflected as opening stock because section 22(2) (opening stock) refers only to stock which was held at the beginning of the year and therefore does not include stock which has been acquired during the course of the year. The result therefore is that, where trading stock is acquired for no consideration, it must be included in closing stock at market value (if it is still on hand at the year-end), but cannot be included in opening stock. A deduction can also not be claimed under section 11(a) because there has been no expenditure incurred in the acquisition of the stock. The net effect is that the market value will be included in closing stock which, in effect, increases taxable income. It is understood that it is the practice of SARS to allow the amount to be treated as opening stock at market value, in the year of acquisition.

4.6.6. PERIODS SHORTER THAN A YEAR OF ASSESSMENT

Section 22(6) states that where the period of assessment is less than a full year, closing stock must be calculated at the end of the period, and opening stock must be accounted for at the beginning of the period.

4.6.7. PRIVATE AND DOMESTIC CONSUMPTION

Section 22(8) deals with several situations, which may be grouped as:

- private or domestic consumption of stock
- all other forms of 'non-trade' disposal of stock
- a change in the use of stock

Interpretation Note No. 65 issued by SARS discusses section 22(8) in some detail.

Private or domestic consumption

If during any year the taxpayer applies trading stock to his private or domestic use or consumption, the taxpayer will be deemed to have recovered or recouped the cost of such stock (if such cost had previously been deducted). The recoupment will be added to income. If the stock had been written down to below cost in terms of section 22(1), only the written-down value will be recouped. Where the cost price of such stock cannot readily be determined, the market value will be recouped.

Private or domestic consumption can only occur in the context of sole proprietors, since there must be no change in ownership of the stock in question.

Other non-trade disposals of stock

Where any taxpayer has:

- donated trading stock; or
- disposed of trading stock otherwise than in the ordinary course of trade, for a consideration which is less than market value; or
- distributed stock *in specie*; or
- applied trading stock for any purpose other than the disposal thereof in the ordinary course of trade; or
- assets which were held as trading stock by the taxpayer cease to be held as trading stock,

the taxpayer is deemed to have recovered or recouped the market value of such stock. If the stock has been sold for less than market value it is only the difference between the market value and the selling price that is recouped.

Donations to Public Benefit Organisations

Where trading stock has been donated and the provisions of section 18A apply (i.e. the taxpayer qualifies for a deduction in terms of that section), the amount included in opening stock in terms of section 22(2) is deemed to be recouped. The section 18A deduction will similarly be limited to the amount of the section 22(8) recoupment.

Provisos

Section 22(8) contains the following provisos relevant to this book:

(a) Where the stock dealt with in section 22(8) has been applied, used or consumed by the taxpayer in carrying on his trade the amount included in his income under section 22(8) shall be deemed to be expenditure incurred for the purposes of the Act. For example, if a food merchant uses trading stock to feed his staff the cost of the stock is added to income in terms of section 22(8). However, he can then claim a section 11(a) deduction equivalent to the amount included in income.

(b) If stock is disposed of otherwise than in the ordinary course of business the amount to be included in income is reduced by any amount which has been received or accrued in respect of the disposal.

4.7. CONCLUSION

Chapter 4 introduces the deductions that SARS allows for trading income. There are specific deductions, which taxpayers will look to first to ascertain whether they apply to their income. Thereafter, taxpayers will look to the general deduction formula for any deduction that may apply, but that they did not receive under a special deduction. In addition to this, there are limits contained in certain deduction provisions.

If one incorporates this chapter into the tax liability calculation, the result would look similar to the following (note that some line items have been condensed and their detail can be confirmed in previous chapters):

Gross income s1		
As per the definition, including, but not limited to:		
Salary, commission, leave pay etc.	XX	
Trading income	XX	
Fringe benefits (refer to previous chapters for detail)	XX	
Passive income (refer to previous chapters for detail)	XX	XX
Less: Exempt income section 10 (refer to previous chapters for detail)		(XXX)
Income		XXX
Less: Deductions (mainly sections 11 to 20 & section 23)		
Legal expenses section 11(c)		(XX)
Restraint of trade section 11(cA)		(XX)
Registration of intellectual property section 11(gB)		(XX)
Acquisition of intellectual property section 11(gC)		(XX)
Research and development section 11D		(XX)
Bad debts section 11(i)		(XX)
Doubtful debts section 11(j)		(XX)
Employers' contributions to funds section 11(l)		(XX)
Annuities to former employees section 11(m)		(XX)
Add: Taxable portion of allowances per section 8(1)		
Travel allowance inclusion		XX
Subsistence allowance inclusion		XX
Other allowance inclusions (entertainment)		XX
Adjustments: Trading Stock		
Opening Stock section 22(2)		(XX)
Closing Stock section 22(1)		XX
Adjustments/Recoupments section 22(8)		XX
Subtotal (needed for s11F calculation)		XXX
Less: Retirement funds deduction section 11F		(XX)
Add: Taxable portion of capital gains (section 26A)		XX
Subtotal (needed for donations deduction - 10% excess)		XXX
Less: Donations deduction section 18A		(XX)
Taxable income		XXX
Individuals and partnerships:		
Tax per the table, based on taxable income		XXX
Less: Rebates		XXX

Tax payable	XXX
Companies:	
Taxable income x 28%	XXX

4.8. INTEGRATED QUESTION

4.8.1. FASHIONZ

Fashionz (Pty) Ltd ('Fashionz') carries on business as a fashion magazine publisher. The company operates solely in Cape Town. Fashionz distributes most of its magazines on credit to the retailers.

The following information is provided in respect of the company's year of assessment ended 31 December 2021:

1. Sales - cash R900 000
   - credit R4 200 000
2. Interest on debtors' accounts R210 000
3. Debts written off R362 500
4. On 31 December 2021, the company had a provision for doubtful debts of R900 000. This amount is recognised in terms of IFRS 9, and includes lifetime expected credit losses of R200 000. The company was entitled to a tax deduction of R162 500 in the 2021 year of assessment. All amounts are in respect of trade creditors.
5. On 23 December 2021, Daniel Meade, the editor in chief of Fashionz visited the Red-Cross Children's Hospital (a registered PBO) and donated R32 000 in cash to the hospital.
6. Staff costs:
   - Salaries of employees R1 200 000
   - Contributions to pension and medical aid funds on behalf of employees R150 000
   - As Daniel was getting sick and tired of co-editor in chief, Wilhemina Slater's bossy and arrogant attitude, he decided to call a shareholder meeting and had Wilhemina removed from her chair by passing a special resolution on 26 July 2021. This was effective immediately. Wilhemina did not take this very well and instituted legal action against the company on the basis of the Employment Equity Act in the CCMA. The company agreed to settle the issue out of court and paid Wilhemina damages amounting to R350 000. This was duly paid on 31 August 2021.
7. On 4 April 2021, Fashionz received a letter from supermodel Heather Macdonald, who is suing the magazine for posting a picture of her eating a gigantic hamburger without her permission. Heather claims that the company is damaging her reputation as a supermodel and is demanding a payment of R2 000 000. Fashionz went to court with Heather but lost the case at the Supreme Court of Appeal. The court ordered Fashionz to pay Heather R1 350 000 for damages to her reputation.
8. Legal expenses incurred
   - Legal cost of the Wilhemina case (refer to note 6 above) R25 000
   - Legal cost of the Heather Macdonald case (refer to note 7 above) R2 000
   - Cost of a restraint of trade agreement in respect of an employee, Christina McKinney who resigned on 1 June 2021 to set up her own business. The restraint is for a period of two years from the date she resigned R15 000
9. Advertising and publicity
   - Cost of advertising in local newspaper R37 000
   - Cost of a billboard R50 000

10. Fashionz is introduced a new magazine in 2021 called the Hotflash. Daniel had appointed Claire Meade as the editor of Hotflash. As Hotflash is a distinctly different magazine with a different brand image, it was unanimously decided in a directors meeting that the vacant land adjacent to Fashionz should be acquired and a new building erected immediately. On 1 May 2021 the company acquired the plot of land at a cost of R2 million. Erection of the building commenced on 1 August 2021 and was completed on 30 September 2021 at a cost of R3 million, Hotflash and its entire staff moved into the new building on 1 November 2021. Fashionz took out a bond of R1.5 million to finance the purchase of the land and the erection of the factory (the full amount will be repaid on 31 December 2022). The balance of the cost was paid in cash.

    Interest on the bond was incurred as follows:

	Total	**Land**	**Factory**
	R	**R**	**R**
1 May 2021 to 31 July 2021:	175 000	175 000	0
1 August 2021 to 30 September 2021:	175 000	140 000	35 000
1 October 2021 to 31 October 2021:	100 000	52 000	48 000
1 November 2021 to 31 December 2021:	175 500	112 000	63 500

YOU ARE REQUIRED TO:

a) Discuss in detail whether the damages payable to Wilhemina Slater is deductible in terms of s11(a).

b) Discuss in detail whether the damages payable to Heather Macdonald is deductible in terms of s11(a).

c) Determine the normal tax payable by Fashionz (Pty) Ltd, if any, in respect of its year of assessment ended 31 December 2021. Provide brief adequate reasons for all amounts included/excluded.

4.8.2. FASHIONZ – SUGGESTED SOLUTION

a) The preamble (or beginning part) of s11 requires the taxpayer to be carrying on a trade - Fashionz is a publisher.

    Section 11(a) requires the following:
    > Expenditure and losses - The R350 000 that Fashionz has agreed to pay out
    > Actually incurred - The company has agreed to pay out (legal obligation from court settlement)
    > In the production of income - The damages paid to Wilhemina Slater is for the unfair dismissal of an employee. The taxpayer's trade is the publishing and distribution of magazines. It is not reasonably expected that damages of this nature would be paid out in the normal course of business of a magazine distributor. Therefore, the damages paid are not closely enough related to the taxpayer's trade and cannot be described as an ‘inevitable concomitant’ of the taxpayer's trade. The damages payment is therefore not in the production of income.
    > not of a capital nature - not the case as relates to a trading expense - employees' salaries

    Section 23(g) disallows expenses incurred to the extent that they are not expended for trade, which is not the case here as the settlement relates to the business.

    Hence because the expenditure is not incurred in the production of income, no deduction is allowed under section 11(a).

b) The preamble (or beginning part) of s11 requires the taxpayer to be carrying on a trade - Fashionz is a publisher.

    Section 11(a) requires the following:
    > Expenditure and losses - The R1 350 000 that Fashionz has been ordered to pay
    > Actually incurred - The company has agreed to pay out (legal obligation from court)

> In the production of income - The damages paid to Heather Macdonald is for publishing her photo without appropriate permission to do so. The taxpayer's trade is the publishing and distribution of fashion magazines. It can be reasonably expected that from time to time, the magazine may infringe personal rights as such, and therefore damages of this nature would be paid out in the normal course of business of a fashion magazine. The damages paid are thus closely enough related to the taxpayer's trade and can be described as an 'inevitable concomitant' of the taxpayer's trade. The damages payment is therefore in the production of income.
> not of a capital nature - not the case as no enduring benefit results.

Section 23(g) disallows expenses incurred to the extent that they are not expended for trade, which is not the case here as the court order relates to the business.

Hence the R1 350 000 is allowed as a deduction under section 11(a).

c)

Cash sales		R900 000
Credit sales		R4 200 000
Interest income		R210 000
Bad debts – section 11(i)		(R362 500)
Allowance for doubtful debts – section 11(j)		
- 2020		R162 500
- 2021	(200 000 x 40%)	(R80 000)
- 2021	(700 000 x 25%)	(R175 000)
Salaries paid – section 11(a)		(R1 200 000)
Contribution to employee's pension and medical aid funds – section 11(*l*)		(R150 000)
- less than 20% x R1.2m = R240 000		
*(SARS practice; alternatively, limited to 10% in terms of s11(*l*))*		
Damages paid to Wilhemina Slater - Not deductible (see part a)		R 0
Damages paid to Heather Macdonald (see part b)		(R1 350 000)
Legal costs – section 11(c)		
- Wilhemina Slater's case - the underlying is not deductible, hence no section 11(c)		R 0
- Heather Macdonald's case - the underlying is deductible, hence legal cost is deductible		(R2 000)
Restraint of trade payment – section 11(cA) deductible over the longer of the restraint period and 3 years	(R15 000/3)	(R5 000)
Advertising		
- Advert in local newspaper – section 11(a) revenue in nature		(R37 000)
- Billboard - no section 11(a) as the expenditure creates an enduring benefit and is thus capital in nature		R 0
Cost of the land and new building - no section 11(a) as it is capital in nature		R 0
- potential deduction under section 13(1) building allowance, but will be covered later		
Finance costs		
- not a new trade therefore s11A n/a		
- building brought into use when staff moved in		
- section 24J interest - Land		(R112 000)
- Building		(R63 500)
Taxable income before s18A deduction		R1 935 500

Section 18A donation deduction		
- Actual	R32 000	
- Limited to 10%	R193 550	(R32 000)
Taxable income		R1 903 500
Tax payable (x 28%)		R532 980

Note: The question could also have asked for gross income, income and taxable income, but because the required asked for tax payable, the amounts have not been grouped as such.

CHAPTER 5

CAPITAL ALLOWANCES AND RECOUPMENTS

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5.1 INTRODUCTION

In terms of section 11(a) of the Act (the general deduction formula), expenditure of a capital nature is not deductible (see Chapter 4). The Act does, however, contain a number of sections in terms of which so-called capital allowances may be deducted. Essentially a capital allowance involves a write-off of the cost of a capital asset over a period of time.

Note that if a VAT vendor buys an asset or incurs an expense, the VAT does not form part of the cost of the asset or part of the expense to the extent that the vendor is entitled to claim the VAT back from SARS as an input.

Learning objectives

By the end of the chapter, you should be able to:

- Determine whether expenditure incurred meets the definition of a repair and qualifies as a deduction.

- Recognise which types of assets qualify for which capital allowances.
- Calculate the allowance available on an asset under the relevant section.
- Recognise whether the disposal of an allowance asset results in a disposal allowance or recoupment.
- Calculate the disposal allowance or recoupment arising on disposal.

5.2 REPAIRS – SECTION 11(d)

The cost of repairing business assets does not qualify as a deduction in terms of section 11(a) because it is of a *capital nature*. Section 11(d), however, allows as a deduction:

- expenditure actually incurred,
- during the year,
- on the repair of property occupied for the purposes of trade *or* in respect of which income is receivable, or
- for the purpose of repairing machinery, implements, utensils and other articles used by the taxpayer for the purposes of his trade, or
- for beetle treatment of the timber of the property mentioned above.

There is no definition of a repair in the Act, but the courts have given the following guidelines:

- In order for an asset to be repaired, there must be damage or deterioration to a part of the original asset or structure and the intention of the taxpayer must be to restore the asset to its original condition.
- A repair is restoration by a renewal or replacement of a subsidiary part of the whole asset.
- The renewal or replacement of a subsidiary part of an asset must be distinguished from the renewal of the entire asset or the purchase of a new asset. Where either the entirety or substantially the entirety of the asset is reconstructed, or a replacement asset is purchased, these costs do not meet the requirements of section 11(d).
- A repair is different to an improvement. An improvement is the creation of a better asset, and the associated costs of the improvement cannot be deducted under section 11(d).
- The materials used need not be the same as the original material, so long as the intention in using different materials is not to improve the asset.
- Where an asset has been improved, no deduction is available for the notional costs that would have been incurred if the asset had merely been repaired.
- When an asset is improved, the result is a better asset, which possibly has an improved income earning capacity. However, the distinction between 'repair' and 'improvement' is sometimes vague, and may rest on the intention of the taxpayer in incurring the expenditure in question.

Example – Repairs and improvements

Mr Gumede owns a house that he purchased as an investment to earn rental income. For the year of assessment ended 28 February 2022 he supplies you with the following information:

(a)	Rental received	R72 000
(b)	Cost of scraping old, blistered paint off the outside walls, and stripping woodwork	8 000
(c)	Cost of filling all cracks in walls and woodwork	3 600
(d)	Cost of repainting walls and woodwork	16 000
(e)	Cost of installing a sprinkler system for the garden	4 800
(f)	Cost of new burglar alarm control box	15 600

The burglar alarm control box was faulty and resulted in many false alarms. The parts needed to repair it were no longer available as it was very old. A completely new control box was connected into the existing system, at a cost of R15 600. The new control box uses less electricity than the old one, but it performs the same function.

Mr Gumede's tax calculation in respect of his rental business is as follows:

(a)	Rental received (Gross income)	R72 000
(b), (c) and (d)	qualify for section 11(d) deduction (Note 1)	(27 600)
(e)	Sprinkler system (an improvement) does not qualify for section 11(d) deduction (Note 2)	-
(f)	Burglar alarm control box qualifies for section 11(d) deduction (Note 3)	(15 600)
	Taxable income from rental trade	R28 800

Note 1: The cost of preparing and repainting is a repair since the old paint was blistered through age.

Note 2: Although the new sprinkler system does not meet the requirements of section 11(d), other capital allowances through which this cost could be claimed may be available (see later in this chapter).

Note 3: Although the complete control box was replaced, it is nevertheless a subsidiary part of the whole burglar alarm system. The box is not the same as the original, but the guidelines above specify that different materials may be used in effecting a repair. The fact that it uses less electricity is not an improvement to the income-earning capacity of the house, but even if it were, the intention was not to improve the house. The old box could not be fixed and had to be replaced. The new box is better than the old box, but the replacement is nevertheless a repair in these circumstances.

5.3 WEAR AND TEAR ALLOWANCE – SECTION 11(e)

5.3.1. GENERAL

The cost of assets, owned and used by the taxpayer in his trade, may not be deducted under section 11(a). However, a deduction is allowed under section 11(e) if the value of an asset has diminished as a result of wear and tear. The section 11(e) wear and tear allowance does not apply to any asset that is subject to a special depreciation allowance (considered later). The wear and tear allowance is not based on cost as the Act refers to *value* as the criteria for calculating the allowance. It is, therefore, possible to claim wear and tear on an asset that has no cost. Where there is a cost, the usual practice is to base the allowance on such cost. Proviso (vii) to section 11(e) provides that whenever wear and tear is determined having regard to the cost of an asset such cost shall be deemed to be

> 'the cost which a person would, if he had acquired such machinery, implements, utensils and articles under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of such machinery, implements, utensils and articles was in fact concluded, have incurred in respect of the direct cost of the acquisition of such machinery, implements, utensils and articles, including the direct cost of the installation or erection thereof.'

The section 11(e) wear and tear allowance is:

- the amount by which the value of any machinery, plant, implements, utensils and articles;
- owned by the taxpayer or acquired by him under an instalment credit agreement; and
- used by the taxpayer for the purpose of his trade;
- has been diminished;
- by reason of wear and tear or depreciation during the year of assessment.
- Where an allowance has been granted under section 11(d) (repairs), the cost of those repairs will not be added to the amount on which the wear and tear allowance is calculated.
- No allowance is given for depreciation of buildings or other structures of a permanent nature.
- A wear and tear allowance is made in respect of foundations or supporting structures if they are designed for an asset which qualifies for the allowance and have a similar useful life.

Example – Wear and tear on movable items

Company X has a 31 December year-end. It buys a truck for R800 000 which it brings into use on 1 May. It is allowed to claim wear and tear at a rate of 20% per annum on the truck.

It also bought a movable site hut for R120 000 on 1 September and put it on a temporary foundation that cost R20 000. It paid transport costs of R8 000 to take the site hut to the building site where it was put onto the foundation. It brought the hut into use on 1 October. It claims wear and tear of 15% per annum on the hut.

Wear and tear for the year	
Truck: R800 000 x 20% x 8/12 =	R106 667
Site hut and foundation: 15% x (120 000 + 20 000 + 8 000) x 3/12 =	5 550
Total section 11(e) allowances	R112 217

The site hut is not a structure of a permanent nature as it is moved from site to site. Wear and tear is only claimed for that part of the year that the asset is used.

- The value of an asset is increased by the cost of moving it from one location to another. Logically, where an asset has been partly written off, the moving costs should be written off over the period left for claiming the write-off of the capital allowance. If the asset has been fully written off, it is submitted that the moving costs should be fully written off in the year incurred.
- No wear and tear allowance is granted on an asset that is written off in terms of section 12C, i.e. certain manufacturing plant and machinery.
- Accounting depreciation is not necessarily the same as wear and tear for tax purposes. Wear and tear is determined in terms of the rate in Binding General Ruling No. 7, whereas accounting depreciation is a based on a more subjective estimate of the useful life of the asset.
- Where VAT has been paid on the acquisition of an asset, and claimed as input tax, the cost of the asset for wear and tear purposes is net of VAT.

Example – Asset moved subsequent to being brought into use

Company Y has a 31 December year-end. On 1 July last year it purchased a mainframe computer for R90 000 including transport and installation costs, and brought it into use on that date. On 1 January this year it moved the mainframe to its new offices, and incurred moving costs of R10 000.

It claims wear and tear of 33% per annum on the mainframe computer.

Section 11(e) Wear and tear for last year	
Mainframe: R90 000 x 33% x 6/12 =	R15 000
Section 11(e) Wear and tear for this year	
Mainframe: R90 000 x 33%	R30 000
Moving costs: R10 000 x 12/30	R4 000
Total wear and tear for current year	R34 000

The moving costs are claimed over the remaining period over which wear and tear on the mainframe computer will be claimed.

5.3.2. INTERPRETATION NOTE NO 47 & BINDING GENERAL RULING NO. 7

Interpretation Note No. 47 (Issue 5) and Binding General Ruling (Income Tax) No. 7 (Issue 4) were issued by SARS on 9 February 2021. They deal with wear and tear on assets. The Binding General Ruling covers the aspects of the interpretation note that are binding, while the interpretation note contains the detail. The following are the key aspects of the interpretation note:

- Wear and tear may only be claimed on assets used for the purposes of trade. Assets held in reserve or as replacements will not qualify for the allowance until they are brought into use.
- Where the asset is used for only a part of the year, the allowance must be apportioned.
- Wear and tear is based on cost (excluding finance charges and VAT which was claimed as input tax).

- Moving costs of an asset must be written off over the remaining estimated useful life of the asset. If the asset has already been written off, the moving costs will be allowed in full in the year incurred.
- If extraordinary repairs are made to an asset, which increase its useful life, the Commissioner may extend the period of the write-off, which means that the wear and tear each year will be lower.
- Taxpayers may use the 'diminishing value method' (i.e. reducing balance method), or straight-line method to calculate wear and tear. In practice, most taxpayers use the straight-line method.
- Selected write-off periods are set out in a Schedule in Appendix C at the back of this book. If an asset is not in the Schedule, the asset must be written off over its expected life. SARS will check the period of this write-off on assessment or audit.
- An application for a shorter write-off period has to be submitted to SARS before submitting the tax return for the particular year that the wear and tear is to be claimed.
- Used assets are to be written off over their expected useful life, taking into account the asset's condition.
- Small item assets that cost less than R7 000 per asset may be written off in full in the year of acquisition. For this purpose, a small item is regarded as an item that normally functions in its own right and is not an individual item that forms part of a set.
- Where an asset is used for both private and business purposes, the wear and tear allowance is reduced proportionately.

5.3.3. STRUCTURES AND WORKS OF A PERMANENT NATURE

The section 11(e) wear and tear allowance is not granted on buildings or other permanent structures and it is therefore important to know what a building or permanent structure is.

Where an item becomes so integrated into a building or structure or work of a permanent nature that it loses its own separate identity, no wear and tear may be claimed. Examples of such items are doors, windows, light switches etc.

Even though a door may be easily removed from a building, the test for 'permanence' is the *intention* of the taxpayer. Doors are normally intended to be permanent parts of a building.

5.4 SPECIAL DEPRECIATION ALLOWANCE

Section 12C provides for a special wear and tear allowance in respect of certain machinery or plant (new or used) brought into use for the first time by the taxpayer for the purposes of his trade and used by him directly in a process of manufacture or a similar process.

'Process of manufacture or similar process' is not defined in the Act, but our courts have held that a process of manufacture is one in which the output of the process is 'essentially different' from the inputs. Whether something is 'essentially different' is of course a matter of degree for which a rule cannot be prescribed.

To determine whether an asset is used *directly* in a process of manufacture or a similar process, the functional test is applied – do the assets in question play an active part in the activities in question, or do they merely provide the place where the activities are carried on? For example, a furnace might be used directly in a process of manufacture, while a warehouse would not.

Notes:

1. The plant or machinery must be owned by the taxpayer (or acquired by the taxpayer under an instalment credit agreement).
2. The write-off period under section 12C of the cost of the asset is either four or five years, depending on whether the asset is new or second-hand.
3. The allowance is not apportioned where the asset is only used for a part of a year.
4. In order to qualify for the allowances, the asset must be acquired for a cost (section 12C(2)). Section 12C(5) provides that the deductions which may be allowed in terms of section 12C in respect of any asset shall not in the aggregate exceed the cost to the taxpayer of such asset. This means that a section 12C allowance will not be allowed on a machine acquired for no cost (e.g. through an *in specie* dividend).

5. Section 12C contains a specific provision allowing the deduction to be claimed in respect of foundations and supporting structures.

   Section 12C does not prohibit a deduction in respect of works of a permanent nature, and the expression 'plant' can include permanent structures. As long as the foundation or supporting structure is used as envisaged in section 12C, the allowance will be claimable on the cost of such foundation.

6. No allowance may be claimed on any asset that has qualified for an allowance under section 12E (see 5.5 – Small Business Corporations)

7. Any costs (other than expenditure subject to section 11(a)) incurred in moving an asset that is or was subject to a section 12C allowance will also be subject to the allowance.

   Two situations are considered in section 12C(6):

   (a) Where the moving costs are incurred in respect of an asset that is still being written off under section 12C, the deduction is made in instalments over the number of years that the asset is still to be written off.

   (b) Where the asset is a section 12C asset that has been fully written off, the moving cost is deducted in full in the year in which it is incurred.

Example – Removal costs

In June 2021 Makit (Pty) Ltd moved two second-hand manufacturing machines to a new factory. Machine 1 which cost R100 000 had been brought into use in January 2016. Machine 2 which cost R200 000 had been brought into use in June 2018. The cost of moving machine 1 was R5 000 and the cost of moving machine 2 was R9 000. Makit's year-end is the end of February.

The allowances in respect of the machines are as follows:

Year ended February 2022

Machine 1: section 12C (written off in full by end of February 2020)	nil
Machine 2: section 12C: 200 000 x 20%	(40 000)
Moving costs - machine 1: deducted in full	(5 000)
- machine 2: R9 000 / 2	(4 500)

5.4.1. THREE YEAR WRITE-OFF

A proviso to section 12C was introduced for new or unused machinery or plant acquired and brought into use on or after 1 January 2012 for section 11D research and development purposes to be written off as follows:

- 50% in the year that the plant, machinery, or improvement is brought into use *for the first time*;
- 30% in the next year of assessment; and
- 20% in the year of assessment following that.

For more on section 11D research and development see Chapter 4.

5.4.2. FOUR YEAR WRITE-OFF

A four year write-off is granted in respect of the cost of:

- any new or unused machinery or plant,
- acquired and brought into use by the taxpayer, on or after 1 March 2002, in a process of manufacture or a similar process carried on in the course of the taxpayer's business.

The allowance may not be claimed by taxpayers whose business is banking, financial services, insurance or rental business.

The allowance is:

- 40% of the cost of the asset in respect of the first year (i.e. the year in which the machinery or plant is first brought into use), and
- 20% in each of the subsequent three years.

5.4.3. FIVE YEAR WRITE-OFF

In all circumstances in which the section 12C asset does not qualify for the three or four year write-off, the write-off period is five years, i.e. 20% per annum. The five year write-off therefore applies to:

- all used machinery and plant acquired by the taxpayer
- new or unused machinery which does not qualify for the four year write off.

Example – Four year and five year write-off

X (Pty) Ltd has a 31 March 2022 year-end. It carries on a printing business (process of manufacture). On 1 November 2021 it purchases and brings the following machinery into use:

New printing machine, costing	R3 million
Second-hand binding machine, costing	R800 000

Its section 12C allowances for the year are:

Printing machine: R3 m x 40% =	R 1 200 000
Binding machine: R800 000 x 20% =	160 000
	R 1 360 000

5.5 SMALL BUSINESS CORPORATIONS

Section 12E allows a deduction of 100% of the cost of manufacturing plant and machinery brought into use by a small business corporation (section 12E(1)), and a three-year accelerated write-off of other assets (section 12E(1A)), or (at the option of the taxpayer) the regular wear and tear allowance for which the asset qualifies. The definition of Small Business Corporations (SBC's) and other provisions are discussed in Chapter 3.

The section 12E (1) allowance applies to:

- plant and machinery
- owned by or acquired by the taxpayer under an instalment credit agreement
- and brought into use for the first time by the taxpayer on or after 1 April 2001
- for the purpose of the taxpayer's trade (other than mining or farming)
- used by the taxpayer directly in a process of manufacture (or similar process) carried on by the taxpayer.

The deduction is 100% of the cost of the asset and is allowed in the year that the asset is brought into use. Cost is defined as:

- the lesser of the cost to the taxpayer or an arm's length cash cost
- the cost of installation or erection is included

Costs of moving assets from one location to another that qualify for an allowance under this section are allowed in full when incurred.

Section 12E(1A) provides that non-manufacturing assets (i.e. assets which are not written off 100% in terms of section 12E(1)) may be written off either in terms of section 11(e) or over 3 years as follows:

(a) 50% of the cost in the year the asset is brought into use.

(b) 30% in the next year.

(c) 20% in the final year.

There is no apportionment of the section 12E allowance for part of the year. The asset must satisfy the requirements of either sections 11(e), 12B or 12C. The choice between the section 11(e) wear and tear and the section 12E three-year allowance is at the election of the taxpayer and may be done on an asset-by-asset basis. Where an asset costs less than R7 000, the section 11(e) write off is at a rate of 100% of the cost. It would therefore be better to claim the section 11(e) allowance on such small assets, as section 12E contains no similar provision.

Example – Small Business Corporation

X CC is 100% owned by Mr Q. Its income statement for the year ended 28 February 2022 is as follows:

Consulting income	R 15 000
Sales of handbags	182 000
Interest income	3 000
	R200 000
Salary to Mr Q	(24 000)
Salary to Mrs Q	(24 000)
Office expenses	(22 000)
Depreciation at 20% on furniture and office equipment purchased for R30 000* on 1 May 2021 (i.e. 10 months)	(5 000)
Net profit	R125 000

*This furniture consisted of an office chair that cost R3 000, and a filing cabinet that cost R27 000.

Tax calculation of X CC for 2022:

Net profits per accounts	R125 000
Add back depreciation	5 000
	R130 000
Deduct section 12E(1A) allowance R27 000 x 50%	(13 500)
Deduct section 11(e) wear and tear allowance on chair (which is 100% because the chair cost less than R7 000)	(3 000)
Taxable income	R113 500

For the rates of tax applicable to SBC's refer to Chapter 3.

5.6 BUILDING ALLOWANCES

No wear and tear may be claimed on the cost of buildings, as they are permanent structures, and they are not used directly in a process of manufacture. However, the Income Tax Act has a number of provisions in terms of which a taxpayer may claim an annual allowance on the cost of buildings.

5.6.1. BUILDING ANNUAL ALLOWANCE – INDUSTRIAL/FACTORY BUILDINGS

Section 13(1) provides for an annual allowance on manufacturing buildings. The allowance applies to buildings where the taxpayer incurs the cost of erecting the building, and to certain buildings purchased by the taxpayer.

The building must be used for housing a process of manufacture, or a process similar to a process of manufacture, in the course of the taxpayer's trade. It also applies where the taxpayer lets the building to a tenant who carries on a process of manufacture or similar process in the building.

Buildings erected by the taxpayer

It is important to note that the taxpayer may claim the building annual allowance even if the building is built on land that the taxpayer does not own. For example, the taxpayer may have rented the land for, say, 50 years, and decides to build a factory on it. As long as the taxpayer has the use of the factory, and has incurred the cost of erecting the building or the improvements to the building, it is entitled to the annual allowance, provided that it satisfies the other requirements of the section.

The annual allowance provides by section 13(1) depends on the date when the building was erected, not on the date it was purchased by the taxpayer. If erection of the building commenced:

- between 15 March 1961 and 1 January 1989, (both dates inclusive) an allowance of **2%** will be granted;
- on or after 1 January 1989 an allowance of **5%** will be granted.

Buildings used wholly or mainly for research and development purposes on or after 1 October 2012 also qualify for the section 13 annual allowance.

Allowances may also be claimed in respect of improvements, regardless of whether an allowance may be claimed on the original building. Section 13(9) defines 'improvements' as being any extension, addition, or improvements (other than repairs) to a building that are effected in order to increase or improve the industrial capacity of the building. An allowance for cosmetic or other improvements not affecting the industrial capacity

of the building may not be claimed under section 13(1). Note that where an allowance is claimed for improvements, the rate is determined by reference to the date on which work on the improvements commenced, and not the construction date of the original building.

Purchased industrial/factory buildings

It is not only the person who builds a building who qualifies for the building allowance. There are two instances where a purchased building is subject to the allowance:

- *Used Buildings* (section 13(1)(d)): Where the building is purchased from a person/entity that was entitled to the allowance, and is used by the taxpayer in a process of manufacture or a similar process (or by a tenant to which the taxpayer lets the building). This only applies to buildings that were erected on or after 15 March 1961.
- *New Buildings* (section 13(1)(dA)): Where the purchased building is new (i.e. has never been used). The taxpayer (purchaser) must then use the building (wholly or mainly) for a process of manufacture or similar process, or it must be let and used by the tenant for carrying on a process of manufacture or a similar process.

In the case of a used building on which the seller is entitled to a 2% allowance, the purchaser is entitled to a 2% allowance on his cost (of the building), even though his cost may be higher than the seller's cost. If the seller was entitled to a 5% allowance, the purchaser may claim a 5% allowance on his cost.

The allowance is claimed on the cost of the building to the purchaser and not the original cost i.e. each successive purchaser establishes a new cost on which the allowance is claimed. The period over which the allowances are claimed is reset, i.e. the purchaser may be restricted to a 2% allowance by virtue of when the building was originally built, but is allowed to claim that allowance for fifty years, irrespective of the number of years in which the seller has claimed an allowance.

Example – Purchased building

In February 2022 Mr B bought a building from Mr A for R3 million. Mr A had constructed the building for R1 million in 1983 and had used the building for carrying on a process of manufacture until the date of sale.

For their 2022 years of assessment:

- Mr A can claim an allowance of R1m x 2% = R20 000
- Mr B can claim an allowance of R3m x 2% = R60 000

In the year of the sale both taxpayers may claim an allowance, since both owned the building for a portion of the year. Section 13 allowances are not apportioned for part-years.

Assuming Mr B does not sell the building, he will be entitled to claim a 2% allowance every year for fifty years.

Wholly or mainly

The term 'wholly or mainly' is taken as meaning that more than half of the floor area of the building must be used for carrying on a process of manufacture or similar process. Where the building is let, one has to look at how the tenant is using it.

If, for example, a building has a number of floors (levels), which are being let to different tenants, one would have to look at how the tenants are using the floor area. If, for example, one tenant repairs engines, one would look at the floor area used for this activity, as it is similar to a process of manufacture. Another tenant may be assembling components, and this floor area would also qualify. A third tenant may be running a consultancy business, and that floor area would not qualify. Once the owner has worked out how the floor area is being used, by adding up all the areas used for manufacturing or similar processes and comparing it to the total floor area, it will know whether the building qualifies for the allowance.

Example 1 – Wholly or mainly in process of manufacture

XYZ (Pty) Ltd bought a three-storey building from Mr P for R4 million (including the cost of the land). Mr P had been entitled to a section 13 allowance at the rate of 5% of the cost of the building. The building was let to three different tenants, who used it as follows:

- X used the ground floor as a warehouse

- Y used the first floor for repairing air-conditioners
- Z used the second floor to manufacture circuit boards

The value of the land when XYZ bought the property was R600 000.

XYZ can claim an annual allowance of 5% x (R4m – 600 000) = R170 000

Only the warehouse used in this example is not a process of manufacture or similar process. Therefore the building is used (by the lessees) mainly for a process of manufacture or a similar process. As a result, the lessor is entitled to the annual allowance for 'manufacturing' buildings. Strictly speaking, if Y and Z have offices and kitchens on their floors, this should be excluded from the 'manufacturing' floor area.

Example 2 – Not wholly or mainly in process of manufacture

Company C buys vacant land for R3 million and spends R10 million to erect a building for manufacturing purposes and for offices for its own use. The floor areas are as follows (in square metres):

Factory floor	250
Staff canteen	50
Administration office	700
	1 000 square metres

The section 13(1) annual allowance claimable by Company C is R*nil*, because the building is used mainly other than in a process of manufacture. The building may however qualify for a section 13*quin* allowance (see 5.6.2).

Cost on which allowance is claimable

The allowance is based on the cost of the building, and is not limited to the arm's length cash cost of the building. This means that finance costs may be capitalised and may form part of the cost of the building for the purpose of determining the allowance. Note that in calculating the cost, the 'cost' of the land must be excluded.

Where the taxpayer had sold an industrial building resulting in a recoupment, and had then elected under section 13(3) to set the recoupment off against the cost of a new industrial building, the allowance on the new building is based on the cost, net of the recoupment (see 5.7.3).

5.6.2. COMMERCIAL BUILDINGS

Section 13*quin* provides for a 5% annual allowance on the cost of any *new and unused* building owned by the taxpayer, if –

- the building is wholly or mainly used by the taxpayer
- during the year of assessment
- for the purposes of producing income in the course of the taxpayer's trade

Notes:

1. The allowance applies to buildings purchased and buildings erected by the taxpayer.
2. The trade in the course of which the building is used must not be the provision of residential accommodation.
3. The taxpayer can use the building in his own trade or let it.
4. Once the taxpayer disposes of the building, he cannot claim the allowance on that building in a future year of assessment.
5. The allowance is not apportioned for part of a year.
6. No allowance is claimable under section 13*quin* if an allowance on the building is claimable under another section of the Act (such as section 13).
7. The allowances over the years cannot exceed the cost or deemed cost of the building.
8. The allowance is subject to the normal section 8(4)(a) recoupment provisions.

In a number of significant respects section 13*quin* is more restrictive than section 13(1). Most importantly:

1. The allowance only applies to buildings or improvements contracted on or after 1 April 2007, provided that construction, erection, or installation commences on or after that date.
2. The allowance is based on the lesser of cost or market value of the building.
3. The allowance applies only to new and unused buildings, and to new and unused improvements to existing buildings.
4. As with section 13(1), where the taxpayer constructs a part of a building or an improvement, the allowance is based on the cost of the part or improvement. However, unlike section 13(1), where the taxpayer acquires:
   a. A 'part of a building' without erecting or constructing that part, the annual allowance is: Cost x 55% x 5%; and
   b. An improvement without erecting or constructing that improvement, the allowance on the improvement is: Cost x 30% x 5% (section 13*quin*(7)).

   SARS treats an improvement to an asset as a separate asset in itself for the purposes of capital allowances. If the improvement satisfies the requirements for the allowance, then the allowance is based on the particular percentage of the cost of the improvements.
5. When the building is sold the new purchaser is not entitled to any allowance as the building is no longer new and unused.

Example – Cost of improvements acquired

Lukuli (Pty) Ltd bought a used building from Hun (Pty) Ltd. The building originally consisted of two storeys when Hun acquired it. Hun repaired the two floors and then built a third floor (storey) on the building. The third floor was totally new and unused when Hun sold the building to Lukuli.

The purchase price of the building to Lukuli was as follows:

- Cost of used portion of building (land plus first 2 storeys)	R15 000 000
- Cost of new portion (3rd storey)	6 000 000
Total cost	R21 000 000

The section 13 quin allowance claimable by Lukuli (Pty) Ltd for each year of assessment is:

R6 000 000 x 5% = R 300 000

Section 13quin (2) states that the cost of the improvement is the arm's length price the taxpayer would have paid if he had acquired (i.e. built) the improvement directly.

As the improvements themselves satisfy the requirements for the allowance (new and unused), section 13 quin applies. The 30% provision does not apply, because the whole building was acquired.

Example – Part of building acquired

Y Ltd paid R4 million on 1 May 2021 to purchase land on which it built a 5-storey building. It then subdivided the building and sold each floor to separate buyers for R1 million per floor. Z Ltd purchased one of these floors for use as its head office.

Calculate the capital allowance claimable by Z Ltd for its year of assessment ended 31 March 2022.

- R1m x 55% x 5% = R27 500

5.6.3. URBAN DEVELOPMENT ZONE (UDZ) ALLOWANCE

Section 13*quat* was inserted into the Income Tax Act at the end of 2003. The aim of this incentive is to encourage the private sector to embark on urban and inner-city renewal and revival. Owners or lessors who bring derelict and obsolete properties, in certain specified areas, back onto the market and into use will be entitled to one of the following capital allowances, based on the cost to them of construction or refurbishment:

- Refurbishment of existing building: 20% straight-line depreciation allowance over a 5-year period (where the existing structural or exterior framework is preserved). Any incidental extension or addition is acceptable.

- *Construction of new buildings and extension of existing buildings:* 11-year write-off period (20% in the first year and 8% per annum thereafter, for the next 10 years). This also applies to additions to existing buildings which are not incidental and which do not preserve the existing structural or exterior framework. Prior to 21 October 2008, the annual write-off was 5% instead of 8%. The 8% applies for all buildings and additions or extensions where erection commences or commenced on or after 21 October 2008.

It does not matter whether the abovementioned buildings are commercial or residential.

In all cases it is up to the taxpayer to make sure that the building is in an urban development zone (UDZ). In this regard the taxpayer should get a certificate from the Municipality confirming that the building is in a UDZ. At the time that the allowance was first introduced, maps were issued setting out the borders of the UDZ's.

Allowances may only be claimed in respect of a building or part of a building brought into use on or before 31 March 2023.

The allowance will only be granted if all the following requirements are met:

- The building or part of the building in respect of which the allowance is claimed *must* be owned by the taxpayer
- The building must be used *solely* for the purposes of the taxpayer's trade (he cannot use part of the building as his private residence, for example)
- The building must be within an urban development zone.
- The erection or improvements must either be to the *whole* building or to a floor area of at least 1 000 square metres.
- The relevant details and certificates must accompany the tax return for the year in which the allowance is claimed.

The deduction ceases where the building ceases to be used by the taxpayer solely for the purposes of his trade, or he sells the building. Where the building is sold for more than its tax value, the seller will have a recoupment, but the purchaser will not be entitled to the allowance.

Example –UDZ allowances

YOU Ltd purchased an old hotel in an urban development zone in order to convert it into offices. The building was purchased on 15 September 2021. The following costs were incurred in making the conversion:

Cost of converting the inside of the hotel to offices (The existing exterior framework was preserved)	R1 900 000
Cost of *repairing* the existing exterior framework of the building	R200 000
Cost of building extra offices and underground parking next to the existing building	R3 000 000

The year-end of YOU Ltd is 28 February 2022. The building was brought into use on 15 January 2022. The allowances claimable by YOU Ltd for each tax year will be as follows:

Conversion	*Amount*	*New building*	*Amount*	*Total*
2022: 20%	R380 000	2022: 20%	R600 000	R980 000
2023: 20%	380 000	2023: 8%	240 000	620 000
2024: 20%	380 000	2024: 8%	240 000	620 000
2025: 20%	380 000	2025: 8%	240 000	620 000
2026: 20%	380 000	2026: 8%	240 000	620 000
2027: 0%	0	2027 – 2031: 8% per annum	240 000 Each year	240 000 Each year

No allowance is claimable on the repairs as these will be written off in full in terms of section 11(d) of the Income Tax Act.

Purchased buildings where the seller (developer) incurred the costs

A section 13*quat* allowance may be claimed on the purchase price of a building or part of a building if it was brought into use on or after 21 October 2008, and if the requirements above are met. The allowance granted is as follows:

- If it is a new building the purchaser may claim the allowance on 55% of his purchase price

- If it is a second-hand building improved by the developer, the purchaser may claim the allowance on 30% of the purchase price.

Low-cost residential units

Accelerated capital allowances are allowed for buildings that qualify as low-cost residential units. A low-cost residential unit is defined in section 1 and the definition is discussed under section 13*sex* below.

The allowances are as follows:

- Where the taxpayer incurs the cost of:
  - refurbishing an existing building - 25% per annum
  - constructing a new building or extending an existing building – 25% in the first year, 13% per annum in years two to six, and 10% in year seven.
- Where the taxpayer purchases either a refurbished or a new building from a developer, the above allowances are based on 30% or 55% of the taxpayer's cost respectively.

5.6.4. DEDUCTION IN RESPECT OF CERTAIN RESIDENTIAL UNITS

Section *13sex* is an allowance available to taxpayers who buy and let residential property. Where the taxpayer acquires a residential unit after 21 October 2008, a 5% residential allowance may be claimed by the taxpayer, provided the requirements of the section are met:

1. The residential unit must be new and unused.
2. If the allowance is to be claimed only on an improvement, then only the improvement needs to be new and unused.
3. The taxpayer must own the unit. Therefore the allowance cannot be claimed on improvements made to property that the taxpayer occupies as a tenant or uses as a lessee.
4. The unit or improvement must be used by the taxpayer *solely* for the purposes of a trade which he carries on.
5. The unit must be situated in the Republic (of South Africa).
6. The taxpayer must own at least 5 residential units in the Republic (they need not be all in the same place) – which must be used for the purposes of a trade carried on by the taxpayer. It seems that the other units need not be subject to the section 13*quin* allowance in order for this section to apply to a new unit.

As the unit has to be used solely for the purposes of a taxpayer's trade and used mainly as a residential unit, it can be either let as a residence to an individual, or used as accommodation for the taxpayer's employee/(s). No allowance is claimable under section 13*sex* if an allowance on the unit or a deduction of the cost of the unit can be claimed under another section of the Income Tax Act.

Low-cost residential unit

Where the unit qualifies as a 'low-cost residential unit' the taxpayer may claim an annual allowance of 10% over ten years instead of 5% over twenty years.

Section 1 of the Income Tax Act defines a low-cost residential unit as either:

- a *building* qualifying as a residential unit, located in the Republic – where the cost does not exceed R300 000; or
- an *apartment* (which is a 'residential unit') in a building located in the Republic – where the cost does not exceed R350 000.

Where the building or apartment is let, the owner must not charge a rental that exceeds (monthly) 1% of the cost of

- the building plus a proportionate share of the cost of the land and the bulk infrastructure
- the *apartment*

The cost on which the 1% per month is based can be increased by 10% each year. The first increase is in the tax year following the year in which the building or apartment is first brought into use.

Example – Residential building allowance

AFD (Pty) Ltd built a block of 18 flats on 1 January 2022 at a total cost of R3,9 million. The block consisted of ten bachelor flats that cost R150 000 each to build, and eight larger flats that cost R400 000 each.

AFD (Pty) Ltd rents the bachelor flats to tenants for R1 200 per month, and the larger apartments for R4 000 per month. The company has a 30 June year-end.

AFD (Pty) Ltd is entitled to the following capital allowances in its 2022 year of assessment:

5% x R400 000 x 8 residential units	R160 000
10% x R150 000 x 10 low-cost residential units	R150 000

Because the bachelor flats cost less than R350 000 each, and the monthly rent charged is less than 1% of the cost, these ten units qualify as low-cost residential units.

Cost on which allowance is based

The cost on which the allowance is based is the lesser of the actual cost or arm's length market value of the unit at the date of acquisition. Where the taxpayer buys the residential unit (which represents only part of a building) without erecting or constructing that unit, or 'acquires an improvement to a residential unit' the cost is deemed to be:

- 55% of the acquisition price where a unit is acquired
- 30% of the acquisition price where an improvement is acquired

If a developer builds a new block of flats and the taxpayer buys five or more of the units (but not the whole block) the taxpayer will be entitled to an allowance based on 55% of the purchase price. Where a developer renovates existing units and sells these to a taxpayer, the purchase price will have to be apportioned between the original units and the improvements, and the taxpayer will be entitled to an allowance of 30% of the portion attributable to the improvements. The improvements are effectively treated as a separate asset for the purposes of the capital allowance.

5.6.5. DEDUCTION IN RESPECT OF SALE OF LOW-COST RESIDENTIAL UNITS ON LOAN ACCOUNT

Where a taxpayer sells a low-cost residential unit to an employee (or to an employee of an associated institution) the taxpayer gets a deduction of 10% of any amount owing to him by the employee (in respect of the unit) at the end of the taxpayer's year of assessment. This deduction is not allowed in the eleventh and subsequent years after the sale of the unit, even if the amount has not been totally written off.

A section 13*sept* deduction may only be claimed in years of assessment ending on or before 28 February 2022. It has been indicated that this subset date will be subject to annual review.

No deduction is allowed if any one of the following applies:

- The disposal is subject to any condition other than an obligation on the employee to sell the unit back to the employer for an amount equal to the actual cash cost to the employee on termination of employment, or in the case of a consistent failure on the part of the employee, for a period of three months, to pay an amount owing on the unit to the taxpayer (or to the associated institution).
- The employee has to pay interest to the taxpayer. The loan must be interest-free, which may give rise to a fringe benefit for the employee.
- The employee buys the unit for more than what it cost the employer.

Recoupment provision

Where the employee repays any part of the loan which he owes to the taxpayer, the taxpayer is deemed to have recouped the lesser of:

- the amount of the repayment; or
- the amount deducted under this section in the current and any previous year of assessment

Although the wording of the section is somewhat unclear, it is submitted that the intention of section 13*sept* is that the employer should receive a deduction over ten years limited to the cost of the unit, and this deduction should be fully recouped by the time that the employee has repaid the loan amount.

Example – Residential building loans

AFD (Pty) Ltd purchases 2 low-cost residential units which it sells to two of its employees (Mr X and Mrs Y) for R200 000 each, being the same as the cost to AFD, on interest-free loan account.

1. At the end of the first year of assessment of AFD, Mr X still owed R200 000 to AFD, and Mrs Y owed R185 000 (as she had repaid R15 000 during the year).

   The section 13*sept* deduction claimable by AFD is as follows:

Mr X: R200 000 x 10%	(R20 000)
Mrs Y: R185 000 x 10%	(18 500)
Total section 13*sept* deduction	(R38 500)

(There is no recoupment in respect of what Mrs Y paid during the year because it was not part of what was owing at the year-end or any previous year end.)

2. At the end of the next year of assessment, Mr X owed R 190 000 and Mrs Y owed R101 000.

   The allowance claimable by AFD is as follows:

Mr X: R190 000 x 10%	(R19 000)
Mrs Y: R101 000 x 10%	(10 100)
Total section 13*sept* deduction	(R29 100)

   At the same time, the recoupment included by AFD is:

Recoupment, Mr X: Lesser of R10 000 or R39 000	10 000
Recoupment, Mrs Y: Lesser of R84 000 or R28 600	28 600
Total section 13*sept* recoupment	R38 600

3. At the end of the third year, Mr X owed nothing, having repaid R190 000 during the year, while Mrs Y still owed R101 000.

   The section 13*sept* recoupment and deduction recognised by AFD is as follows:

Section 13*sept* allowance, Mr X:	R*nil*
Section 13*sept* allowance, Mrs Y: R101 000 x 10%	(10 100)
Recoupment, Mr X: Lesser of R190 000 or (R39 000 – R10 000)	29 000
Total section 13*sept* recoupment and deduction	R18 900

5.7 DISPOSAL OF ALLOWANCE ASSETS

Allowances are granted in respect of the allowance assets above in recognition that their value is being consumed as they are being used to produce taxable income. The cost of the asset less the allowances granted to date is typically referred to as the asset's *tax value* on that date. For so long as the taxpayer continues to hold the asset the allowances granted can only ever be an estimate of the decrease in value. However, when the asset is sold or otherwise disposed of, a real amount can be put to its value, and it is possible to determine whether the actual decrease has been either more or less than the estimate implicit in the capital allowances granted.

To address this the Act contains provisions both to create additional allowances, where the capital allowances to date have been insufficient to cover the decrease in value, and to recover allowances that have proved to be in excess of the decrease in value.

5.7.1. ALLOWANCES IN RESPECT OF DISPOSAL OF ASSETS – SECTION 11(o)

Section 11(o) provides for a deduction of the amount by which the cost of the asset (to the taxpayer) exceeds the sum of the tax allowances or deductions in respect of the asset and the proceeds on disposal. The section only applies to the disposal of an asset that was subject to the following allowances:

- machinery or plant which qualify for a section 11(e), 12C or 12E allowance

- implements, utensils and articles which qualify for a section 11(e) allowance

The deduction applies where there has been an 'alienation, loss or destruction' of qualifying assets. According to Interpretation Note 60 this would include where an asset has been consigned to a scrap heap situated on the land of another person, since the taxpayer would be parting with ownership, but would not include the mere withdrawal from use where ownership is retained.

The deduction is not granted in respect of any asset that has an expected useful life (for tax purposes) exceeding ten years. So, for example 'pleasure craft', which have a write-off period of 12 years in terms of Binding General Ruling No. 7, would not qualify for a section 11(o) allowance when disposed of.

The deduction is also not available in respect of disposals to a connected person.

The cost of machinery, plant, implements or articles is deemed to be the actual cost plus any costs of moving the asset from one location to another. The actual cost is the arm's length price in a cash transaction.

Example – Calculation of section 11(o) allowance

A taxpayer purchased a delivery van for R120 000 on 1 March 2019 and brought it into use on that date. On 28 February 2022 the van is sold for R10 000. Section 11(e) wear and tear of R30 000 (per annum) was claimed for the years of assessment ending at the end of February 2020, 2021 and 2022, i.e. R90 000 (R30 000 x 3 years).

For the year ended 28 February 2022 the section 11(o) allowance is determined as follows:

Original cost		R120 000
less - tax allowances	90 000	
- selling price	10 000	(100 000)
Section 11(o) allowance		(R20 000)

As can be seen from the above calculation, the section 11(o) allowance can also be calculated as the amount by which the tax value of the asset exceeds the proceeds on disposal, where the tax value is the tax carrying amount of the asset.

For the year ended 28 February 2022 the section 11(o) allowance can also be determined as follows:

Tax Value:	Original cost	R120 000	
	less - tax allowances	(90 000)	30 000
less - selling price			(10 000)
Section 11(o) allowance			(R20 000)

5.7.2. GENERAL RECOUPMENT PROVISION – SECTION 8(4)(a)

Where an asset is sold for a price in excess of its tax value (i.e. cost less allowances), the difference between the selling price (up to a maximum of the original cost) and tax value is a taxable recoupment of the deductions previously claimed. In terms of section 8(4)(a) of the Act, such recoupments are included in the taxpayer's income, unless the special provisions of s 8(4)(e) apply (section 8(4)(e) is beyond the scope of this book).

Example - Recoupments

Mr C purchased a used motor vehicle for use in his trade. The cost of the vehicle was R180 000, and wear and tear was claimed at the rate of 20% per annum on the straight line method. The vehicle was brought into use on 1 April 2018.

Calculate the amount that will be recouped and included in taxable income if the vehicle is sold for (a) R200 000 or (b) R160 000 on 30 June 2021.

Solution

Cost on 1/4/2018	R180 000
Wear and tear: 2019 (180 000 x 20% x 11/12)	(33 000)
2020 and 2021 (180 000 x 20% x 2)	(72 000)
To 30 June 2021 (180 000 x 20% x 4/12)	(12 000)
Tax value at 30/6/2021	R63 000

(a) Recoupment if sold for R200 000:

Selling price limited to cost (R200 000 limited to R180 000)	R180 000
Tax value	(63 000)

Recoupment	R117 000

The proceeds must be limited to cost in order that the recoupment does not exceed the sum of the allowances previously granted. The amount in excess of the cost will in most circumstances lead to a capital gain (see Chapter 6).

(b) Recoupment if sold for R160 000:

Proceeds (less than cost)	R160 000
Tax value	(63 000)
Recoupment	R97 000

5.7.3. DEFERRAL OF RECOUPMENT OF BUILDING ALLOWANCES – SECTION 13(3)

An asset subject to section 13(1) allowances is not eligible for a section 11(o) scrapping allowance. However it is subject to a section 8(4) recoupment if it is sold for more than its tax value.

To allow for the fact that the taxpayer may use the proceeds on disposal to purchase a new building, section 13(3) provides that any section 8(4)(a) recoupment may, at the option of the taxpayer, be set off against the cost of a new building instead of being included in taxable income. The result is that the taxpayer does not need to include the recoupment in his taxable income, but his future capital allowances on the new building are reduced by the amount of the recoupment over the life of the new building.

The new building must be purchased or erected within 12 months of the event giving rise to the recoupment in respect of the old building. The Commissioner may allow this 12-month period to be extended. Note that the new building must qualify for the annual allowance.

There is no similar deferral provision in respect of commercial buildings on which section 13*quin* allowances have been claimed and are subsequently recouped.

Example – Building recoupment

ABC (Pty) Ltd had erected a factory building in January 2012, and brought it into use on 31 March 2012. The building cost was R1 million. On the last day of its tax year (30 June 2021) it sold the building for R3 million, and had a recoupment of R500 000.

On 15 February 2022, ABC (Pty) Ltd purchased a new and unused building from Property Developers (Pty) Ltd. The cost was made up as follows:

Land	R2 000 000
Building	17 000 000
Total	R19 000 000

ABC brought the building into use on 15 February 2022. It carried on a manufacturing business in the building. It elected to set the recoupment of the first building off against the cost of the new building. Its annual allowance calculation for the year of assessment ended 30 June 2022 is as follows:

Cost of building	R17 000 000
Section 13(3) set-off	(500 000)
Cost on which allowance is based	R16 500 000
Annual allowance (5%)	R825 000

5.8 CONCLUSION

Capital allowances are necessary because the general deduction formula does not allow the deduction of expenditure of a capital nature. Chapter 5 outlines the capital allowances available in respect of moveable and immoveable assets, plant and machinery and other assets, as well as expenditure on repairs. It also covers the possible tax consequences of the disposal of an allowance asset.

If one incorporates this chapter into the tax liability calculation, the result would look similar to the following (note that some line items have been condensed and their detail can be confirmed in previous chapters):

Gross income section 1		
As per the definition, including, but not limited to:		
Salary, commission, leave pay etc.	XX	
Trading income	XX	
Fringe benefits (refer to previous chapters for detail)	XX	
Passive income (refer to previous chapters for detail)	XX	
Recoupment section 8(4)(a)	XX	XX
Less: Exempt income section 10 (refer to previous chapters for detail)		(XXX)
Income		XXX
Less: Deductions (mainly sections 11 to 20 & section 23)		
Legal expenses section 11(c)		(XX)
Restraint of trade section 11(cA)		(XX)
Registration of intellectual property section 11(gB)		(XX)
Acquisition of intellectual property section 11(gC)		(XX)
Research and development section 11D		(XX)
Bad and doubtful debts sections 11(i) & 11(j)		(XX)
Employers' contributions to funds section 11(l)		(XX)
Annuities to former employees section 11(m)		(XX)
Repairs section 11(d)		(XX)
Wear and tear section 11(e)		(XX)
Special depreciation allowance section 12C		(XX)
Building allowances section 13(1) or section 13*quin*		(XX)
Disposal allowance section 11(o)		(XX)
Adjustments: Trading Stock		
Opening Stock section 22(2)		(XX)
Closing Stock section 22(1)		XX
Adjustments/Recoupments section 22(8)		XX
Add: Taxable portion of allowances section 8(1)		
Travel allowance inclusion		XX
Subsistence allowance inclusion		XX
Other allowance inclusions (entertainment)		XX
Add: Taxable portion of capital gains section 26A		XX
Subtotal (needed for retirement fund contribution deduction)		XXX
Less: Retirement fund contribution deductions section 11F		(XX)
Subtotal (needed for donations deduction)		XXX
Less: Donations deduction section 18A		(XX)

Taxable income	XXX
Individuals and partnerships:	
Tax per the table, based on taxable income	XXX
Less: Rebates	XXX
Tax payable	XXX
Companies:	
Taxable income x 28%	XXX

5.9 INTEGRATED QUESTION

5.9.1. MAKEMUCH (PTY) LTD (37 MARKS)

On 1 July 2021 Makemuch (Pty) Ltd commenced trading. All of the shares of Makemuch (Pty) Ltd are owned by Mr Angus McMuch. Angus does not own shares in any other company.

Makemuch has come to the end of its first year of trading, and Angus has requested that you assist in calculating its 2022 taxable income, based on the following information:

a. Sales for the year consisted of sales to South African customers of R15 549 000, and sales to overseas customers of R5 000 000.

b. The company purchased an empty plot of land for R350 000 on 1 July 2021. It built a factory on this plot (Factory A) at a further cost of R670 000. This factory was completed and brought into use on 1 September 2021 and houses its manufacturing plant.

c. On 12 July 2021 the company purchased the ground floor of a new building in the Cape Town CBD to serve as its offices and showroom. The purchase price was R175 000.

d. On 1 August 2021 the company purchased new manufacturing machinery (Machine A) for R125 000, and second-hand machinery (Machine B) for R62 000.

e. On 1 November 2021 the company purchased a computerized point-of-sale (POS) system to handle its entire customer invoicing. The system cost R57 600. It was available for use on the purchase date and was brought into use on 31 November 2021. The South African Revenue Service allows a straight-line write-off over 3 years for this system in terms of section 11(e).

f. On 1 December 2021 the company reconfigured the layout of the inside of its upholstery plant. As a result, Machinery B had to be moved at a cost of R8 000.

g. In January 2022 the company purchased twelve newly developed townhouses. This consisted of eight small units at a cost of R180 000 each, and four larger units at a cost of R420 000 each.

   - Six of the smaller units were rented to tenants at R1 500 each
   - Two of the larger units were rented to tenants at R3 300 each
   - The remaining units were sold at cost on interest-free loan account to Makemuch employees. Each employee was required to pay an initial amount of 10% of the purchase price, apart from which the full selling price remains outstanding at year-end in each case.

h. In February 2022 vandals broke five large windows at the company's factory. Makemuch spent R37 250 to replace four of the windows, and a further R19 000 replacing the fifth window with a set of sliding doors to provide a side exit to its smoking area for staff.

i. The salary expense for the year was R2 576 000.

j. Total purchases of raw materials for the year amounted to R3 537 000.

k. The company's year-end stock count revealed that the following were on hand at year-end:

   - raw materials with a total cost of R925 760.
   - work in progress at various stages of completion with total cost to date of R48 000.
   - damaged goods with a cost of R56 000, that will be sold for R10 000.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Makemuch (Pty) Ltd for the year of assessment ended 30 June 2022, assuming the company is not a small business corporation. You may ignore capital gains tax. **(25 marks)**
2. Determine whether Makemuch qualifies as a small business corporation. **(6 marks)**
3. Calculate what the capital allowances of Makemuch in respect of items (c) to (e) would have been if the company had qualified as a small business corporation. **(6 marks)**

5.9.2. MAKEMUCH (PTY) LTD – SUGGESTED SOLUTION

1.	Taxable income of Makemuch (Pty) Ltd for its 2022 year of assessment			
a	Sales	15 549 000 + 5 000 000	20 549 000	**1**
	Resident taxed on worldwide income therefore include all sales			
b	s13(1): Manufacturing building	670 000 x 5%	(33 500)	**2**
	No capital allowance for cost of land			
c	s13quin: Purchase part of commercial building	175 000 x 55% x 5%	(4 813)	**2**
d	s12C: New machinery	125 000 x 40%	(50 000)	**1**
	s12C: Second-hand machinery	62 000 x 20%	(12 400)	**1**
e	s11(e): Computer equipment	57 600 x 1/3 x 7/12	(11 200)	**2**
	Deductions apportioned for s11(e), but not for s12 or s13. Calculated from date brought into use.			
f	s12C: Moving costs	8 000 x 20%	(1 600)	**1**
	Claimed over remaining tax life of machines (2nd hand)			
g	Rent income	R3 300 x 2 x 6 + R1 500 x 6 x 6	93 600	**2**
	s13*sex*: Townhouses rented	R420 000 x 2 x 5%	(42 000)	**1**
	s13*sex*: Low-cost units rented	R180 000 x 6 x 10%	(108 000)	**2**
	Six units qualify as low-cost as the cost was less than R300 000 and the rent per month is less than 1% of cost (R180 000 x 1% = R1 800)			
	s13*sept*: Allowance on low-cost units sold on interest-free loan account to employees	(R180 000 – R18 000) x 2 x 10%	(32 400)	**2**
	Only the loans in respect of the two low-cost units qualify for the allowance			
h	s11(d): Repairs		(37 250)	**1**
	s13*quin*: Improvement to factory building that does not increase industrial capacity	R19 000 x 5%	(950)	**1**
i	s11(a): Salaries		(2 576 000)	**1**
j	s11(a) Raw materials		(3 537 000)	**1**
k	s22(1): Closing stock			
	- Raw materials		925 760	**1**

	- Work in progress	48 000	**1**
	- Damaged stock	10 000	**1**
	Damaged stock included at realizable value if Commissioner informed as to reason and method of determining value.		
	Taxable Income	R15 179 247	**1**

2. The following are relevant in determining whether Makemuch (Pty) Ltd is qualifies as a small business corporation (SBC):
   - It is a private company **1**
   - The only shareholder is a natural person **1**
   - The shareholder does not hold any equity interests in any other companies **1**
   - The company does not earn investment income or income from personal services **1**
   - However, the company's revenue exceeds R20 million **1**

   Makemuch meets all of the requirements for qualification as an SBC, except that its turnover exceeds the limit of R20 million. Therefore Makemuch is not an SBC. **1**

3. If Makemuch had qualified as an SBC, its capital allowances in respect of the items identified would have been as follows:

c	s13*quin*: purchase part of commercial building *Only assets that meet the criteria of s11(e), s12B or s12C qualify for SBC allowances under s12E*	175 000 x 55% x 5%	(4 813)	**2**
d	s12E: Machinery used in process of manufacture	(125 000 + 62 000) x 100%	(187 000)	**2**
e	s12E: Other equipment *30% deductible in year 2; 20% deductible in year 3*	57 600 x 50%	(28 800)	**2**
			Total	**37**

CHAPTER 6

CAPITAL GAINS TAX

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6.1 INTRODUCTION

Capital Gains Tax (CGT) was introduced into the Income Tax Act with effect from 1 October 2001. It essentially applies to all disposals of capital assets on or after that date where the proceeds on disposal of the assets are not included in gross income. The basic principle is that if a capital asset is sold at a profit, the profit is subject to CGT, and if it is sold at a loss, the capital loss can be set off against other capital profits. If there are no other capital profits in the year, the capital loss is carried forward to the next year.

Learning objectives

By the end of the chapter, you should be able to:

- Calculate the capital gain or loss on the disposal of an asset
- Calculate the aggregate capital gain or loss for the year, and the taxable capital gain included in taxable income or assessed capital loss carried forward
- Determine the valuation date value of an asset acquired prior to the introduction of capital gains tax
- Identify when a deemed disposal has taken place and determine the resultant capital gains tax consequences
- Identify which disposals or portions of disposals are excluded from capital gains tax

6.2 PERSONS LIABLE FOR CGT

A distinction is made between persons who are resident in South Africa and persons who are not. This is dealt with in paragraph 2 of the 8th Schedule.

Residents

CGT applies to any (capital) asset of a South African resident. This means that a South African resident is taxed on 'capital gains' made on the sale or disposal of assets which he owns anywhere in the world.

Non-residents

As far as non-residents are concerned, the sale or disposal of the following assets is subject to the CGT provisions, if the assets are capital in nature:

- fixed (immovable) property situated in South Africa
- any interest or right in immovable property situated in South Africa (including mineral rights)
- assets effectively connected to a South African permanent establishment

An 'interest in immovable property situated in South Africa' is an equity shareholding in a company whose primary asset is immovable property. This provision stops people from placing immovable property in a company and selling their shares in the company instead of the property in an attempt to fall outside the CGT net.

A South African permanent establishment of a non-resident is generally an office, branch, or other fixed place of business in South Africa.

Non-residents will not be liable for CGT on other assets that they own even if situated in the Republic (such as shares, other than those that represent an interest in immovable property).

6.3 BASIC FRAMEWORK OF CGT

6.3.1 BASICS OF CGT

The basic calculation of a capital gain is as follows (using assumed figures):

Proceeds from sale of (capital) asset	R80 000
Less: Base cost of asset	(35 000)
Capital gain	R45 000

Whether the proceeds on sale of an asset are included in gross income or are subject to capital gains tax depends on the facts and circumstances of each disposal. For example, a land dealer who sells land as trading stock will be subject to normal tax on the profit made, while an investor who holds land as a long-term capital asset will be subject to CGT on the profit made when he sells the land.

'Capital gains tax' is not a separate tax from income tax. The way it works is that only part of a person's capital gain is included in his taxable income. It is then subject to normal tax. In terms of section 26A of the Income Tax Act, the 'taxable capital gain' must be included in the taxable income of a person for the year of assessment. The 'taxable capital gain' is calculated in terms of the rules in the 8th Schedule to the Income Tax Act.

Paragraph 10 of the 8th Schedule states that a taxable capital gain is 40% of a natural person's net capital gain for a year of assessment. For companies and other legal entities, the taxable capital gain is 80% of that entity's net capital gain for the year.

Paragraph 8 of the 8th Schedule basically defines a 'net capital gain' as follows:

Aggregate capital gain for the year (see definition of 'aggregate capital gain' below)	XXX
Less: Any assessed capital loss brought forward from the previous year	(XX)
Net capital gain	RXXX

Paragraph 6 of the 8th Schedule defines the 'aggregate capital gain' as the excess of all the capital gains for the year, reduced by the sum of all the person's capital losses, and if the person is a natural person, further reduced by the annual exclusion of R40 000.

Example - Company

Company A sold land (which had cost it R300 000 in 2015) for R740 000 in 2022. The tax on the capital gain is calculated as follows:

Proceeds	R740 000
Base cost	(300 000)
Capital gain	R440 000
Taxable capital gain (80%)	R352 000
Tax at 28%	R98 560

The company's effective rate of tax on the capital gain is therefore 22.4%. It is this effective rate of tax on the capital gain that is normally referred to as 'capital gains tax'.

Example - Individual

Mr A is on the maximum marginal rate of 45%. He sold land (which had cost him R300 000 in 2015) for R740 000 on 28 February 2022. The tax on the capital gain is effectively as follows:

Proceeds	R740 000
Base cost	(300 000)
Capital gain	R440 000
Annual exclusion	(40 000)
Aggregate capital gain/net capital gain	R400 000

The aggregate capital gain is the same as the net capital gain because there are no capital losses brought forward from the previous year.

Taxable capital gain (40%)	R160 000
Tax at 45%	R72 000

As this is 18% of the person's net capital gain, it is often said that the effective rate of 'capital gains tax' for individuals is 18% when a person is on the maximum rate of tax.

6.3.2 SIMPLE CGT EXAMPLES - INDIVIDUALS

Example – Individual: capital gain

Mr Z sold the following capital assets during the year ended 28 February 2022 and made the profits and losses shown. No other capital assets were sold.

	Profit / (loss)
Shares in A Ltd	R 90 000
Shares in B Ltd	40 000
Shares in C Ltd	20 000
Shares in D Ltd	(65 000)

Calculation of taxable capital gain

Total capital gains	R150 000
Total capital losses	(65 000)
	R 85 000
Less: Annual exclusion	(40 000)
Aggregate capital gain	R45 000
Less: Assessed capital loss brought forward (assume)	*nil*
Net capital gain	R45 000
Taxable capital gain (R45 000 x 40%)	R18 450

Example – Individual: capital loss

Mr Y sold the following capital assets during the year ended 28 February 2022 and made the profits and losses shown. Mr Y had an assessed capital loss of R800 brought forward.

	Profit / (loss)
Shares in A Ltd	R 100 000
Shares in B Ltd	50 000
Shares in C Ltd	30 000
Shares in D Ltd	(180 000)
Shares in E Ltd	(43 000)

Calculation of taxable capital gain or capital loss:

Total capital gains	R 180 000
Total capital losses	(223 000)
	(43 000)
Less: Annual exclusion	40 000
Aggregate capital loss	(3 000)
Add: Assessed capital loss brought forward	(800)
Assessed capital loss carried forward to next year	(R 3 800)
Amount included in taxable income	*nil*

Example – Individual: no gain or loss

Mr X sold the following capital assets during the year ended 28 February 2022, making the profits and losses indicated. Mr Z did not have any assessed capital loss brought forward.

	Profit / (loss)
100 shares in A Ltd	R 140 000
20 shares in B Ltd	30 000
1 000 shares in C Ltd	(120 000)
800 shares in D Ltd	(45 000)

He has sold no other capital assets during the year.

Calculation of taxable capital gain or capital loss:

Total capital gains	R 170 000
Total capital losses	(165 000)
	5 000
Annual exclusion R40 000, (limited to net figure)	(5 000)
Aggregate capital gain	*nil*

Notes:

1. Capital gains and losses are calculated separately for each asset disposed of.
2. The annual exclusion reduces the sum of the capital gains and capital losses for the year before the assessed capital loss balance carried forward from previous years is taken into account and before the 40% inclusion is calculated.
3. Only natural persons and special trusts (as defined in the 8th Schedule) are subject to the annual exclusion.
4. The annual exclusion reduces either the net gain or the net loss for the year. This is why it is called an exclusion and not a deduction. Any unused portion of the exclusion falls away.
5. The taxable capital gain is included in taxable income in terms of section 26A.
6. If the capital losses exceed the capital gains for the year, the net loss (known as the 'assessed capital loss') is not deducted from taxable income, but is carried forward to the next year's calculation of the net capital.

6.3.3 SIMPLE CGT EXAMPLE - COMPANIES

Example – Company: combined calculation

Quick (Pty) Ltd has the following income and expenses, and profits and losses for the year:

Gross income	R 300 000	
Tax-deductible expenses	(130 000)	
Capital gain on sale of shares in A Ltd	50 000	
Capital gain on sale of shares in B Ltd	40 000	
Capital loss in sale of shares in C Ltd	(20 000)	
Calculation of tax payable:		
Gross income		R 300 000
Deductions		(130 000)
		170 000
Total capital gains	R 90 000	
Total capital losses	(20 000)	
Aggregate capital gain	R70 000	
Assessed capital loss brought forward	*nil*	
Net capital gain	R 70 000	
Taxable capital gain (80% of R70 000)		56 000
Taxable income		R 226 000
Tax per table (28%)		R 63 280

Notes:

1. As the taxpayer is a company, the annual exclusion is not applicable.
2. As the taxable capital gain is included in taxable income, it may be reduced by any assessed loss brought forward from the previous year.

6.4 ASSET

The capital gains tax provisions apply to the disposal, or deemed disposal, of all assets. The provisions are not limited to capital assets, but the 8th Schedule does provide that if the amount arising on the sale or disposal of an asset is included in income, it is not included in proceeds.

'Asset' is defined in paragraph 1 of the 8th Schedule (the 'definitions' paragraph) as:

- Property of whatever nature (movable or immovable).
- Including tangible and intangible assets (corporeal and incorporeal).
- Including any coin made mainly from gold or platinum.
- Including rights or interests of whatever nature to or in such property.

Currency is excluded from the definition of 'asset'. This means, for example, that if an asset is donated there is capital gains tax for the donor, but if cash is donated there is no capital gains tax because cash is not an asset.

This definition extends the concept of asset to what would not normally be considered an asset. 'Goodwill', for example, is not tangible or intangible property. It obtains its value from the underlying assets of a business. As it is an interest in an asset, it is an asset in itself for CGT purposes.

Example

Mr X lived in Germany during the Second World War. The regime at that time took away the castle he owned and he fled the country, fearing for his life. He came to live in South Africa. Some time after the war the new German Government decided that everyone who had had their property taken away during the Second World War, without receiving proper payment, should have the right to claim compensation from the government.

This right is an asset in Mr X's hands. If he sells it the proceeds will be subject to CGT. If the German Government pays him compensation, this will also be subject to CGT.

6.5 DISPOSAL

The Eighth Schedule deals with both disposals and deemed disposals. 'Disposal' is defined in paragraph 1 of the 8th Schedule as,

- an event, act, forbearance, or operation of law
- as envisaged in paragraph 11 of the Schedule

and

- an event, act, forbearance, or operation of law
- which the Act treats as the disposal of an asset.

Paragraph 11 is very broad in its ambit. It states that a disposal includes any event, act, forbearance or operation of law that results in:

- the creation, variation, transfer, or extinction of an asset
- the sale of an asset
- the donation of an asset
- the expropriation, conversion, grant, cession, exchange of an asset
- any alienation or transfer of ownership of an asset
- the forfeiture of an asset
- the termination of an asset
- the redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment of an asset (see exclusion below relating to the issue or cancellation of shares by a company)
- the scrapping, loss or destruction of an asset

- the vesting of an interest in an asset of a trust in a beneficiary (this is effectively a disposal of the asset by the trust to the beneficiary)
- the distribution of an asset by a company to a shareholder (this is a disposal by the company)
- the decrease in value of a person's interest in a company, trust or partnership as a result of a 'value shifting arrangement'

The CGT implications of share options are beyond the scope of this book.

The following (not the complete list) are deemed *not* to be disposals,

- the transfer of an asset as security for a debt
- the transfer of such asset back to the debtor
- the issue or cancellation of a share by a company (deemed not to be a disposal for that company)
- the disposal by a person in respect of the issue of any bond, debenture, note or other borrowing of money or obtaining of credit from another person

6.6 PROCEEDS

The starting point in calculating a capital gain or a capital loss on the disposal of an asset is the proceeds received or accrued on the disposal of the asset. 'Proceeds' is defined in paragraph 1 of the 8th Schedule as 'the amount to be determined in terms of Part VI'. Part VI contains paragraphs 35 to 43B of the 8th Schedule.

6.6.1 PROCEEDS FROM DISPOSAL – PARAGRAPH 35

In terms of paragraph 35(1) the proceeds from the disposal of an asset are equal to:

- the amount received by, or accruing to, the taxpayer in respect of the disposal; or
- any amount that is treated as having been received by or accrued to the taxpayer in respect of the disposal (deemed proceeds).

6.6.2 REDUCTION OF PROCEEDS

Paragraph 35(3) provides that the proceeds from the disposal of an asset must be reduced by:

- any amount of the proceeds that must be or was included in gross income
- any amount that must be or was taken into account when determining the taxable income (not being the capital gains tax inclusion in taxable income)
- any amount that is repayable to the person who acquired the asset
- reductions to accrued proceeds caused by cancellation, variation, termination, prescription or waiver of the debt claim or other events other than any cancellation or termination of an agreement that results in the asset being reacquired by the person that disposed of it

Example – Reduction of proceeds

(a) X (Pty) Ltd sells trading stock for R1 000 (excluding VAT)

The proceeds are	R1 000
Reduced by amount included in gross income	(1 000)
	Nil

(b) Y (Pty) Ltd sells a machine (a capital asset) for R1 000 (excluding VAT). The machine had originally cost R800 (excluding VAT) and had a tax value of R200 when it was sold. The sale gives rise to a section 8(4)(a) recoupment of R600 (allowances previously claimed).

The proceeds are	R1 000
Reduced by the recoupment	(600)
	R400

Notes

1. Where a person is entitled to any amount payable after the year-end, the amount must be treated as having accrued during the year (paragraph 35(4)). This scenario is to be distinguished from when that person only becomes entitled to the proceeds in the following year.
2. The exclusions set out above make it clear that a gain cannot be taxed twice, and also make it clear that the CGT provisions apply to all assets, not just capital assets.
3. Proceeds must be reduced by any amount that is repaid or becomes repayable during the year.
4. If the debt owing to the person who disposed of the asset is waived or prescribes, or is cancelled or reduced in any way, the proceeds giving rise to the debt must be reduced.
5. Paragraph 39A states that if any of the proceeds from the disposal of an asset will not accrue during the year, any capital loss on the asset sold or disposed of must be disregarded and effectively carried forward to be deducted from the proceeds when they accrue in the later year. If no further proceeds will accrue, the loss may be deducted from other capital gains (subject to the various limitations in the schedule).
6. Section 24M of the Act states that if any of the proceeds on the disposal of an asset cannot be quantified in the year of assessment, the unquantified amount must be deemed not to have accrued until such time as it becomes quantifiable.
7. There are certain transactions where the taxpayer is deemed to have received proceeds on the disposal of an asset. Generally, the taxpayer is deemed (in terms of that particular provision) to have received an amount equal to the market value of the asset, and the person acquiring the asset is deemed to have paid market value for it at the time of acquisition (refer to 6.8).

6.6.3 DONATIONS AND SALES AT LESS THAN MARKET VALUE – PARAGRAPH 38

Where a person donates an asset, such person is deemed to have disposed of it for its market value. The donee is deemed to have acquired it for the same market value (paragraph 38). Special provisions exist for donations to spouses (refer to 6.11).

In addition to donations, paragraph 38 also applies to

- an asset disposed of for a consideration not measurable in money
- an asset disposed of to a connected person for a consideration which is not an arm's length price.

Example - Individuals

Mr X sells his property to his family trust for R1 400 000 at a time when its market value is R2 million. He had purchased the property for R1 million on 1 January 2016. As the trust is connected to Mr X, the sale is deemed to take place at market value. Mr X's capital gain (ignoring the donations tax implications) is:

Deemed selling price (market value)	R2 000 000
Actual cost	(1 000 000)
Capital gain	R1 000 000

Example - Companies

Company A and Company B are part of the same group of companies, and are therefore connected persons. Company A sells land which is worth R10 million to company B for R2 million (its original cost to company A). One year later, Company B sells the land for R11 million. The capital gains tax position (ignoring the donations tax implications) is as follows:

Company A - deemed selling price (market value)	R10 000 000
Actual cost	(2 000 000)
Capital gain	R8 000 000

When Company B sells the property, its actual profit is R9 million, but its capital gain is:

Company B – actual selling price	R11 000 000
Deemed cost (para 38)	(10 000 000)
Capital gain	R1 000 000

6.7 BASE COST

A capital gain or capital loss is determined by deducting the base cost of an asset from the proceeds on the disposal of the asset. The base cost of an asset is determined in terms of the provisions contained in Part V of the Eighth Schedule (paragraphs 20 to 34).

Capital gains and losses incurred on the disposal of assets acquired before the introduction of CGT on 1 October 2001 (pre-valuation date assets) are dealt with differently from those for assets acquired on or after 1 October 2001.

6.7.1 BASE COST – PARAGRAPH 20

In simple terms, the base cost of an asset is the cost of acquiring it, plus all costs of improving or adding to it. The important provisions in paragraph 20 are as follows:

1. The costs of acquiring, creating, or improving the asset are part of the base cost (actual cost, transaction costs, moving costs, etc). The cost of valuing the asset for CGT purposes is also part of the base cost.
2. Only certain costs incurred in respect of the disposal of the asset can form part of the base cost (sales commission, advertising, valuation costs, accounting and legal costs, removal costs, etc) – para 20(1)(c).

Example – Improvements and selling costs

Mrs P bought a holiday house for R400 000 in 2012. In 2016 she spent R25 000 to add a garage. In 2022 the property was sold for R600 000 on her behalf by an estate agent. The estate agent's fee is 4% of the selling price.

Original purchase price	R400 000
Cost of improvements	25 000
Selling costs (estate agent fee)	24 000
Base cost	R449 000

3. In limited circumstances, one-third of the interest expense in acquiring a listed share or a participatory holding in a collective investment scheme may be added to base cost.
4. Paragraph 20 also contains the following deeming provisions:
   - Where an employee receives or buys an asset at a discount, and the difference between the market value of the asset and what he pays is taxed as a fringe benefit, this market value becomes the base cost of the asset in the employee's hands.
   - Where a person is given an asset for services rendered, and is taxed on the value of that asset, such value becomes the base cost of that asset in the person's hands.

6.7.2 AMOUNTS REDUCING THE BASE COST OF AN ASSET

If an expense is allowable as a deduction or was otherwise taken into account in determining taxable income, it cannot form part of the base cost – paragraph 20(3). This is a very important aspect of base cost. For example, it may seem that paragraph 20 permits a large range of expenses to be taken into account in the determination of base cost, and that is true. However, if any of the expenses listed in paragraph 20 have been subject to a normal tax deduction they must be excluded from base cost. This is similar in principle to the rule that if amounts received are included in gross income, the proceeds on the sale or disposal must be reduced by such amounts.

The base cost must be further reduced by the following amounts if the related expense was originally included in the base cost;

- expenses which are recovered or recoverable
- expenses/costs paid by another person.

Example – Reduction of base cost by allowances

Mr A and Mr B each own the same type of asset. Mr A uses his asset in his private capacity, whereas Mr B uses his asset wholly in his trade. Both A and B acquired their respective assets for R1 000 in October 2020. Both taxpayers sold their assets in February 2022 for R1 500. Mr B had claimed allowances on the asset amounting to R600 by the date of sale.

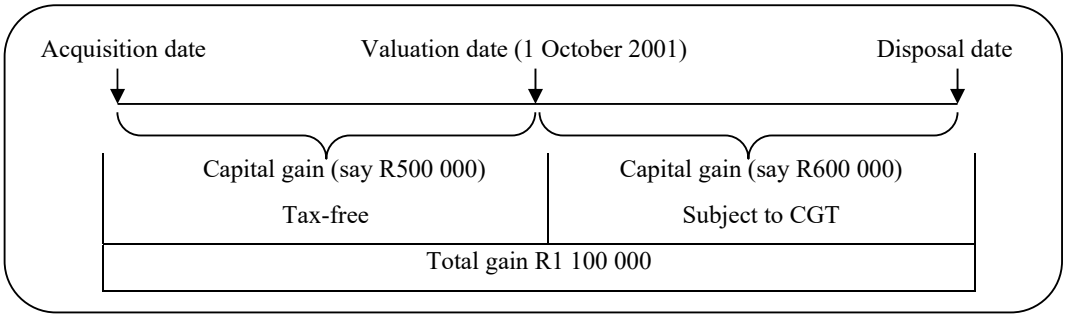
Determine the capital gain or capital loss for each taxpayer.

		A		**B**
Amount received or accrued		R1 500		R1 500
Less recoupment		0		(600)
Proceeds		1 500		900
Less base cost:				
Original expenditure	1 000		1 000	
Allowances	(0)	1 000	(600)	400
Capital gain		R 500		R 500

Note: Mr A could not claim any capital allowances. Mr B claimed allowances, which reduces his base cost.

6.7.3 ASSETS ACQUIRED BEFORE OCTOBER 2001

Assets acquired before 1 October 2001 are referred to as 'pre-valuation date assets'. In terms of the capital gains tax legislation, only capital gains earned on or after 1 October 2001 fall within the ambit of the legislation. This concept can be diagrammatically illustrated as follows:



A portion of the total gain representing the amount earned before 1 October 2001 must be excluded from CGT. This apportionment is made by calculating the 'valuation date value' of the asset at 1 October 2001. This is used to (generally) increase the base cost of the asset above the actual expenditure, thus decreasing the capital gain calculated.

In terms of paragraph 25 the base cost of an asset acquired before 1 October 2001 is calculated as follows:

Valuation date value at 1 October 2001	RX XXX
Plus: Allowable expenditure incurred on or after 1 October 2001	XXX
Base cost	RX XXX

6.7.4 DETERMINATION OF VALUATION DATE VALUE

Paragraph 26 states that where the proceeds on the disposal of a pre-valuation date asset exceed the expenditure allowable in terms of paragraph 20 (incurred both before and on or after 1 October 2001) the person who has disposed of the asset may adopt any one of the following as the valuation date value:

- The market value on 1 October 2001
- The time–apportionment base cost
- 20% of the disposal proceeds (after deducting from those proceeds an amount equal to the expenditure allowable, in terms of paragraph 20, incurred on or after 1 October 2001)

Note that the third option would have to be used if the taxpayer did not have the asset valued and had no record of the actual original cost of the pre-valuation date asset.

Example – Proceeds exceed expenditure

Capri (Pty) Ltd acquired an asset in October 1991 at a cost of R1 000. In 2012 an additional R200 was spent on the asset. The asset was sold in September 2022 for R1 500. The market value on 1 October 2001 was R1 050. Because the proceeds (R1 500) exceed the expenditure (R1 200), paragraph 26 applies.

The taxpayer now has the choice of valuation date value between:

Market value on 1 October 2001	R1 050
Time-apportionment (assume)	1 081
20% x (1 500 – 200)	260

The capital gain or loss is then determined as follows:

Proceeds		R1 500
Valuation date value	R1 081	
Plus post-1 October 2001 expenditure	R 200	(R1 281)
Capital gain		R219

Since the market value on 1 October 2001 could result in an effectively inflated base cost (because of market conditions on 1 October 2001), paragraph 26(3) carries a limitation on the valuation date value if market value has been adopted and the expenditure is known. If the taxpayer has adopted the market value as the valuation date value and the proceeds are lower than the market value (but exceed the total expenditure), the valuation date value must be limited to the proceeds reduced by expenditure incurred on or after 1 October 2001. This means that it is not possible to create a loss by using market value (para 26(3)).

Example – Market value exceeds proceeds

Capri (Pty) Ltd acquired an asset in October 1991 at a cost of R1 000. In 2012 an additional R200 was spent on the asset. The asset was sold in September 2022 for R1 500. The market value on 1 October 2001 was R1 800. Because the proceeds (R1 500) exceed the expenditure (R1 200), paragraph 26 applies. If the time apportionment method is applied a capital gain arises. If market value is adopted the determination is as follows:

Because market value (R1 800) is greater than the proceeds (R1 500) the valuation date value is deemed to be:

Proceeds	R1 500
Less expenditure after 1 October 2001	(200)
Valuation date value	R1 300

The capital gain or loss is then determined as follows:

Proceeds		R1 500
Valuation date value	R1 300	
Plus post 1 October 2001 expenditure	R 200	R1 500
Capital gain/loss		R *nil*

The so-called 'kink test' in paragraph 26 is aimed at ensuring that, where an accounting profit arises, a capital loss cannot be created by using a valuation date market value which is larger than the proceeds. The market value is in effect limited to the proceeds, resulting in neither a capital gain nor a capital loss. A gain would arise if the time apportionment method were used, but no-one would choose to do so.

Where the taxpayer no longer has a record of the expenditure i.e. cannot determine expenditure before valuation date, paragraph 26(2) reduces the choice of valuation date value to:

- The market value on 1 October 2001 (per paragraph 29)
- 20% of the disposal proceeds (after deducting from those proceeds an amount equal to the expenditure allowable, in terms of paragraph 20, incurred on or after 1 October 2001)

It is interesting to note that the loss limitation rule in paragraph 26(3) applies only where the market value was adopted and the expenditure is known. This means that a loss can be created by using market value where expenditure is not known, because the limitation in paragraph 26(3) does not apply.

Example – Capital loss using market value

Capri (Pty) Ltd acquired an asset in October 1991 but has lost the records. In 2012, R200 was spent on the asset. The asset is sold in September 2022 for R1 500. The market value on 1 October 2001 was R1 800. Because expenditure is not known paragraph 26 applies. If market value is adopted the determination is as follows:

The capital gain or loss is then determined as follows:

Proceeds		R1 500
Valuation date value	R1 800	
Plus post 1 October 2001 expenditure	R 200	R2 000
Capital loss		(R500)

Where the proceeds on disposal of a 'pre-valuation date' asset do not exceed the expenditure allowable in terms of paragraph 20 incurred both before and on or after 1 October 2001, a different set of rules apply in determining the valuation date value. Simplistically these rules also serve to exclude a portion of the difference between the proceeds and the total expenditure from CGT. Such situations are beyond the scope of this book.

6.7.5 TIME-APPORTIONMENT BASE COST

Time-apportionment 'base cost' is somewhat of a misnomer. All that the time apportionment calculation achieves is a value at 1 October 2001 (the valuation date value). By adding the subsequent costs (incurred after 1 October 2001) as permitted by paragraph 20 the base cost is determined (assuming the time apportionment calculation was chosen as the valuation date value). The time apportionment method requires that the person must know when the asset was bought and how much it cost. It is also necessary to know how much was spent on improving the asset over the period it was owned. The time apportionment basis is referred to as 'TAB'.

A time apportionment calculation is done in terms of one or both of these formulae i.e.

- the basic formula to determine the valuation date value
- the adjustment to the formula where certain costs are incurred on the asset on or after 1 October 2001

6.7.6 THE BASIC TAB FORMULA

Paragraph 30(1) of the 8th Schedule provides that the time-apportionment base cost of a 'pre-valuation date asset' (Y) is calculated in accordance with the following formula –

$$Y = B + \frac{[(P - B) \times N]}{T + N}$$

Where –

B = expenditure (per paragraph 20) incurred before 1 October 2001

P = proceeds (per paragraph 35) on disposal (or the result of the adjustment formula – see below)

N = number of years determined from the date that the asset was acquired to 30 September 2001. (N is limited to 20 where the expenditure allowable in respect of the asset, per paragraph 20, was incurred in more than one year of assessment prior to 1 October 2001.) Part of a year is treated as a full year. For example, the period from 15 July 2000 to 30 September 2001 is two years.

T = the number of years from 1 October 2001 until the date the asset was disposed of after that date. Part of a year is again treated as a full year.

Example - TAB

Mrs R bought a holiday house on 1 June 1991 for R200 000. She sold it on 30 March 2022 for R500 000. She did not value the house on 1 October 2001. Calculate her capital gain.

Proceeds		R500 000
Base cost: $B + \frac{[(P - B) \times N]}{T + N}$		
$R200\,000 + \frac{[(500\,000 - 200\,000) \times 11]}{21 + 11}$	=	(303 125)
Capital gain		R196 875

Part of a year is treated as a full year, therefore the period from 1 June 1991 to 1 October 2001 is 11 years. The period from 1 October 2001 to 30 March 2022 is 21 years.

6.7.7 THE ADJUSTMENT TAB FORMULA

Where a portion of the expenditure allowable (per paragraph 20) in respect of the asset was incurred on or after valuation date, the proceeds to be used to determine the 'time-apportionment base cost' of the asset must be adjusted to reflect the fact that some of the proceeds would not have arisen if the asset had been sold at the valuation date, since additional costs (e.g. on improvements) were incurred after the valuation date.

The proceeds are therefore adjusted in accordance with the formula:

$$P = R \times \frac{B}{(A + B)}$$

where –

P = amount to be used as proceeds in the basic TAB formula (the basic formula)

R = actual proceeds net of selling costs (refer to 6.7.8)

A = allowable expenditure incurred on or after 1 October 2001

B = allowable expenditure incurred before 1 October 2001.

It is important to note that this adjustment is only for the purposes of determining the base cost of the asset. When the capital gain is calculated the proceeds are once again the full amount received and the selling costs are added to the base cost.

Example – Use of adjustment formula

Mrs R bought a holiday house on 1 June 1991 for R200 000. She spent R30 000 improving the holiday house during September 2001, and R20 000 during November 2012, and sold the house for R550 000 on 30 March 2022, the capital gain is calculated as follows:

Proceeds			R550 000
Base cost:	$B + \frac{[(P - B) \times N]}{T + N}$	$P = R \times B/(A + B)$	

P = R550 000 x 230 000/(20 000 + 230 000)
= R506 000

Therefore, the base cost is:

$R230\,000 + \frac{[(506\,000 - 230\,000) \times 11]}{21 + 11}$ =	(324 875)	
Plus cost of improvements after 1 October 2001	(20 000)	(344 875)
Capital gain		R205 125

6.7.8 SELLING EXPENSES AND THE TAB FORMULAE

Certain 'selling expenses' are to be treated as a deduction from P or R in the various formulae, for the purposes of the time apportionment calculation. The expenses are:

- The remuneration of a consultant, agent, accountant, etc. in respect of and relating to the sale of an asset (such as estate agent's commission)
- Transfer costs relating to the sale
- Stamp duty, transfer duty, or similar duty relating to the sale
- Advertising costs to find a buyer

In the basic TAB formula the selling expenses are deducted from 'P', unless the adjustment formula applies, in which case the selling expenses are deducted from 'R'. In the adjustment formula, because the selling expenses are deducted from 'R' they are not included in 'A'.

It is important to note that this treatment is only for the purposes of determining the valuation date value. When determining the base cost at the date of disposal the selling costs are included in the base cost as expenditure incurred on or after 1 October 2001.

The effect is illustrated in the following examples:

Example – Selling expenses and TAB

Mrs R bought a holiday house on 1 June 1991 for R200 000. She sells it on 30 March 2022 for an amount of R550 000. She did not value the house on 1 October 2001. Mrs R incurred R10 000 in selling agent's fees and R12 000 in legal fees in March 2022 when she sold the house. Calculate her capital gain.

Proceeds R550 000

Base cost: $B + \frac{[(P - B) \times N]}{T + N}$

Therefore, base cost is:

$200\,000 + \frac{[(528\,000^* - 200\,000) \times 11]}{21 + 11}$ =	(312 750)	
Plus expenditure after 1 October 2001	(22 000)	(334 750)
Capital gain		R215 250

* P = R550 000 – 10 000 – 12 000

Example – TAB and adjustment formula

The taxpayer bought fixed property before 1 October 2001, made improvements before 2001, made further improvements after 2001, and then sold it in April 2022.

Purchase in September 1963	R 11 000
Improvements before 2001	19 000
Valuation at 1 October 2001	not done
Improvements after 2001	23 000
Selling price in April 2022	852 000
Selling agent's commission	40 000

Time apportionment works out at 39 years before, but limited to 20 years before 1 October 2001.

Using the TAB formula and the 20% of proceeds formula as alternatives, the calculation of the valuation date value (i.e. the value at 1 October 2001) is as follows:

Step one – the adjustment formula

$P = R \times B/(A + B) = (R852\,000 - 40\,000) \times \frac{(11\,000 + 19\,000)}{(23\,000) + (11\,000 + 19\,000)}$

P = R459 623

Step two – the basic TAB formula

$Y = B + [(P - B) \times N]/(T + N) = (R11\,000 + 19\,000) + \frac{[(459\,623 - (11\,000 + 19\,000)) \times 20]}{21 + 20}$

Y = R239 572

The calculation of the capital gain is then as follows:

Proceeds (actual)		R852 000
Less: Base cost		
Valuation date value per TAB	R239 572	
Improvements after 1 October 2001	23 000	
Agent's commission (selling expense)	40 000	(302 572)
Capital gain		R549 428

On the 20% of proceeds rule, the calculation is as follows:

Proceeds (actual)		R852 000
Less: Base cost		
Valuation date value per 20% x (R852 000 – 23 000 – 40 000)	R157 800	
Improvements after 1 October 2001	23 000	
Agent's commission (selling expense)	40 000	(220 800)
Capital gain		R631 200

This calculation can be used even if the taxpayer does have the necessary documentary evidence for expenditure incurred before 1 October 2001. It is only the TAB method that is not allowed to be used if the taxpayer cannot properly determine the expenditure incurred before 1 October 2001 on the asset.

6.8 DEEMED DISPOSALS AND DEEMED ACQUISITIONS

6.8.1 EVENTS TREATED AS ACQUISITIONS & DISPOSALS

Paragraph 12 of the 8th Schedule deals with events treated as disposals and acquisitions. These are situations where there is no actual acquisition or disposal by the taxpayer, but for CGT purposes there is deemed to be an acquisition or disposal. The importance of an event being treated as an acquisition is that it sets a new base cost for the taxpayer, which he can deduct from the proceeds of a subsequent disposal.

Paragraph 12(1) states that where an event described in paragraph 12(2) occurs, the following is deemed to have taken place:

- the person is deemed to have disposed of the asset for proceeds equal to its market value

  then

- the person is deemed to have reacquired the asset at an expenditure equal to the market value.

6.8.2 ACQUISITION & DISPOSAL – COMMENCING OR CEASING TO BE RESIDENT

Paragraph 12(2)(a)(i) states that when a person commences to be a resident that person is deemed to have:

- disposed of all his assets for market value prior to becoming a resident – there is no effect here, because as a non-resident the person is not taxed in South Africa on his worldwide income;
- and to have reacquired those assets for the same value on becoming a resident – this sets the base cost at that point.

This rule does not apply to the assets of a South African permanent establishment of that person, or to fixed property located in South Africa. These would already be subject to tax in South Africa prior to the person becoming a resident.

Section 9H of the Act considers (in part) the implications where a person ceases to be resident. That person is deemed to have disposed of all his assets the day before ceasing to be a resident. However, there is no deemed disposal in respect of immovable property in South Africa and the assets of a permanent establishment in South Africa, since a non-resident will remain subject to tax on the disposal of these assets.

6.8.3 ACQUISITION & DISPOSAL – SOUTH AFRICAN PERMANENT ESTABLISHMENT

A South African permanent establishment of a non-resident can be an office, branch, or other fixed place of business in South Africa. Normally, if a non-resident disposes of an asset (other than fixed property) situated in South Africa, no capital gains tax arises. However, the disposal of assets of a permanent establishment of the non-resident in South Africa will give rise to capital gains tax.

Paragraph 12(2)(b) deals with assets that enter or exit the capital gains tax net by becoming or ceasing to be assets of a permanent establishment in South Africa by deeming there to have been an acquisition or disposal.

If an asset of a non-resident becomes part of that person's permanent establishment in the Republic otherwise than by way of acquisition (for example, where it is sent to the permanent establishment from overseas), this is a deemed acquisition and is brought into the South African capital gains tax net at market value.

If the asset ceases to be an asset of that person's permanent establishment in the Republic otherwise than by way of a disposal contemplated in paragraph 11 (for example when it is removed from the Republic), this is a deemed disposal. The proceeds from the disposal are deemed to be the market value of the asset at the date of the deemed disposal.

6.8.4 DISPOSAL & ACQUISITION – CAPITAL ASSET BECOMES TRADING STOCK

Paragraph 12(2)(c) states that, if a capital asset changes its nature to trading stock in the hands of the taxpayer, this is a deemed disposal of the capital asset for market value. An asset not held as trading stock becomes

trading stock when the taxpayer has a change of intention. The effect of this provision is that at the time of the change of intention the person is deemed to have disposed of the asset for its then market value.

Note that in terms of section 22(3)(a)(ii) of the Act the trading stock is deemed to be acquired at a cost equivalent to the same market value that was deemed to be the proceeds per the Eighth Schedule.

Example – Capital asset to trading stock

Capo (Pty) Ltd (which has a June year-end) owns land, which it acquired as a fixed asset (i.e. a capital intention). The land has a base cost of R1m. In July 2021 Capo changes its intention *vis-a-vis* the land and decides to develop it and deal with it as trading stock. At the time the market value is R5m. Capo then develops the land at a cost of R3,5m, subdivides it into separate residential plots and sells the plots for R10m in total, in the period January to June 2022.

The income tax effects for the year ended 30 June 2022 are as follows:

Gross income (sale of plots)		R10 000 000
Opening stock (s 22)		(5 000 000)
Development costs (s 11(a))		(3 500 000)
Capital gains tax:		
Deemed proceeds	R5 000 000	
Base cost	(1 000 000)	
Capital gain	R4 000 000	
Include in taxable income 80%		3 200 000
Taxable income		R4 700 000

6.8.5 ACQUISITION – TRADING STOCK CEASING TO BE TRADING STOCK

Paragraph 12(3) provides that where an asset is held as trading stock and the taxpayer changes his intention with regard to the asset so that it is held as a capital asset or a non-business (i.e. personal-use) asset (without a change in its ownership), the person will be deemed to have:

- disposed of the asset for an amount (cost or market value – see below)
- and then reacquired the asset (as a capital or private asset) for a cost equal to that amount.

Section 22(8) deals with two different situations:

- If trading stock is applied by a taxpayer for his domestic use or consumption the cost price of such stock is included in his income (s 22(8)(a)). It is clear that this provision only applies to a natural person.
- If assets that were held as trading stock cease to be held as trading stock by the taxpayer the market value of such trading stock is included in income (section 22(8)(b)(v)). This provision applies to both natural and non-natural persons.

The deemed cost of acquisition of the asset as a capital asset for the purposes of the Eighth Schedule will either be cost or market value, depending on which of the s 22(8) provisions applies.

Example – Trading stock to capital asset

The UVW Trust bought 10 sectional title units in a block of apartments for resale. The cost was R400 000 per unit, and all 10 units were brought into trading stock. It sold 8 units for R600 000 each and then decided to keep the last two for use by its beneficiaries. It transferred those units from trading stock to fixed assets. Three years later it sold one of those units to a beneficiary for its market value then of R850 000. The tax calculation in the year that the 8 units were sold and the two were converted from trading stock to capital is as follows:

Gross income on sales of 8 units	R4 800 000
Section 22(8) recoupment on two units	1 200 000
Section 11(a) cost of 10 units	(4 000 000)
Taxable income	R2 000 000

In the year that the one unit (now a capital asset) is sold the capital gain is:

Proceeds	R850 000
Base cost	(600 000)
Capital gain	R250 000

6.8.6 DISPOSAL & ACQUISITION – PERSONAL-USE ASSETS

Paragraph 12(2)(d) provides for a deemed acquisition of an asset when it ceases to be held by a person as a personal-use asset (and commences to be held as a trading asset of a capital nature, for example). If a personal-use asset is sold, or destroyed, the provision does not apply, because the person does not continue to hold the asset.

A personal-use asset is an asset held by a natural person that is used mainly for purposes other than the carrying on of a trade. Capital gains and capital losses on disposal of such assets are disregarded for as long as they remain personal-use assets (see 6.9.2).

When a person disposes of a personal-use asset there is no capital gains tax effect. Therefore, when a personal-use asset changes to a business asset, this establishes the cost of the asset at its market value, at the time that it becomes a non-personal-use asset. When the asset is subsequently sold there will be a CGT effect.

Example – Personal use asset to business asset

Mr F has a motor car that had cost him R150 000 and that he uses only for private purposes. If he sells the car, there will be no capital gains tax effect (i.e. the capital gain or capital loss is disregarded), because it is a personal-use asset.

However, Mr F decides to use the motor car in his business. He runs a pizza business as a sole proprietor and intends to use the car for deliveries. At the time that he starts to use the motor car in his business, its value is R105 000. There is no capital gains tax effect when he starts to use the car, except that it becomes a business asset with a base cost of R105 000.

A few months later he sells the car for R112 000. Mr F then has a capital gain of R112 000 – 105 000 = R7 000

Where a business asset changes to a personal use asset, the effect is the opposite (para 12(2)(e)). The taxpayer is deemed to have sold the asset for market value (but only for capital gains tax purposes).

Example – Business asset to personal use asset

Mr G trades as a sole proprietor. He has a motor car that had cost him R150 000 and that he uses for business purposes. He claimed wear and tear of R90 000 over the years on the car, so that its tax value was R60 000. Mr G decides to stop using the motor car in his business and lent it to his daughter to use for going to university. At the time that his daughter starts to use the motor car, its value is R80 000. The capital gains tax is as follows:

Deemed proceeds		R80 000
Cost	R150 000	
Wear and tear	(90 000)	
Base cost for CGT purposes		(60 000)
Mr G has a capital gain of		R20 000

It is interesting to note that a change in use does not trigger a recoupment of the wear and tear. If Mr X had *given* the car to his daughter there would have been a recoupment of the wear and tear in terms of section 8(4)(m) of the Income Tax Act. In that case the proceeds would be reduced by the recoupment included in a person's gross income (refer to 6.6.2).

6.9 EXCLUSIONS FROM CGT

The 8th Schedule contains a number of exclusions, only some of which are considered in this book. The general principle is that any capital gain or capital loss made, which is subject to an exclusion, must be disregarded when calculating the person's aggregate capital gain or aggregate capital loss for the year.

The exclusions considered here are as follows:

1. The primary residence exclusion (paragraph 45)
2. Personal-use assets (paragraph 53)
3. Disposal of micro business assets (paragraph 57A)
4. Compensation for personal injury, illness or defamation (paragraph 59)
5. Gambling, games and competitions (paragraph 60)
6. Donations and bequests to public benefit organisations (paragraph 62)

6.9.1 PRIMARY RESIDENCE EXCLUSION

A 'primary residence' is any structure in which a natural person ordinarily resides as his or her main residence and is used mainly for domestic purposes.

The general principle is that up to R2 million of the capital gain or capital loss determined on the disposal of a primary residence must be disregarded when calculating a natural person's aggregate capital gain or loss. Paragraph 45(3) provides that only one residence at a time may be the primary residence of a person.

Example – Primary residence exclusion

Mr X sells his primary residence on for R9 million. The base cost of the residence is R6 million. This is the only transaction during the year considered in terms of the 8th Schedule. The aggregate capital gain is calculated as follows:

Proceeds	R9 000 000
Base cost	(6 000 000)
Capital gain	3 000 000
Primary residence exclusion (natural persons only)	(2 000 000)
Capital gain	1 000 000
Annual exclusion (after considering all other capital gains or losses)	(40 000)
Aggregate capital gain	R960 000

R2 million rule

If a primary residence is sold for R2 million or less, the full capital gain or capital loss on the disposal is disregarded (i.e. not taken into account), provided the residence was used exclusively as a primary residence.

6.9.2 PERSONAL-USE ASSETS

Paragraph 53 provides that a natural person (or a 'special trust') must disregard a capital gain or capital loss in respect of the disposal of a personal-use asset. A personal-use asset is any asset used mainly for purposes other than the carrying on of a trade.

Therefore if a person uses his private motor vehicle mainly for business use, it is not a personal use asset, whereas if he uses it mostly for private use it is a personal use asset. If he receives a travel allowance in respect of the use of the vehicle for business purposes, it must be treated as being used mainly for non-trade purposes (paragraph 53(4)). Both capital gains and capital losses made on the disposal of personal use assets are disregarded. Only natural persons can hold assets as 'personal use assets'.

Examples of personal use assets are:

- Private motor vehicle
- Personal jewellery
- Art collection (private)
- Personal furniture, antiques

So, for example, if a person sells his personal art collection to a trust, he will not be taxed on a capital gain. If a trust sells an art collection it will be taxed on the capital gain.

Certain assets may not be considered personal-use assets, including:

- a coin made mainly from gold or platinum of which the market value is mainly attributable to the material from which it is minted or cast
- immovable property
- an aircraft, the empty mass of which exceeds 450 kilograms
- a boat exceeding ten metres in length
- a financial instrument

6.9.3 DISPOSAL OF MICRO BUSINESS ASSETS

A micro business is subject to turnover tax if it meets the criteria of the 6th Schedule (see Chapter 8).

Paragraph 57A of the 8th Schedule states that a registered micro business will not be subject to capital gains tax, and may not deduct any capital loss which arises on the disposal of any asset if it is part of the micro business. Instead, the 6th Schedule provides that, where an asset is used mainly for business purposes, 50% of the proceeds on the disposal of a capital asset are included in the taxable turnover of the micro business.

6.9.4 GAMBLING, GAMES AND COMPETITIONS

Paragraph 60 provides that a natural person must disregard a capital gain or capital loss if it is in respect of a disposal relating to any form of gambling or competition. The gambling, game or competition must be authorised by or conducted in terms of the laws of the Republic. Therefore, the following must be disregarded –

- cash winnings
- prizes
- sale of the ticket for a profit or loss

Therefore it appears that foreign winnings are subject to capital gains tax. Paragraph 60 is worded in such a way that nobody may claim a capital loss on gambling, games or competitions (local or foreign). It is submitted that the question of whether a foreign win gives rise to a capital gain is very complicated when one considers the many ways in which a person can win money in such competitions.

Note that in terms of the National Gambling Act and the Lotteries Act, it appears that it is illegal for a South African citizen to gamble on foreign lotteries, sweepstakes, etc. from South Africa.

6.9.5 DONATIONS AND BEQUESTS TO PUBLIC BENEFIT ORGANISATIONS AND EXEMPT PERSONS

Paragraph 62 provides that any capital gain or capital loss determined in respect of the donation or bequest of an asset to the government or any provincial administration (per section 10(1)(a), or to a public benefit organisation (PBO) approved by the Commissioner in terms of section 30, a recreational club as contemplated by section 30A, or a person referred to in sections 10(1)(cA), (cE), (d)(vi), or (e), must be disregarded.

6.10 LOSS LIMITATION RULES

Paragraph 15 provides that a capital loss in respect of certain assets must be disregarded, to the extent that the assets are not used to carry on a trade, including:

- An aircraft with an empty mass exceeding 450 kilograms
- A boat exceeding 10 metres in length

Therefore, if a taxpayer sells a boat that is over 10 metres long, which he only uses for private purposes, he will be taxed on any gain he makes, but will not be allowed to deduct any loss he makes.

If a paragraph 15 asset is used for private and trade purposes, an apportionment must be made and only the capital loss relating to the business use may be claimed.

6.11 ROLLOVER RELIEF – TRANSFERS BETWEEN SPOUSES

Rollover relief means that the recognition of income tax consequences is deferred until a future date. Rollovers only apply in certain situations. Only the rollover relief available on transfers between spouses is considered in this book.

Section 9HB provides that when an asset is transferred between spouses, the transferor is deemed to have disposed of it at base cost, and the transferee is deemed to have:

(i) acquired the asset on the same date that the asset was acquired by the transferor;

(ii) for the same expenditure as was incurred by the transferor;

(iii) on the same date and in the same currency as the expenditure was incurred by the transferor; and

(iv) used the asset in the same way as it was used by the transferor; and

(v) received an amount equal to any amount received by or accrued to the transferor in respect of that asset that would have constituted proceeds had that asset been transferred to a person other than the transferee.

The effect is that no capital gain or capital loss is recognised for the transferor, and the transferee still has the same options of determining the base cost (in the case of a pre-valuation date asset) as the transferor would have had. For this reason, the paragraph does not provide that the transferee receives the asset at the transferor's base cost. The section also applies to the transfer between spouses of trading stock, which is deemed to be transferred at its tax cost.

The paragraph only applies if the transferee spouse is a South African resident (or if the asset is fixed property in South Africa or the asset of a South African permanent establishment).

6.12 CONCLUSION

When there is a disposal of an asset, a taxpayer must calculate the capital gains tax implications, unless the asset is excluded from CGT. In order to calculate CGT, the proceeds and base cost must be established. In most cases this will be the actual proceeds and costs, but special rules apply in respect of certain disposals and deemed disposals, and in respect of assets acquired prior to the introduction of CGT.

The capital gains tax section of the tax liability calculation looks similar to the following:

Taxable portion of capital gains (s26A)		
For each asset:		
Proceeds paragraph 35		
Proceeds	XX	
less: Recoupment	(XX)	XX
less: Base Cost paragraph 20		
Original purchase price	XX	
less: Allowances	(XX)	(XX)
or Valuation date value	XX	
plus: Post 1 October 2001 expenditure	(XX)	(XX)
Capital gain		XX
Other capital gains / losses		XX
less: Annual exclusion (individuals only)		(XX)
Aggregate capital gain		XXX
less: Assessed capital loss brought forward from previous year		(XX)
Net capital gain		XXX
Taxable capital gain section 26A – 40%		X
Taxable capital gain section 26A – 80% for companies		X

6.13 INTEGRATED QUESTION

6.13.1 SUPER SCOOTER (PTY) LTD (21 MARKS)

Super Scooter (Pty) Ltd ('Super Scooter' or 'the company') is preparing its annual return for its year of assessment ended 30 June 2022, and has requested your assistance in determining the tax effects of the following:

- The company purchased an empty plot of land for R350 000 on 1 July 2021. It built a factory on this plot (Factory A) at a further cost of R670 000. This factory was completed and brought into use on 1 September 2021 and houses its manufacturing plant.

- On 1 November 2021 the company purchased new manufacturing machinery (Machinery A) for R125 000, and second hand industrial sewing machines (Machinery B) for R62 000.

- On 30 June 2022 Super Scooter sold Factory A and the machinery at the factory (Machinery A) to Big Bikes (Pty) Ltd ('Big Bikes'). The purchase price was determined as follows:

Purchase price for factory and land	R1 200 000
Purchase price for machinery	R60 000
Total purchase price	R1 260 000

YOU ARE REQUIRED TO:

1. Determine the capital allowances in respect of Factory A, Machinery A and Machinery B for its 2022 year of assessment. **(3 marks)**

2. Determine the tax values of Factory A and Machinery A, and the resultant recoupments or disposal allowances arising from the sale of the assets to Big Bikes on 30 June 2022. **(8 marks)**

3. Determine the taxable capital gain or loss to be included in the taxable income of Super Scooter in respect of the sale to Big Bikes on 30 June 2022. **(10 marks)**

6.13.2 SUPER SCOOTER (PTY) LTD – SUGGESTED SOLUTION

1.	s13(1): manufacturing building				
	No capital allowance for cost of land		670 000 x 5%	(33 500)	**1**
	s12C: New machinery		125 000 x 40%	(50 000)	**1**
	s12C: Second-hand machinery		62 000 x 20%	(12 400)	**1**
2.	Cost of Factory A + land (350 000 + 670 000)		1 020 000		**1**
	Less: capital allowances		(33 500)		**1**
	Tax value of Factory A + land		986 500		
	Recoupment/disposal allowance				
	Selling price		1 200 000		
	s8(4)(a): Selling price (limited to cost)		1 020 000		**1**
	Less tax value		(986 500)		**1**
	Recoupment			33 500	
	Cost of machinery A		125 000		**1**
	Less: capital allowances		(50 000)		**1**
	Tax value of Machinery A		75 000		
	Recoupment/disposal allowance				
	Selling price		60 000		
	s11(o): Tax value		75 000		**1**
	Less selling price		(60 000)		**1**
	Disposal allowance			(15 000)	
2.	Factory A + land				
	Selling price	1 200 000			**1**
	less: recoupments	(33 500)			**1**
	Proceeds		1 166 500		
	Cost price	1 020 000			**1**
	Less: capital allowances	(33 500)			**1**
	Base cost		(986 500)		
	Capital gain on Factory A + land		180 000		
	Machinery A				
	Proceeds		60 000		**1**
	Cost price	125 000			**1**
	Less: capital allowances	(50 000)			**1**
	Less: disposal/scrapping allowance	(15 000)			**1**
	Base cost		(60 000)		
	Capital gain on Machinery A		-		
	Aggregate capital gains		180 000		**1**
	Taxable capital gain at 80% inclusion rate			144 000	**1**
				Total	**21**

CHAPTER 7

VALUE-ADDED TAX

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7.1 INTRODUCTION

VAT is levied on the supply of goods and services by persons registered as vendors in terms of section 23 of the VAT Act. Only persons carrying on an enterprise in the Republic or partly in the Republic can register as VAT vendors. A person can only register as a VAT vendor if the value of the taxable supplies which that person makes in the course of an enterprise meets certain minimum requirements over a 12-month period.

VAT is currently levied at 15% on standard-rated supplies, and 0% on zero-rated supplies. No VAT is levied on exempt supplies.

Example – Calculation of VAT

Vendor A wants to set the selling price of an item of trading stock such that R100 will be recognised on each sale. The item is standard rated. His selling price therefore needs to be R100 x 1.15 = R115. When the sale occurs, his journal entries will be:

Dr Bank	115	
Cr Sales		100
Cr VAT liability		15

Where a vendor pays VAT as part of the consideration paid to another vendor, he may offset the VAT paid (called 'input tax' or 'input VAT') against the VAT he has charged his own customers (called 'output tax' or 'output VAT'). The difference between the sum of the output VAT and the sum of the input VAT on all supplies during the period is the amount payable to, or refundable from, SARS.

Example – VAT return

A vendor buys goods for R115 (including VAT) from a vendor and sells them for R230 (including VAT). Assuming these were his only transactions for the period his VAT return would be as follows:

Output tax on all supplies falling within the VAT period	R30
Less: Input tax on all supplies falling within the VAT period	(15)
VAT payable to SARS for the period	R15

Where input tax was paid in an earlier tax period, but not claimed, it can be claimed in a later tax period (if the claim is made within 5 years). This is different from Income Tax, where an expense has to be claimed in the income tax year it was incurred (unless a specific provision defers the deduction).

The VAT system is a self-assessment system (section 28). VAT returns (VAT 201) have to be submitted by the last business day on or before the 25th of the month after the end of the tax period, unless the returns are submitted electronically via eFiling. Electronic returns may be submitted on the last business day of the following month.

The VAT Act is document intensive. The vendor has to keep all tax invoices, as well as debit notes and credit notes to back up the output tax and input tax for which he has accounted. These are the documents he issues as well as the documents issued to him.

Importantly, unlike Income Tax, there is no distinction in VAT between capital and revenue items. Irrespective of whether a vendor supplies capital goods or trading stock, VAT must be levied if the vendor sells goods that he used in his enterprise or if he sells them in the course of his enterprise.

Learning objectives

By the end of the chapter, you should be able to:

- Identify who must and who may register as a VAT vendor.
- Identify what supplies are subject to VAT and at what rate.
- Determine when a vendor is entitled to claim a VAT input.
- Calculate the VAT payable or refundable at the end of a VAT period.
- Recognise in what circumstances a supply is deemed to have occurred.
- Apply the special provisions applicable to transactions with connected persons.

7.2 VALUE-ADDED TAX

A vendor includes VAT in the selling price of his goods and services, and although the VAT is borne by the customer, it is collected by the vendor and paid over to SARS. At the same time, the vendor pays any VAT included in the purchase price charged by his suppliers. He then claims this amount back from SARS. The net VAT payable on the purchase and resale of goods is therefore the VAT on the value added to the goods by the vendor.

Example – Chain of supply

Vendor A sells trading stock for R115 000 to Vendor B. Vendor B sells the trading stock to the public for R149 500. The VAT accounted for by each vendor is as follows (assuming all amounts are VAT inclusive):

Vendor A		
Output tax on stock	R115 000 x 15/115	R15 000
Vendor B		
Output tax	R149 500 x 15/115	R19 500
Input tax	R115 000 x 15/115	(R15 000)
	VAT payable to SARS	R4 500

If you look at these calculations you will see that Vendor B has actually paid VAT on the value added by him to the stock he sold. He bought the stock for R100 000 plus VAT, and sold it for R130 000 plus VAT. He therefore added value of R30 000. The VAT on R30 000 is R4 500. This is from where the term 'value-added' tax is derived.

What is also important is that Vendor B could claim a VAT input on the stock he bought, in the period he bought it, even if the stock was to be sold some months later. There is no matching of purchases and sales in the VAT calculation.

7.3 DEFINITIONS – OUTPUT TAX

The VAT Act introduces a number of terms that are specific to VAT, and on which the calculation of VAT depends. It is therefore important to begin with an understanding of some of the key terms.

The first definition to be considered is that of Output Tax, since many of the other important definitions are linked to their use in the definition of Output Tax.

7.3.1 OUTPUT TAX

Section 1 defines 'output tax' as the tax charged under section 7(1)(a) in respect of the supply of goods and services by a vendor.

Section 7(1)(a) provides that VAT shall be levied and paid at 15% for the benefit of the *National Revenue Fund* on

- the value of
- a supply
- of goods or services
- in the Republic (of South Africa)
- by a vendor
- in the course or furtherance
- of an enterprise

7.3.2 VALUE

Value is defined in section 10. VAT is calculated on the value of the goods or services supplied. Value is therefore an amount excluding VAT. The VAT-inclusive amount is termed the 'consideration'. The amount of VAT included in the consideration is called the 'tax fraction'.

Example

A vendor sells goods for R200 excluding VAT.

- The value of the goods is R200
- The consideration is R200 x 1.15 = R230
- The tax fraction is 30/230 = 15/115
- The consideration multiplied by the tax fraction = R230 x 15/115 = R30 VAT

A deposit does not represent consideration received, and therefore does not include any VAT element. At the time that the deposit is applied against the purchase price it becomes a consideration and will then give rise to output VAT (unless an invoice has already been issued, in which case output VAT would already have arisen at the invoice date).

7.3.3 SUPPLY

Supply is defined in section 1 as including performance in terms of a sale, rental agreement, instalment credit agreement, and all other forms of supply, whether voluntary, compulsory, or by operation of law. It can include any transfer of ownership, possession, or use. It does not include anything done for nothing (i.e. for no consideration) unless one of the anti-avoidance provisions applies. The supply must always be of goods or services. Therefore, even an expropriation of property is a supply by the owner of the property.

Supply therefore does not only include sales. It includes any transfer of ownership. Deemed supplies as set out in section 8 of the VAT Act are also included.

It is important to note that VAT is only chargeable on supplies, not on the mere receipt of money. In the case of *CSARS v British Airways PLC* [67 SATC 167, 2005 (4) SA 231 (SCA)], British Airways recovered (from its passengers) the 'passenger service charge' which the Airports Company Limited made on it. SARS wanted VAT from British Airways on this charge. The court held that the charge was in respect of a service supplied by the Airports Company. British Airways was merely recovering it directly from its passengers. Therefore the Airports Company had to account for the VAT on the charge, not British Airways.

7.3.4 GOODS

'Goods' is defined in section 1 as:

- corporeal (tangible) movable things
- fixed property
- any real right in such things or fixed property, and
- electricity

The definition of 'goods' specifically *excludes* –

- money
- any right under a mortgage bond or pledge
- any revenue stamp

If something is not a good, then for VAT purposes it is a service. Therefore the sale of shares, patents, trademarks and any other intangible asset is a supply of 'services' for VAT purposes. In terms of section 8(7), the sale of goodwill as part of the sale of a business is deemed to be a supply of goods.

The definition of 'goods' is important, for example, when one is looking at the purchase of second-hand goods.

7.3.5 SERVICES

'Services' is defined in section 1 as –

- anything done or to be done
- the granting, assignment, cession, or surrender of rights
- the making available of any facility or advantage

The sale of intangible property is the supply of a service, because it is the cession of a right (e.g. the sale of a patent, design, trade mark, or copyright). The sale of goodwill as part of the sale of a business is deemed to be a supply of goods. The sale of shares is also defined as a service as it is not the supply of a tangible good, but as it is a financial service, it is exempt from VAT.

Section 8 deems certain things to be the supply of a service, such as the receipt of a payment from an insurance company in settlement of a claim.

7.3.6 VENDOR

Section 1 defines a vendor as a person who is registered as a vendor or who is required to be registered as a vendor. Therefore the provisions of the VAT Act could apply to someone who is not registered if they are supposed to be registered.

For registration requirements refer to 7.5.

7.3.7 ENTERPRISE

Before a person can register as a VAT vendor, the person has to carry on an enterprise. An enterprise is defined in section 1 as –

- any activity carried on continuously or regularly
- in the Republic of South Africa, or partly in the Republic
- in the course of furtherance of which goods are sold (supplied), or services are rendered (supplied)
- for a consideration
- whether or not for profit

Among others, the following are specifically excluded -

- services rendered by an employee to an employer
- private or recreational pursuits or hobbies
- VAT exempt activities (per section 12)

- a commercial accommodation establishment which does not have taxable supplies in excess of R120 000 in a 12-month period.
- special rules apply to municipalities and public entities

7.4 DEFINITIONS – INPUT TAX

7.4.1 INPUT TAX

Input tax is defined in section 1 of the VAT Act as

- VAT charged to a vendor by another vendor, on the supply of goods or services to him (i.e. the VAT the purchaser pays or bears); or
- VAT paid on the import of goods, and VAT on certain goods of the class subject to excise duty; or
- the tax fraction (15/115) of the cost of second-hand goods acquired by way of purchase and sale from a non-vendor or in terms of a sale not subject to VAT. The sale must take place in the Republic and the seller must be a Republic resident insofar as the asset is concerned.

7.4.2 SECOND HAND GOODS

This term is defined as meaning goods that were previously owned and used. A vendor is allowed to claim a notional VAT input when he purchases second hand goods (by way of an agreement of purchase and sale, from a South African resident person who is not a VAT vendor).

The purpose of this notional input allowed on second hand goods purchased from a non-vendor is to address the fact that (at least in theory) the person who sold the goods to the non-vendor would have charged output VAT that was never recovered as input VAT by anyone at the time.

Certain items are specifically excluded from the definition of second hand goods, such as animals and gold coins.

7.5 REGISTRATION

7.5.1 REGISTRATION

Section 23 deals with the registration requirements and states that, if a person carries on an enterprise, in the Republic or partly in the Republic, he has to register as a vendor if the value of his taxable supplies (standard and zero-rated) at the end of any 12-month period (for all enterprises carried on by him) has exceeded R1 million. Registration is also necessary if the person's taxable supplies to be made within the next 12 months in terms of a contractual obligation in writing will exceed R1 000 000.

Section 23 provides that in calculating the turnover limit one can ignore the following (at the Commissioner's discretion):

- Proceeds received as a result of any cessation of or any substantial and permanent reduction in the size or scale of the person's enterprise
- The replacement of any plant or other capital asset used in the enterprise
- Abnormal circumstances of a temporary nature

Obviously, if a person is registered, the above proceeds will be subject to VAT. They are merely ignored when calculating whether the R1 million turnover limit has been exceeded or is likely to be exceeded, since they are unlikely to occur on a regular basis.

A person can also register voluntarily if turnover in a 12-month period has exceeded R50 000 or is likely to exceed R50 000. This may be desirable in the situation where a person's suppliers and customers are both mostly vendors.

Example – voluntary registration

Mr A is a VAT vendor, and Mr B is not. Both purchased an item of trading stock from a VAT vendor for R115 (including VAT). Both wish to make R50 profit on the sale of an item.

- Mr A can claim his VAT input back from SARS. The after-tax cost of the trading stock to him will be R100. Likewise, he will need to add VAT to his selling price, so in order to make a R50 profit he will have to sell the stock for R172.50 (R150 x 1.15).

- Mr B cannot claim any VAT input, but also does not need to charge any output VAT. To achieve a R50 profit he will have to sell the stock for R165 (R115 + R50).
- A customer who is a VAT vendor will prefer to buy from Mr A rather than Mr B, because he can claim the VAT charged by Mr A as an input. He cannot claim anything against his purchase from Mr B. The after-tax cost of stock from Mr A is therefore cheaper than from Mr B (R150 v R165).
- A customer who is not a VAT vendor will prefer to buy from Mr B rather than Mr A, because Mr B's total price is cheaper (R165 v R172.50), and as a non-vendor he in unable to claim any input VAT.

7.5.2 CATEGORY OF VENDOR

Vendors are divided into different categories according to the size of their turnover. The greater their turnover, the more frequently they are required to submit VAT returns. The most significant categories are categories A and B, which are required to submit returns every two months, category C, which must submit monthly returns, and category E, which must submit an annual return.

7.5.3 REFUSAL TO REGISTER

SARS can refuse to register a person if any of the following apply:

- The person has no fixed abode or place of business
- The person does not keep proper accounting records for his enterprise
- The person does not have a bank account for his enterprise
- The person's VAT registration was previously cancelled due to him not performing his duties under the VAT Act.

7.5.4 CANCELLATION OF REGISTRATION

A vendor can apply in writing for his registration to be cancelled if he no longer satisfies the requirements for being registered (section 24). Where a vendor ceases to carry on all enterprises, he is supposed to advise SARS within 21 days so that his registration can be cancelled.

SARS can also decide on its own to cancel a person's registration. This is usually done where the person's VAT returns show that his supplies are less than the registration limit of R50 000 in a 12-month period.

7.5.5 ONUS ON THE VENDOR

Section 25 requires the vendor to notify SARS of any change in its status (name, address, members of partnership changing, turnover changing if this affects the registration, appointment or resignation of representative vendor, etc).

7.5.6 LIABILITY OF VENDOR

Section 26 states that if a person ceases to be a vendor, he remains liable for the VAT Act obligations which arose while he was a vendor.

7.6 TIME AND VALUE OF SUPPLY

The rules for the time of a supply are set out in section 9. The period in which the time of supply falls determines in which period the VAT on that supply has to be accounted for.

The rules for the value of a supply are set out in section 10. The value is the amount on which the 15% VAT is based.

7.6.1 TIME OF SUPPLY – GENERAL RULE

The general rule for time of a supply is set out in section 9(1) as the earlier of

- the date of the invoice, or
- the date of payment of any part of the price

No regard is had to the time the goods are delivered or the service rendered unless specifically provided for (e.g. in respect of fixed property). The invoice need not be a 'tax invoice' to trigger the time of supply. An invoice is any document notifying of an obligation to make payment. A vendor must within 21 days of the date of a supply (subject to certain exceptions) issue a tax invoice in respect of that supply.

Another important point to note is that the liability for output VAT is triggered by the issue of an invoice (which may not need to be a tax invoice), but the right to claim input VAT is triggered by the possession of a tax invoice.

7.6.2 TIME OF SUPPLY – RENTAL AGREEMENT

A rental agreement is defined in section 1 of the VAT Act as any agreement for the letting of goods (excluding a lease which falls into the definition of 'instalment credit agreement').

Section 9(3)(a) states that where goods are supplied under a rental agreement or services are supplied under an agreement or law which provides for periodic payments, each period is a separate supply which is deemed to take place at the earlier of when payment is due or is actually made. This provision overrides the general rule in section 9(1) and the connected persons rule in section 9(2).

7.6.3 TIME OF SUPPLY – INSTALMENT CREDIT AGREEMENT

An instalment credit agreement is either

- a sale in terms of which payment will be made in the future, the purchase price includes finance charges, and the transfer of ownership is delayed, or
- a lease of at least 12 months that includes finance charges, and the total instalments plus any residual value exceeds the cash value of goods at the time the lease was entered into.

The time of supply under a lease agreement is the earlier of delivery of the goods or payment of the first instalment.

7.6.4 TIME OF SUPPLY – FIXED PROPERTY

Section 9(3)(d) deals with the time of supply of fixed property. The time of supply is the earlier of registration in the name of the purchaser or payment of any part of the purchase price. Note that the payment of a deposit is not treated as the payment of any part of the purchase price.

Where fixed property is purchased from a non-vendor, a notional input may be claimed in the manner allowed for second-hand goods. However, in this case section 16(3) stipulates that the input claim may only be made once the transfer is made in a deeds registry, and then only to the extent that the purchaser has made payment.

7.6.5 VALUE OF SUPPLY

The general rule for the value to be placed on the supply of goods or services per section 10 is that it should be the consideration less the portion that represents VAT. The general rule for determining consideration is:

(a) if the consideration is in money, such money

(b) if the consideration is not in money, the open market value of the supply at the time of supply.

Specific rules exist for determining the value of supply in certain circumstances. Most of these have to do with deemed supplies. To avoid repetition, each rule is explained together with the supply to which it relates (see 7.12).

7.6.6 OPEN MARKET VALUE

Section 3 defines 'open market value' as 'the consideration in money which the supply of those goods or services would generally fetch if supplied in similar circumstances at that date in the Republic, being a supply freely offered and made between persons who are not connected persons'. It must include the VAT charged. In other words, it is the arm's length price.

If one cannot determine the arm's length price of the particular transaction, one must look at the arm's length price for a 'similar supply' in the Republic. The section defines 'similar supply' as one that has characteristics, quality, quantity, materials, etc. that are the same as, or closely or substantially resemble, the supply under consideration.

Where none of these methods can be used, the Commissioner can set a method for determining the open market value.

7.6.7 VALUE OF SUPPLY - INSTALMENT CREDIT AGREEMENTS

If goods are supplied under an instalment credit agreement, the consideration is the cash value of the goods. Such cash value includes VAT and excludes finance charges.

Example – Instalment credit agreement

Mr L buys a new motor car on hire purchase from a motor dealer. In terms of the agreement the purchase price is R165 000, payable in equal instalments over 36 months. Mr L could have purchased the same car for R115 000 in cash.

- The cash value of the car is R115 000.
- The finance charges included in the hire purchase price amount to R50 000. Finance charges are exempt from VAT.
- The consideration is therefore R115 000. This means that the VAT is R15 000 and the value is R100 000.

7.7 ZERO-RATING

Zero-rated supplies are subject to VAT at 0%. Therefore, if a person's turnover for the year is more than R1 000 000 and he only makes zero-rated supplies, he still has to register as a vendor. Notwithstanding that a vendor makes zero-rated supplies, he can still claim input tax of the VAT paid on supplies made to him because the supply he makes is a taxable supply, even though the VAT on that supply is zero.

This is different from a person who makes exempt supplies. In both cases there is no VAT on the supply, but in the case of a person who makes exempt supplies, he cannot claim VAT inputs.

Section 11(1) sets out which supplies of goods are zero-rated and section 11(2) sets out which supplies of services are zero-rated. The main zero-rated supplies are dealt with here.

7.7.1 EXPORT OF GOODS

Goods that are exported in terms of section 11(1)(a) are zero-rated.

'Exported' basically means consigned or delivered (by the vendor) to an address in an export country. If the vendor gives the goods to a foreign purchaser in South Africa and the purchaser takes the goods out of the country this is not an export by the vendor, but may fall into the provisions relating to an 'export incentive scheme', in which case the purchaser may claim a refund of the VAT paid by him.

The vendor has to keep certain documentation to be allowed to zero-rate the sale. Section 11(3) states that the Revenue Service has the power to decide on what documentation is necessary before an export can be zero-rated. The documents required are essentially those that prove that the goods were in fact exported, and are set out in interpretation notes 30 and 31.

7.7.2 EXPORT OF SECOND HAND GOODS

The export of second hand goods, on which a notional VAT input has been claimed, cannot be zero-rated in full. Output VAT must be charged to the extent of the notional input previously claimed.

7.7.3 SUPPLY OF A GOING CONCERN

The sale or supply of an enterprise or part of an enterprise as a going concern may be zero-rated if certain requirements are met. This is discussed in full in 7.12.4.

7.7.4 FUEL LEVY

Section 11(1)(h) zero-rates fuel and all fuel levy goods. This is because there is already tax in the price of fuel.

7.7.5 OTHER ZERO-RATED SUPPLIES OF GOODS

The following goods are also zero-rated in terms of section 11(1):

- The sale of basic foodstuffs
    - Government regulation brown bread
    - maize meal
    - unprocessed samp

- unprocessed mealie rice
- certain dried mealies
- unprocessed dried beans
- lentils
- pilchards or sardinella
- certain milk powders
- certain dairy powder blends
- rice
- 'unprocessed' vegetables
- 'unprocessed' fruit
- vegetable oil (not olive oil)
- certain cultured milk
- brown wheaten meal (not separated)
- raw hen's eggs
- edible legumes

The exemption does not apply where these are supplied as part of a meal. The full cost of the meal is subject to VAT if supplied by a vendor.

- The sale of petroleum oil and oils obtained from bituminous minerals
- The sale of gold coins issued by the Reserve Bank
- The supply of goods by an inbound duty-free shop
- The supply of sanitary towels.

7.7.6 ZERO-RATED SERVICES

The list of services on which a zero rate is applicable in terms of section 11(2) includes:

- Export related services:
  - The transport of passengers and goods to and from an export country
  - The transport of passengers from a place in the Republic to another place in the Republic if it is part of an international flight
  - The transport of goods from a place in the Republic to another place in the Republic if it is part of an international transport. Ancillary transport services are included in this provision.
  - The insuring of passengers and goods referred to above
  - The arranging of the above insurance
  - The arranging of the transport referred to above
- Services rendered outside the Republic
- Vocational training of employees of a non-resident employer who is not a vendor.

7.8 EXEMPT SUPPLIES

7.8.1 GENERAL

A person who only makes exempt supplies is deemed not to be carrying on an enterprise and cannot register as a vendor. If a person is registered because, in addition to exempt supplies, he also makes taxable supplies, he can only claim input tax deductions in respect of his taxable supplies. Where the input tax relates to taxable and exempt supplies it has to be apportioned in the ratio of 'taxable' to exempt turnover, unless SARS approves a different method. This is in terms of a general binding ruling set out in the VAT 404 guide issued by SARS.

Exempt supplies are listed in section 12 of the VAT Act.

7.8.2 FINANCIAL SERVICES

Financial services are exempt from VAT in terms of section 12(a). Financial services include loaning money and charging interest, exchanging currency, and transferring shares. Financial services also include the premiums paid in respect of medical aid, as well as for pension, provident fund and retirement annuity fund contributions.

A fee paid for arranging any of the above or in respect of consulting on any of the above is not exempt from VAT.

7.8.3 RESIDENTIAL ACCOMMODATION IN A DWELLING

Section 12(c) exempts the supply (by way of an agreement for letting and hiring) of residential accommodation in a dwelling.

The supply of residential accommodation must be distinguished from the supply of commercial accommodation. In the case of the supply of residential accommodation, a lease agreement exists. The tenant is given the use of the property and occupies it as his or her dwelling.

Commercial accommodation is more in the nature of a service. The lessee does not exercise substantial control over the commercial accommodation and is given 'domestic goods and services' along with the commercial accommodation (cleaning, maintenance, electricity, television, radio, furniture and fittings, etc).

7.8.4 EDUCATION SERVICES

Section 12(h) exempts the supply of educational services. The main requirements are set out in the nature of the supplies described below. The exemption applies to:

- The supply by the State or a school registered under the South African Schools Act, of education.
- The supply of educational services by a public college or private college established, declared or registered as such under the Further Education and Training Colleges Act, 2006.
- The supply of educational services by an institution that provides higher education on a full time, part-time or distance basis and which is established or deemed to be established as a public higher education institution under the Higher Education Act, 1997.
- The supply of certain educational services by tax-exempt Public Benefit Organisations.
- The supply of goods or services by a school, university, technikon or college solely or mainly for the benefit of its learners or students that are necessary for and subordinate and incidental to the supply of the exempt services if such goods or services are supplied for a consideration in the form of school fees, tuition fees or payment for board and lodging.
- The supply of services to learners or students or intended learners or students by the Joint Matriculation Board referred to in section 15 of the Universities Act, 1955 (Act No. 61 of 1955).

Vocational or technical training provided by an employer to his employees and employees of an employer who is a connected person in relation to that employer does not constitute the supply of an educational service for the purposes of the education exemption.

Example – Educational PBO

The ABC Primary School charges school fees of R12 000 per year. Included in this fee is R500 for books and stationery.

- R11 500 is exempt as it relates to educational services of a registered school.
- R500 is exempt as it relates to good necessary, incidental and subordinate to the provision of the educational services.

7.8.5 TRANSPORT BY ROAD OR RAIL

Section 12(g) provides that the supply by any person in the course of a transport business of any service comprising the transport by that person in a vehicle operated by him of fare-paying passengers and their personal effects by road or railway (excluding a funicular railway) shall be exempt, unless zero-rated.

Example – Road transport

Shooday Ltd has the following income for its two-month VAT period (exclusive of VAT):

-	rental of buses without drivers to other businesses	R40 000
-	bus fares earned in its passenger transport business	20 000
-	hiring of buses and drivers, where the drivers remained under the supervision of Shooday Ltd	15 000

Shooday's output tax for the period is as follows: R40 000 x 15% = R6 000

No VAT can be charged on the bus fares or on the hiring of buses where Shooday supplies and supervises the drivers, as it is not supplying the use of a bus, but is supplying a road transport service, which is VAT exempt.

The important point here is that the supplier must operate the transport (i.e. be the driver or employ the driver). If a person hires buses to a school and the school supplies its own drivers, this is not a transport service. It is a hiring service and the hire charge has to be standard-rated.

Where a tour operator pays for transport and on-charges this transport to the overseas tourist (whether the tourist is in the country or not) the on-charge can be exempted from VAT.

Note also that the supply of transport cannot be an isolated supply. It has to be in the course of a transport business.

7.8.6 OTHER EXEMPT SUPPLIES

- Trade union subscriptions
- The supply by an association not for gain of certain donated goods.
- The supply of goods by a non-resident, unless they are the supply of duty-free goods which have not been cleared through Customs for sale in the Republic. This provision is meant to deal with the supply of goods imported and entered for storage in a licensed Customs and Excise storage warehouse. As far as the South African resident is concerned, however, the import of goods into the Republic is subject to VAT.
- The supply of crèche or after-school care for children.
- The sale or letting of land outside the Republic.
- The supply of services to members in the course of management of a sectional title body corporate, a share block company, and any housing development scheme for aged persons (unless the supplier elects for them to be subject to VAT).
- The supply of lodging or board and lodging by a local authority that operates a hostel or boarding establishment for non-profit purposes.
- The letting of land for the purpose of erecting a residential dwelling.

7.9 INPUT TAX

In order for a vendor to be able to claim a deduction for input VAT two requirements must be met:

1. Input VAT must have been incurred.

   In terms of the input tax definition this happens either when VAT is paid by the vendor as part of the purchase price of goods or services from another vendor, or when VAT is paid directly to SARS on the importation of goods or services by the vendor. A notional input VAT amount also arises when the vendor purchases second hand goods from a non-vendor. This is the only situation in which a vendor may claim VAT that was not actually paid by him.

2. The goods or services on which the input VAT has arisen must have been acquired by the vendor in the course of making taxable supplies (whether standard-rated or zero-rated).

   No input may be claimed where the goods or services were acquired for a purpose other than making supplies (e.g. for personal use) or for the purposes of making exempt supplies, even though VAT may have been paid by the vendor.

In order to claim the input, the vendor must be in possession of a valid tax invoice (see 7.13).

7.9.1 APPORTIONMENT OF INPUT DEDUCTIONS – SECTION 17(1)

If a good or service is only to be used partly for making taxable supplies, only a portion of the input tax may be claimed. If the proportion of 'taxable' use is 95% or more, the full input may be claimed.

Where a vendor makes both VAT exempt and taxable supplies he has to apportion those VAT inputs which cannot be specifically attributable to the one or other type of supply, on the basis of his turnover, unless the Revenue Service approves another method of apportionment.

The formula for the turnover based method is:

Total value of taxable supplies / Total value of all supplies (taxable & exempt)	x	VAT inputs common to both types of supply	=	input tax claimable

7.9.2 PROHIBITED INPUT DEDUCTIONS – SECTION 17(2)

Section 17(2) sets out what may not be claimed as input tax by a vendor.

Motor cars

No VAT input may be claimed in respect of any motor car supplied to or imported by the vendor, whether the supply is by way of purchase or lease. Where the vendor is denied an input, he does not have to charge output tax when he sells that motor car.

A motor car is defined in section 1 as a motor car, station wagon, minibus, double-cab light delivery vehicle, and any other motor vehicle of a kind normally used on public roads, which has three or more wheels, and is constructed or converted wholly or mainly for carrying passengers.

'Motor car' does not include vehicles capable of accommodating only one person or suitable for carrying more than 16 persons. It also does not include caravans, ambulances, vehicles of unladen mass of 3 500 kilograms or more, or vehicles constructed for a special purpose other than the carriage of persons and having no accommodation for carrying persons other than such as is incidental to its purpose. It also does not include special game viewing vehicles, or hearses. These vehicles must be constructed and used specifically and solely for the specific purposes.

No VAT input may be claimed by a vendor on motor cars which he purchases, rents, or hires unless he is a motor dealer or other enterprise which so acquires the car for the purpose of selling or leasing the car to customers (at an economic rental) in the ordinary course of an enterprise which continuously or regularly supplies cars in this way. A motor car acquired by such vendor for demonstration purposes or for temporary use prior to a taxable supply by such vendor shall be deemed to be acquired exclusively for the purpose of making a taxable supply.

Note that the fact that a vendor may not claim a VAT input on the acquisition of a motor car (whether it is the acquisition of the use or of the ownership) does not mean that he cannot claim a VAT input on the costs of repair, maintenance, insurance, or accessories related to the motor car. It is only if an accessory is for the purposes of entertainment that the VAT input cannot be claimed (e.g. an MP3 player).

Example – VAT inputs prohibited and allowed

Can a VAT input be claimed in respect of the following purchases? Where possible, all persons are vendors, incurring the expenses in the course of their business. Give brief reasons for each answer.

1. Company X purchases a minibus capable of carrying more than 16 persons for use in its road transport business.
2. Pharmacy Y purchases a scooter so that it can deliver medicines to customers.
3. Doctor G is away from home on a conference for the weekend. He hires a car in order to travel from his hotel to the conference every day.
4. Doctor G is away from home on a conference for the weekend. He purchases a meal in a restaurant.
5. Company H is a car hire company. It purchases a motor car for the use of its managing director.
6. ANV Model Agency accommodates 3 international models in a hotel in Cape Town for a week. The models are in Cape Town for a fashion advert and are not employees of the agency.
7. RST (Pty) Ltd buys tea and coffee for the staff kitchen.
8. Company LK, an accounting firm, buys an office building consisting of 4 floors. The top floor is to be used by it as a recreation area, kitchen, and canteen for its staff. The building cost R4 million (i.e. R1 million per floor).

Answers

1. No VAT input claimable as company X carries on an exempt passenger (road) transport business and therefore does not make supplies which are subject to VAT.
2. Pharmacy Y can claim an input as a scooter only has two wheels and is therefore not a 'motor car'.

3. The hire of a car is the supply of a motor car, so Dr G cannot claim an input.
4. Dr G can claim an input on this entertainment as he is away from his usual place of residence for at least one night, and away from his usual place of business.
5. No VAT input can be claimed as the vehicle is not being purchased for hire or for sale, and the managing director's use of it is not temporary.
6. The model agency cannot claim an input because the hotel accommodation is 'entertainment' as defined and the models are not employees of the agency, nor are they away from their usual place of business.
7. The supply of tea and coffee is the supply of 'entertainment' as defined, and no VAT input can be claimed.
8. Company LK can only claim a VAT input on the R3 million as the top floor is to be used for the purposes of 'entertainment' as defined (provision of food, beverages, and recreation). Even though the building is a single asset, an apportionment is necessary, because the section uses the words 'to the extent that'.

Entertainment expenses

VAT cannot be claimed as an input in respect of goods or services acquired by a vendor to the extent that such goods or services are acquired for the purposes of entertainment. There is no *de minimus* rule here. If goods are acquired 96% for business purposes, and 4% for entertainment purposes, only 96% of the VAT may be claimed as an input.

Entertainment is defined in section 1 as 'the provision of any food, beverages, accommodation, entertainment, amusement, recreation or hospitality of any kind by a vendor whether directly or indirectly to anyone in connection with an enterprise carried on by him'.

Example – Provision of food

X (Pty) Ltd pays rental of R57 500 per month (including VAT) for its offices. It uses 10% of the floor space as a kitchen for staff. Its monthly VAT input is as follows:

R57 500 x 90% x 15/115 = R6 750

The provision does not apply to vendors who provide entertainment as part of a business that continuously or regularly supplies entertainment to customers for a consideration which covers all the direct and indirect costs of such entertainment.

Example – Theatre

The SDF Theatre (Pty) Ltd brought 5 international actors to Cape Town to take part in a theatrical production the company was running and paid the cost of their stay at a local hotel, plus the cost of all their meals while they acted in the play. The actors were not employees of the company.

The company's income and expenditure for the period was as follows (all amounts include VAT, except the amounts paid to the actors):

Amounts earned from ticket sales	R1 240 000
Various production costs (direct and indirect)	(600 000)
Fees paid to actors	(350 000)
Cost of hotel accommodation	(40 000)
Cost of meals and beverages	(20 000)

The VAT return of the company for the period will be as follows:

Output tax: R1 240 000 x 15/115	R 161 739
Input tax:	
Production costs, R600 000 x 15/115	(78 261)
Fees paid to actors (supply of services by non-vendor, therefore no VAT charged)	-
Hotel accommodation and meals and beverages, R60 000 x 15/115	(7 826)
Due to SARS	R75 652

VAT may be claimed as an input if the entertainment is to an employee or office holder or any connected person in relation to the vendor if the entertainment is supplied for a charge which covers all the direct and indirect costs of providing it. Obviously, the charge will be subject to output tax. Meals or refreshments given to the crew on a ship can also qualify for VAT inputs.

If an employee or office holder of the vendor, or a partner if the vendor is a partnership, or a self-employed natural person, is away from his usual residence and usual working place in the Republic for at least one night on business, the VAT on his subsistence expenses (food, hotel accommodation, etc.) may be claimed as an input while he is away.

Example – Away from usual residence

BV (Pty) Ltd is located in Cape Town, where all of its staff are based.

It arranged a 3-day seminar at a hotel in Johannesburg and incurred the following costs (including VAT):

Hotel costs for staff	R20 000
Meals for staff	23 000
Hotel cost for independent visiting lecturer	12 000
Meals for visiting lecturer	5 000

The staff were required to go to Johannesburg to attend the seminar. The independent lecturer was brought in from Botswana to lecture to the staff.

The VAT inputs are as follows:

Hotel costs for staff	R20 000
Meals for staff	23 000
	R43 000
VAT input at 15/115 =	R5 609

As the visiting lecturer is not a staff member, office holder, or partner of BV (Pty) Ltd, the section 17(2) limitation applies to prevent the VAT on the hotel costs and meals being claimed as an input.

VAT on entertainment inputs may also be claimed in the following situations:

- The vendor supplies meals or refreshments as organizer of a seminar or similar event to a participant in the seminar or event, and the amount paid by the participant for this covers the cost of the meal or refreshment.
- The vendor supplies a meal or refreshment as part of a transport service on which he charges VAT (e.g. air transport).
- Entertainment goods or services are acquired by a local authority for the purpose of providing sporting or recreational facilities or public amenities to the public in certain circumstances.
- Goods and services are acquired for a staff member or office holder of the vendor, incidental to the admission into a medical care facility, such as meals or refreshments supplied to an employee in hospital.

Fees or subscriptions

No VAT input may be claimed in respect of any fees or subscriptions paid by the vendor in respect of membership of any club, association or society of a sporting, social or recreational nature (section 17(2)(b)).

This prohibition does not apply if, for example, the subscriptions are in respect of membership of a professional association.

7.9.3 DOUBLE INPUTS

Section 17(4) states that any input can only be claimed once.

7.10 CALCULATION OF VAT PAYABLE – SECTION 16(3)

Section 16(3) provides that the amount of tax payable in a tax period shall be calculated by deducting from output tax certain amounts. The following are the more important deductions:

- Input tax
- Input tax that was not claimable in a previous period (because the taxpayer did not have a tax invoice) if he then obtains a tax invoice. Once the vendor has a tax invoice he has to claim the input within 5 years.
- The tax fraction (15/115) of any claim paid to any other person in terms of a short-term contract of insurance
- The VAT on that portion of a debt owing to the vendor which has gone bad

Example – VAT calculation

XYZ (Pty) Ltd carries on a manufacturing business and asks that you calculate the VAT payable by it or refundable to it, during the VAT period, based on the following information. All amounts are VAT inclusive where applicable:

Sales of inventory	R230 000
Sale of fixed asset	57 500
Rental from letting dwelling (house)	4 000
Fee from sundry consulting	11 500
Interest received	33 600
Purchases of raw materials	(103 500)
Purchase of factory building in South Africa from non-vendor	(700 000)
Rent paid for offices	(10 350)
Wages paid to staff	(55 000)
Bad debts	(43 700)

Output tax		*Input tax*	
VAT on sales of inventory (15/115 x 230 000)	R30 000	Notional input on building (15/115 x 700 000)	R91 304
Interest is exempt from VAT	-	On rental expense (need tax invoice)	1 350
Fixed asset sold (15/115 x 57 500)	7 500	On purchases (need tax invoice)	13 500
Rental from dwelling is exempt	-	Wages are not subject to VAT	-
VAT in consulting fee	1 500	Bad debts (15/115 of 43 700)	5 700
	R39 000		R111 854

X (Pty) Ltd is therefore entitled to a refund of R72 854 (R111 854 – R39 000).

7.11 ACCOUNTING BASIS

Section 15 provides for the calculation of tax on one of two different bases, i.e. an invoice basis, or a payments basis. Only the invoice basis is considered in this chapter.

If a vendor is on the invoice basis, he must account for the VAT on a supply in the period in which the supply takes place or is deemed to take place. This is why the time of supply is so important. Therefore, for example, a vendor on the invoice basis will claim a VAT input based on a tax invoice he has, even if he has not paid the creditor. If he does not pay the creditor within 12 months of becoming liable to do so, he has a claw-back of the VAT in terms of section 22(3). The invoice basis leads to cash flow problems for certain businesses. Once a supply takes place and an invoice is issued, the output tax must be accounted for, no matter how long the debtor takes to pay. If the debt goes bad, the vendor can claim a VAT input of the tax fraction of the amount of the debt that has gone bad.

There are certain supplies that must always be accounted for at a set time, however, regardless of the basis used by the vendor. These are supplies over R100 000 (including VAT), supplies under instalment credit agreements, and sale of fixed property.

7.12 DEEMED SUPPLIES

7.12.1 GENERAL

In certain circumstance a vendor is deemed to have made a supply of goods and services, notwithstanding the fact that no goods or services may have actually changed hands. Sections 8 and 18(3) of the VAT Act set out the deemed supply provisions. The more important deemed supplies are covered below.

7.12.2 FRINGE BENEFITS – SECTION 18(3)

Section 18(3) provides that where an employer has granted a fringe benefit to an employee (per the 7th Schedule to the Income Tax Act), VAT is payable on the value of that fringe benefit.

Section 10(13) sets out how to value fringe benefits for VAT purposes. It provides that the consideration in money for the supply (i.e. the amount including VAT) shall be deemed to be an amount equal to the cash equivalent of the benefit or advantage granted to the employee or office holder. The cash equivalent is an amount net of the input VAT claimed by the employer.

The VAT payable is then calculated as the deemed consideration as above, i.e. the cash equivalent, multiplied by the tax fraction. It seems anomalous that the VAT is the tax fraction (15/115) of a VAT exclusive amount, but this is how the provision is worded.

Where the employer's business involves the making of both taxable and exempt supplies, the value of the fringe benefit that is subject to VAT must only be based on the value of taxable supplies to total supplies.

No VAT is payable if the fringe benefit is tax-free or is an exempt or zero-rated supply, or is the supply of food, accommodation, or entertainment (where the employer would have been denied a VAT input).

Example – Fringe benefits

Company V gave the following fringe benefits to its employees (shown at cost, including VAT where applicable):

-	Gifts of electronic equipment	R57 500
-	Use of residential accommodation	24 000
-	Theatre tickets	2 300
-	Long service awards of watches to 3 employees	12 000

The output tax payable by Company V is based on the amount of the taxable value of the fringe benefit, as follows:

-	Gifts of electronic equipment	(57 500 x 100/115)	R50 000
-	Use of residential accommodation	(exempt supply)	24 000
-	Theatre tickets	(entertainment – input denied)	2 300
-	Long service awards of watches	(12 000 x 100/115 – 15 000)	-

The only fringe benefits subject to VAT from the list above are the gifts of electronic equipment. The theatre tickets are defined as the supply of entertainment on which an input is denied (see 7.9.2). The residential accommodation is an exempt supply. The watches are tax-free, being below the taxable limits of R5 000 per employee for long service awards.

The VAT output VAT payable by Company V is therefore:

-	Gifts of electronic equipment	(50 000 x 15/115)	R6 522
-	Use of residential accommodation	(exempt supply)	-
-	Theatre tickets	(input denied therefore no output)	-
-	Long service awards of watches	(0 x 15/115)	-
	Output VAT on fringe benefits		R6 522

The one exception to the above principle is the determination of the value on which to calculate the output tax each month for the use of 'company cars'. The calculation is based on the 'determined value', which for VAT purposes is the cost of the vehicle excluding VAT and finance charges. It is important to note that this is different from the 'determined value' used for the purposes of Income Tax and the deemed cost tables applicable to travel allowances, which is the cost excluding finance charges but *including* VAT.

- Where the employer cannot claim a VAT input (motor cars), the value of the consideration is deemed to be 0,3% per month of the determined value of the motor car.
- Where a VAT input can be claimed (other motor vehicles), the consideration is deemed to be 0,6% per month of the determined value.
- Where the employee has the obligation to maintain the vehicle, the consideration for the deemed supply is reduced by the lesser of R85 per month, or the deemed consideration.

Example 1 – Motor car fringe benefit

In March, Company H buys a motor car for R200 000 plus VAT of R30 000. It gives the use of the vehicle as a fringe benefit to its employee, so it cannot claim the VAT as an input. The employee does not bear any of the costs of repairs or maintenance. During March the company spends R4 025 on maintenance and R1 150 on insurance for the vehicle and claims the VAT on these costs as an input, as it is permitted to do.

The company will include the following in its March VAT return.

Output tax payable by the company on the fringe benefit		R200 000 x 0,3% x 15/115	R78,26
Input VAT:	Motor car	Input denied s 17(2)	-
	Maintenance	R4 025 x 15/115	(525,00)
	Insurance	R1 150 x 15/115	(150,00)

Example 2 – Motor car fringe benefit (with maintenance paid by employee)

As in example 1 above, except that the employee is liable for all maintenance costs, and incurs maintenance costs of R4 025 in March.

The company will include the following in its March VAT return.

Output tax payable by the company on the fringe benefit		(R200 000 x 0,3% - R85) x 15/115	R67,17
Input VAT:	Motor car	Input denied s 17(2)	-
	Repairs	Incurred by employee	-
	Insurance	R1 150 x 15/115	(150,00)

The employee would be unable to claim any VAT on the maintenance cost as he or she would not be a vendor.

7.12.3 PERSON CEASING TO BE A VENDOR – SECTION 8(2)

Whenever a person ceases to be a vendor any goods (other than those on which an input deduction was denied under s 17(2)) that form part of his enterprise are deemed to be supplied immediately prior to him ceasing to be a vendor. This means that when a person ceases to be a vendor he will have to pay an output tax on all assets in his enterprise. This is necessary from SARS' point of view because the person was able to claim an input on the goods when purchased on the basis that they would result in an output when sold, which will no longer be the case once the person has deregistered as a vendor.

The output tax is paid at the rate of 15/115 on the lesser of the cost of the goods (including VAT) or their market value at the date that the person ceases to be a vendor.

In terms of the second proviso to section 22(3)(ii), the vendor is required to account for output VAT on any unpaid debts in respect of which input VAT was previously claimed (if not already accounted for under the 12-month VAT input claw-back provision).

7.12.4 DISPOSAL OF GOING CONCERN – SECTION 8(7)

The supply of an enterprise or part of an enterprise as a going concern is deemed to be a supply of goods (per section 8(7)). This supply may be zero-rated in terms of s 11(1)(e) if certain conditions are met, i.e.

- both the seller and the purchaser are VAT vendors
- the seller gets a copy of the purchaser's VAT registration form
- the sales agreement must be in writing and state:
  - the business is sold as a going concern
  - the rate of VAT on the sale is 0% (zero-rated)
  - the business will be an income-earning activity at the date of transfer to the new owner
  - the enterprise will remain active and operating until its transfer to the purchaser

In order for a business to be sold as a going-concern, it has to be the sale of an income-earning activity. The parties have to agree in their written contract that the going concern will be an income earning activity on the date the ownership is transferred to the purchaser. The parties must have an intention to transfer an income-producing activity. Therefore, if a lessor sells a building to a lessee this is not the transfer of an income-earning business, as the lessee cannot let the building to himself.

The purchaser must be a vendor and the seller must retain proof that the purchaser is a vendor (a copy of his VAT 103 registration form). If the purchaser is not a vendor, the agreement of sale must be made conditional upon the purchaser being a VAT vendor at the time of the supply of the business. In some cases, where the business is supplied before the purchaser is registered as a vendor, SARS may backdate the registration of the purchaser as a vendor.

Note that a sale or supply can only be zero-rated if the agreement is in writing. Therefore, even if the sale is between group companies it is important to have it in writing if it is to be zero-rated.

7.12.5 INSURANCE CLAIMS – SECTION 8(8)

When a vendor receives an indemnity payment in terms of a short-term insurance contract the payment is deemed to be made for services rendered by such person (the insured) to the insurer. In theory the VAT output charged counters the fact that the payment received will be used by the recipient to pay for repairs or replacement items on which a VAT input will be claimed (although this is not a requirement for the supply to be deemed to have taken place). For this reason, the deemed supply provision does not apply in the case of a motor car which has been completely destroyed or lost. This is because the Act prohibits an input deduction on the purchase of motor cars (see 7.9.2).

Example

A machine owned by M (Pty) Ltd, a VAT vendor, was damaged in a fire. M (Pty) Ltd incurred repair costs of R115 000, and was fully compensated for this amount from its insurer.

Output VAT on deemed supply when insurance received	R15 000
Input VAT on repairs	(R15 000)

A short term insurer must charge VAT on its monthly premiums (unlike long term life insurance which is exempt). The insurer may claim a notional VAT input on the claim paid.

7.12.6 NON-SUPPLIES – SECTION 8(14)

If an input tax deduction is prohibited in terms of section 17(2) of the VAT Act, the subsequent supply of the goods is not subject to VAT. This is the case, for example, where a vendor (who is not a car dealer) sells a motor car or supplies food and beverages in respect of which he is not allowed to claim input tax. This provision does not apply to the case where the use of a motor car is supplied as a fringe benefit to an employee. There is VAT on the value of the fringe benefit.

Example – Non supply

H (Pty) Ltd, a VAT vendor, bought a motor car for R575 000 and a machine for R1 150 000 for use in its business, as capital assets. After a number of years, the motor car was sold for R250 000 and the machine was sold for R700 000.

The input tax on the purchase of these assets is as follows:	
- motor car (no VAT input claimable per section 17(2)(c))	-
- machine (R1 150 000 x 15/115)	(R150 000)
The output tax on the sales of these assets is as follows:	
- motor car (no VAT input was claimable per section 17(2)(c))	-
- machine (R700 000 x 15/115)	R91 304

This provision would also apply to the on-supply of entertainment where the vendor was not in the entertainment business.

7.12.7 SUPPLY OF GOODS OR SERVICES USED PARTLY FOR MAKING TAXABLE SUPPLIES – SECTION 8(16)

Section 8(16) deems the supply of goods or services used partly to make taxable supplies (and partly for another purpose – such as private use or making exempt supplies) to be made *wholly* in the course of the vendor's enterprise.

Example – Home study

Mr Y is a registered vendor. He uses a room in his home as an office for the purposes of his business. He bought his home for R800 000 in 2007 and sells it in 2022 for R1 750 000.

The sale is subject to VAT instead of transfer duty, because the house was used partly to make taxable supplies (i.e. the use of the office). The VAT on the sale is R1 750 000 x 15/115, i.e. R228 261.

Exclusion

The subsection does not apply to fixed property which the person acquired before 30 September 1991 (the commencement date of VAT) if the vendor is a natural person who used the property mainly as his or her

private residence and claimed no VAT inputs in respect of the property itself (such as on improvements made to it).

Corresponding input

Section 16(3)(h) gives a corresponding input for that part of the asset which was not used in the enterprise, just prior to the sale. This is to compensate for the fact that VAT is charged on the full selling price, even on the private or exempt portion. The VAT input is based on the lower of original cost and open market value on the date of sale.

Example – Sale of guesthouse

Mrs Y is a registered vendor. She bought her home in 2011 from a VAT vendor for R1 150 000. She uses 30% of the house as a guesthouse, and so claimed VAT input of 30% of the VAT paid, i.e. R45 000.

She sold the house in 2022 for R1 500 000 plus VAT. Her VAT return has to be as follows:

Output tax (section 8(16): R1 500 000 x 15%	R225 000
Input tax (section 16(3)(h)): R1 150 000 x 15/115 x 70%	(105 000)
VAT due to SARS	R120 000

If the purchaser is going to use the house as his residence, he cannot claim any part of the VAT as input tax. If he is also going to use 30% of the house as a guesthouse, he could, if he is a vendor, claim an input of 30% of R225 000.

7.13 TAX INVOICES, CREDIT NOTES, DEBIT NOTES

In order for a vendor to be allowed to deduct input tax from output tax in calculating how much he must pay to the Revenue Service after the end of his tax period, he must have a valid tax invoice from the vendor who has supplied the goods or services to him. If he does not, he may not claim input VAT until such a time as he is in possession of a valid tax invoice.

Section 20 deals with tax invoices and provides that a tax invoice must be issued for every taxable supply made by a vendor (except where the value of the supply is R50 or less). Only one tax invoice can be issued per supply. If a copy of a tax invoice is made it must be clearly marked 'copy'.

A VAT invoice must contain the following information:

- the words 'tax invoice', 'VAT invoice' or 'invoice'
- the name, address and VAT registration number of the supplier
- the name, address and VAT registration number of the recipient (if applicable)
- an individual serialized number
- the date upon which the invoice is issued
- a description of the goods or services supplied
- the quantity or volume of the goods or services supplied
- either the value of the supply, the tax, and the consideration, or the consideration for the supply and a statement that it includes tax charged and the rate at which the tax is charged (0% or 15%)
- If the invoice is for R5 000 or more, the trading name and address of the recipient as well as its VAT registration number must be included on the invoice.
- The Commissioner can give permission for some information to be omitted from a tax invoice, or direct that a tax invoice is not required to be issued.
- A tax invoice must be stated in South African currency unless it is a zero-rated supply.

Where a tax invoice has been issued and the supply is cancelled or fundamentally altered or varied, or the amount has been altered, the vendor must issue a credit note or a debit note reflecting the change.

The information these must contain is set out in section 21:

Credit note	*Debit note*
• the words 'credit note' • the name, address and registration number of the vendor • the name and address of the recipient (unless the original supply was for R5 000 or less) • the date issued • the amount of the credit and the VAT, or the inclusive price and the rate of VAT included • brief explanation of circumstances • reference to original transaction, e.g. invoice number	• the words 'debit note' • the name, address and registration number of the vendor • the name and address of the recipient • the date issued • the amount of the debit and the VAT, or the inclusive price and the rate of VAT included • brief explanation of circumstances • reference to original transaction, e.g. invoice number

Note that the credit note and debit note do not have to have serialized numbers. The debit and credit notes must reflect the recipient's VAT registration number where applicable.

7.14 IRRECOVERABLE DEBTS – SECTION 22

A vendor who accounts for VAT on the invoice basis, and who has furnished a VAT return in which the output tax on a particular debt is accounted for, may claim a deduction of the VAT fraction of the part of that debt that has become bad (irrecoverable).

What is important is the following:

- The vendor must have made the entries in his accounting system to record that the debt is written off.
- The vendor must have ceased recovery action taken by himself and must have decided either not to take any further action or must have handed the debt over to an attorney or debt collector for collection.
- If an amount is recovered later, output tax must be accounted for on the amount recovered.

Example – irrecoverable debt

Dr YT renders a medical service to the Department of Health and charges them R10 000 plus VAT. He accounts for the VAT in his VAT return in the period that the supply is made, because he accounts for VAT on the invoice basis.

The Department refuses to pay him the VAT in the mistaken belief that he should not charge them VAT as they are a Government Department. The Department pays him R10 000 only. After trying exhaustively to collect the VAT of R1 500, Dr YT eventually gives up. He reverses the R1 500 in his books.

His VAT deduction in terms of section 22(1) of the Act is: R1 500 x 15/115 = R195,65

Notes:

1. If the vendor cedes a debt at face value on a non-recourse basis and it is subsequently written off, the vendor who ceded the debt cannot claim a deduction under section 22. The person to whom the debt is now owed is entitled to the deduction if a vendor.
2. If the debt is ceded on a recourse basis, the deduction can only be claimed when the debt is ceded back to the vendor, who then writes it off.

7.15 RECORD KEEPING

The VAT Act requires that a vendor keep very detailed records. The maintenance of an adequate audit trail is essential. A vendor must keep a record of how his system works and how the output and input tax is calculated. Section 55 sets out the records that must be kept (invoices, books of account, VAT calculations, bank statements, deposit slips, stock lists, etc.). Basically, the records must be kept for a period of 5 years from the date upon which the return relevant to the last entry in the record was received by the Commissioner of the South African Revenue Service. Certain other records have to be kept for 5 years from the date of the last entry in the books concerned.

7.16 LATE PAYMENTS OF VAT AND INTEREST ON REFUNDS

If VAT is paid late, a penalty of 10% is payable, plus interest at the prescribed rate for the period the VAT remains unpaid. This interest is levied in terms of the Tax Administration Act.

7.17 VAT AND MICRO BUSINESSES

In years of assessment commencing prior to 1 March 2012, a registered micro business (for income tax purposes) was not permitted to register as a VAT vendor. From this date onward, VAT vendors may now freely register under as micro businesses if these taxpayers believe that it is in their best interests to do so, and vice versa.

7.18 VAT AND CONNECTED PERSONS

7.18.1 DEFINITION OF 'CONNECTED PERSON' IN THE VAT ACT

The definition of 'connected persons' in the VAT Act is much wider than in the Income Tax Act.

For natural persons it includes relatives (to the third degree of consanguinity, and spouses – as per the Income Tax Act). It also includes trusts of which the natural person or his or her relatives is a beneficiary or one of the beneficiaries.

For a trust it is any person who is, or may be, a beneficiary. For a partnership it is any partner and any person connected to that partner. For a close corporation it is any member and any person connected to that member.

For a company it is any person (other than another company) who holds 10% or more of the shares or voting rights in the company (directly or indirectly). In working out this 10%, the holdings or voting rights of the person's spouse, minor child, or any trust (of which the person, spouse or minor child is a beneficiary) must be combined.

Also, for a company it is any other company, the shareholders in which are substantially the same persons as in the first company (or which is controlled by the same persons who control the first company).

Any body, entity or trust connected to a person connected to a company is also connected to that company.

The separate enterprises, branches or divisions of a single vendor or association not for gain are connected to each other.

A person and a superannuation scheme are connected if the employees, office holders or former employees or office holders of the person are members of the scheme (mainly).

7.18.2 CONNECTED PERSONS - TIME OF SUPPLY

Where a supply is made to a connected person, the time of supply is the earlier of the date when an invoice is issued, when any payment is received and –

- In the case of the supply of moveable goods, the date when such goods are removed
- In the case of immovable property, the date when such property is made available to the recipient
- In the case of services, the date when such services are performed.

For rental agreements between connected persons, the above connected persons rule does not apply. The time of supply is the earlier of when payment is due or made, regardless of when invoices are issued.

7.18.3 CONNECTED PERSONS - VALUE OF SUPPLY

Where the supplier and recipient are connected persons and the recipient is able to claim a full VAT input, the value of the supply is whatever is agreed by the parties. This is because whatever SARS is able to collect in output tax from the seller it will then have to allow as an equal input tax deduction to the recipient. There is therefore no potential loss to the fiscus if the transaction is not at an arm's length value.

However, if the supplier and the recipient are connected persons, and the recipient cannot claim an input of the VAT on the supply, the transaction will result in a net output tax. There is therefore a potential loss in tax revenue if the parties agree to a price below market value. Section 10(4) provides that, where the supplier and the recipient are connected persons, and the recipient cannot claim a full input deduction on the supply, the supply is deemed to be made for the open market value if the actual consideration is less than the open market

value of the supply, or if the whole of the consideration cannot be determined at the time of supply. The rule also applies if the recipient can only claim a partial VAT input.

In most cases the connected persons rule will apply because the recipient is not a vendor. However, it may also apply where the recipient is a vendor, but is unable to claim the full input (for example, because the supply is a motor car purchased from a dealer that is a connected person, or the recipient will use the supply to make partly taxable and partly exempt supplies).

Example 1 – Connected persons

ABC Ltd is the holding company of XYZ (Pty) Ltd. XYZ (Pty) Ltd is a VAT vendor but ABC Ltd is not. ABC Ltd purchases trading stock from XYZ (Pty) Ltd. The parties agree to a price of R57 500, although the open market value of the stock is R115 000.

- ABC Ltd is unable to claim a VAT input as it is not a vendor
- XYZ (Pty) Ltd will have to pay output VAT of R115 000 x 15/115 = R15 000

Note that XYZ (Pty) Ltd's invoice would actually reflect this VAT as follows:

Price	R42 500
VAT	R15 000
Price incl VAT	R57 500 as agreed

Example 2 – Connected persons

DEF (Pty) Ltd and UVW (Pty) Ltd are fellow subsidiaries of XYZ (Pty) Ltd. DEF is a property management company while UVW earns equal amounts of revenue from the portfolio of residential and commercial properties that it owns. DEF manages the properties of UVW and charges a management fee. It also manages the properties of various third parties.

DEF charges UVW a monthly management fee of R13 800. For a similar portfolio of properties it would charge a third party R23 000 per month.

- Since only 50% of UVW's supplies are taxable, it can claim only claim a partial VAT input
- Since UWV cannot claim a full VAT input and the transaction is at less than market value, DEF will have to pay output VAT of R23 000 x 15/115 = R3 000
- UVW's VAT input claim will be R3 000 x 50% = R1 500

7.19 CONCLUSION

Chapter 7 covers the basics of Value-Added Tax. A number of important definitions have been introduced, which are significant not only in terms of VAT theory but also for the purposes of applying the VAT Act to transactions. The chapter outlines who must charge output VAT and in what circumstances, and who may be able to claim input VAT and in what circumstances. Issues of timing and valuation have also been considered.

7.20 INTEGRATED QUESTION

7.20.1 GLUEMAIL (18 MARKS)

Gluemail (Pty) Ltd ('Gluemail') is a South African resident company registered for Value-Added Tax ('VAT'). Gluemail is a wholly owned subsidiary of Teal (Pty) Ltd, a South African resident non-vendor. Gluemail is a retailer of gym equipment and has been operating in South Africa since 2015. The company has been experiencing low sales, and is considering deregistering as a VAT vendor on 28 February 2022. Gluemail has a 2-month VAT period.

The following transactions took place during the VAT period ended 28 February 2022:

Note: All amounts include VAT where appropriate, unless stated otherwise. Where applicable, tax invoices are on hand.

1. Sales of gym equipment amounted to R950 000. Included in this figure are sales to a Namibian client that amounted to R50 000. The rest of the sales are to South African customers.

2. Gluemail purchased a second-hand delivery vehicle from a non-vendor on 1 January 2022 for R129 000. The vehicle had a market value of R110 000 on the day of purchase and a market value of R90 000 on 28 February 2022.
3. Gluemail paid salaries of R156 000 to its employees and also paid electricity and water expenses of R12 000.
4. Gym equipment with a market value of R7 000 and a cost of R4 500 (excluding VAT) was given to Gluemail's managing director on 16 January 2022.
5. Gluemail purchased new gym equipment with a cost of R320 000 (market value R300 000) from non-vendors and second-hand gym equipment from vendors for a cost of R100 000 (market value R120 000).
6. One of Gluemail's drivers was involved in an accident and the company's motor car was completely destroyed. Trading stock to the value of R20 000 that was in the car was also destroyed. Gluemail received compensation to the value of R130 000 for the motor car and R15 000 for the goods destroyed. The motor car had been purchased from a vendor on 2 January 2022.
7. As Gluemail was considering deregistering as a VAT vendor, it sold a machine with a value of R67 000 to Teal (Pty) Ltd for R40 000. The machine was purchased new for R108 000 on 1 July 2021.
8. One of Gluemail's trade debtors became insolvent on 16 February 2022. Gluemail decided to write off the R25 000 debt owed by the debtor on the same day. Gluemail also decided not to take any action in order to try and recover the debt.
9. Gluemail had various investments in a South African bank and earned interest income of R11 000.

YOU ARE REQUIRED TO:

1. Explain when a registered VAT vendor would be able to deregister. **(3 marks)**
2. Calculate the output and input VAT relating to the transactions that took place during the VAT period ended 28 February 2022. **(15 marks)**

7.20.2 GLUMAIL – SUGGESTED SOLUTION

1. A company can deregister as a VAT vendor if
- it is no longer conducting an enterprise **1**
- its taxable supplies for a 12-month period are less than R1 million. **1**

If a company earns a turnover of less than R50 000 per annum, it must deregister. **1**

2.		**Input**	**Output**	
1	Sales - to foreigners - zero-rated		-	**1**
	Sales to SA residents R900 000 x 15/115		117 391	**1**
2	Purchases - second-hand rule			
	Lower of cost and MV R110 000 x 15/115	14 348		**1**
3	Salaries - not an enterprise for the employee, no input arose charged	-		**1**
	Electricity and water R12 000 x 15/115	1 565		**1**
4	Fringe benefits - stock at lower of cost and MV		587	**1**
	deemed supply R4 500 x 15/115			
5	Purchase new equipment – non-vendor	-		**1**
	Purchase - second-hand R100 000 x 15/115	13 043		**1**
6	Purchase of motor car - input denied	-		**1**
	Insurance on motor car - completely destroyed - no output		-	**1**
	Insurance on stock - deemed supply R15 000 x 15/115		1 957	**1**
7	Sale of machine to non-vendor connected person for less than MV - deemed supply at MV			**1**
	R67 000 x 15/115		8 739	**1**
8	Bad debts - deemed input - R25 000 x 15/115	3 261		**1**
9	Interest income - exempt supply financial service		-	**1**

Total 18

CHAPTER 8

TURNOVER TAX

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8.1 INTRODUCTION

Part IV of Chapter II of the Income Tax Act deals (in sections 48 to 48C) with the *Turnover Tax* payable by Micro Businesses. The tax came into operation on 1 March 2009 and applies in respect of all years of assessment commencing on or after that date.

The benefits of being registered as a micro business are that the business is taxed on a turnover basis at a very low rate. The profits are not subject to normal tax. This means that it is not necessary to record trading stock at the year-end. It is also not necessary to keep a record of expenses. The business is also taxed on a receipts basis, not on accruals. Therefore, the amount of debtors does not affect the tax calculation.

Learning objectives

By the end of the chapter, you should be able to:

- Determine whether a person meets the definition of a micro business
- Consider whether it would be an advantage for that person to register for turnover tax
- Give an overview of the basics of registration and deregistration

- Calculate taxable turnover and tax payable
- Understand how turnover tax interacts with other taxes

8.2 THE INCOME TAX ACT

The provisions of the Income Tax Act dealing with the turnover tax for micro businesses are as follows:

- Section 48 states that the definitions in section 1 and the Sixth Schedule apply to Micro Businesses (unless the context requires another meaning).
- Section 48A states that the tax is known as the turnover tax, in respect of the 'taxable turnover' of a registered micro business (for a year of assessment).
- Section 48B states that the rates of tax must be fixed annually by Parliament. The rates apply until they are changed and are not necessarily amended annually. The rates of tax to be levied on the taxable turnover of a registered micro business are currently as follows:

Turnover	Tax Liability
On the first R335 000	0%
R335 001 to R500 000	1% of each R1 above R335 000
R500 001 to R750 000	R1 650 + 2% of the amount above R500 000
R750 001 to R1 000 000	R6 650 + 3% of the amount above R750 000

- Section 48C includes the following transitional provisions:
  - If an amount is received and included in a registered micro business's taxable turnover, it cannot be taxed again in a period that the business is not registered as a micro business.
  - If an amount accrues to a registered micro business, and would have been included in that business's taxable turnover had it been received by the micro business, then if it is received at a time when the business is no longer registered as a micro business, only 10% of the amount will be included in that taxpayer's taxable income for the year of assessment in which it is received.
  - Where a registered micro business is deregistered, its trading stock on that date is included as opening stock at the beginning of that year of assessment, since it did not receive a deduction when the stock was purchased.

8.3 THE SIXTH SCHEDULE

The Sixth Schedule deals with the detail of the turnover tax.

Natural persons, companies, and close corporations can qualify as micro businesses. The main requirement is that the 'qualifying turnover' for a year of assessment must not exceed R1 million. Trusts cannot qualify as micro businesses.

8.3.1 QUALIFYING TURNOVER

Qualifying turnover is defined in paragraph 1 of the 6th Schedule as

- the total receipts
- from carrying on business activities
- excluding any amount of a capital nature
- excluding any amounts exempt from tax in terms of sections 10(1)(zK) (small business funding entities) or 12P (amounts received or accrued from government grants)

Note that qualifying turnover is different from taxable turnover. It is merely a way of working out whether the person qualifies as a micro business. If, for example a capital receipt pushes the person's receipts over R1 million, it does not affect his registration as a micro business.

Example – Qualifying turnover v taxable turnover

Co X commenced trading on 15 June 2021. Its total receipts for the period from 15 June to 28 February 2022 were R775 000, including R30 000 that it received on the disposal of some equipment used in the business.

- Co X's qualifying turnover is R745 000, since qualifying turnover excludes capital receipts.

8.3.2 QUALIFYING TURNOVER LIMIT

The turnover limit for qualifying turnover is proportionately reduced if the person carries on business for less than 12 months in the year. This is done by taking into account the number of full months that business was *not* carried on (Paragraph 2 of the 6th Schedule).

Example – Qualifying turnover

Co X commenced trading on 15 June 2021. Its turnover for the period from 15 June to 28 February 2022 was R745 000. Does its turnover qualify it to be registered as a micro business?

Limit: R1 000 000

Proportional limit: R1 000 000 – (1 000 000 x 3/12) = R750 000

The 3/12 is based on the three full months that a business was not carried on. In other words, if a micro business is carried on for part of a month, then this is used to calculate the limit, which may also be calculated as follows:

- 15 June to 28 February is 8,5 months. Therefore, use 9 months (treating part of a month as a full month if the calculation is done this way around). Therefore 9/12 x R1 million = R750 000.

The result of the formula (whichever way it is done) is that Co X's turnover is within the limit for the 2022 year of assessment.

8.3.3 TAXABLE TURNOVER

Paragraph 5 of the 6th Schedule states that the taxable turnover of a registered micro business consists of:

- revenue amounts received during the year of assessment
- from carrying on business activities
- in the Republic
- including amounts described in paragraph 6 (see 8.3.4)
- excluding amounts described in paragraph 7 (see 8.3.5)
- less any amounts refunded to any person by that registered micro business in respect of goods or services supplied by that registered micro business to that person during that year of assessment or any previous year of assessment.

There is no definition of 'business activities' in the Act. In this regard, the precedent laid down in the many tax cases has to be examined. 'Revenue amounts' are those amounts that are not of a capital nature. This concept is discussed in detail in Chapter 2.

8.3.4 INCLUSIONS IN TAXABLE TURNOVER

Paragraph 6 states that the following amounts are included in taxable turnover of a registered micro business:

- For all micro businesses: 50% of all receipts of a capital nature from the disposal of:
  - immovable property used mainly for business purposes (other than trading stock)
  - any other asset used mainly for business purposes (other than any financial instrument)
- For companies and close corporations: 100% of investment income as defined (excluding dividends and foreign dividends)

Example – Taxable turnover

Mr Y left his job and started his micro business on the 1 March 2021. His turnover for the year to 28 February 2022 was R800 000. He therefore qualifies to register as a micro business.

He converted his garage into business premises at a cost of R100 000. The garage made up 10% of the total property, which had cost R1 200 000 in 2010. The property was his primary residence.

He sold the property on 5 January 2022 for R2,3 million. Mr Y also sold some equipment used in the business on 2 February 2022 for R30 000.

Calculate Mr Y's taxable turnover and the tax payable. Assume that the capital gain on the primary residence (after specific exclusions but before the annual exclusion) amounts to R18 000.

Solution

Business taxable turnover		R800 000
50% on disposal of asset used mainly for business purposes		15 000
Total taxable turnover (subject to turnover tax)		R815 000
Tax per tables		R8 600
Capital gain on disposal of property	R18 000	
Less: Annual exclusion (limited to)	(18 000)	
Taxable income		-
Total tax		R8 600

In contrast to the equipment, the property was not used mainly (i.e. more than 50%) for business purposes. It is therefore excluded from the calculation of the taxable turnover of the micro business and would be taxed separately, although in this case the capital gain is Rnil.

8.3.5 EXCLUSIONS FROM TAXABLE TURNOVER

Paragraph 7 states that the following amounts are excluded from the taxable turnover of a registered micro business (which means that these amounts are not taxed at the special tax rate for micro businesses):

- For natural persons - *Investment income* (see 8.3.6 below for the definition of investment income). All these amounts are included in the individual's normal gross income. Note that for companies and close corporations that are registered micro-businesses, all investment income (excluding dividends and foreign dividends) must be included in the entity's taxable turnover.
- Amounts exempt from tax in terms of sections 10(1)(zK) (small business funding entities) or 12P (certain government grants)
- Any amount *received* by the registered micro business where that amount accrued to it prior to its registration as a micro business, and that amount was subject to tax in terms of the normal provisions of the Income Tax Act.
- Any amount received from any person by way of a refund in respect of goods or services supplied by that person to that registered micro business.

8.3.6 INVESTMENT INCOME

Paragraph 1 of the Sixth Schedule sets out the definition of 'investment income'. It includes the following:

- Rental on immovable property. Rental on movables is not included.
- Dividends, foreign dividends and interest.
- Proceeds from the disposal of financial instruments.
- Royalties, annuities and similar income.

8.3.7 PERSONS THAT DO NOT QUALIFY AS MICRO BUSINESSES

Paragraph 3 of the 6th Schedule sets out the circumstances under which a person does not qualify as a micro business. If any one of the following applies, the person cannot register his or its business as a micro business.

- ***Natural persons***
  - The person has shares or has any interest in the equity of any company or close corporation
    - at any time during the year of assessment.
    - certain shareholdings are permitted – see 8.3.8 below.
  - More than 20% of that person's total receipts during that year of assessment consist of income from the rendering of a professional service.
  - The person is a personal service provider at any time during the year of assessment.
  - The person is a labour broker without an exemption certificate at any time during the year of assessment.
  - The total of the following amounts exceeds R1,5 million over a period of three years (being the current tax year and the last two tax years), or a shorter period than three years if the person was a registered micro business for such shorter period:
    - receipts from the disposal or sale of immovable property used mainly for business purposes; and
    - receipts from the disposal of any other capital asset used mainly for business purposes.
- ***Company or close corporation***

  In addition to the restrictions that apply to natural persons, a company or close corporation cannot register as a micro business if any of the following apply:
  - The company or close corporation cannot be a registered micro business if the year of assessment does not end on the last day of February,
  - or if any of the shareholders is a person other than a natural person (or the estate of a deceased or insolvent person) at any time during the year of assessment,
  - or if any of the shareholders has an interest in the equity of any other company or close corporation – at any time during the year of assessment – certain interests are permitted, however (see below).
  - The company cannot be a registered micro business if it is a tax-exempt Public Benefit Organisation (PBO) – per section 30 of the Income Tax Act.
  - The company cannot be registered as a micro business if it is a tax-exempt Recreational Club – per section 30A of the Income Tax Act.
  - The company cannot be registered as a micro business if it is an association contemplated in terms of section 30B of the Income Tax Act.
  - The company cannot be registered as a micro business if it is a small business funding entity as contemplated in section 30C of the Income Tax Act.
  - More than 20% of that company's total receipts during that year of assessment consist of investment income and income from the rendering of a professional service.
- ***Partnerships***

  A person who is a member of a partnership cannot register as a micro business if:
  - Any of the partners is not a natural person, or
  - The person is a partner in more than one partnership at any time during the year of assessment, or
  - The qualifying turnover of the partnership for that year exceeds the R1 million per annum limit.

8.3.8 PERMITTED SHAREHOLDINGS AND INTERESTS

An individual who wishes to register his business as a micro business cannot hold shares in any other company or close corporation. Similarly, in order for a company or close corporation to be registered as a micro business, its shareholders or members cannot hold shares in any other company or close corporation. This is to prevent businesses from being split into different companies to keep the turnover (per company) below the R1 million threshold in order to take advantage of the lower tax rate for micro businesses.

The following shareholdings are permitted (whether the shares are held by a natural person who is a micro business or a shareholder in a micro business, or a company or close corporation which is a micro business) in terms of *paragraph 4* of the Sixth Schedule:

- shares in a listed South African company – para (a) of the definition of 'listed company'
- shares in a portfolio of a collective investment scheme – para (e) of the definition of 'company'
- shares in a sectional title body corporate, a share block company, or similar entity – per section 10(1)(e)
- shares in a venture capital company – per section 12J
- less than 5% of the shares or interest in a social or consumer co-operative or a co-operative burial society (or similar co-operative or society)
- less than 5% of the shares or interest in a primary savings (or savings and loans) co-operative bank as defined in the Co-operative Banks Act, 2007 (Act No. 40 of 2007), that may provide, participate in or undertake only banking services as described in section 14(2)(a) or (b) of that Act
- shares in a Friendly Society as defined in the Friendly Societies Act (25 of 1956)

In the case of a company, that the holder of shares in the micro business does not hold shares in another entity other than:

- shares in a company, close corporation, or co-operative, if the company, close corporation, or co-operative –
  - has not during any year of assessment carried on any trade; and
  - has not during any year of assessment owned assets with a total market value of more than R5 000
- shares in a company, etc. which has taken the steps set out in section 41(4) to liquidate, wind up or deregister. If the company, etc. withdraws or invalidates these steps, the permission falls away.

8.3.9 PROFESSIONAL SERVICES

If more than 20% of a person's total receipts during the year of assessment consist of income from the rendering of a professional service (together with investment income in the case of a company), that person cannot be a registered micro business. The list of professional services is set out in the definitions in paragraph 1 of the 6th Schedule, i.e. –

> **"'professional service'** means a service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation or veterinary science"

If a professional person owns shares in a company that is a micro business, it seems that as long as the company does not render a professional service, it can register as a micro business if it satisfies the other requirements of the Schedule.

8.3.10 REGISTRATION AS A MICRO BUSINESS

If a person meets the requirements for registration, he may elect to be registered as a micro business before the beginning of the year of assessment or such later date as the Commissioner may prescribe in the Government Gazette. If he starts a micro business during the year, he may elect to be registered within two months of starting the business. In either case, the Commissioner will register him from the beginning of the year of assessment. (Paragraph 8 of the 6th Schedule)

If a micro business voluntarily deregisters or is compelled to deregister, it may not again be registered as a micro business (paragraph 8(3)).

8.3.11 DEREGISTRATION AS A MICRO BUSINESS

There is voluntary deregistration and compulsory deregistration.

Paragraph 9 states that a business may elect to be deregistered before the beginning of a year of assessment or during a year of assessment. If it is voluntarily deregistered during a year of assessment, deregistration is effective from the beginning of that year of assessment.

Paragraph 10 deals with compulsory deregistration and states that the business has 21 days to tell the Commissioner that it no longer qualifies for registration (for example, if the business acquires non-permitted shareholding).

As far as turnover is concerned, the business must notify the Commissioner even if it thinks (based on reasonable grounds) that its turnover will exceed the R1 million limit for the year. On such application, the Commissioner must decide whether or not the increase in turnover will be temporary or nominal and then direct whether or not the micro business to remain registered.

If the Commissioner determines that a micro business should be deregistered, he does so from the beginning of the next month. This means that the business still qualifies as a micro business for the month that the conditions for registration no longer apply.

8.3.12 TAX PAYMENTS – MICRO BUSINESS

A micro business is not subject to the provisional tax requirements in the 4th Schedule. Paragraph 11 of the 6th Schedule sets out that the micro business must pay tax twice a year (interim payments), i.e.

- Within the first six months (by 31 August) it must estimate its taxable turnover for the year and pay tax on half of its taxable turnover. The estimate cannot be less than the taxable turnover for the previous year unless, on application, the Commissioner approves a lower estimate.
- By the end of the year (by 28 or 29 February) it must estimate its taxable turnover again, calculate the tax, and pay this tax (less the amount already paid at the end of the first six months of the tax year).

Interest is payable on late payments at the prescribed rate.

If the year-end estimate is less than 80% of the actual taxable turnover for the year when it is finally determined, an 'additional tax' of 20% of the shortfall in tax is payable.

The Commissioner has the power to waive all or part of this additional tax if he is satisfied that the estimate was not deliberately or negligently understated, and was seriously made based on the information available to the taxpayer.

Example – Additional tax

Co F is registered as a micro business. Its taxable turnover for the year is R625 000. It paid interim tax on an estimated turnover of R350 000 for the year. Its additional tax is therefore as follows:

80% of R625 000 =	R500 000
Tax on R500 000 =	R1 650
Tax on R350 000 =	(150)
Shortfall	R1 500
Additional tax: R1 500 x 20% =	R300

Where the micro business does not make an estimate, or the Commissioner is not satisfied with its estimate, he can estimate the taxable turnover and issue an assessment for the tax due, in which case the 20% penalty may not be raised.

8.3.13 CONNECTED PERSONS – MICRO BUSINESS

If a connected person carries on business activities that should properly be regarded as part of the activities of the micro business, and that one of the main reasons for the connected person carrying on the business

activities is so that the micro business does not exceed the turnover limit, then the turnover of the connected person must be included in the turnover of the micro business (paragraph 13 of the 6th Schedule).

Example – Connected persons

Mrs S carries on a business of selling flowers. Her turnover for the year is R800 000. The S Family Trust (of which Mrs S is a beneficiary) also sells flowers in the same area. An independent person works for the trust, but the trust's profits will eventually be paid to Mrs S or her immediate family. The trust's turnover for the year is R400 000. Mrs S and the Trust are connected persons because she is a beneficiary of the trust. The trust was formed and carries on part of the business so that Mrs S does not have a turnover of more than R1 million for the year.

As the conditions set out in paragraph 13 are met, the turnovers must be added together. As the qualifying turnover is R1,2 million, Mrs S must deregister as a micro business per paragraph 10.

8.3.14 RECORD KEEPING – MICRO BUSINESS

Paragraph 14 states that a registered micro business must retain a record of—

(a) amounts received by that registered micro business during a year of assessment;

(b) dividends declared by that registered micro business during a year of assessment;

(c) each asset of that registered micro business as at the end of a year of assessment with a cost price of more than R10 000; and

(d) each liability of that registered micro business as at the end of a year of assessment that exceeded R10 000.

8.4 EXEMPT INCOME – MICRO BUSINESS

Section 10(1)(zJ) exempts from tax any amount received or accrued to or in favour of a 'registered micro business', from carrying on a business in the Republic of South Africa. This is necessary in order to prevent double taxation, because the turnover is taxed.

If a natural person is registered as a micro business, the following amounts are not exempt under this section because they are not included in the taxable turnover of the micro business:

- Investment income
- Remuneration as defined in the Fourth Schedule (salaries, wages, etc.)

8.5 DIVIDENDS TAX – MICRO BUSINESS

A shareholder in a registered micro business which is a company or close corporation is exempt from the Dividends Tax to the extent that the aggregate amount of dividends paid by that registered micro business to its shareholders during the year of assessment in which that dividend is paid, does not exceed R200 000 – section 64F(h).

8.6 CAPITAL GAINS TAX – MICRO BUSINESS

Paragraph 57A of the 8th Schedule states that a registered micro business will not be subject to capital gains tax, and may not deduct any capital loss which arises on the disposal of any asset if it is part of the micro business.

Capital assets are only treated as part of the micro business if used *mainly* for business purposes.

Note that this paragraph must be read with paragraph 3 of the 6th Schedule that states if the receipts from the sale of such assets exceeds R1,5 million over a period of three years or less, the person does not qualify to be registered as a micro business when this limit is exceeded.

When a sale of a capital asset pushes the business over the R1,5 million threshold the gain is still free of capital gains tax, because it is only in the next month that the business is deregistered as a micro business (per paragraph 10(2) of the 6th Schedule).

8.7 VAT – MICRO BUSINESS

A micro business may register voluntarily as a VAT vendor. Due to the fact that its turnover does not exceed R1 million, it is not obliged to register.

Section 78A of the VAT Act provides that if a person deregisters as a micro business, and then registers as a VAT vendor, he has to account for VAT on amounts received after he becomes a vendor, even if the supply was made when he was a micro business. This is because those receipts will not have been included in the taxable turnover of the micro business.

In addition, any VAT paid on expenditure incurred while the person was a micro business cannot be claimed as input tax after registration. This restriction does not seem to apply to capital assets purchased (if a deemed input may be claimed in terms of section 18(4)(b) of the VAT Act).

8.8 CONCLUSION

Turnover tax may significantly reduce the administrative burden on a taxpayer. It also may have a tax benefit, depending on the taxpayer's taxable turnover in comparison to his, her or its taxable income.

In order to pay turnover tax a taxpayer must meet the criteria for registration and must register as a micro business.

8.9 END OF CHAPTER EXAMPLES

Example 1 – Company registered as a micro business

Quicktoo (Pty) Ltd expects its receipts and expenses for the year of assessment ending 28 February 2022 to be as follows:

Turnover of business	R 750 000
Proceeds on sale of surplus business assets	R300 000
Interest received	14 000
Rental from fixed property	60 000
	R 1 124 000

Running costs of business	R 200 000
Repairs to fixed property	11 000
	R 211 000

a) Does Quicktoo's turnover qualify it to be registered as a micro business?
b) Assuming Quicktoo is registered as a micro business, calculate its total tax for the year.

a) Qualifying turnover

Qualifying turnover	R824 000

Qualifying turnover excludes the capital amount of R300 000.
Qualifying turnover is below the limit of R1 000 000. Quicktoo therefore qualifies as a micro business.

b) The tax paid by Quicktoo will be as follows:

Revenue receipts	R 824 000
50% of proceeds on disposal of capital assets	R150 000
Taxable turnover	R 974 000
Tax per table	R 13 370

Investment income is included in the turnover of a micro business that is not a natural person. Together with income from the rendering of a professional service, it may not exceed 20% of total receipts.

Example 2 – Individual registered as a micro business

Mr S (who is 40 years old) is registered as a micro business. His receipts for the year of assessment ended 28 February 2022 are as follows:

- Turnover of business	R 690 000
- Interest received	29 800
- Salary	300 000
- Rental from fixed property	60 000
	R1 079 800

His expenses and costs are as follows:

- Running costs of business	R 200 000
- Pension fund contributions	15 000
- Medical aid contributions for Mr S and his wife	9 600
- Repairs to fixed property	11 000
	R 235 600

Calculate the tax paid by Mr S for his 2022 year of assessment.

Tax calculation

Salary		R 300 000
Interest received	R 29 800	
Interest exemption	(23 800)	6 000
Rental income	R 60 000	
Repairs	(11 000)	49 000
Taxable income before pension contribution deduction		R 355 000
Pension fund contributions of R15 000, limited to the lesser of		
- R350 000, and		
- 27.5% of the higher of		
- remuneration (R300 000), or		
- taxable income (R355 000)		
- taxable income (before taxable capital gains)		
Therefore all contributions are deductible		(15 000)
Taxable income		R 340 000
Tax per tables		R 71 214
Less: Primary rebate		(15 714)
Less: Medical credit rebate		
- R664 x 12		(7 968)
Less: Additional medical expenses tax credit		
- contributions	R9 600	
- 4 x medical credit rebate	(31 872)	
	-	
In the absence of additional medical expenditure Mr S will not qualify for an additional medical credit		-
		R 47 532
Tax on R690 000 turnover of micro business (per table)		5 450
Total tax		R 52 982

CHAPTER 9

TAX ADMINISTRATION

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9.1 INTRODUCTION

The Tax Administration Act (No. 28 of 2011) was promulgated on 4 July 2012. It came into effect on 1 October 2012 (except for certain provisions relating to interest on tax).

The Tax Administration Act incorporates into one piece of legislation certain tax administration provisions that are generic to all tax Acts and administrative provisions that were duplicated in the different tax Acts.

The Tax Administration Act has 272 sections, which are divided into 20 chapters. The most important aspects of the TAA as they pertain to tax compliance at a fundamental level are covered in this chapter.

The TAA applies to a variety of tax Acts. For the purposes of the topics covered in this book, the significant Acts include the Income Tax Act and the VAT Act. However, it is important to note that any administrative provision in a *particular* Act takes preference over a similar provision in the TAA.

Learning objectives

At the end of this chapter, you should have an overview of:

- How the Tax Administration Act interacts with the various tax Acts
- The basics of tax administration insofar as it relates to routine tax compliance

9.2 ARRANGEMENT OF CHAPTERS AND SECTIONS OF THE TAA

Chapter 1 – section 1 – Definitions
Chapter 2 – sections 2 to 21 – General administration provisions
Chapter 3 – sections 22 to 24 – Registration of taxpayers
Chapter 4 – sections 25 to 39 – Returns and records
Chapter 5 – sections 40 to 66 - Information gathering
Chapter 6 – sections 67 to 74 – Confidentiality of information
Chapter 7 – sections 75 to 90 – Advance rulings
Chapter 8 – sections 91 to 100 – Assessments
Chapter 9 – sections 101 to 150 – Dispute resolution
Chapter 10 – sections 151 to 168 – Tax liability and payment
Chapter 11 – sections 169 to 186 – Recovery of tax
Chapter 12 – Sections 187 to 189 – Interest [certain provisions have not yet come into effect]
Chapter 13 – Sections 190 to 191 – Refunds
Chapter 14 – Sections 192 to 207 – Write off or compromise of tax debts
Chapter 15 – Sections 208 to 220 – Administrative non-compliance penalties
Chapter 16 – Sections 221 to 233 – Understatement penalty
Chapter 17 – Sections 234 to 238 – Criminal offences
Chapter 18 – Sections 239 to 243 – Reporting of unprofessional conduct
Chapter 19 – Sections 244 to 257 – General provisions
Chapter 20 – Sections 258 to 272 – Transitional provisions
Not all these Act chapters are considered in this book.

9.3 DEFINITIONS

Section 1 of the TAA sets out a number of definitions which apply to the Act as a whole. Important definitions are dealt with in the various discussions to follow, but the following are useful to note at this stage:

An '**assessment**' is the *determination* of the *amount* of a tax liability or refund, either by way of

- Self-assessment (for example, VAT, provisional tax, dividends tax, stamp duty or transfer duty)
- An assessment by SARS (for example, income tax or estate duty)

A self-assessment is any return in which the amount of tax due appears on the return. In a VAT return, the vendor calculates the VAT due and this is shown on the return. In the case of an income tax return the amount of tax due is not shown on the return. The income tax is calculated by SARS (either automatically by the SARS computer system when a return is submitted by e-filing, or manually by means of a determination made by a SARS official), and the tax due is shown on a separate assessment. In the unlikely event that a return is not required, a 'self-assessment' is the payment of the tax.

'**Business day**' is any day other than a Saturday, Sunday or public holiday, and for the purposes of 'dispute resolution' it also excludes the days from 16 December to 15 January of the next year.

'**Company**' bears the meaning per the Income Tax Act.

'**Date of assessment**' – for a self-assessment it is the date the return is submitted

– for a SARS assessment it is the date of the issue of the notice of assessment

(In the unlikely event that a return is not required, the date of assessment is the date of last payment of the tax for the tax period, or an 'effective date' set out in section 187.)

'**Return**' is a form, declaration, document or other manner of submitting information to SARS by the taxpayer or a third party. It either incorporates a self-assessment or is the basis on which a SARS assessment is made.

'SARS official' means—

(a) the Commissioner;

(b) an employee of SARS; or

(c) a person contracted by SARS, other than an external legal representative, for purposes of the administration of a tax Act and who carries out the provisions of a tax Act under the control, direction or supervision of the Commissioner.

Persons from other organs of State whose services are obtained by SARS are also included in the definition of 'SARS official'.

A 'senior SARS official' is a person who has specific authority in writing from the Commissioner for specific powers and duties, or a person occupying a post designated by the Commissioner for a certain purpose.

A '**shareholder**' is a person who (or which) holds a beneficial interest in a share in a company as defined in the Income Tax Act.

A '**tax period**' is as defined in the particular tax Act for that tax.

A '**thing**' is a corporeal (tangible) or incorporeal (intangible) thing. A table and a chair are examples of corporeal things (things you can touch). A share in a company and a patent are examples of incorporeal things. Although you may be able to touch a share certificate (because it is a piece of paper) you cannot actually 'touch' a share. A share is a bundle of rights, which exists in the minds of people. The share certificate and various company documents and legislation record what these rights are.

9.4 GENERAL ADMINISTRATIVE PROVISIONS

Section 2 sets out the purpose of the TAA. Basically, it is to align the administration of the various tax Acts, set out the powers and duties of SARS, and prescribe the rights and obligations of the taxpayers.

Section 3 explains what is meant by 'administration of a tax Act'. Basically, this is the obtaining, by SARS, of information that may affect a person's tax liability, ensuring that taxpayers comply with the various tax Acts, determining the person's liability for tax, collecting that tax, and investigating any tax offences.

Section 4 sets out the application of the TAA (to persons subject to any tax Act).

Section 5 sets out what is meant by 'a practice generally prevailing'. A practice has to be set out in an official publication. A practice falls away if it is withdrawn or a court overturns it. An 'official publication' is defined in section 1 as:

- A binding general ruling
- An interpretation note
- A practice note
- A public notice issued by a senior SARS official, or by the Commissioner

Note that a SARS Guide is not a practice generally prevailing.

Section 6 sets out the powers and duties of SARS.

Section 7 states that a SARS official may not act where there is a conflict of interest which could give rise to bias.

Section 8 states that each SARS official must have an identity card. A SARS official need only have an identity card issued by SARS when exercising his or her powers or duties outside of SARS premises.

Section 9 deals with decisions or notices by a SARS official. These do not seem to be limited to discretions (as in the case of section 3 of the Income Tax Act prior to its amendment).

9.5 REGISTRATION OF TAXPAYERS

Section 22 deals with registration requirements in extremely brief terms. A person may be obliged to register under a tax Act, or be able to register voluntarily, in which case that person has to register in terms of the requirements of the TAA. The period of registration is set out in the relevant tax Act. If it is not, the person has 21 business days to register.

The TAA merely says that the person must register in the 'prescribed form and manner'. The section says that if the person has not submitted all the prescribed information, the person is deemed not to have applied for registration.

Section 23 requires the taxpayer to provide SARS with any change in registration particulars, within 21 business days.

Section 24 states that SARS may allocate a tax reference number to a person who registers, and also to a person who SARS registers unilaterally. This reference number has to be used in all correspondence with SARS.

9.6 E-FILING

Registered taxpayers can submit their tax returns online at www.sarsefiling.co.za. In addition, the system can be used to make any tax declarations (such as a voluntary disclosure) as well as pay taxes which are due. Persons registered for e-filing have later deadlines for tax return submissions.

In addition to the above, taxpayers can make a request for a tax return to be corrected. They can object to incorrect assessments and appeal against a disallowance of an objection. They can also upload documents in response to a request by SARS, or as support for any objection or appeal against an assessment.

Taxpayers can access historical returns, notices of assessment, and a statement of account.

The website contains numerous forms and guides related to e-filing.

There are a wide variety of taxes and tools catered for through e-filing, including Income Tax and VAT.

9.7 RETURNS AND RECORDS

Section 25 states that a person who submits a return must do so in the prescribed form and manner. The date of submission is usually set in terms of the particular tax Act. If no date is set in the tax Act, the Commissioner will set a date by public notice. Any extension of time to submit a return does not affect the deadline for paying the tax.

A return must be signed by the taxpayer (or representative) and contain all the information required in terms of the tax Act (or by the Commissioner).

The fact that a person does not receive a return does not affect the obligation to make the return. Prior to the issue of an original assessment, SARS may require an amended return to be submitted, in order to correct an undisputed error.

Section 26 enables the Commissioner, by public notice, to require third parties to submit returns for a person with whom that party transacts (like employers, banks, or asset managers).

Section 27 enables SARS to require a person to submit further or more detailed returns regarding any matter for which a return is required or prescribed by a tax Act.

Section 28 enables SARS to require a person who *submits* financial statements or accounts prepared by *someone else* to submit a statement or certificate issued by *that other person* setting out the extent of the other person's examination of the books and documents of the taxpayer, and whether or not the entries in the books and documents disclose the true nature of the underlying transactions, etc.

Section 29 sets out the duty to keep records. Generally, the particular tax Act sets out the requirements in this regard. The TAA sets out the period, however, for which these records must be kept.

- Where a person has submitted a return, he has to keep the relevant records for 5 years from the date of submission.
- Where a person is required to submit a return, but has not done so, no period is mentioned. Presumably, the records must be kept indefinitely.

- Where a person is not required to submit a return, but has engaged in an activity with a tax effect, that person must keep the relevant records for 5 years from the end of the relevant tax period.
- Section 1 defines 'tax period' for the various taxes. For income tax, a tax period is a year of assessment. For VAT, a tax period is generally the period in respect of which a VAT return is made.

Section 32 states that if SARS is conducting an audit or investigation, or an assessment or SARS decision is in dispute, the records pertinent to this have to be kept until the audit is completed or the assessment or decision finalised.

Section 30 states that records have to be kept in their original form or in a form specified by SARS (see 'electronic records' below).

Section 31 states that the records have to always be available for inspection by SARS.

Section 33 deals with translation.

Sections 34 to 39 deal with *Reportable Arrangements*. Basically, a reportable arrangement is one in terms of which a 'tax benefit' is or will be derived or is assumed to be derived by *any* participant, *and* – certain other factors are present, as specified in the section. The Commissioner for SARS (CSARS) can also list reportable arrangements by public notice.

- *Section 36* sets out the 'excluded arrangements'. CSARS can also exclude an arrangement by public notice. So far, the Minister has excluded arrangements where the tax benefit does not exceed R5 million, or where the tax benefit is not one of the main benefits of the arrangement (or the main benefit).
- *Section 37* sets out the disclosure obligation. The promoter of the arrangement has the primary responsibility. *Section 38* sets out the information to be submitted. *Section 39* states that SARS must issue a 'reportable arrangement reference number' to each participant ('participant' is defined in section 34).

Electronic records

Government Notice No. 787 in Gazette 35733, effective 1 October 2012, sets out the electronic form in which records should be kept. An 'acceptable electronic form' is one which satisfies the standard contained in section 14 of the Electronic Communications and Transactions Act (ECT Act).

SARS has to be able to access the records readily, as well as be able to read and correctly analyse them. The electronic copy must be kept in the Republic (unless permission is obtained from a senior SARS official to keep them outside South Africa).

The taxpayer must also keep proper systems documentation.

Section 14 of the ECT Act is fairly vague. It states that the integrity of the record must pass assessment. This is done by considering whether the information has remained complete and unaltered, except for the addition of any endorsement and any change which arises in the normal course of communication, storage and display. One must also consider the purpose for which the information was generated and all other relevant circumstances.

9.8 ASSESSMENTS

Section 91 deals with original assessments. Where a return made by a taxpayer does not incorporate a determination of the amount of the tax liability, SARS has to make the original assessment. Where the tax return incorporates the taxpayer's determination of the amount of the tax liability (e.g. a VAT return), the submission of the return is an original 'self-assessment'.

If no return is required, the payment of the amount of tax due is an original assessment.

If the taxpayer is supposed to submit a return, but does not, SARS may make an estimated assessment under *section 95*. An estimated assessment does not relieve the taxpayer of the obligation to submit a return. The taxpayer has 40 business days from the date of the estimated assessment to request that SARS issue a reduced or additional assessment by submitting a true and full return or the relevant material. SARS may extend the 40-day period for submission.

Section 92 deals with additional assessments, and *section 93* deals with reduced assessments.

Section 96 sets out what has to be in the notice of assessment. *Section 97* requires the recording of assessments. *Section 98* deals with the withdrawal of assessments. *Section 99* deals with the period of limitations for issuing assessments. In this regard there is a 3-year rule for SARS assessments, and a 5-year rule for self-assessments.

Section 100 deals with the finality of an assessment or decision. An assessment becomes final, for example, in the following cases (the list is not exhaustive):

- No objection has been made, or the objection has been withdrawn.
- After an objection is wholly or partly disallowed, no appeal is filed, or the appeal has been withdrawn.
- The dispute has been settled.
- An appeal has been settled by the court and no further appeal is made.
- In certain cases, SARS may make additional assessments, but not if an appeal has been determined by a higher court.

9.9 DISPUTE RESOLUTION

Sections 101 to 150 deal with dispute resolution. The rules are the same as existed prior to the implementation of the Tax Administration Act.

The TAA chapter sets out the rules for

- Burden of proof
- Objection and appeal
- The Tax Board (not covered in this book)
- The Tax Court (not covered in this book)
- Appeal to the High Court (not covered in this book)
- The settlement of a dispute

9.9.1 BURDEN OF PROOF

Section 102 states that the taxpayer bears the burden of proving that an amount is not taxable, etc. The only burden of proof resting on SARS is to show that the amount of an estimated assessment under section 95 is reasonable, or that an understatement penalty under Chapter 16 is based on correct facts. If the taxpayer objects to an assessment, the burden of proof is on the taxpayer to show that the assessment is incorrect.

If the taxpayer appeals against the disallowance of his objection, the burden of proof is on the taxpayer to show, in the tax court, that the tax treatment is incorrect and should be as he thinks is correct. When determining whether the burden of proof has been discharged, the courts will assess the balance of probability with regard to the particular circumstances surrounding the item in question. This means that the taxpayer must show that his interpretation of both the facts and the applicable tax law is more probable than the Revenue Service's interpretation.

9.9.2 OBJECTION

Section 104 states that if a taxpayer is aggrieved by an assessment, he may object to the assessment. In addition to objecting to an assessment, a taxpayer may also object to a decision (made by a SARS official) with which he does not agree. The TAA and the various tax Acts set out which decisions may be objected to.

The objection must be in terms of the rules made under *section 103*. These rules are made by the Minister of Finance.

Currently, the rules (contained in *Government Notice No. 550* in Gazette 37819 of 11 July 2014) provide for the following:

1. Prior to lodging an objection, the taxpayer may write to the Commissioner within 30 business days (as defined) after the date of the assessment and request written reasons for the assessment.
2. The Commissioner has 30 days after receiving the notice to show the taxpayer where he has already provided reasons, or if he has not he has 45 days to give such reasons in writing. If the Commissioner needs more time due to exceptional circumstances or the complexity of the matter, he must advise the taxpayer that he needs a further 45 days.

3. The taxpayer has 30 days from the later of the date of assessment or the date the written reasons are given or indicated as having already been given (see point 2 above) to object to the assessment and deliver the objection to the Commissioner. Where a taxpayer has lodged a late objection and the Commissioner has not condoned it, the Commissioner's decision is subject to objection and appeal by the taxpayer. The period for the objection may not be extended beyond an extra 30 business days unless a senior SARS official is satisfied that exceptional circumstances existed which gave rise to the delay in lodging the objection. An objection (in any event) may not be extended where more than three years have lapsed from the date of the assessment or where the grounds are based wholly or mainly on any change in practice generally prevailing on the date of assessment.
4. The objection must be in writing, and must specify in detail the grounds upon which it is made (grounds of objection). The objection must be signed by the taxpayer.
5. The objection must be in the form prescribed by the Commissioner and must be delivered to the address specified in the assessment. An 'ADR 1' form is used for the objection. A separate ADR 1 form must be used for each year of assessment. The form contains details of the tax in dispute, any penalties, additional tax, and interest. Where the taxpayer submits his return using e-filing, the objection can also be submitted electronically. A different form is used in this case. It is found by clicking on 'Notice of Objection' on the work page.
6. Where the objection does not comply with the above requirements the Commissioner has 30 days to notify the taxpayer. If he does not do so, the objection will be deemed to be valid.
7. The Commissioner has 30 days to request the information, documents or things required to decide on the taxpayer's objection and the taxpayer then has 30 days to comply.
8. On timeous request by the taxpayer he may be given a further 20 days to comply.
9. The Commissioner has 60 days after the objection to decide on it (or 45 days after receiving the further information requested).
10. If the matter is complex, or the circumstances exceptional, the Commissioner may take a further 45 to decide the matter, and must inform the taxpayer of the delay.
11. On receipt of an objection from a taxpayer the Commissioner may allow part of or the entire objection, and issue a revised assessment, or he may disallow it (section 106(2)).
12. If he disallows the objection, he must notify the taxpayer. If the objection is disallowed in whole or in part, the taxpayer may appeal against that decision (section 107).

9.9.3 APPEAL AGAINST DISALLOWED OBJECTION

Section 106 provides that SARS may allow an objection, disallow it, or allow it only in part. The notice containing SARS's decision must state the basis for the decision, and set out a summary of the procedures for appeal. The taxpayer then has the right to note an appeal against the disallowance (section 107).

Currently, the rules state that the notice of appeal must be in writing and must be made within 30 days of the notice disallowing the objection. The notice of appeal is set out on a special form (ADR2), signed by the taxpayer or his representative (in certain circumstances), and contains details of the tax in dispute and the grounds of appeal.

If the notice is lodged late, the Commissioner may accept it if he is satisfied that –

- reasonable grounds exist for the delay (21 business days)
- exceptional circumstances exist (45 business days)

If the Commissioner does not grant an extension, his decision is subject to objection and appeal by the taxpayer. Even though the taxpayer appeals against a disallowance of his objection, he is still required to pay the tax due. If he wins his case in the Tax Court, the tax overpaid will be refunded to him with interest at the prescribed rate.

Where a taxpayer appeals against the disallowance of an objection, the matter can then be dealt with in one of three ways:

(a) It goes to the Tax Board and possibly to the Tax Court after the Tax Board.

(b) It goes directly to the Tax Court.

(c) It goes into the Alternative Dispute Resolution (ADR) process and thereafter to the Tax Board or Tax Court if it is not resolved in the ADR process.

The steps to be followed after an objection is disallowed, and the taxpayer does not accept the disallowance, are as follows:

1. The notice of appeal must be made within 30 days, setting out the grounds of appeal.
2. In the notice of appeal, the taxpayer may opt to make use of alternative dispute resolution procedures (ADR procedures).
3. If the taxpayer does not opt for ADR procedures, the Commissioner has 20 days to ask him if he wants to make use of the ADR procedures.

9.9.4 ALTERNATIVE DISPUTE RESOLUTION

The Alternative Dispute Resolution (ADR) process has been developed as a less formal, more cost-effective, and speedier way to resolve tax disputes. It is part of the rules governing the objection and appeal procedures. It applies to all forms of taxes (income tax, VAT, transfer duty, stamp duty, estate duty, donations tax, UIF contributions, and skills development levies).

It is opted for by the taxpayer at the stage that he submits a notice of appeal when his objection to the assessment is disallowed or allowed only in part.

The Rules governing the ADR process are contained in Government Gazette 37819 Notice 550, and are essentially as follows:

The taxpayer indicates on the notice of appeal that he wants to use the ADR process. If SARS accepts that the matter is suitable for ADR, the ADR process must be commenced within 30 days of receipt of the notice by SARS, and completed 90 days thereafter. This time period can in certain circumstances be extended.

A senior SARS official appoints a suitably qualified person to act as facilitator, whose task is to facilitate dispute discussions with a view to bring it to a swift conclusion. The facilitator will schedule a meeting and which the parties will present their positions. The parties may agree that in the event that consensus cannot be reached the facilitator will make a recommendation, but the facilitator cannot make a binding ruling. All proceedings are confidential and may not be used subsequently in evidence if the dispute is not resolved.

Where the parties are able to reach agreement, this is recorded in writing and signed by both parties. SARS must then issue an assessment giving effect to the agreement within 45 days.

Where the parties are unable to reach consensus, they may agree to a settlement, which must also be recorded in writing, and an assessment must be issued by SARS within 45 days of the settlement.

The ADR process terminates 90 days after commencement (unless extended), or when either party delivers notice of termination to the other.

If the ADR process is terminated without resolution or settlement, the taxpayer has 20 days to decide whether to continue with the appeal to either the tax board or tax court.

Section 164 of the Tax Administration Act provides that a disputed amount of tax must be paid by the taxpayer despite having lodged an objection or noted an appeal, unless a senior SARS official directs otherwise.

9.9.5 SETTLEMENT OF DISPUTES

Part F of the TAA (sections 142 to 150) gives the Commissioner the power to settle disputes with the taxpayer.

Section 142 defines a dispute as a disagreement on the interpretation of either the relevant facts, or the law, or both (arising pursuant to an assessment or a decision of SARS). It states that settlement does not mean that one party has to accept the other's interpretation. It means merely that the tax liability is agreed to.

Section 143 states that although SARS has a duty to collect taxes, there are circumstances where it will be to the best advantage of the State to compromise and settle a dispute. *Section 145* sets out when it would be **inappropriate** to settle, while *section 146* sets out when it is **appropriate** to settle. *Section 147* sets out the

procedures for settlement. *Section 150* provides that the taxpayer's assessment must be altered to reflect the terms of the settlement and is thereafter not subject to objection and appeal.

9.10 TAX LIABILITY AND PAYMENT

Chapter 10 contains sections 151 to 168. This chapter sets out the definition of taxpayer, person chargeable to tax, withholding agent, responsible party, and representative taxpayer. It deals with the liability of each of these persons, and circumstances under which a representative taxpayer, responsible party, or withholding agent, becomes personally liable for the tax.

The time and manner that tax is to be paid is dealt with in Part B of the chapter.

Part C of the chapter deals with the taxpayer account. Although separate accounts are kept for each type of tax, SARS can allocate the payments on a first-in, first-out basis over all taxes due by the person.

Part D allows SARS to enter into instalment payment agreements with the taxpayer.

9.11 RECOVERY OF TAX

Chapter 11 sets out the procedures for collecting tax (*sections 169 to 186*). It deals, for example, with when SARS may institute liquidation or sequestration proceedings against the taxpayer (from *section 177*). It also deals with collecting debts from third parties (from *section 179*).

Part E deals with tax recovery on behalf of foreign governments. Part F deals with remedies with respect to foreign assets.

9.12 INTEREST

Chapter 12 deals with general interest rules, the period over which interest accrues, and the rate of interest (the prescribed rate) (*sections 187 to 189*). As at 1 October 2012, only part of this chapter came into effect.

9.13 REFUNDS

Chapter 13 is very short (*sections 190 and 191*). It states that SARS may audit a refund, but the refund can be made, notwithstanding the audit, if the taxpayer gives security for the tax. The refund has to be claimed within 3 years (SARS assessment) or 5 years (self-assessment) (*section 190*).

SARS may also set refunds off against other taxes owing by the taxpayer (*section 191*).

9.14 ADMINISTRATIVE NON-COMPLIANCE PENALTIES

Chapter 15 comprises *section 208 to 220.*

Administrative *non-compliance* penalties are penalties, for example, for the failure to keep proper records, failure to report any reportable arrangements, non-compliance with a request for information, obstruction of SARS officials, or for the failure to comply with tax obligations or public notices published by the Commissioner for SARS.

- There is a fixed-amount non-compliance penalty (from section 210) and a
- percentage-based non-compliance penalty (from section 213).

The fixed-amount penalty increases monthly, calculated from one month after the penalty assessment (i.e. it is levied for each month that the non-compliance continues after the date of the penalty assessment) subject to a maximum (35 months or 47 months, depending on whether or not SARS has the taxpayer's current address). The amount depends on the taxpayer's taxable income or assessed loss for the *preceding* year of assessment. Special rules apply for large companies and large exempt institutions.

The non-compliance penalty does not apply where the percentage-based penalty applies, or where the reportable arrangement penalty applies, or where the understatement penalty applies.

The amount of the penalty is set out in section 211 of the TAA as follows:

Table 9: *Fixed amount penalty table*

1 Item	2 Assessed loss or taxable income for preceding year	3 'Penalty'
(i)	Assessed loss	R250
(ii)	R0 – R250 000	R250
(iii)	R250 001 – R500 000	R500
(iv)	R500 001 – R1 000 000	R1 000
(v)	R1 000 001 – R5 000 000	R2 000
(vi)	R5 000 001 – R10 000 000	R4 000
(vii)	R10 000 001 – R50 000 000	R8 000
(viii)	Above R50 000 000	R16 000

The percentage-based penalty (per section 213) is imposed where SARS is satisfied that the taxpayer has not paid the tax as and when required under a tax Act. This penalty is equal to a percentage of the tax not paid.

It seems that the amount of the penalty is prescribed in the particular tax Act, and not in the TAA.

A person can request that a penalty be remitted (section 215). This must be done on the prescribed form. This request must contain the grounds and supporting documents. The penalty can only be remitted in exceptional circumstances.

9.15 PENALTIES

Chapter 16 deals with the understatement penalty and voluntary disclosure (not covered in this book). It contains *sections 221 to 233.*

Section 222 sets out the circumstances under which an understatement penalty is paid. The understatement penalty is a percentage in accordance with the table set out in section 223, applied to the shortfall of the tax. In looking at the tax rate of the taxpayer, one takes the maximum tax rate applicable to the taxpayer, ignoring any assessed loss or other benefit brought forward from a preceding tax year. It applies to taxes as defined in section 1, which includes all taxes, not just income tax (*section 221* definitions).

Section 221 defines 'understatement' as a default in rendering a return, an omission from a return, an incorrect statement in a return, (if no return is required) the failure to pay the correct amount of tax, and an 'impermissible avoidance arrangement' in terms of the Income Tax Act, VAT Act, or the general anti-avoidance provisions of any other tax Act. 'Substantial understatement' is a case where the prejudice to the *fiscus* exceeds the *greater* of 5% of the amount of tax properly chargeable or refundable under a tax Act for the relevant period, or R1 000 000.

Section 223 contains the understatement penalty percentage table:

Table 12: *Understatement Penalty Table*

1 Item	2 Behaviour	3 Standard Case	4 If obstructive, or if it is a 'repeat case'	5 Voluntary disclosure after notification of audit	6 Voluntary disclosure before notification of audit
(i)	Substantial understatement	10%	20%	5%	0%
(ii)	Reasonable care not taken in completing return	25%	50%	15%	0%
(iii)	No reasonable grounds for tax position taken	50%	75%	25%	0%
(iv)	Impermissible avoidance arrangement	75%	100%	35%	0%
(v)	Gross negligence	100%	125%	50%	5%
(vi)	Intentional tax evasion	150%	200%	75%	10%

The amount of the understatement penalty is determined by determining which of the behaviours apply, and if more than one applies, then SARS will apply the highest applicable understatement percentage in the penalty

table to the shortfall. In other words, the percentages are not added together. For example, if a taxpayer's behaviour involves both that no reasonable grounds exist for a tax position taken, *and* gross negligence, then item (v) will apply.

Section 221 defines a 'repeat case' as one which takes place within 5 years of a previous case.

9.16 CRIMINAL OFFENCES

Section 234 sets out a list of criminal offences for non-compliance with 'tax Acts'. If a person is convicted of a criminal offence, they may be subject to a fine or imprisonment for up to two years. These offences include, but are not limited to, the failure to register (either as a taxpayer or a tax practitioner), the failure to render a return, the failure to retain records, the refusal to supply information or give assistance to SARS, and the dissipation of assets so as to impede the collection of taxes, penalties or interest.

Section 235 sets out the criminal offences relating to the evasion of tax. In this case the penalty on conviction is a fine or imprisonment for up to five years.

Section 236 deals with a criminal offence relating to the secrecy provisions in a tax Act. On conviction there is a fine or imprisonment for up to two years.

Section 237 covers a criminal offence where a person submits a return to SARS under a forged signature, or otherwise submits a return to SARS on behalf of another person without that person's consent and authority. The penalty is either a fine or imprisonment for up to two years.

Section 238 confirms that a person charged with a tax offence may be tried in any competent court having jurisdiction, as well as any competent court having jurisdiction by virtue of the geographical location of the accused or the pace where they carry on business.

9.17 REPORTING OF UNPROFESSIONAL CONDUCT

Section 240 requires all tax practitioners to be registered. The aim is to regulate tax practitioners and be able to report a tax practitioner to his or her controlling body if his or her intentional or negligent act resulted in a taxpayer avoiding or unduly postponing performance of a tax obligation.

Tax practitioners are required to be registered with a recognised controlling body (or fall under the jurisdiction of a recognised controlling body) by the later of 1 July 2013 or 21 business days after the date on which that person for the first time provides the advice or completes or assists in completing a tax return. Section 1 of the TAA defines a return as a form, declaration, document or other manner of submitting information to SARS (which is either a self-assessment or the basis on which an assessment is to be made by SARS).

Section 240A is added to the TAA to deal with the recognition of controlling bodies for tax practitioners. *Section 241* sets out the procedure for a senior SARS official to lodge a complaint, against a tax practitioner, with a recognised controlling body.

Section 241 sets out the procedure for a senior SARS official to lodge a complaint against a tax practitioner, with a recognised controlling body. *Section 243* indicates that a complaint is to be considered by a controlling body according to its rules, and includes provisions to preserve the secrecy of taxpayer information during the course of investigating the complaint.

9.18 GENERAL PROVISIONS

Chapter 19 contains *sections 244 to 257*. It deals with deadlines, public officers of companies, addresses for delivery of documents and notices, authentication of documents, delivery of documents, and confirmations of the tax compliance status of a taxpayer.

CHAPTER 10

ASSESSED LOSSES

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10.1 INTRODUCTION

An 'assessed loss' is defined as the amount by which the deductions of a taxpayer for the year of assessment (claimed under section 11) exceed the income in respect of which these deductions are admissible.

The provisions relating to most assessed losses are contained in sections 20 and 20A of the Act, and deal with the requirements for offsetting:

- an assessed loss incurred during the same year of assessment from carrying on one trade against taxable income from another trade, and
- a balance of assessed loss brought forward from the previous year of assessment against taxable income in the current year of assessment.

In order to give effect to these sections it therefore is important firstly to identify the trades in which the taxpayer is engaged, and then to determine whether any restrictions are imposed by the sections either on setting off losses from one trade against another, or on utilising an assessed loss brought forward from the previous year of assessment.

Example - Calculation

X (Pty) Ltd

Gross income:		
Sales		R100 000
Interest		10 000
		110 000
Less deductions:		
Cost of stock purchased - section 11(a)	80 000	
Factory rental	40 000	
Salaries/wages	30 000	(150 000)
Opening stock		(60 000)
Closing stock		70 000
Assessed loss		(R30 000)

Learning objectives

By the end of this chapter, you should be able to:

- Determine whether a company is entitled to utilise an assessed loss brought forward from the previous year
- Determine whether an individual may have an assessed loss from a trade ring-fenced
- Perform basic assessed loss calculations for companies and individuals

10.2 UTILISING AN ASSESSED LOSS BROUGHT FORWARD

10.2.1 DEFINITION OF TRADE

A 'trade' is an activity that a person undertakes in order to earn income. It must be distinguished from a passive activity, like investment of surplus funds.

Section 20(1) refers to the determination of the taxable income derived by any person from *carrying on any trade*. Trade is defined in section 1 of the Act as including:

> "every profession, trade, business, employment, calling, occupation or venture, including the letting of any property and the use of or the grant of permission to use any patent as defined in the Patents Act or any design as defined in the Designs Act or any trade mark as defined in the Trade Marks Act or any copyright as defined in the Copyrights Act or any other property which is of a similar nature".

SARS has the view that, in addition, the taxpayer generally has to have a profit motive for its activities in order for those activities to qualify as a trade. In this regard, the taxpayer's intention is important. In addition, SARS suggests that an objective test should also be applied. In other words, not only must the taxpayer have an intention to make a profit (subjective test) but there must be a reasonable prospect of him making a profit within a reasonable time (objective test).

10.2.2 THE TRADE REQUIREMENT

In order for a *company* to utilise an assessed loss brought forward from the previous year of assessment, it must trade in the current year of assessment. If a company does not trade for a full year of assessment, then any assessed losses accumulated up until that year are lost.

Strictly speaking, in order to keep an assessed loss available for future use, it is also required that there be income from the trade in each year of assessment, against which the balance brought forward can be applied and a new balance of assessed loss calculated. However, SARS has indicated that as long as the company has proved that a trade has been carried on during the year of assessment the company will be entitled to set off its balance of assessed loss from the preceding year.

Example – Carry forward of assessed loss (companies)

A (Pty) Ltd has a balance of assessed loss of R100 000 at 31 December 2020, its year end. If A (Pty) Ltd fails to carry on a trade for the whole of its 2021 year, the assessed loss will be lost and will not be available for set-off against any trade income which may arise in the 2022 or subsequent tax years. If, on the other hand, it carries on trade for one day of the 2021 year, the balance will be carried forward, and may be set off against any income which arises in 2022.

The Revenue Service has indicated that trading for only a few days in the year will not help unless the company carried on a genuine trade.

The requirement to trade applies only to companies. An individual may carry forward an assessed loss indefinitely, irrespective of whether he continues to trade. He may also set off an assessed loss against non-trade income (such as interest).

Example – Carry forward of assessed loss (individual)

Mr A has a balance of assessed loss of R100 000 at 29 February 2020. The assessed loss resulted from the trading activities of the fish-and-chip shop that he owned and operated as a sole proprietor. On 29 February 2020 Mr A sold his shop, and had no income for the 2021 year of assessment. On 1 March 2021 he started a new business landscaping gardens, from which he earned R120 000 taxable income for the year of assessment ended 28 February 2022.

Mr A is entitled to set off the balance of assessed loss brought forward of R100 000 against his taxable income in the current year of R120 000, notwithstanding the fact that he did not conduct the fish-and-chip shop trade in the 2021 tax year.

10.2.3 COMMENCEMENT OF TRADE

A distinction has to be made between the laying of business plans and of implementing them. It is only when the plans are implemented that trading starts.

It is unlikely that a company has commenced trading if it has no assets with which to trade. In order to deduct expenses and carry a loss forward, a company must commence trading during a year of assessment. If it does not commence trading, its expenses have to be capitalised.

Section 11A then allows the company to deduct certain capitalised expenses in the year it commences trading, if such expenses would have been deductible had they been incurred after trading commenced. This would include preparatory expenses.

10.3 SET-OFF OF LOSSES IN THE CURRENT YEAR

10.3.1 GENERAL

Section 20 provides that no taxpayer may set off any assessed loss incurred during the current year from a trade carried on outside the Republic against any income derived by that taxpayer from the carrying on of a trade in the Republic. Such a loss must be carried forward to the next year of assessment, at which time it may only be offset against taxable income from a trade carried on outside the Republic. This applies both to individuals and to companies.

The setting-off of an assessed loss of an individual arising from the carrying on of one trade against the income derived from the carrying on of another trade is also subject to the provisions of sections 20A. Section 20A provides for the 'ring-fencing' of assessed losses in certain situations. 'Ring-fencing' means that the utilisation of a loss from a trade is limited to the subsequent income from that trade. It is as if a fence was put around the trade and the income and expenses kept on the inside of that fence. No part of the expenses and losses can leak out and be set off against the income from another trade. Section 20A does not apply to companies.

Section 20A only applies to individuals whose taxable income for the year (before setting off any current or preceding years' assessed loss from any trade) is equal to or greater than the level at which the maximum rate of tax applies (R1 656 600 for the 2022 year of assessment).

Example – Taxable income for application of section 20A

Mr Khajee has the following income and losses for the 2022 year of assessment:

Salary	R1 530 000
Income from rental properties	200 000
Expenses in respect of rental properties	(320 000)
Capital gain on sale a rental property	520 000
Assessed loss brought forward from previous year	(20 000)

His taxable income for the year before losses is therefore:

Salary	1 530 000
Loss from rental properties	(120 000)
Taxable capital gain (R520 000 – R40 000 annual exclusion) x 40%	192 000
Prior year assessed loss	(20 000)
Taxable income before adjustments	R1 582 000
Add back: loss from trade	120 000
prior year assessed loss	20 000
Taxable income after adding back losses	R1 722 000

As Mr Khajee's taxable income after adding back the current year assessed loss and balance of assessed loss is higher than the threshold of the maximum marginal rate of tax (R1 656 600) section 20A could apply to him. If it applied, it might not allow the rental property loss to be set off against his other taxable income.

For taxpayers in this category, the section may apply in one of two situations:

1) The trade in which the assessed loss arose is included in the list of 'suspect trades'

OR

2) if the taxpayer has, during a five-year period ending on the last day of the tax year, incurred an assessed loss in the relevant trade in at least three years of assessment (before utilising the balance of any assessed loss brought forward).

If the criteria in (1) or (2) above are met, the assessed loss in that trade may be ring-fenced and may not be set off against income from another trade carried on by the taxpayer. The ring-fenced loss must be carried forward until such time as there is taxable income from the same trade against which the loss may be utilised.

The list of suspect trades is as follows:

(i) any sport practiced by the person or any relative;
(ii) any dealing in collectibles by the person or any relative;
(iii) the rental of residential accommodation (unless at least 80% is used by persons who are not relatives of the person for at least half of the year of assessment);
(iv) the rental of vehicles, aircraft or boats as defined in the Eighth Schedule (unless at least 80% of such assets are used by persons who are not relatives of the person for at least half of the year of assessment);
(v) animal showing by the person or any relative;
(vi) farming or animal breeding carried on (otherwise than on a full-time basis);
(vii) any performing or creative arts practiced by the person or any relative;
(viii) any form of betting or gambling practiced by the person or any relative; or
(ix) the acquisition or disposal of any crypto-asset.

A loss made in a 'suspect trade' may be automatically ring-fenced from the first year in which losses arise.

Example – Suspect trade: Part-time farming

Mr Smith earns a salary of R2 000 000 per annum from employment in the 2022 year of assessment. He also carries on farming activities on a part-time basis. For the 2022 year the farm makes a loss of R200 000.

Mr Smith will be taxed on a taxable income of R2 000 000 (his salary) and will have a balance of assessed loss of R200 000 in respect of the farming trade, which may be carried forward and set-off against future farming income.

When deciding whether a trade is part-time, SARS looks at whether the taxpayer is involved full-time or part-time in the trade. They would only treat a trade as full-time if it takes up most or all of the taxpayer's normal working hours.

If a trade is not a suspect trade, the three-out-of-five-year time rule can apply. This means that if a trade makes losses in three out of five years of trading, the loss from the third loss-making year may be ring-fenced to income from that trade in the future.

Example – three-out-of-five-year rule

Mr Jones is a full-time consultant who earns a salary of R2 000 000 per annum. He also designs web sites part-time. As this is not a suspect trade, the time rule applies. Assume that he has made profits and losses from this part-time business as follows:

Year of assessment	*Profit/(Loss) from secondary trade*
2018	3 000
2019	(18 000)
2020	22 000
2021	(4 000)
2022	(10 000)

Mr Jones has made losses in three out of five years, i.e. the five years are 2019, 2021, and 2022. Therefore, the loss in 2022 is ring-fenced unless Mr Jones can pass the facts and circumstances test (see below). The losses in 2019 and 2021 were allowed in those years and remain so, i.e. his previous assessments are not re-opened.

10.3.2 FACTS AND CIRCUMSTANCES TEST

An assessed loss from a trade will not be ring-fenced if the taxpayer is able to prove that the trade has a reasonable prospect of making a profit within a reasonable time. This is known as the 'facts and circumstances test'. It is an objective test and applies to both the three-out-of-five-year time rule, and to the suspect trades test.

The section does not indicate what a reasonable period or reasonable prospect is. This depends on the particular facts and circumstances of the trade. Section 20A(3) states that in trying to determine whether there is a reasonable prospect of a profit within a reasonable period, all of the following factors must be taken into account:

(a) The proportion of the gross income derived from that trade in that year of assessment in relation to the amount of the allowable deductions incurred in carrying on that trade during that year. If the gross income is very low and the expenses are very high, this may indicate that there is not a reasonable prospect of a profit. This will be a negative indication. If the gross income is high, but the expenses are higher, this will be viewed in a more positive way.

(b) The level of activities carried on by that person or the amount of expenses incurred by that person in respect of advertising, promoting or selling in carrying on that trade. If a business is to be profitable, the taxpayer needs to actively seek opportunities to earn income from the business. This implies that ongoing advertising and promotion may take place. If the activity is not a real business, but more in the nature of a hobby, advertising may be irregular.

(c) Whether that trade is carried on in a commercial manner, taking into account—

(i) the number of full-time employees appointed for purposes of that trade (other than persons partly or wholly employed to provide services of a domestic or private nature);
(ii) the commercial setting of the premises where the trade is carried on;
(iii) the extent of the equipment used exclusively for purposes of carrying on that trade; and
(iv) the time that the person spends at the premises conducting that business.

If the employees, place and equipment are used for a dual use (business and private) this will be a negative factor. Ideally, the taxpayer should be able to show that the location was especially chosen, and the employees and equipment should be used solely for the business. The time that the taxpayer spends on the business will be determined by circumstances, however.

(d) The number of years of assessment during which assessed losses were incurred in carrying on that trade in relation to the period from the date when that person commenced carrying on that trade and taking into account—

(i) any unexpected events giving rise to any of those assessed losses; and
(ii) the nature of the business involved.

If there are losses over a number of years, and these losses arose through circumstances beyond the taxpayer's control, or the taxpayer can explain the reasons for the losses, this is a positive factor. It indicates that where there is a reason for the loss, and this reason can be dealt with in future, there is a possibility of future profits. If a loss has arisen only because there were large capital allowances claimed on an asset, but the cash flow of the business is positive, this is a positive factor, because when the period for claiming the capital allowances has elapsed, the business will show a taxable profit.

(e) The business plans of that person and any changes thereto to ensure that taxable income is derived in future from carrying on that trade. It is important that the taxpayer be able to produce a feasibility study showing how he or she intends to make the business profitable in the future.

(f) The extent to which any asset attributable to that trade is used, or is available for use, by that person or any relative of that person for recreational purposes or personal consumption. If an asset is used for personal purposes, this is a negative factor. The amount of private use will be looked at. The asset should not generally be available for private use.

The above facts and circumstances are used to determine, objectively, whether the business is being carried on in a commercial manner, with a commercial purpose, or whether it is merely a hobby or lifestyle choice. The onus is on the taxpayer of showing that the business is conducted in a commercial manner with the main aim of making a profit.

10.3.3 THE SIX-OUT-OF-TEN-YEAR RULE

If a loss is made in a suspect trade for at least six years in a ten-year period, the losses from that trade will be ring fenced in that year and in all future years to the income from that trade. At this point the facts and circumstances escape clause can no longer be used by a taxpayer. Therefore, the loss is automatically ring-fenced in year six.

This rule does not apply to farming. It also does not apply to trades that are not suspect trades.

10.3.4 FLUCTUATING TAXABLE INCOME

If a person's taxable income (ignoring the loss-making trade) is above the maximum tax rate threshold (R1 656 600 for 2022), the ring-fencing provisions can apply. If the income drops below the threshold in the next year, section 20A does not apply to the loss for that year, but the loss from the previous year remains ring-fenced.

Example – Fluctuating taxable income

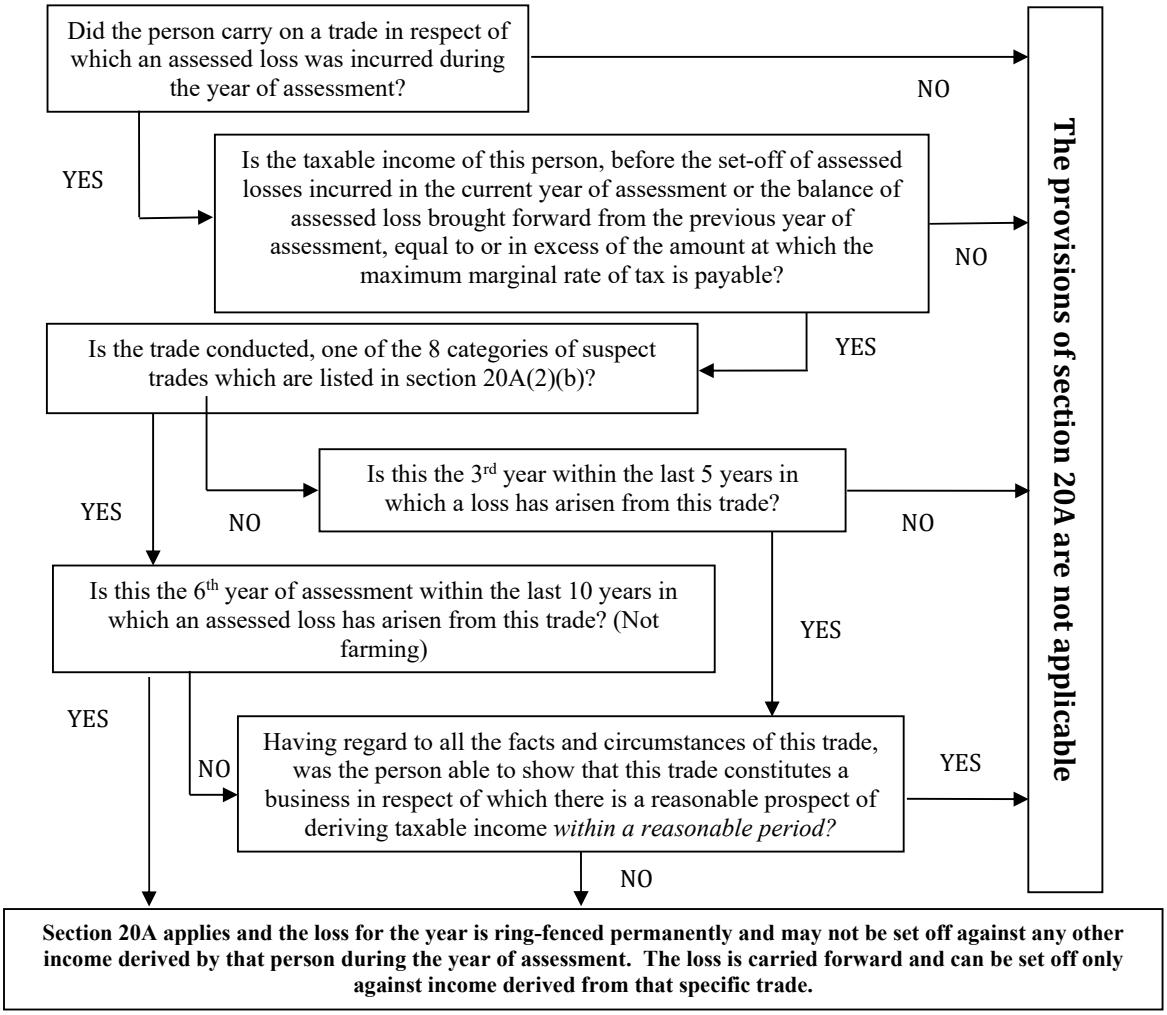
Mrs Dludlu carries on a normal full-time trade, which is profitable, and a suspect trade that is sometimes profitable and sometimes runs at a loss. Assume that her suspect trade has no reasonable prospect of deriving a profit in a reasonable period. Assume also that in each year, except 2019, her taxable income from other trades exceeds the amount at which the maximum marginal rate of tax is applied.

The following table sets out the amount of the ring-fenced loss from year to year.

Tax year	*Taxable income Normal trade*	*Tax profit/(loss) Suspect Trade*	*Taxable income to be assessed*	*Ring-fenced Loss c/f*
2018	R980 000	(R120 000)	R980 000	(R120 000)
2019	220 000	(80 000)	140 000	(120 000)
2020	1 510 000	50 000	1 510 000	(70 000)
2021	1 620 000	15 000	1 620 000	(55 000)
2022	1 740 000	(63 000)	1 740 000	(118 000)

In 2019 the taxable income before the loss was below the tax threshold, so the loss for that year could be claimed (normal rules apply). The R120 000 which was ring-fenced from 2018 stays ring-fenced and is only set off against the R50 000 earned from that suspect trade in 2020 and the R15 000 earned in 2021.

10.3.5 DECISION TREE – PRODUCED BY SARS – WITH MINOR MODIFICATIONS



TAX TABLES AND RATES — APPENDIX A

1. RATES OF NORMAL TAX PAYABLE BY NATURAL PERSONS, DECEASED ESTATES, INSOLVENT ESTATES, AND SPECIAL TRUSTS IN RESPECT OF THE YEARS OF ASSESSMENT COMMENCING ON 1 MARCH 2021.

Taxable income excluding retirement fund lump sum benefits	*Rates of tax*
Does not exceed R216 200……	18% of taxable income
Exceeds R216 200 but does not exceed R337 800	R38 916 plus 26% of the amount by which the taxable income exceeds R216 200
Exceeds R337 800 but does not exceed R467 500	R70 532 plus 31% of the amount by which the taxable income exceeds R337 800
Exceeds R467 500 but does not exceed R613 600	R110 739 plus 36% of the amount by which the taxable income exceeds R467 500
Exceeds R613 600 but does not exceed R782 200	R163 335 plus 39% of the amount by which the taxable income exceeds R613 600
Exceeds R782 200 but does not exceed R1 656 600	R229 089 plus 41% of the amount by which the taxable income exceeds R782 200
Exceeding R1 656 600……	R587 593 plus 45% of the amount by which the taxable income exceeds R1 656 600

Note that this table does not apply to retirement fund lump sum benefits arising on retirement or death, retirement fund lump sum withdrawal benefits, or severance benefits. These benefits have their own table.

The income tax table must be used together with the **natural persons' tax rebates** –

Primary rebate – all individuals	R15 714
Secondary rebate – individuals over 65	R8 613
Tertiary rebate – individuals over 75	R2 871

2. RATES OF TAX FOR ORDINARY COMPANIES (OTHER THAN SMALL BUSINESS CORPORATIONS AND MICRO BUSINESSES)

28%

3. RATES OF TAX FOR REGISTERED MICRO BUSINESSES

The rate of tax referred to in section 48B of the Income Tax Act to be levied in respect of the taxable turnover of a person that is a registered micro business as defined in paragraph 1 of the Sixth Schedule to the Income Tax Act, 1962, in respect of any year of assessment ending during the period of 12 months ending on 28 February 2022 is set out in the table below:

Taxable turnover	*Rate of tax*
Not exceeding R335 000	0 per cent of taxable turnover
Exceeding R335 000 but not exceeding R500 000	1 per cent of amount by which taxable turnover exceeds R335 000
Exceeding R500 000 but not exceeding R750 000	R1 650 plus 2 per cent of amount by which taxable turnover exceeds R500 000
Exceeding R750 000	R6 650 plus 3 per cent of amount by which taxable turnover exceeds R750 000

4. RATES OF TAX FOR SMALL BUSINESS CORPORATIONS

The rate of tax referred to in section 5(2) of the Income Tax Act to be levied in respect of the taxable income of a company which qualifies as a small business corporation as defined in section 12E of the Income Tax Act, 1962, in respect of any year of assessment ending during the period of 12 months ending on 31 March 2022 is set out in the table below:

Taxable income	***Rate of tax***
Not exceeding R87 300	0 per cent of taxable income
Exceeding R87 300 but not exceeding R365 000	7% of taxable income as exceeds R87 300
Exceeding R365 000 but not exceeding R550 000	R19 439 plus 21% of the amount by which taxable income exceeds R365 000
Exceeding R550 000	R58 289 plus 28% of the amount by which taxable income exceeds R550 000

5. TRAVEL ALLOWANCE

Travel allowance for years of assessment commencing on or after 1 March 2021

Cost Scale - Where the value of the vehicle -	***Fixed Cost R***	***Fuel Cost c/km***	***Maintenance Cost c/km***
Does not exceed R95 000	29 504	104,1	38,6
Exceeds R95 000 but does not exceed R190 000	52 226	116,2	48,3
Exceeds R190 000 but does not exceed R285 000	75 039	126,3	53,2
Exceeds R285 000 but does not exceed R380 000	94 871	135,8	58,1
Exceeds R380 000 but does not exceed R475 000	114 781	145,3	68,3
Exceeds R475 000 but does not exceed R570 000	135 746	166,7	80,2
Exceeds R570 000 but does not exceed R665 000	156 711	172,4	99,6
Exceeds R665 000	156 711	172,4	99,6

Simplified method

Where—

(a) the provisions of section 8(1)*(b)*(iii) are applicable in respect of the recipient of an allowance or advance; and

(b) no other compensation in the form of a further allowance or reimbursement is payable by the employer to that recipient,

the rate per kilometre is, at the option of the recipient, equal to ***382 cents*** per kilometre.

Note that employees' tax is based on 80% or 20% of the travel allowance, depending on circumstances.

6. EMPLOYER-OWNED MOTOR VEHICLES

The tax is based on the value of the private use of the vehicle each month and is withheld as part of employees' tax.

– *Vehicle not subject to a maintenance plan*

Value of private use per month = 3,5% x determined value (the determined value includes VAT, but excludes finance charges)

– *Vehicle subject to a maintenance plan (as defined)*

Value of private use per month = 3,25% x determined value (the determined value includes VAT, but excludes finance charges)

This value can be reduced (on assessment) where the employee keeps accurate records of distances travelled for business purposes.

Where the employee -

(aa) bears the cost of all fuel used for the purposes of the private use of the vehicle (including travelling between the employee's place of residence and his place of employment), the

value of private use will be reduced at the end of the year by an amount determined for the total kilometres travelled for private purposes by applying the travel allowance rates; or

(bb) bears the full cost of maintaining the vehicle (including the cost of repairs, servicing, lubrication and tyres), or licence, or insurance, the value of private use shall be reduced at the end of the year by a formula based on the kilometres travelled for private purposes in relation to the total kilometres travelled for the year.

Note that the employees' tax is based on 80% or 20% of the value of the fringe benefit, depending on circumstances.

SUBSISTENCE ALLOWANCE — APPENDIX B

The following amounts will be deemed to have been actually expended by a recipient to whom an allowance or advance has been granted or paid for the year of assessment commencing on 1 March 2021 –

(a) Where the accommodation, to which that allowance or advance relates, is in the Republic and that allowance or advance is paid or granted to defray –

(i) incidental costs only, an amount equal to R139 per day; or

(ii) the cost of meals and incidental costs, an amount equal to R452 per day; or

(b) where the accommodation, to which that allowance or advance relates, is outside the Republic and that allowance or advance is paid or granted to defray the cost of meals and incidental costs, an amount per day determined in accordance with the following table for the country in which that accommodation is located –

Table: Daily Amount for Travel outside the Republic - from 1 March 2021

Country	Currency	Amount
Australia	Australian $	230
Brazil	Reals	347
China (PR of)	US $	127
Germany	Euro	120
India	Indian Rupee	5 852
Mozambique	US $	128
Namibia	Rand (ZAR)	950
Nigeria	US $	242
United Kingdom	British Pounds (GBP)	102
USA	US $	146
Zimbabwe	US $	123

Note: The amounts presented above are for a sample of countries only. For a full list of countries refer to *Government Gazette* No. 42258. For countries where no specific rate is provided, a daily rate of US $ 215 is applicable.

WEAR AND TEAR ALLOWANCE APPENDIX C

Binding General Ruling No. 7 (issue 4), issued on 9 February 2021, sets out the section 11(e) write-off periods acceptable to SARS (see discussion in Chapter 5) for any asset brought into use on or after 24 March 2020. Where an asset is used for part of a year, the allowance in that year must be reduced to the amount which bears to the total for the year, the same ratio as the part of the year bears to a full year.

Asset	**Proposed write-off period (in years)**
Cellular telephones	2
Computers	
Main frame / servers (see note)	5
Personal	3
Computer software (main frames)	
Purchased	3
Self-developed	5
Computer software (personal computers)	2
Delivery vehicles	4
Furniture and fittings	6
Laboratory research equipment	5
Motors	4
Motorcycles	4
Office equipment – electronic	3
Office equipment – mechanical	5
Passenger cars	5
Photocopying equipment	5
Photographic equipment	6
Refrigeration equipment	6
Shop fittings	6
Telephone equipment	5
Television and advertising films	4
Trucks (heavy duty)	3
Trucks (other)	4

Note: The rates presented above are for a sample of assets only. For a full list of countries refer to Binding General Ruling No. 7.

QUICK REFERENCE TABLE — APPENDIX D

1. INCOME TAX - REBATES FOR INDIVIDUALS

Income Tax - Rebates for individuals	***2022***	***2021***	**2020**
Primary – s 6(2)(*a*) – under age of 65	*R15 714*	*R14 958*	R14 220
Secondary – s 6(2)(*b*) – age 65 and older	*R8 613*	*R8 199*	R7 794
Tertiary – s 6(2)(*c*) – age 75 and older	*R2 871*	*R2 736*	R2 601
Income Tax threshold- – individuals	***2022***	***2021***	**2020**
Below 65 years of age	*R87 300*	*R83 100*	R79 000
Age 65 and older	*R135 150*	*R128 650*	R122 300
Age 75 and older	*R151 100*	*R143 800*	R136 750
Interest exemption- (local)– individuals	***2022***	***2021***	**2020**
Below 65 years of age	*R23 800*	*R23 800*	R23 800
Age 65 and older	*R34 500*	*R34 500*	R34 500

2. MEDICAL CREDIT REBATE – INDIVIDUALS

	2022	***2021***	**2020**
Taxpayer only	*R332*	*R319*	R310
Taxpayer and one dependant	*R664*	*R638*	R620
Per additional dependant	*R224*	*R215*	R209

3. CAPITAL GAINS TAX - INDIVIDUALS

	2022	**2021**	**2020**
Primary residence exclusion for individuals This reduces the capital gain or capital loss	*R2 000 000*	R2 000 000	R2 000 000
Primary residence exclusion for individuals No capital gain is taken into account if the proceeds do not exceed this amount	*R2 000 000*	R2 000 000	R2 000 000
Annual exclusion for individuals & special trusts	*R40 000*	R40 000	R40 000
Annual exclusion in the year of death	*R300 000*	R300 000	R300 000
Disposal of small business if over 55	*R1 800 000*	R1 800 000	R1 800 000
Capital gains tax inclusion rates for individuals			
Inclusion rate	*40%*	40%	40%
Effective rate	*0 – 18,00%*	0 – 18,00%	0 – 18,00%

INTEREST RATES APPENDIX E

There are three main categories for interest rates charged in terms of the legislation administered by SARS, i.e.-

- interest *charged* by SARS on outstanding taxes, duties and levies and *payable* by SARS to a taxpayer in respect of refunds of tax on successful appeals and certain delayed refunds (the 'prescribed rate')

1/03/2019 – 31/10/2019	10,25%
1/11/2019 – 30/04/2020	10,00%
01/05/2020 – 30/06/2020	9.75%
01/07/2020 – 31/08/2020	7.75%
01/09/2020 – 31/10/2020	7,25%
01/11/2020 –	7,00%

- interest payable on credit amounts (overpayment of provisional tax) in terms of section 89*quat*(4) of the Income Tax Act, 1962 refunds (the 'prescribed rate' minus 400 basis points, or 4%)

1/03/2019 – 31/10/2019	6,25%
1/11/2019 – 30/04/2020	6,00%
01/05/2020 – 30/06/2020	5,75%
01/07/2020 – 31/08/2020	3,75%
01/09/2020 – 31/10/2020	3,25%
01/11/2020 –	3,00%

- interest applicable to a loan denominated in the currency of the Republic, as described in paragraph (a) of the definition of 'official rate of interest' in paragraph 1 of the Seventh Schedule to the Income Tax Act, 1962 – i.e. interest on a loan given as a fringe benefit and interest on a loan given by way of a share (i.e. a deemed dividend). The 'official rate of interest' is the repo rate plus 100 basis points (i.e. 1%).

1/12/2018 – 31/07/2019	7,75%
1/08/2019 – 31/01/2020	7,50%
01/02/2020 – 31/03/2020	7,25%
01/04/2020 – 30/04/2020	6,25%
01/05/2020 – 31/05/2020	5,25%
01/06/2020 – 31/07/2020	4,75%
01/08/2020 – 30/11/2021	4,50%
01/12/2021 -	4.75%

PRIME OVERDRAFT RATES APPENDIX F

PRIME OVERDRAFT RATE OF SOUTH AFRICAN BANKS

Date	*Rate*	*Date*	*Rate*	*Date*	*Rate*
29/03/2018	10,00%	23/11/2018	10,25%	19/07/2019	10,00%
17/01/2020	9,75%	20/03/2020	8,75%	15/04/2020	7,75%
22/05/2020	7,25%	24/07/2020	7,00%	19/11/2021	7.25%