

TAX ALERT

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INTERPRETATION OF THE TERM 'SUBSTANTIALLY THE WHOLE'

The South African Revenue Service (SARS) released Binding General Ruling No. 20 (issue 2) (BGR 20) on 20 January 2016, which provides clarity on the interpretation of the term 'substantially the whole' as referred to in specific sections of the Income Tax Act, No 58 of 1962 (Act).

ESTATE DUTY IMPLICATIONS FOR NON-RESIDENT INDIVIDUAL INVESTORS IN SOUTH AFRICAN ASSETS

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INTERPRETATION OF THE TERM 'SUBSTANTIALLY THE WHOLE'

The term 'substantially the whole' was introduced in the revised tax system for public benefit organisations (PBOs) in 2000, to achieve a more supportive fiscal environment and to give effect to the proposals and recommendations made by the Katz Commission, as set out in the Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa.

To the extent that 'substantially the whole' of such undertaking or activity is directed towards the recovery of costs, the receipts and accruals derived by any of the aforementioned entities from any business undertaking or trading activity will be exempt from normal tax.

The South African Revenue Service (SARS) released Binding General Ruling No. 20 (issue 2) (BGR 20) on 20 January 2016, which provides clarity on the interpretation of the term 'substantially the whole' as referred to in specific sections of the Income Tax Act, No 58 of 1962 (Act).

By way of background, the term 'substantially the whole' was introduced in the revised tax system for public benefit organisations (PBOs) in 2000, to achieve a more supportive fiscal environment and to give effect to the proposals and recommendations made by the Katz Commission, as set out in the Ninth Interim Report of the Commission of Inquiry into Certain Aspects of the Tax Structure of South Africa.

In general, the term 'substantially the whole' allows approved associations, PBOs, recreational clubs and small business funding entities (SBFE) to carry on limited business undertakings or trading activities, provided that the sole or principal object of:

- an approved association, remains the promoting of the common interests of persons (being members of a company, society, or association of persons) carrying on any particular kind of business, profession or occupation approved by the Commissioner for SARS;
- a PBO, remains the carrying on of a public benefit activity as listed in Part I of the Ninth Schedule to the Act;

- a recreational club, remains the provision of social and recreational facilities for its members; and
- a SBFE, remains the provision of funding for small, medium and micro-sized enterprises.

Accordingly, to the extent that 'substantially the whole' of such undertaking or activity is directed towards the recovery of costs, the receipts and accruals derived by any of the aforementioned entities from any business undertaking or trading activity will be exempt from normal tax.

In BGR 20, SARS ruled that the receipts and accruals from business undertakings and trading activities of the aforementioned entities will be exempt from normal tax, if at least 90% or more of the undertaking or activity is directed toward the recovery of costs. SARS has however made provision for leniency where 85% or more of the business undertakings or trading activities of the aforementioned entities, are directed at the recovery of costs.

BGR 20 applies from the date of issue until it is withdrawn, amended or the relevant provisions of the Act are amended.

Nicole Paulsen and Gigi Nyanin



ESTATE DUTY IMPLICATIONS FOR NON-RESIDENT INDIVIDUAL INVESTORS IN SOUTH AFRICAN ASSETS

The Ruling deals with the estate duty implications for non-resident individual investors (Investors), specifically where such an Investor, who is a resident in Country X, purchases a linked investment plan from a company incorporated and resident in Country X, which carries on the business of life insurance (the Company).

The Investor will be the beneficial owner of the underlying investment funds or unit trust funds, which will be held in the name of an independent nominee of the Company on behalf of the Investor. Upon the death of the Investor, the investment policy will fall into the Investor's estate and be dealt with by his/her executor.



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The Company applied for this Ruling. It proposes to offer each Investor a linked investment plan, which offers exposure to South African assets and to assets located in Country X. The Company indicated that South African unit trust funds would be offered as underlying asset options to the Investors. The proposed linked investment will offer Investors the following:

- firstly, it will be a discretionary savings vehicle;
- secondly, it will allow each Investor to have complete liquidity and earn dividends and interest from either or both the Country X and South African assets;
- thirdly, it will be a single premium discretionary (non-compulsory) product held under Linked Investment Service Providers; and
- fourthly, it will be a single contract with the Company to purchase multiple underlying unit trust products in Country X or South Africa, or both.

The Investor will be the beneficial owner of the underlying investment funds or unit trust funds, which will be held in the name of an independent nominee of the Company on behalf of the Investor. Upon

the death of the Investor, the investment policy will fall into the Investor's estate and be dealt with by his/her executor.

The purchase of a linked investment plan triggers the application of the EDA as follows:

- Section 2(1) of the Estate Duty Act states that estate duty is payable in respect of the estate of any deceased person.
- Section 3(1) of the EDA states that a deceased person's estate consists of all the deceased person's property at his/her date of death and of property deemed to be that of the deceased person at date of death.
- The definition of 'property' in s3(2) of the Act, includes any interests in property held by the deceased immediately prior to his/her death.
- As the linked investment plan offered Investors the option of earning dividends and interest from South African assets held through the plan, which could constitute rights in property, the Company seems to have sought clarity on whether such amounts received would in fact be subject to estate duty.

ESTATE DUTY IMPLICATIONS FOR NON-RESIDENT INDIVIDUAL INVESTORS IN SOUTH AFRICAN ASSETS

CONTINUED

The Ruling provides certainty to non-resident companies, who wish to provide their local investors with an opportunity to invest in South African assets regarding the estate duty consequences of such investments.



SARS considered these provisions of the EDA and issued its Ruling in the following terms:

1. Estate duty, in terms of the EDA, will be payable by an Investor's estate, in respect of any underlying South African assets held under the linked investment plan.
2. The South African investments held by an independent nominee of the Company on behalf of the Investor, will constitute property of the Investor's deceased estate.
3. The Investor would still be entitled to claim any rebates in terms of s4A of the EDA in determining the dutiable amount. This means that amounts received by the Investor from South African assets in terms of the linked investment plan, up to an amount of R3.5 million, would be exempt from

estate duty. If the deceased was the spouse of a deceased person, receipts of up to R7 million could be exempt from estate duty tax, depending on how much of the R3.5 million rebate the deceased spouse claimed.

4. The estate duty would be levied at the rate of 20% in terms of the First Schedule of the EDA.

The Ruling provides certainty to non-resident companies, who wish to provide their local investors with an opportunity to invest in South African assets regarding the estate duty consequences of such investments. It makes it clear that any income received by a non-resident investor, by virtue of his investment in South African assets, will be subject to the provisions of the EDA, upon the Investor's death.

Louis Botha and Heinrich Louw

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OUR TEAM

For more information about our Tax practice and services, please contact:



Emil Brincker
National Practice Head
Director
T +27 (0)11 562 1063
E emil.brincker@cdhlegal.com



Mark Linington
Director
T +27 (0)11 562 1667
E mark.linington@cdhlegal.com



Lisa Brunton
Senior Associate
T +27 (0)21 481 6390
E lisa.brunton@cdhlegal.com



Dries Hoek
Director
T +27 (0)11 562 1425
E dries.hoek@cdhlegal.com



Heinrich Louw
Senior Associate
T +27 (0)11 562 1187
E heinrich.louw@cdhlegal.com



Ben Strauss
Director
T +27 (0)21 405 6063
E ben.strauss@cdhlegal.com



Mareli Treurnicht
Senior Associate
T +27 (0)11 562 1103
E mareli.treurnicht@cdhlegal.com



Ruaan van Eeden
Director
T +27 (0)11 562 1086
E ruaan.vaneeden@cdhlegal.com



Tessmerica Moodley
Senior Associate
T +27 (0)21 481 6397
E tessmerica.moodley@cdhlegal.com



Yashika Govind
Associate
T +27 (0)11 562 1289
E yashika.govind@cdhlegal.com



Gigi Nyanin
Associate
T +27 (0)11 562 1120
E gigi.nyanin@cdhlegal.com



Nicole Paulsen
Associate
T +27 (0)11 562 1386
E nicole.paulsen@cdhlegal.com



Louis Botha
Candidate Attorney
T +27 (0)11 562 1408
E louis.botha@cdhlegal.com

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JOHANNESBURG

1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN

11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

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