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TAX & EXCHANGE CONTROL ALERT

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Tax incentive provisions for special economic zones: SARS issues draft binding general ruling

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Tax incentive provisions for special economic zones: SARS issues draft binding general ruling

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In South Africa's 2021 Budget, it was announced that the sunset clauses for a number of tax incentive provisions in the Income Tax Act 58 of 1962 (Act) would not be extended.

However, one of the incentive provisions which has had its sunset clause extended is section 12R, and the concomitant section 12S, which deals with the tax incentives available for so-called "qualifying companies" that operate in special economic zones (SEZs). Pursuant to the Taxation Laws Amendment Act 23 of 2020 coming into effect in January this year, this incentive provision for SEZs will now apply until 31 December 2030. On 3 June 2021, the South African Revenue Service (SARS) issued a draft binding general ruling (Draft BGR) to provide guidance on the interpretation and application of the excluded activities, referred to in section 12R(4)(b) of the Act, that are conducted by a qualifying company located within an SEZ.

What is a "qualifying company"?

The tax incentive provisions in sections 12R and 12S of the Act do not automatically apply to any company that conducts activities within an SEZ. In order for a company to enjoy the benefits of the incentive provisions, it must be a "qualifying company" as defined in section 12R(1) of the Act, in the year of assessment in which it seeks to claim the benefits available under these provisions.

In order to be a "qualifying company" under section 12R, the following requirements must be met:

- the company must be incorporated in South Africa or have its place of effective management in South Africa;
- it must carry on trade in an SEZ designated by the Minister of Trade and Industry in terms of the Special Economic Zones Act 16 of 2014, and approved by the Minister of Finance after consultation with the Minister of Trade and Industry for purposes of this section by notice in the Government Gazette;
- this trade must be carried on from a fixed place of business situated within an SEZ;
- not less than 90% of the company's income must be derived from carrying on this trade within one or more SEZ; and
- depending on whether the company was carrying on its trade in an SEZ approved for purposes of section 12R before or after 1 January 2013, certain additional requirements may also have to be met.

Disqualifying activities and the Draft BGR

Section 12R(4) of the Act states that even if a qualifying company is located in an SEZ, it is not a qualifying company if it conducts certain activities. For example, section 12R(4)(b) states that if a company conducts any activity classified in the SIC Code, which the Minister of Finance may designate by notice in the Government Gazette, it is not a qualifying company.

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Persons who wish to comment on the Draft BGR have until 3 September 2021 to do so.

The Draft BGR explains that considering the wording of sections 12R(4)(a) and 12R(4)(b) and the strict interpretation of the provisions that must be adopted according to case law, a qualifying company could be disqualified from the incentive even if the disqualifying activity is only ancillary to its main trade. The Draft BGR explains that such an interpretation would create an absurdity as some of the activities listed in the Government Gazette are required to be undertaken as part of most business processes. It further states that as the purpose of the SEZ regime is to promote investment in certain under-capitalised manufacturing and industrial sectors, and thereby to create jobs, a business-like interpretation must be adopted.

The Draft BGR therefore states that in SARS' view, if an activity listed in the Government Gazette is ancillary to the manufacturing or industrial process undertaken by the qualifying company, the qualifying company would not be disqualified from the income tax incentive under section 12R(4)(b). The specific

ruling proposed by the Draft BGR is that *"where an activity is an integral part of the manufactured product to protect or transport the final product, it is accepted that it [a qualifying company] is not disqualified, provided the secondary product is not sold separately."*

As an example, if a qualifying company manufacturing appliances in a designated SEZ packages the final manufactured product for safe and secure transport, the activity of packaging would not disqualify it under section 12R. Even though the activity of packaging is listed as an excluded activity in Government Gazette 39930, the packaging is a necessary activity in support of the manufacturing trade of the company and is not conducted as a separate income-earning activity.

Comment

The practical approach proposed in the Draft BGR should be welcomed. Persons who wish to comment on the Draft BGR have until 3 September 2021 to do so.

Louis Botha

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