5 OCTOBER 2018

TAX & EXCHANGE CONTROL ALERT

IN THIS **ISSUE**

NO CAPITAL GAINS TAX? RULING ON THE DISPOSAL OF PROPERTY BY A PBO

On 31 August 2018, SARS published Binding Private Ruling 309 (BPR 309), which deals with the disposal of an asset by a public benefit organisation (PBO). Specifically, the ruling dealt with the application of the definition of "gross income" in s1 of the Income Tax Act, No 58 of 1962 (Act) and the capital gains tax exemption in paragraph 63A of the Eighth Schedule to the Act.

INTEREST-FREE LOANS TO TRUSTS: PROPOSED AMENDMENTS, PUBLIC COMMENTS AND NATIONAL TREASURY'S RESPONSE

In the 2018 draft Taxation Laws Amendment Bill, 2018 (Draft TLAB), published on 16 July 2018, it was proposed that s7C of the Income Tax Act, No 58 of 1962 (Act) should be further amended, to broaden the scope of the provision. The proposed amendment relates specifically to s7C(1)(ii)(bb).

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"Gross income" in s1(1) of the Act, in relation to any year or period of assessment, means, the total amount, in cash or otherwise, received by or accrued to or in favour of a South African resident, excluding receipts or accruals of a capital nature.

Legal context

"Gross income" in s1(1) of the Act, in relation to any year or period of assessment, means, the total amount, in cash or otherwise, received by or accrued to or in favour of a South African resident, excluding receipts or accruals of a capital nature.

Paragraph 63A of the Eighth Schedule to the Act states that a PBO, approved by SARS in terms of s30(3) of the Act, must disregard any capital gain or capital loss realised in respect of the disposal of an asset if:

- that PBO did not use that asset on or after valuation date (1 October 2001) in carrying on any business undertaking or trading activity; or
- substantially the whole of the use of that asset by that PBO on and after valuation date was directed at a purpose other than carrying on a business undertaking or trading activity, or carrying on a business undertaking or trading activity contemplated in s10(1)(cQ)(ii)(aa), (bb) or (cc) of the Act.

In Binding General Ruling 20 (Issue 2) (BGR 20), SARS stated that in the strict sense the term "substantially the whole" is regarded by SARS to mean 90% or more. However, BGR 20 states that SARS would accept a percentage of not less than 85%. BGR 20 further states that the percentage must be determined using a method appropriate to the circumstances.

Facts of BPR 309

The applicant owns three properties that are adjacent to each other. The properties each consists predominantly of vacant land with a few buildings grouped together on sections of the land. The properties have to date been utilised to house the applicant's organisation and to enable it to fulfil its various objectives as a PBO and in particular, to enable members of the public to conduct spiritual retreats. The properties were acquired with the proceeds of donations received.

The income of the applicant has decreased, and it expects that this trend would continue in the future. It further expects that it would become increasingly difficult for it to sustain and maintain its properties, and to earn sufficient income to continue to fulfil its core function of carrying on public benefit activities. In response, the applicant had taken a decision to utilise the properties to generate additional income by using them for business. However, that income was insufficient, and the applicant has decided to sell the properties.

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The applicant must disregard any capital gain or capital loss determined in respect of the disposal of the property in terms of paragraph 63A(b)(i).

The aggregate footprint of the buildings on the properties constitutes 4.9% of the aggregate extent of the properties. As the properties will be consolidated on disposal, the usage area calculations were applied to the whole area of the properties and it was determined that only 8% of the consolidated property was used for business. The applicant has therefore not violated the allowable 15% requirement in respect of business usage and accordingly substantially the whole of the use of the asset was directed at a purpose other than a business undertaking or trading activity.

The applicant proposes to sell the three properties to an unconnected and independent third-party developer. The title of the properties will be consolidated as one in the deeds registry and it will be sold as a single property.

Ruling

Regarding the proposed transaction, SARS ruled as follows:

- the proceeds on the disposal of the property will not form part of the applicant's "gross income" as defined in s1(1); and
- the applicant must disregard any capital gain or capital loss determined in respect of the disposal of the property in terms of paragraph 63A(b)(i) of the Eighth Schedule to the Act.

Louis Botha

Who's Who Legal

Emil Brincker has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory and Who's Who Legal: Corporate Tax – Controversy for 2017.

Mark Linington has been named a leading lawyer by Who's Who Legal: Corporate Tax – Advisory for 2017.

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The Draft TLAB also proposes that this amendment will apply retrospectively from 19 July 2017.

National Treasury published a response document dated 12 September 2018, containing its responses to the public input received on the Draft TLAB and the draft Tax Administration Laws Amendment Bill, 2018.

In the 2018 draft Taxation Laws Amendment Bill, 2018 (Draft TLAB), published on 16 July 2018, it was proposed that s7C of the Income Tax Act, No 58 of 1962 (Act) should be further amended, to broaden the scope of the provision. The proposed amendment relates specifically to s7C(1)(ii)(bb).

Section 7C

Currently, the provision in question states that s7C applies in respect of any loan, advance or credit made by a natural person, or a company in relation to which that natural person is a connected person, as defined in paragraph (d)(iv) of the definition of "connected person" in s1 of the Act, to:

- a company, if at least 20% of the equity shares in that company are held, directly or indirectly, by *the* trust referred to in s7C(1)(i) of the Act, or *by a beneficiary of that trust*; or
- a company, if at least 20% of the voting rights in that company can be exercised, by *the* trust referred to in s7C(1)(i) of the Act, or *by a beneficiary of that trust*.

The proposed amendment will change the above italicised words so that the provision will apply where 20% of the equity shares are held by a trust *alone or jointly with any person that is a connected person in relation to that trust*, or where 20% of the voting rights in that company can be exercised *alone or jointly with any person that is a connected person in relation to that trust*.

The Draft TLAB also proposes that this amendment will apply retrospectively from 19 July 2017.

Public input received and response from National Treasury

National Treasury (NT) published a response document dated 12 September 2018 (Response Document), containing its responses to the public input received on the Draft TLAB and the draft Tax Administration Laws Amendment Bill, 2018. Regarding s7C, it also received public input. The Response Document sets out the input received and NT's response thereto.

The first comment referred to in the Response Document states that the proposed 2018 amendments seek to clarify the scope of application of the anti-avoidance measure in respect of companies held by trusts, but that the formulation of the proposed 2018 amendments result in the rules applying even though the trust does not hold any shares at all. The proposed wording does not achieve the intended outcome that the trust should at least hold a share in the company as it can mean that if the connected person of the trust (ie the beneficiaries of the trust and their relatives) collectively hold at least 20 per cent of the shares of the company,

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National Treasury stated in the Response Document that clarifications around the use of the official rate of interest as a benchmark across the various provisions of the Act will be made.

the anti-avoidance measure applies. Changes should be made to ensure that the rules apply where the trust itself at least holds a share in the company. In response to this comment from the public, NT stated that in its view, the comment was misplaced as the proposed wording of the Draft TLAB already had this intended effect.

The second comment was that the term "connected person" in relation to a trust includes persons who are "connected persons", for example relatives, in relation to the beneficiaries. The proposed wording in the Draft TLAB therefore broadens the proposal considerably and should be restricted to beneficiaries of the trust.

NT responded that it partially accepts this comment and explained that the introduction of the anti-avoidance measure was a result of family members structuring their affairs using trusts and companies that involved various family members in order to transfer assets or returns from those assets among themselves. Avoidance is then facilitated through beneficiaries holding shares in companies in which the family trust holds shares. In some instances a close relative of the beneficiary (ie father, uncle or son) that is not a beneficiary may hold shares in the company. However, NT noted that the current definition of "connected person" in relation to trusts includes relatives or beneficiaries and that the term "relative" is defined for purposes of the Act. Whilst the scenarios envisaged under the anti-avoidance measure includes relatives that are not beneficiaries of a trust, NT acknowledges that the current definition of a relative that includes all relations within the third degree of consanguinity may be too wide. A definition of a relative will be considered for purposes of these rules to limit it to relatives within the second degree of consanguinity.

The last comment related to the anti-avoidance measure triggering a deemed donation on the difference between interest actually charged (if any) and the interest that would have been charged had interest-free or low interest loans been subject to interest at the "official rate of interest". The comment noted that some technical questions remain unanswered around this determination of a deemed donation. It is therefore proposed that a calculation method be prescribed in the legislation for deemed interest. The comment noted that s64E(4)(d) of the Act has a similar problem and that it may be appropriate to rather amend s7D of the Act, which applies to the calculation of all deemed interest so that it covers both the *in duplum* rule and the calculation method. The comment concluded by noting that current SARS practice for s64E of the Act seems to be applying daily simple interest on the daily balance outstanding and it proposes that this method be used.

NT accepted this comment and stated in the Response Document that clarifications around the use of the "official rate of interest" as a benchmark across the various provisions of the Act will be made. Similar to the practice around s64E determinations, daily simple interest will be used.

We now await the release of the revised Draft TLAB, which will be amended to incorporate the feedback given by NT.

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OUR TEAM

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR
Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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