Taxation and Farming webinar

Hosted by Absa Relationship Banking
and Non-banking Financial Services (NBFS)

TAXATION AND FARMING

CONTENTS

FRAMEWORK FOR THE CALCULATION OF THE TAXABLE INCOME OF A FARMER 2
FIRST SCHEDULE INTRODUCTION 4
MEANING OF 'FARMING OPERATIONS' 6
LIVESTOCK AND PRODUCE (PARA 2-11) 8
LIVESTOCK AND PRODUCE - ACQUIRED BY DONATION OR INHERITANCE 17
DISPOSAL AS A GOING CONCERN 20
FARMING EXPENDITURE AND ALLOWANCES 21
AVERAGE RATING FORMULA (PARA 19) 31
GAME FARMERS 44
CAPITAL ALLOWANCES 45
VAT 50
TAX PERIODS 50
DIESEL REFUND SCHEME 50
ZERO-RATED SUPPLIES 53
SECTION 9HA DISPOSAL TO AND FROM DECEASED ESTATE 59
DEATH OF A FARMER 60
TAXATION OF DECEASED ESTATES 61
DEATH OF GAME FARMER (NEW IN 69 ISSUE 2) 63
PRIMARY RESIDENCE 67
INTRODUCING MEASURES TO PREVENT ESTATE DUTY AND DONATIONS TAX AVOIDANCE THROUGH THE USE OF INTEREST FREE OR LOW INTEREST LOANS TO A TRUST 69
RING-FENCING OF ASSESSED LOSSES OF CERTAIN TRADES (SECTION 20A) 75

Disclaimer

The information in these notes is for general information purposes only and is not a substitute for professional advice, legislation or textbooks on the relevant subject matter. Neither Mazars, Upskill nor the presenter accept any responsibility for any actions taken or not taken on the basis of the information in these notes.

NB: The information contained in the notes is specifically drafted, worded and used to illustrate only the key concepts presented, and as such is not to be regarded as a technical reference source by attendees.

Income

Sales:	Produce …………………	Rxxx
	Livestock …………………	xxx
Forced sales:	Drought -	xxx
	☐ Tax in year of sale – par 13	
	☐ Tax in Year 6 or on withdrawal – par 13A	
Private consumption at cost (if not available, then market value) ………		xxx
Donations at market value …………………		xxx
Employees' rations at market value …………………		xxx
Subsidies …………………		xxx
Recoupments:	s 8(4) recoupments, para 12(1B) after reduction Claimed under ss 11(e) and 12B (50/30/20) ……….	xxx
Total farming income for par 8 purposes…………………		Rxxx
Closing stock:	Produce at market value (excluding standing crops and wool on sheep) …………………	xxx
	Livestock at standard values …………………	xxx
	Note: No consumables and spares!	
Total farming income after closing stock…………………		Rxxx
Less: Total farming expenses…………………		(xxx)

Expenses

Opening stock:	Produce at market value (excluding standing crops and wool on sheep) …………………	(xxx)
	Livestock at standard values …………………	(xxx)
	Inheritance/Donation at market value …………..	(xxx)
Purchases:	Livestock (par 8): Tests 1 and 2 ………………...	(xxx)

☐ **Test 1**:

Total farming income – …	Rxxx
Plus: Closing stock at standard value..	xxx
Less: Opening stock at value per par 4	(xx)
Deduction limited to ……………………	Rxxx

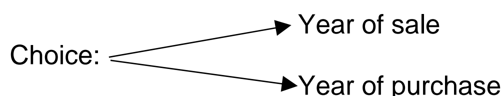
Carry excess over to Test 2

☐ **Test 2:**

Excess after Test 1………………………	Rxxx
Plus: Opening stock at value per par 4..	xx
Less: Closing stock at market value……	(xx)
Further deduction………………………	Rxxx

Carry excess over to next year

(Purchases: Drought (Forced sale) – Include at par 8 test above)



General farming expenses ………………………………………… (Rxxx)

- ☐ Feed purchased
- ☐ Seeds and fertilizer
- ☐ Veterinary expenses
- ☐ Wages
- ☐ Employer's contributions to retirement funds and medical funds
- ☐ Salaries
- ☐ Employees' rations at market value

Capital allowances :

Section 11e:	Wear-and-tear allowance…………………………	(xxx)
	Binding ruling 7: Rates	
	Vehicles used to transport people	
	Office equipment	
Section 12B:	50/30/20 capital allowance………………………	(xxx)

	Machinery, implements, articles used by the farmer in the carrying on of farming operations		
Net farming income…………………………………………………………………..			xxx
***Plus:* Capital gain on farming assets**	**…………………………………….**		xxx
***Less:* Capital development expenses**			
Par 12(1)(a) and (b):	Soil erosion……………………………………………..		(xx)
	Noxious plants…………………………………………		(xx)
	(Can create a loss)		
Taxable income from farming (para 12 (3))			**xxx**
Par 12(1)(c) to (i):	Development expenditure:		
	Balance forward (previous year disallowed)………	xx	
	Less: Par 12– Recoupments in current year………..	(xx)	
	Deduct: net balance carried forward/ add net recoupment ……………………………….		(xx)
	Less: Current year expenditure		
	Fences…………………………………………	xx	
	Irrigation scheme……………………………..	xx	
	Roads………………………………………….	xx	
	Dipping tanks………………………………….	xx	
	Trees…………………………………………...	xx	
	Electric power………………………………….	xx	
		xx	
Limited to taxable income before deduction para 12(1)(c)-(i)	……………	(xx)	(xx)
Taxable farming income………………………………………………………………......			Rxxx

First Schedule

The taxable income of any person carrying on pastoral, agricultural or other farming operations must, *in so far as it is derived from such operations*, be determined in accordance with the ordinary provisions of the Act, but subject to the special provisions set out in the First Schedule to the Act. In other words, the taxable income of farmers must be determined in the same way as for other taxpayers, except where the special provisions in the First Schedule apply.

Although ascertained separately, the taxable income derived from farming operations is included with any income from all other sources, whether in the case of an individual, a company or any other taxable entity. Where the First Schedule to the Act provides for any expenditure to be deducted or any allowance to be claimed, subject to the provisions of that Schedule, such expenditure or allowances may create a current loss for set off against current year income from another trade, or an assessed loss. The authority for this is to be found in s 20 of the Act, read with s 11(*x*) and s 26 of the Act, and the First Schedule thereto.

The special provisions of the First Schedule may be summarised as follows:

Act reference	***Provision***
First Schedule:	
Para 3	Treatment of livestock and produce
Para 4	Valuation of livestock and produce at beginning of year of assessment
Para 4(*a*)(ii)	Livestock and produce acquired by the farmer by donation or inheritance
Para 5	Valuation of livestock at end of year of assessment
Paras 6 and 7	Standard values in respect of livestock
Para 8	Deduction in respect of cost of livestock
Para 9	Valuation of produce at end of year of assessment
Para 11	Donations of livestock and produce
Para 12	Deduction of capital expenditure in respect of development and improvements
Paras 13 and 13A	Sale of livestock due to drought and stock disease
Paras 14 to 16	Plantation farmers and rating formula
Para 17	Relief available in the event of damage to sugarcane caused by fire
Para 19	Relief provided by 'averaging' provision
Para 20	Expropriation of farming land by State or other bodies
Income Tax Act:	
S 12B	Depreciation allowance in respect of new machinery, implements, utensils or articles brought into use on or after 1 July 1988
S 17A	Soil erosion expenditure incurred by lessor of farming land

Generally speaking, where a company conducts farming operations, the taxable income derived from such operations is arrived at in the same manner as for an individual. However, there are certain provisions which apply only in the case of companies and others which apply only to individuals and not to companies. For example, the concessions in the First Schedule, provided by paras 15(3) (rating concession on income from disposal of plantations or forest produce), 17 (relief on

disposal of sugar cane damaged by fire), 19 (averaging provisions in respect of income from farming), and 20 (sale of land to the State and other bodies) do not apply to companies.

Except where otherwise indicated, any references to paragraphs are references to paragraphs of the First Schedule of the Act.

MEANING OF 'FARMING OPERATIONS'

Before the First Schedule can apply the taxpayer must derive taxable income from 'pastoral, agricultural or other farming operations' (section 26(1)).

Farming operations involve the performance of a range of physical activities associated with the land with a view to profit and farming operations as contemplated in s 26(1) are a particular form of 'trade' within the broad definition of that term in s 1. Although s 26(1) does not specifically mention losses, it is clear that the intention is that the Schedule should apply even when the taxpayer derives a loss instead of a taxable income from farming operations.

The general rule is that s 26(1) and the First Schedule will not apply unless the taxpayer is carrying on farming operations. Despite this general rule, s 26(2) provides for the continued operation of certain paragraphs of the Schedule even when the taxpayer discontinues his farming operations in certain circumstances.

There is no definition of the words 'farming operations' in the Act. The question whether a person is carrying on farming operations is one of fact.

There is no requirement in the Act that a person occupies lands of a certain size or extent or earns a certain amount of income before he may be regarded as carrying on farming operations. Several cases lend support to the concept emerging from an early case that, as long as there is a genuine intention to develop land as a farming proposition in the hope that an ultimate profit will be derived, farming operations are being carried on.

A person who lets a farm and in return receives a cash rental is clearly not carrying on a farming operation. The rental he receives is not derived from farming operations but from the ownership of the land. It may be suggested that when the consideration for the letting of a farm consists of a percentage of the produce (a partiarian lease or agreement) and not a cash payment, the lessor must be regarded as carrying on farming operations.

The true legal nature of such a partiarian lease has, however, given rise to conflicting decisions. For many years SARS has relied upon this decision in ITC 166 for the view that if a rental takes the form of a percentage of the crops or livestock, the lessor must be deemed to be carrying on farming operations in partnership with the lessee and is assessable as a farmer.

In practice grazing fees are regarded as having been derived from farming operations.

A farmer engaged in the breeding of thoroughbred horses who also races the horses he breeds for stakes carries on two businesses, one the industry of breeding horses, which is a farming operation, and the other the business of horse-racing, which is not a farming operation .

There must be a direct connection between the farming operations and the income derived. Thus if a farmer invests surplus funds, even funds derived from farming operations, the interest received on the investment would not normally be regarded as income derived from farming operations.

The wording "farming operations" includes only activities connected with what the farmer derives from his land. The farmer need not be the owner of the land, but must enjoy a right to it and the yield of the land (eg a usufructuary).

SUBSIDIES

Inclusion in income

Special inclusion (I)

An amount received by or accrued to a farmer by way of a grant or subsidy in respect of:

- the 'soil-erosion works' referred to in s 17A(1) or
- any of the matters referred to in para 12(1)(*a*) to (*i*) of the First Schedule (expenditure on farming development and improvements)

will be included in the farmer's gross income by virtue of para (*l*) of the definition of the term 'gross income' in s 1.
For example, a subsidy received by a farmer on the cost of the construction of dams would be included in his gross income.

Special inclusion (IC)

Government Grant or subsidy (in cash or kind) as defined in section 12P

Section 12P

- Draft IN 59 (issue 2)
- Exempt government grants are granted by bodies listed in the 11th Schedule
- No double dipping: expenses incurred when utilizing the exempt government grant monies are not deductible for tax purposes

Should a government grant or subsidy not fall within the ambit of section 12P, the amount will not be exempt for tax purposes. The grant or subsidy is taxed in the year of its receipt or accrual. Expenses incurred will be deducted in terms of the relevant allowances once the requirements for the specific deduction have been met.

When a government grant takes the form of an asset, there is no “cost” on which to claim an allowance. Taxpayers must consider claiming the value (market value) in terms of section 11(e), the wear and tear provision.

LIVESTOCK AND PRODUCE (PARA 2-11)

LIVESTOCK STANDARD VALUES FIXED BY REGULATION

The regulation standard values are intended to apply both to pedigree and to other stock of any breed, but farmers are entitled to adopt separate values for pedigree and other stock, subject to the Commissioner's approval in terms of para 6(3).

The following is an extract from part D of the Regulations under the Act:

> 'For the purpose of paragraph 6 of the First Schedule to the Act, the standard value applicable to any class of livestock shall in the case of every farmer who is required to account for such value be as set out hereunder:

Classification	*Standard Values* *R*
Cattle -	
Bulls	50
Oxen	40
Cows	40
Tollies and Heifers -	
Two to three years	30
One to two years	14
Calves	4
Sheep -	
Wethers	6
Rams	6
Ewes	6
Weaned lambs	2
Goats -	
Fully grown	4
Weaned kids	2
Horses -	
Stallions, over 4 years	40
Mares, over 4 years	30
Geldings, over 3 years	30
Colts and fillies, 3 years	10
Colts and fillies, 2 years	8
Colts and fillies, 1 year	6
Foals, under 1 year	2
Donkeys -	
Jacks, over 3 years	4
Jacks, under 3 years	2
Jennies, over 3 years	4
Jennies, under 3 years	2
Mules -	
Four years and over	30
Three years	20
Two years	14
One year	6
Ostriches, fully grown	6
Pigs -	
Over 6 months	12
Under 6 months (weaned)	6
Poultry, over 9 months	1
Chinchillas, all ages	1'

Livestock and produce-General

The value of all livestock and produce held and not disposed of at the beginning and end of each year of assessment must be included in the farmer's tax return (para 2)

All livestock and produce used by the farmer in his farming operations are regarded as non-capital in nature, irrespective of the purpose for which they were acquired. This will be the case even where livestock is acquired as a capital asset (eg cows for a dairy farmer), where the cows are not held for resale. The purchase of livestock if therefore deductible in terms of s11(a) (general deduction formula), subject to relevant ring-fencing provisions. Any proceeds on disposal of livestock would be included in gross income.

Private use

Livestock that is held by the farmer purely for private or domestic use do not form part of farming operations and will not be included in opening or closing stock

Livestock and produce - natural increases and losses

Natural increases in livestock during a year of assessment are automatically brought to account by being included in income if sold during the year of assessment, or, if not sold, by being included in the stock on hand at the end of the year.

Losses of livestock owing to the death or theft of animals during a year of assessment are automatically allowed as a deduction from income, since the stock on hand at the end of the year will not include the lost livestock.

PRODUCE - meaning of 'produce'

It is only the value of 'livestock and produce' on hand at the beginning and end of each year of assessment that must be brought into account in terms of the First Schedule for the purpose of the computation of a farmer's taxable income (para 3(1)).

Consumable stores

The First Schedule makes no provision for the inclusion in taxable income of the value of consumable stocks and stores on hand at the end of the year of assessment, for example, stocks of fuel, spare parts for equipment and machinery, spraying materials, fertilizers, packing materials and other stores that cannot be regarded as produce. Section 22 , which provides for the inclusion in taxable income of the trading stock of ordinary traders, does not apply to farmers.

The word 'produce' is not defined in the Act. Crops that have not reached the stage of being converted into produce having a saleable or marketable value (growing crops) cannot be regarded as 'produce held' for the purposes of the First Schedule. Only produce that has been gathered and is marketable need be included in the return. Therefore growing crops and wool on the sheep's back need not be returned.

The reference to *all* produce held and not disposed of in para 2 and the reference to produce acquired otherwise than by purchase or in the ordinary course of farming operations in para 4(1)(*a*)(ii) and (*b*)(ii) ensure that the Schedule is concerned not only with a farmer's own produce but also with produce acquired from others for farming purposes. It must follow that all produce bought by the farmer, for instance, for use as feed for his livestock, must be included in his return, and its value must be included in his income.

In practice a farmer is required to bring to account all produce on hand at the end of the year, whether it is grown or produced by him or acquired from other farmers for the purpose, for example, of feeding his livestock or of supplementing his own stocks of produce available for sale.

Livestock and produce - 'held and not disposed of'

The precise meaning to be given to the words 'held and not disposed of' in paras 3(1) and 4(1) of the First Schedule is not entirely clear although the decision of the Supreme Court of Appeal in *Avenant v C: SARS*[1] assists in the interpretation of this expression. It was implicitly accepted in this decision that, in principle, the identity of a natural product may be transformed by some form of treatment such that it ceases to exist as 'produce' (but it was held that, in this particular matter, the pressing of grapes into pulp and the natural fermentation process that ensued did not make the result different from the produce of the harvest) and that 'produce' does not need to be in saleable form and can include work in progress. Thus, in this particular matter, 'wine in process' was held to be the 'produce' of a wine farmer.

As a general principle, it is submitted that livestock or produce is 'held and not disposed of' if the taxpayer has dominium in it, that is, if he is the owner - even if only the joint owner in undivided shares - of the livestock or produce. It is considered that, in the context in which they are used in the First Schedule, the words 'disposed of' imply a parting of ownership. For example, if animals are sold under a contract requiring their delivery for its completion, they are not 'disposed of' until they are delivered to the buyer in terms of the contract. Until delivery is made the animals are still in the ownership of the seller. It is submitted that, if just before the end of the year of assessment the farmer has on this basis sold livestock that is to be delivered in the next year, it is 'held and not disposed of' at the end of the first year. Unless this view was correct, not only would the livestock be excluded from the closing stock but neither would the selling price be taxable in the first year, since there can be no accrual until delivery has been made.

On this reasoning, it must follow that in an ordinary lease of animals the animals must be regarded as being 'held and not disposed of' by the lessor and not the lessee.

Paragraph 3(3) provides that livestock that is the subject of a 'sheep lease' or similar agreement concerning livestock and produce that is the subject of a similar agreement will be deemed to be held and not disposed of by the grantor ('lessor') of the lease or agreement.

A distinction must be drawn between an ordinary lease of livestock and a 'sheep lease'. With an ordinary lease ownership of the livestock vests in the lessor, and the livestock cannot be regarded as being 'held and not disposed of' by the lessee. With a 'sheep lease' the livestock does not vest in the 'lessor', since upon delivery the 'lessee' acquires ownership, his obligation being to restore to the 'lessor' upon the expiry of the stipulated period the same quantity and quality of the animals 'hired' by him. Paragraph 3(3) departs from this position by deeming the livestock under a 'sheep lease' to be held and not disposed of by the 'lessor'. But, in any event, it is unlikely that the transfer of livestock by way of a 'sheep lease' amounts to a disposal of that livestock for purposes of the Act.

A usufructuary of animals is entitled only to the progeny over and above the full complement of the herd or flock. The full number of the animals must be maintained, the young replacing the old as they die, but the herd or flock as an entity must be returned, since the ownership in it is vested in the remainderman or bare dominium holder. The usufructuary is not obliged to make good any animals that die if the animals do not produce young ones. It must follow, therefore, that a usufructuary of livestock need not include in his returns of income the animals that are the subject of the usufruct, since they do not vest in him and their values at the beginning and end of the year therefore do not form part of his income. He must, however, include the progeny over and above the number that is required to maintain the full complement of the herd or flock. Other animals bought by the usufructuary for use on his farm must be returned together with the surplus progeny.

SARS appears to view the matter differently, and holds that livestock in which a farmer enjoys a usufruct must be regarded

---

[1] (2016) 78 SATC 343 (SCA)

as being 'held and not disposed of' by him, and its value must be included in his income.

It is considered that this practice is not correct at law. SARS, on the other hand, regards its practice as being confirmed by *SBI v Aveling*.[2]

But, whatever the correct view might be, it is important to distinguish a usufructuary interest from a mere right to the net income derived from a herd, for example, by the estate of a deceased testator. Such a herd is surely held and not disposed of by the estate.

LIVESTOCK- STANDARD VALUES

Paragraph 5(1) of the First Schedule effectively provides that the value to be placed upon livestock held and not disposed of at the end of any year of assessment is the standard value applicable to that livestock. Legislation requires that this value be used even though the standard value is lower than the market values of the livestock. If no standard value is provided for a specific species then the deemed closing value of the livestock is NIL.

Standard values must be used by all farmers, including companies and the estates of deceased persons.

In terms of para 6 the standard value of any class of livestock of a farmer other than a company and other than the estate of a deceased person is

- whatever standard value is fixed for that class of livestock by regulation under the Act or
- whatever other standard value the farmer adopts when rendering his first return of income for his farming operations or when including a particular class of livestock in his income for the first time (para 6(1)(*b*)).

The same standard values apply to any class of livestock included for the first time in the return of a farmer other than a company and other than the estate of a deceased person.

Paragraph 6(1)(*c*) provides for the identical determination of standard values when the farmer is a company or the estate of a deceased person in the first year of assessment of the company or estate ending on or after 1 January 1977 in which a particular class of livestock is included. The standard value of any class of livestock is

- whatever standard value is fixed for that class of livestock by regulation under the Act or
- whatever other standard value the company or the executor of the estate adopts when rendering a return of income for that year of assessment.

Farmers are therefore given the option of valuing livestock either at the standard values fixed by regulation or at their own valuations. The standard value adopted by a farmer that is not fixed by regulation may not be more that 20% higher or lower than the standard value fixed by regulation for livestock of a relevant class.

As long as a farmer carries on farming operations, once the famer adopts a value for a particular class of livestock, the farmer is prohibited from altering that value at a later stage.

Para 6(1)(*b*), (*c*) and (*d*) permit him to adopt his own standard values only in his *first* 'farming' return or in the return in which a class of livestock is included for the *first* time, as such the farmer is effectively prevented from going over from standard values fixed by regulation, once he has chosen these values, to his own standard values.

---

[2] 1978 (1) SA 862 (A), 40 SATC 1

Valuation of breeding stock

Breeding livestock held and not disposed of by a farmer at the end of the year of assessment must, like other livestock, be valued at standard values (para 5(1) of the First Schedule).

PRODUCE - valuation of produce

The value to be placed upon produce included in any return must be a 'fair and reasonable value' (para 9 of the First Schedule).

In practice SARS requires that produce be valued at the lower of its average cost of production or market value. The average cost of production must be determined with reference to the farmer's actual costs, excluding the cost of purchases of livestock and expenditure on developments and improvements. The Special Court for Hearing Income Tax Appeals has held that para 9 does not oblige the Commissioner to determine the value of produce on the basis of its market value He may take the cost or market value, whichever he chooses, but, as already noted, the general practice is to take the cost or market value, whichever is the lower. This basis would also apply to produce purchased from outside sources.

LIVESTOCK RING-FENCING

The purpose of para 8 of the First Schedule is to 'ring-fence' a farmer's deduction of the cost of his purchases of livestock, that is, to limit his deduction to his farming income. This prevents the farmer from creating a large farming loss with the purchase of livestock. This is due to the fact that that the closing stock value of livestock is calculated using the standard values, while the deduction for the purchase is at the much higher acquisition cost.

Part one (para 8(1))

The deduction in terms of 11(a) is limited to an amount that, together with the livestock held and not disposed of by him at the beginning of the year concerned, does not exceed the income received by or accrued to him from farming during that year and the value of livestock held and not disposed of by him at the end of that year. (Paragraph 8(1).)

In other words, the maximum deduction on account of the purchase of livestock in any particular year of assessment may be expressed as follows:

Maximum deduction = Farming income + SV of closing stock of livestock - SV of opening stock of livestock,
in which 'SV' represents the value of livestock held and not disposed of established under para 5, that is, its standard value.

This limitation imposed upon the deduction of the cost of livestock purchases is based essentially upon a farmer's *income* derived from farming. If, as it presumably is, the term 'income' is used in its sense as defined in s 1, it would, it is submitted, represent the farmer's 'gross income' from farming (which would exclude receipts and accruals of a capital nature or from a foreign source) less any exempt income associated with farming, and before any expenses, whether allowable or not.

An amount that has been disallowed because it exceeds the limit imposed under this livestock ring-fence is carried forward and deemed to be expenditure incurred by the farmer on the acquisition of livestock during the succeeding year of assessment (para 8(2)). A formula to represent this situation would take the following form:

Expenditure to be carried forward = (Disallowed expenditure brought forward from previous year + Current expenditure) - Maximum deduction (see above)

Part two (para 8(2))

This para allows a further deduction if the market value of the closing stock exceeds the sum of the disallowed portion (part 1) and the opening stock at standard value. This further deduction under part 2 is available only when there was a reduction in the market value of closing stock

Exemption from limitation provision

The limitation will not apply to the cost of livestock that is no longer "held and not disposed of" by the farmer at the end of the year of assessment. A farmer who has disposed of or lost his entire herd will therefore not be affected by this limitation.

LIVESTOCK AND PRODUCE - INSOLVENCY OR LIQUIDATION

If a farmer's estate is sequestrated, it is necessary to determine his taxable income derived from farming operations for the period from the beginning of the year of assessment to the date of the sequestration of his estate. Livestock held and not disposed of by the farmer at the end of the period of assessment terminating at the date of the sequestration of his estate under the law relating to insolvency must be valued at his elected standard values. In terms of para 9 produce on hand at that date must be valued at whatever fair and reasonable value is fixed by the Commissioner. In practice this value is taken as the cost of production or the market value of the produce, whichever is lower.

The insolvent estate is a 'person' for tax purposes and the trustee or administrator of the estate is the representative taxpayer in respect of any income received by or accrued to the estate .

Section 25C provides that the estate of a person prior to sequestration and his insolvent estate are deemed to be one and the same person. If the order of sequestration is set aside, the person's insolvent estate and his estate after the order has been set aside will also be regarded as one and the same person.

Livestock: - lessee under a 'sheep lease' or similar agreement

Paragraph 3(3) of the First Schedule deems any livestock that is the subject of a 'sheep lease' or similar agreement concerning livestock and any produce that is the subject of a similar agreement to be held and not disposed of by the grantor ('lessor') of the lease or agreement.

In practice SARS accepts that the 'lessee' need not disclose the value of the 'hired' livestock or produce. For example, if he 'hires' livestock under a 'sheep lease', SARS permits the 'lessee' at the end of each year of assessment to exclude from the physical stock of animals on hand the quantities of livestock falling in the classifications elected by him. The 'lessee' is not required to identify the animals that are the subject of the 'sheep lease', because if the effect of para 3(3) is that any 'hired' livestock is deemed not to be held by the 'lessee', the number to be excluded from the physical stocks on hand at the end of a particular year of assessment must accord with livestock that is the subject of the 'sheep lease', that is, the quantities set out in the agreement and not the actual numbers that may be identified and are physically on hand at the end of the year.

It must also follow that if the 'hired' animals are not to be regarded as being held by the 'lessee', they cannot fall within para 4(1)(*a*)(ii) and (*b*)(ii) as being livestock acquired by the farmer 'during the current year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations'. Accordingly, the value of the 'hired' animals does not increase the value of livestock on hand at the beginning of the year of assessment in terms of para 4(1). Both para 4(1)(*a*)(ii) and (*b*)(ii) refer to livestock 'acquired', and it has already been pointed out that by virtue of para 3(3) livestock that is the subject of any 'sheep lease' is not regarded as vesting in the lessee, so that it could not have been 'acquired' by

the 'lessee' within the meaning of para 4(1)(*a*)(ii) or (*b*)(ii).

If they vest in the 'lessee', all progeny of the 'hired' animals must be included in the lessee's return, and their value at the end of the year of assessment will be included in his income. If the 'lessee' is entitled during the currency of the lease to sell any of the 'hired' livestock, the proceeds constitute income. Notwithstanding such sales, it is submitted that the 'lessee' is entitled to exclude from the physical stocks of animals on hand at the end of the year the quantities set out in the agreement, even though the effect is to exclude from the return new purchases by the 'lessee' or progeny belonging to him.

If on the termination of the 'sheep lease', when the 'lessee' is required to return to the 'lessor' or his executors the 'hired' animals, the 'lessee' discharges his obligation by handing over animals from his existing stock on his farm, no tax adjustment need be made. If the 'lessee' has to buy certain of the animals in order to return the exact number to the 'lessor', the cost of his purchases is a proper deduction from his income. If in terms of the agreement he need only compensate the 'lessor' for shortages and need not buy any animals, the compensation is again properly deductible from his income. The cost of the purchases or compensation may be deducted only in the year in which the expenditure is actually incurred. No deduction may be made of any provision for compensation or for animals still to be acquired for the purpose of making good shortages, but if in anticipation of the termination of the agreement the 'lessee' starts buying animals, expenditure has then been incurred and a deduction may be claimed.

The rental stipulated in the agreement is properly deductible from income, whether it is to be paid in cash or in kind.

Livestock and produce - partnerships

Since a partnership is not a taxable entity, it is not entitled to elect standard values that may be applicable to the firm or to the individual partners. Each partner must elect his own standard values, which must be applied to his interest in the number of livestock on hand at the beginning and end of the year of assessment and used in the partnership business. In this respect the legal rights of the partners to the ownership of the livestock used in the business must be borne in mind. If the partners choose different standard values, their respective shares of the taxable income or assessed loss from the partnership farming will also differ. If an existing farmer joins a partnership firm, he is not entitled to choose new standard values differing from those elected for his private farming operations. In terms of the Act he must elect only one set of standard values, which must be applied to his livestock in all the farming ventures he carries on, whether in a partnership or for his own account. The converse must also apply, namely, that if he commences farming as a partner in a firm carrying on farming and elects his standard values, those values must also apply to any separate farming venture he subsequently embarks upon.

Each partner's share of the livestock that is an asset of the partnership firm must be determined in the ratio in which the partners share profits or losses, unless the partnership agreement provides to the contrary. But if it is the intention that ownership in the livestock remains vested in one or more of the partners to the exclusion of the other partners, only those partners who enjoy ownership in the livestock on hand at the beginning and end of the year of assessment are required to include details of animals in their annual returns. For example, one of the partners may bring his livestock into the firm on the clear understanding that the animals belong to him only and not to the firm, except that all progeny accrue for the benefit of the partnership. The other partners are therefore obliged to bring into the computation of their taxable incomes only their interest in the progeny on hand at the beginning and end of each year. In regard to partnership assets generally

RECOUPMENT (PARA 11)

Livestock and produce – donation

Livestock or produce donated by a farmer, whether to charitable institutions or to any other person, must result in a smaller

quantity of stock on hand at the end of the year.

Paragraph 11(*c*)(i) of the First Schedule provides that, if during a year of assessment livestock or produce has been donated by a farmer, its market value must be included in his income for that year.

It is to be observed that it is not the cost price of the donated livestock or produce that must be included in the farmer's income but its market value.

In addition to the taxation of the value of a donation of livestock or produce in terms of para 11, its value will also be subject to donations tax, unless the donation is exempt from that tax. But note that the definition of the term 'donation' for the purposes of donations has not been made applicable to para 11.

Livestock and produce - disposal for inadequate consideration

Livestock or produce disposed of by a farmer, other than in the ordinary course of his farming operations, for a consideration less than the market value thereof, must result in a smaller quantity of stock on hand at the end of the year.

Paragraph 11(*c*)(ii) of the First Schedule provides that if during a year of assessment livestock or produce has been disposed of by a farmer, other than in the ordinary course of his farming operations, for a consideration less than the market value thereof, its market value must be included in his income for that year. It is to be observed that it is not the cost price of the livestock or produce disposed of that must be included in the farmer's income, but its market value. The inclusion in income equal to market value must be reduced by the consideration received by or accrued to the farmer (proviso (*b*) to para 11).

Livestock and produce - private consumption

A farmer's stock of livestock and produce at the end of a year of assessment may be reduced because he has consumed or used livestock or produce for himself, his family or the persons employed by him in his home.

A farmer is therefore called upon to pay tax on the cost price to him of the livestock and produce so consumed during any year of assessment. Where the cost price cannot be readily determined, the market value of the livestock and produce must be included in his income for that year of assessment (para 11(*a*) and (A)).

On the other hand, the value of livestock and produce used by the farmer as rations for his farm employees is effectively not taxable. The cost of providing rations for farm workers is deductible, since the livestock and produce so applied in the ordinary course of his farming operations constitutes deemed expenditure incurred (proviso (*a*) to para 11). Thus an inclusion in income and a deduction must be recorded for tax purposes and, since both transactions have exactly the same value, the net effect is neutral

Livestock and produce - removal from the Republic

Paragraph 11(*b*) of the First Schedule provides that when, during a year of assessment, a farmer for purposes other than that of the 'production to the farmer' of income from sources within the Republic removes his livestock or produce from the Republic, there must be included in his income for that year an amount equal to the market value of the livestock or produce.

Livestock and produce - distributed *in specie*

Paragraph 11(*c*)(iii) of the First Schedule provides for the situation in which a farmer that is a company distributes

livestock or produce *in specie* to a holder of a share of the company.

This provision achieves for farming companies what the proviso to s 22(8) achieves for other companies. The result is that when, on or after 21 June 1993 and during a year of assessment, a farmer that is a company distributes livestock or produce *in specie* to a holder of a share of the company, an amount equal to the market value of the livestock or produce will be included in its income for that year of assessment. The targeted distribution *in specie* is widely stated, being described as livestock or produce 'distributed *in specie*'.

This is the wording used to cover the same situation in s 22(8), which is naturally inapplicable to livestock or produce distributed in this manner, on account of its coverage by para 11. It is considered that the proper time to value livestock or produce distributed *in specie* is the date on which it was distributed.

Livestock and produce - other disposals

If livestock and produce has been applied by a farmer for a purpose other than

- the disposal thereof in the ordinary course of his farming operations;
- private consumption;
- the removal thereof from the Republic;
- donation;
- disposal of such livestock for an inadequate consideration;
- a distribution *in specie* in the case of a farming company,

its market value must be included in his income for that year (para 11(*c*)(iv)).

LIVESTOCK AND PRODUCE - ACQUIRED BY DONATION OR INHERITANCE

A farmer may acquire livestock or produce during a year of assessment otherwise than by purchase, natural increase or in the ordinary course of farming operations. For example, he may acquire livestock or produce by donation or inheritance. Should he merge the livestock or produce so acquired in his general farming activities, it follows that the proceeds arising on the sale of that livestock or produce will be included in his income. If it is not sold but remains on hand at the end of the year, its value will be included in his closing stock. ***Special rules apply in terms of section 25 and section 9HA in respect of livestock bequeathed to a resident surviving spouse.***

Opening stock

For a farmer who was carrying on farming operations on the last day of the year of assessment immediately preceding the current year of assessment, the deemed value for opening stock is the market value of livestock or produce

- acquired by him during the current year otherwise than by purchase, natural increase or in the ordinary course of farming operations, or
- previously held by him for purposes other than pastoral, agricultural or other farming operations, which he commenced to hold for any of these purposes during the current year of assessment.

(Paragraph 4(1)(*a*)(ii).)

Similarly, for a farmer commencing or recommencing farming operations during the year of assessment, the deemed value for opening stock is also the market value of livestock or produce (excluding livestock or produce held and not disposed of by him at the end of the day immediately preceding the date of the commencement or recommencement)-

- acquired by him during the current year otherwise than by purchase, natural increase or in the ordinary course of farming operations, or
- previously held by him for purposes other than pastoral, agricultural or other farming operations, which he commenced to hold for any of these purposes during the current year of assessment.

(Paragraph 4(1)(*b*)(ii).)

Because this deemed value is added to the value of the livestock or produce on hand at the beginning of the year of assessment (opening stock), the result is an effective deduction of the market value of livestock or produce acquired in this way, for example, by donation or inheritance.

Since no direction is given at what date the market value is to be established, it must be assumed that it is the date of acquisition that is significant. Under the practice of SARS livestock or produce acquired by donation is valued at the date of donation, and livestock or produce acquired by inheritance is valued at the date of confirmation of the liquidation and distribution account of the estate of the person from whom it was inherited.

Should the livestock or produce received by way of donation or inheritance not be brought on to the taxpayer's farm or not be used for the purpose of farming but is immediately disposed of, it is submitted that the proceeds are in the nature of capital, arising from the realization of a capital asset. In such a situation the special valuation rule described here does not apply. It applies only to a situation in which the livestock or produce received by way of donation or inheritance is used or held for the purpose of farming. SARS accepts this principle in practice.

Closing stock

Should the farmer merge the livestock or produce acquired by donation or inheritance into his general farming activities, proceeds arising

from sale will be included in income. Stock and produce so acquired, held and not disposed of by the end of the year of assessment will be included in closing stock at its standard value.

LIVESTOCK AND PRODUCE - COMMENCEMENT OR RECOMMENCEMENT OF FARMING

Paragraph 4(1)(*b*)(i) of the First Schedule provides that the value of the opening stock of livestock or produce of any person commencing or recommencing farming operations during a year of assessment will be deemed to be the value of the livestock or produce held and not disposed of by that person at the end of the day immediately preceding the date of commencement or recommencement of farming operations. In other words, the value of any livestock or produce held and not disposed of at the end of the day immediately preceding the date of commencement or recommencement of farming operations is allowed as a deduction in the year in which farming operations are commenced or recommenced.

In practice the Commissioner allows as a deduction the fair market value of produce at the date of commencement or recommencement of farming operations, while livestock must be valued in accordance with the method of valuation prescribed in para 5, that is, at elected standard values.

The provisions of para 4(1)(*b*)(i) do not apply to the executors of the estate of a deceased person in whom the livestock or produce belonging to the deceased vests who commence farming from the date of the farmer's death, since the livestock or produce would not have been held by them at the end of the day prior to the date of his death. It is livestock or produce

- acquired by him during the current year otherwise than by purchase, natural increase or in the ordinary course of farming operations; or
- previously held by him for purposes other than pastoral, agricultural or other farming operations, which he commenced to hold for any of these purposes during the current year of assessment,

and is therefore deemed to have a value equal to its market value (para 4(1)(*b*)(ii)). That is, the livestock or produce held by the executors at the commencement of farming must be valued at its market price at the date of the farmer's death.

The same principle applies to persons who acquire livestock or produce by way of donation or inheritance and commence farming with it for the first time, who must deduct as the value of opening stock the market value of the livestock or produce.

If the donee or heir held and had not disposed of the livestock or produce at the end of the day immediately preceding the date of commencement of farming operations, however, the provisions of para 4(1)(*b*)(i) will apply, and the livestock must be valued on the basis of the standard values elected by him, while produce will be valued at its fair market value.

Livestock and produce - cessation of farming

The implication of s 26(1) is that the First Schedule usually applies only when the taxpayer derives a taxable income (or an assessed loss) from farming operations. Under certain circumstances this general rule must be modified in relation to livestock and produce.

The first possibility is that in the year of assessment in which he ceases to carry on farming operations the farmer disposes of all his livestock or produce. Not surprisingly, it has been held that the proceeds will constitute a receipt of an income nature and be taxable. No matter what the reason for the disposal, it will constitute a disposal of trading stock. What also seems clear is that the proceeds will form part of the farmer's 'taxable income derived from farming operations'.

The second possibility is that, although the farmer ceases farming operations, he retains his livestock or produce, lets his

livestock or produce or enters into a 'sheep lease' or similar agreement relating to his livestock or produce. In these circumstances s 26(2) and para 3(2) and (3) of the Schedule come into operation.

Section 26(2) provides that certain provisions of the First Schedule will remain applicable in relation to the livestock or produce of a person who has discontinued carrying on farming operations until the year of assessment during which he disposes of the last of his livestock or produce. These provisions of the First Schedule will apply if

- the person has discontinued carrying on farming operations;
- he is still in possession of any livestock or produce or has entered into a 'sheep lease' or similar agreement relating to livestock or produce; and
- the livestock or produce has been taken into account, and expenditure in respect of the livestock or produce has under the provisions of the Act or any previous Income Tax Act been allowed in the determination of the taxable income derived by him when his farming operations were carried on.

The provisions of the First Schedule that will apply in these circumstances are paras 1 (years of assessment), 2 (opening and closing stocks), 3 (inclusion in income of value of closing stock and deduction of value of opening stock), 4 (valuation of opening stock), 5 (valuation of livestock), 6 (standard values), 7 (standard values), 9 (valuation of produce) and 11 (donation, disposal for inadequate consideration, removal from the Republic or distribution *in specie* of livestock or produce).

Paragraph 3(2) provides that, for the purposes of para 3(1) (inclusion in income of value of closing stock and deduction of value of opening stock), when a person has discontinued farming operations during a year of assessment but at the end of that year holds and has not disposed of livestock or produce, the value of that livestock or produce must be included in his income for that year and for all subsequent years of assessment for so long as that livestock or produce or any part of it is held and not disposed of.

Read together with s 26(2), para 3(2) means that in each year of assessment in which some portion of the livestock or produce (that has been 'taken into account and in respect of which expenditure . . . has been allowed in the determination of the taxable income derived . . . when [farming] operations were carried on') of the former farmer is on hand, the value of that livestock or produce at the end of the year of assessment will be included in his income, while the value of that livestock or produce at the end of the previous year will be allowed as a deduction. Since the value of the livestock or produce will throughout be treated as trading stock, it must follow that the proceeds arising upon the disposal of the livestock or produce will form part of the former farmer's income, although it is unclear whether the proceeds will form part of his 'taxable income derived from farming operations').

The value referred to in para 3(2) is either the standard value fixed by regulation or the standard value adopted by the former farmer).

It has been held in relation to an earlier version of para 3(2) that before it can apply there must be a complete discontinuance of farming operations and not a discontinuance of only some of those operations.

Losses of the original herd of livestock owing to death or theft would automatically be allowed as a deduction from income, since the value of livestock on hand at the end of the year of assessment would exclude the livestock lost in this manner.

DISPOSAL AS A GOING CONCERN

On the disposal of his farm as a going concern, the amount realized by a farmer for standing crops, that is, crops not gathered and marketable, is not taxable (*as income from trading stock*) as long as no price is specifically allocated to growing crops. The full proceeds received for the sale of the farm with the crops growing on it, it is submitted, are of a capital nature, and subject to capital gains tax.

In such circumstances the purchaser of the farm is not entitled to claim as a deduction the proportion of the purchase price that is attributable to the standing crops. The acquisition of the growing crops cannot be divorced from the acquisition of the land, and since the purchase of the land is of a capital nature, the acquisition of the standing crops, which is portion of the realty, is similarly of a capital nature. The fact that the growing crops may be the most valuable portion and that they induced the purchase of the farm cannot affect the legal position.

The above principles do not apply to the sale or purchase of a farm on which a plantation is growing. Paragraphs 14, 15 and 16 have the effect of including in the gross income of a farmer who disposes of a plantation together with the land on which it is growing the value or selling price of the plantation. Conversely, a purchaser is allowed to deduct the cost of acquisition of such a plantation.

When, however, a farm is sold as a going concern, and the seller and the purchaser agree on a price for the growing crops included in the sale as distinct from a price for the bare farm, the agreed price for the growing crops is taxable in the hands of the vendor and is allowable as a deduction to the purchaser. As long as this intention is clear, it is not imperative that the two items be dealt with in separate contracts; they may be dealt with in one contract. These principles will not apply when a farm is sold as a going concern without any separate amount being stipulated as the price of the growing crops.

FARMING EXPENDITURE AND ALLOWANCES

The expenditure that a farmer may claim as a deduction in the determination of his taxable income is governed by the ordinary provisions of the Act subject to the First Schedule. The First Schedule makes provision for the deduction of expenditure incurred on development and improvements, and there are also special provisions for the deduction of capital expenditure incurred by plantation farmers.

Apart from these special provisions, the allowable expenditure of a farmer is subject to the same rules that apply to all other taxpayers.

Expenditure on items such as the following would represent farming expenditure deductible from income, being expenditure incurred in the production of income and not of a capital nature:

- Purchase of livestock (whether acquired for resale or use in farming as permanent assets, for example, trek oxen or animals acquired for breeding).
- Hire of farm land.
- Animal feed.
- Fertilizer and manures.
- Wages of farm employees. (When wages are paid to employees employed in the construction of the capital works set out in para 12 of the First Schedule they cannot be claimed as revenue expenses but must be regarded as part of the cost of the capital works and deductible to the extent set out in terms of para 12.)
- Rations bought for employees.
- Seeds, plants and trees. In practice the cost of seeds and plants is allowed as a deduction even when annual cropping does not involve the destruction of the plant. The cost of plantations and of their establishment is deductible in terms of para 15. Expenditure incurred on the planting of trees, shrubs or perennial plants for the production of grapes or other fruit, nuts, tea, coffee, hops, sugar, vegetable oils or fibres is deductible under para 12(1)(*g*). Thus the cost of sugar-cane, pineapple and strawberry plants as well as the cost of planting is deductible. The cost of replacing trees in an established plantation, orchard or vineyard is deductible.
- Expenses of clearing land. The cost of clearing land for the purpose of farming is in practice allowed as a deduction provided that in the year in which the expenditure is incurred income is derived from farming. The cost of the eradication of noxious plants and alien vegetation is deductible in terms of para 12(1)(*a*), and the cost of establishing any area used for the planting of trees, shrubs or perennial plants for the production of grapes or other fruit, nuts, tea, coffee, hops, sugar, vegetable oils or fibres is deductible in terms of para 12(1)(*g*).
- Veterinary surgeon's fees for services rendered to animals.
- Medicines for animals.
- Rates and taxes.
- Packing materials, for example, grain-bags, wool-packs and binding wire.
- Medical services for employees.
- Interest on loans or bank overdrafts used for farming purposes.
- Legal expenses in terms of s11(c)
- Travelling and entertainment expenses in terms of s11(a)

A farmer is also entitled to claim the special deductions granted to all other taxpayers, such as the deductions for repairs and lease premiums, except that the wear-and-tear allowance and allowances on alienation, loss or destruction are unavailable on most items of farming equipment whose cost qualifies for deduction as 'development' expenditure.

The wear-and-tear allowance and allowances on alienation, loss or destruction are available on items excluded from the deduction for 'development' expenditure but used by the farmer for the purposes of his trade, for example, motor vehicles whose sole or primary function is the conveyance of persons, caravans, aircraft and office furniture or equipment. If the farmer also carries on activities other than farming, for example, manufacturing, all the appropriate allowances (eg s12C) are available to him in relation to those activities in the same way as to any other taxpayer.

In the same way as any other taxpayer, a farmer is prohibited from claiming any deduction of his personal or domestic expenditure, such as the cost of repairs to his private homestead or the wages and rations of his domestic servants.

Lessor of farming land

Lessors of land let for farming purposes are entitled to a deduction of expenditure incurred on 'soil-erosion work' in terms of s 17A, subject to the following conditions:

- Pastoral, agricultural or other farming operations must take place on the land during the year of assessment by the lessee
- Expenditure must be incurred by the lessor in the construction of soil erosion works, which must be certified by an officer designated under the Conservation of Agricultural Resources Act
- The deduction is limited to taxable income drived from the letting of this type of land during the year of assessment and any excess is carried forward to the following year of assessment.

The rental included in taxable income will not be farming income because it is not linked with the lessor's farming activities.

DEVELOPMENT EXPENDITURE PARA 12

Paragraph 12(1) of the First Schedule provides that in the determination of the taxable income derived by any farmer there will be allowed as deductions the expenditure incurred by him during the year of assessment in respect of

a) the eradication of noxious plants and alien invasive vegetation;
b) the prevention of soil erosion;
c) dipping-tanks;
d) dams, irrigation schemes, boreholes and pumping-plants ('irrigation schemes' would cover expenditure on water furrows and pipelines);
e) fences;
f) the erection of, or extensions, additions or improvements (other than repairs) to buildings used in connection with farming operations, other than those used 'for domestic purposes'
g) the planting of trees, shrubs or perennial plants for the production of grapes or other fruit, nuts, tea, coffee, hops, sugar, vegetable oils or fibres, and the establishment of any area used for the planting of such trees, shrubs or plants. The purchase of a farm with existing trees and shrubs on it will not qualify for the para 12(g) deduction;
h) the building of roads and bridges used in connection with farming operations.;
i) the carrying of electric power from the main transmission lines to the farm apparatus or under an agreement concluded with the Eskom in terms of which the farmer has undertaken to bear a portion of the cost incurred by the Eskom in connection with the supply of electric power consumed by the farmer wholly or mainly for farming purposes.

Assessed Loss

- Para's (a) and (b) above can create a loss (ie the expense is always deductible)
- Para's (c)-(i) above cannot create an assessed loss, the expenses are limited to taxable income from farming.

The expenditure exceeding taxable income must be added back to farming income. The excess will be deemed to be expenditure incurred on items (c)-(i) in the following year of assessment. The taxable income derived from farming operations is for this purpose calculated before the deduction of expenditure on items (*c*) to (*i*) and before the inclusion in income of the excess.

The excess expenditure carried forward may be reduced in the succeeding year by recoupments arising in that year in terms of para 12(3B) in certain circumstances.

The excess expenditure on items (*c*) to (*i*) may not be deducted from his income from non-farming sources but must effectively be carried forward from year to year until it is fully deducted from taxable income from farming in the sense applicable for present purposes. The amount carried forward may conveniently be referred to as the 'qualifying balance', and will in certain circumstances be reduced by recoupments of 'development' expenditure on movable assets
Because a 'qualifying balance' of capital expenditure may be carried forward from one year to the next in terms of para 12(3), it must follow that if a farmer ceases farming operations in any year of assessment, he is no longer entitled to carry forward any qualifying balance of capital expenditure, since he is no longer assessable in terms of the First Schedule, and para 12(3) applies only to persons assessed in terms of the First Schedule. Even if such a farmer recommences farming in a subsequent year, it is submitted that he is not entitled to carry forward the capital expenditure to that year.

Para 12 must be strictly construed. There is no justification in para 12 for the extension of the exemption it provides.

Para 12 requirements

- The deductible expenditure on development and improvements as set out in para 12 must be incurred by the farmer personally. He may not claim expenditure incurred by any other person.
- The expenditure incurred by the farmer must be incurred in connection with his own farming operations. The legislature did not intend that a farmer who at his own expense incurs development expenditure not for his own use but for the use of another farmer should be entitled to deduct the expenditure incurred from his own income.

It is not a requirement of para 12 that a farmer be the owner of the farming property in order that he may be entitled to the allowances in respect of development and improvements. A lessee or usufructuary of farming lands may claim the capital allowances if the expenditure has been incurred by him even though the buildings or improvements are to revert to the landlord or the bare dominium holder on the termination of the lease or usufruct.

INTERACTION OF PARA 12 AND OTHER CAPITAL ALLOWANCES

Paragraph 12(2) provides that when a deduction 'is allowable' under para 12(1) ('development expenditure') for any machinery, implements, utensils or articles or for capital expenditure on scientific research, the farmer may not also claim a wear-and-tear allowance under s 11(*e*) or an allowance on alienation, loss or destruction under s 11(*o*) on the machinery, implements, utensils or articles.

For example, a farmer is debarred from claiming the wear-and-tear allowance on pumping plant for which a deduction is allowable under para 12(1)(*d*).

A farmer who ceases to carry on farming operations during any year of assessment and thereafter disposes of immovable

property on which he carried on those operations, is allowed to elect to treat the qualifying balance of under-deducted capital development expenditure carried forward as expenditure incurred and paid in respect of the immovable property for the purposes of the capital gains tax. The effect of this wil be an increase in the base cost of the relevant asset/s.

Development expenditure - incurred 'in respect of'

In terms of para 12(1) the expenditure must be incurred by the farmer 'in respect of' the listed items. It has been stated that 'the words *in respect of* may be used in various senses, and in each case it is essential to examine the context in order to ascertain the sense in which [they are] used'.[3]

It is submitted that expenditure cannot be said to be incurred 'in respect of' a particular subject-matter, for example, a dam or fence, unless it has a direct relationship to that matter The expenditure referred to in para 12(1) is expenditure directly incurred in the carrying out of the capital works listed in para 12(1)(*a*) to (*i*), and would, for example, include the cost of labour and materials. The cost of machinery, implements, utensils and articles, including vehicles, used to carry out such works, for example, a bulldozer used to prevent the erosion of soil, would not, it is submitted, qualify for deduction under para 12(1)(*a*) to (*i*) but may, if not excluded, qualify for deduction under s 12C (the '40/20/20/20' depreciation allowance), on the ground that these assets are used by the farmer 'for farming purposes'. The question whether expenditure qualifies under items (*a*) or (*b*) of para 12(1) or under s 12C is important because of the limitation imposed upon the deduction of expenditure on development and improvements other than that referred to in items (*a*) and (*b*).

Any assets not qualifying for deduction under para 12(1) might still qualify for the wear-and-tear allowance and the allowance on alienation, loss or destruction provided by s 11(*e*) and s 11(*o*) respectively or for the '40/20/20/20' depreciation allowance.

[3] Per Solomon JA, who delivered one of the two judgments of the court, in *CIR v Crown Mines Ltd* 1923 AD 121 at 128. See also *SIR v Raubenheimer* 1969 (4) SA 314 (A), 31 SATC 209 at 215-16; *Buglers Post (Pty) Ltd v SIR* 1974 (3) SA 28 (A), 36 SATC 71 at 75; *De Villiers v CIR* 1929 AD 227, 4 SATC 86 at 88; ITC 1273 (1978) 40 SATC 166 at 169-70; ITC 1340 (1980) 43 SATC 210 at 212-13.

Development expenditure - 'taxable income derived from farming operations'

The yardstick for measuring the amount to be deducted for expenditure incurred on development and improvements by a farmer for a year of assessment is the 'taxable income derived from farming operations' for that year of assessment (para 12(3) of the First Schedule).

The word 'derived', it is submitted, should be treated as being synonymous with the words 'arising' or 'accruing'. Interest and rent accruing from the investment of surplus funds are not uncommon items of taxable income accruing to a farmer but, since they are clearly not derived from farming operations, they do not come into the computation.

The dictionary meaning of the word 'derived', it has been held, means 'to come from something as its source'.

But what of

(*a*) the value of livestock or produce on hand at the beginning and end of the year of assessment;

(*b*) livestock or produce consumed by the farmer and his family;

(*c*) the value of livestock or produce donated or disposed of by a farmer other than in the ordinary course of his farming operations for a consideration less than the market value thereof, and included in his income in terms of para 11;

(*d*) amounts included in a farmer's income in terms of s 8(4)(*a*) representing wear-and-tear allowances on farming assets recouped and amounts included in his gross income in terms of para 13A representing the previously untaxed proceeds of livestock disposed of on account of drought;

(*e*) subsidies;

(*f*) grazing-fees; and

(*g*) rentals from the hiring out of farming assets?

It is submitted that because items (*a*), (*b*) and (*c*) above must form part of taxable income and because they all have their source or origin in the farming operations carried on, they constitute taxable income derived from farming operations.

It is also submitted that amounts included in a farmer's income in terms of para 12(1C) on account of the disposal of certain movable assets constitute taxable income derived from farming operations, since the deductions allowed on account of these assets are specifically allowed in the determination of taxable income derived from farming operations.

The amount of the excess of the expenditure on development and improvements allowed under para 12(1)(*c*) to (*i*) over the taxable income from farming that is to be included in a farmer's income under para 12(3) also constitutes taxable income derived from farming operations, since para 12(3) expressly requires this excess to be included in the income from such operations.

If grazing fees and rentals received from the letting of farming assets are received not because of any farming operation carried on but by virtue of the farmer's ownership of the land or the farming assets, it is submitted that they do not form part of the taxable income derived from farming operations. In practice, however, grazing fees are regarded as having been derived from farming operations. The position is clear when an owner of land lays down grass and manages and tends the land so as to produce grass and then arranges for the seasonal eating of the grass by cattle brought on to the land. In such a situation the business of farming is carried on, and the moneys received for the granting of the grazing rights constitute taxable income derived from farming.

Rentals received from the letting of livestock do not in truth form part of taxable income derived from farming operations, since the letting of animals is not ordinarily a farming operation. In this respect they are no different from rentals received from the hiring out of any other farming asset. But because para 3(3) has the effect of requiring a farmer to bring into account the value of livestock or produce that he 'lets' in terms of a 'sheep lease', or similar agreement, it would seem proper to regard the whole operation of letting the livestock under such an agreement as a farming operation and the rental as constituting taxable income derived from farming operations. The proceeds derived from the outright disposal by the farmer of livestock or produce subject to such an agreement would, it is submitted, form part of his taxable income derived from farming operations.

An interesting point arises when a farmer carrying on farming operations uses the produce of his farm for the purpose of converting it into a manufactured article produced in a separately run factory. For example, a fruit farmer may transfer all his fruit to his factory for conversion into jam or canned fruit, or a dairy farmer may use all the milk produced on his farm for the purpose of its conversion into cheese in a separate factory. In these circumstances it would seem that the farmer's taxable income is not derived from the carrying on of farming operations but from the disposal of manufactured products. If this contention is correct, it must follow that the farmer is not entitled to claim his capital expenditure on development and improvements, since there is no taxable income derived from farming operations.

It is understood that in practice a farmer who carries on a manufacturing process such as the canning of fruit and uses mainly his own farming produce, for example, fruit, as the raw material in the manufacturing process will be regarded by SARS as carrying on only farming operations and deriving income only from farming. But if he acquires the materials for his manufacturing process mainly from outside sources, SARS accepts that he is carrying on two distinct trades, namely, farming and manufacturing. In these circumstances it requires him to draw up separate income statements for his farming operations and for his manufacturing business and to charge the farming product to the manufacturing department at a current market price as if the two departments were conducted by two distinct taxpayers. In this way the farmer may return a taxable income derived from farming operations and may therefore claim the allowances for expenditure on development and improvements. There is no reported authority for the distinction drawn by SARS.

Where a partnership is engaged in farming operations, the partnership income so derived and allocated to the respective partners constitutes 'income from farming operations' in their hands as envisaged in s 26(1), and the fiscal benefits accorded by the First Schedule apply. It is conceivable, however, that a partner in a farming partnership may receive, outside of his share in that farming income, remuneration for services rendered to the partnership. In that event, such remuneration will not constitute income derived from farming operations, as envisaged in s 26(1), and the fiscal benefits of the First Schedule will not apply to such income.

DEVELOPMENT EXPENDITURE - ASSESSED LOSS

The para 12 expenditure is deducted before taking into account any assessed losses (in terms of s20) brought forward from the previous year of assessment or from any other trades carried on by the taxpayer in the current year of assessment.

Development expenditure - farming buildings

No deduction is available under para 12(1)(*f*) in respect of the erection, extension, addition, or improvement (other than repairs) to buildings used in connection with farming operations where they are used 'for domestic purposes'.

In addition to the above limitation, there is also a 'recoupment' provision, which provides that if in any year of assessment a building in relation to which a deduction has been allowed to a farmer under para 12(1)(*f*)in the current or in any previous year of assessment is used for the domestic purposes of any person other than an employee of the farmer, there must be included in the farmer's income for the current year of assessment the amount originally deducted less one-tenth of that amount for every completed period of one year (not exceeding ten years) during which the building was used by the farmer in connection with his farming operations other than for the domestic purposes of persons who are not his employees (para 12(6)). The words 'completed period of one year' clearly do not refer to a completed year of assessment.

This recoupment provision does not operate when the farmer sells his farm, including buildings used by employees in respect of which he has received allowances.

In practice the deduction will not be allowed for the cost of rooms or parts of buildings that are not used in connection with farming operations, even though the remainder of the building is so used. When the greater part of a building is used in connection with farming operations, the courts may refuse to apportion the expenditure and may allow the deduction in full.

A farmer who carries on a manufacturing process such as the canning of fruit in a building and uses mainly his own farming produce, for example, fruit, as the raw material in the manufacturing process will be regarded by SARS as carrying on farming operations in the building and will be required to claim the deduction under para 12(1)(*f*) for the building. But if he acquires the materials for his manufacturing process mainly from outside sources, SARS accepts that he is carrying on two distinct trades, namely, farming and manufacturing, and will permit him to claim the allowance on buildings available to manufacturers. There is no reported authority for the distinction drawn by SARS.

Development expenditure - recoupments

Save for one exception relating to movable assets, the deductions allowed to a farmer under para 12 of the First Schedule are not subject to taxation if recovered or recouped. The recoupment provision contained in s 8(4)(*a*) does not extend to expenses deducted in terms of the First Schedule.

Movable assets

Movable assets are dealt with on a special basis in the First Schedule.

Paragraph 12(1B)(*a*) provides that when a farmer disposes of an asset for which a deduction has been allowed to him under para 12(1) whether in the current or a previous year of assessment, there will be included in his income the amount received by or accrued to him or in his favour. If the deduction on account of the asset was allowed under para 12(1), the amount to be included in his income is limited to the expenditure allowed on the movable asset.

When a movable asset (as described above) is disposed of by the farmer to any other person by way of:

- donation or
- for a consideration that is not an adequate consideration or is not readily capable of valuation,

Para 12(1C) deems the farmer to have received a consideration equal to the fair value of the asset, subject to a maximum of the cost to the farmer of the asset. The same amount is deemed to have been paid by the person acquiring the asset from the farmer.

Paragraph 12(3B) effectively protects a farmer from taxation on a recoupment when he has carried forward from the previous year an undeducted 'qualifying balance' of 'development' expenditure in terms of para 12(3), and ensures instead that the qualifying balance will be reduced. It provides that when, in terms of para 12(1B), a recoupment falls to be included in a farmer's income for the current year of assessment and an amount (referred to as the 'qualifying balance') has in terms of para 12(3) been carried forward to the current year of assessment from the preceding year, the recoupment will, to the extent that it does not exceed the qualifying balance, be deducted from the qualifying balance. The recoupment will not be included in the farmer's income under para 12(1B) to the extent that it has been so deducted, and only so much of the qualifying balance as remains after the deduction of the recoupment must be taken into account for the purposes of para 12(3) as expenditure incurred during the current year in respect of the matters mentioned in para 12(3).

Development expenditure - capital gains

For capital gains tax purposes the base cost of an asset acquired on or after 1 October 2001 comprises the base cost expenditure referred to in para 20 of the Eighth Schedule, unless one of the specific rollover rules applies, in which case the base cost is deemed to be the market value of the asset when acquired or the base cost of the asset to the person from whom it was acquired. The allowable expenditure incurred in respect of an asset for capital gains tax purposes must also be reduced by various amounts, including any amount that is or was allowable as a deduction in determining the taxable income of the person concerned before the inclusion of any capital gain (para 20(3)(*a*). Consequently, an amount that qualified for deduction in terms of any other provision of the Act may not form part of the base cost of an asset.

A special rule applies to a farmer who has incurred development expenditure in terms of para 12(1)(*c*) to (*i*) of the First Schedule who ceases to carry on farming operations during any year of assessment and thereafter disposes of immovable property on which he carried on those operations. Paragraph 20A of the Eighth Schedule permits him to treat the qualifying

balance of under-deducted capital development expenditure carried forward as expenditure incurred and paid in respect of the immovable property in calculating any capital gain (para 20A(1).

But para 20A also places a limitation upon the deduction: The amount of the capital development expenditure in respect of which the election may be made is limited to the proceeds from the disposal of the immovable property, reduced by the following amounts:

- In the case of a pre-valuation date asset, any other amount allowable in terms of para 25, that is, the sum of the valuation date value of the asset and the base cost expenditure incurred on or after 1 October 2001.
- In the case of any other asset, the 'para 20 base cost expenditure' .

(Paragraph 20A(2).)

If a farmer adopts or determines the market value of the immovable property as its valuation-date value in terms of para 29(4), he may take into account only capital development expenditure incurred on or after 1 October 2001 for the purposes of calculating the amount in respect of which the election may be made in terms of para 20A(1) (para 20A(3)).

Development expenditure - purchase and sale of a farm

Even though a contract for the purchase and sale of a farm may assign separate values to the land, farming buildings, orchards, vineyards or roads and bridges, no portion of the amounts so allocated is deductible by the purchaser in terms of para 12(1)(*f*), (*g*) or (*h*) of the First Schedule. The reason is that it is an express requirement of para 12(1) that the taxpayer have incurred the expenditure in respect of 'the erection of buildings', 'the planting of trees . . . and the establishment of any area' and 'the building of roads and bridges'. The purchaser is unable to satisfy this requirement, since it is the seller or a previous owner who carried out the erection, planting, establishment or building. A similar situation arises under para 12(1)(*a*), which refers to the 'eradication' of noxious plants and alien invasive vegetation; para 12(1)(*b*), which refers to the 'prevention' of soil erosion; and para 12(1) (*i*), which refers to the 'carrying' of electric power.

When, however, the contract for the purchase and sale of a farm assigns separate values to the dipping-tanks, dams, irrigation schemes, boreholes, pumping plants and fences, in terms of para 12(1)(*c*), (*d*) or (*e*), the requirements of para 12(1)(*f*), (*g*) or (*h*) that buildings be 'erected', trees and other items 'planted' and roads and bridges 'built' by the farmer are not found in para 12(1)(*c*), (*d*) or (*e*). SARS insists, even if separate values are assigned in a contract of sale to the dams, boreholes or fences on a farm, that the taxpayer shows that the dam, borehole or fencing was constructed by him and not by someone else.

If no separate values are assigned to these items, they all form part of the realty, the land, and the total price is then expenditure incurred in respect of the land and not in respect of any dam, borehole or fencing.

When movable assets referred to in para 12(1B) or (1C) are disposed of by a farmer the amounts specified in those provisions will be included in his income or deducted from his 'qualifying balance'.

It is submitted that because a 'qualifying balance' of capital expenditure may be carried forward from one year to the next in terms of para 12(3), it must follow that if a farmer ceases farming operations in any year of assessment, he is no longer entitled to carry forward the 'qualifying balance' of capital expenditure, since he is no longer assessable in terms of the First Schedule, and para 12(3) applies only to persons assessed in terms of the First Schedule. Even if such a farmer

recommences farming in a subsequent year, it is submitted that he is not entitled to carry forward the capital expenditure to that year.

On the other hand, if the farmer continues to carry on farming operations on another farm, it is submitted that he is entitled to carry forward the undeducted balance of his 'development' expenditure. SARS appears to accept this view. It is submitted that a full year of assessment during which the farmer does not carry on farming operations must intervene before the farmer will lose the right to the carry-forward.

Conservation and maintenance expenditure deemed to be farming expenditure

Paragraph 12(1A) of the First Schedule provides that, for the purposes of the First Schedule, expenditure incurred in respect of any matter contemplated in para 12(1)(*a*), (*b*), (*d*) or (*e*) to conserve and maintain land owned by the taxpayer is deemed to be expenditure incurred in the carrying on of pastoral, agricultural or other farming operations if

(*a*) conservation and maintenance is carried out in terms of a biodiversity management agreement that has a duration of at least five years; and

(*b*) such agreement is entered into by the taxpayer in terms of s 44 of the National Environmental Management: Biodiversity Act, 2004; and

(*c*) land utilised by the taxpayer for purposes of carrying on the pastoral, agricultural or other farming operations consists or includes or is in the immediate proximity of the land that is the subject of the said agreement.

The effect of the aforegoing is that, provided conditions (*a*)-(*c*) above are fulfilled, expenditure of the kind contemplated in para 12(1)(*a*)-(*e*) of the First Schedule (but not expenditure in terms of para 12(1)(*f*)-(*i*)) will be deductible in terms of those provisions, even though the expenditure was incurred in order to conserve and maintain land, and not for farming purposes.

However, if during the current or any previous year of assessment, deductions are allowed to the taxpayer in terms of the aforegoing in respect of capital expenditure incurred to conserve or maintain land in terms of an agreement contemplated in that subparagraph, and the taxpayer is in breach of that agreement or violates that declaration, an amount equal to the deductions allowed in respect of expenditure incurred within the period of five years preceding the breach or violation must be included in the income of the taxpayer for the current year (para 12(1D)).

AVERAGE RATING FORMULA (PARA 19)

A farmer is entitled to elect to be taxed in terms of the average rating formula within three months after the end of the year of assessment. Individual farmers are entitled to elect to be taxed in accordance with the averaging provisions, but are not so obliged. However, once accepted, the election is generally binding upon the taxpayer for all future years of assessment.

The average rating formula aims at a reduction in the rate of normal tax owing to the abnormal accrual of income in the current year. It is very likely that the level of taxable income from farming operations will undergo marked fluctuations from one year to the next. This may be due to varying weather conditions, market supply and demand for produce and livestock, or other causes.

It should be noted, however, that an adoption of the averaging provisions means that the taxpayer forfeits entitlement to the concessions extended by-

(*a*) para 13: Provisions relative to the restocking of livestock sold on account of drought or disease;

(*b*) para 15: Rating formula in respect of taxable income derived from plantations; and

(*c*) para 17: Rating formula arising on disposal of sugar cane damaged by fire.

Interpretation Note 29 (issue 2) deals comprehensively with SARS' views on the application of paragraph 19 and contains a number of examples.

The rating formula does not relieve the farmer from tax on any portion of his taxable income (para 19(4)). The farmer will enjoy a lower effective rate of tax than other taxpayers in every year that his actual taxable income from farming exceeds his average taxable income from farming. Yet the farmer will not suffer a higher effective rate when his actual taxable income from farming is higher than the average.

Section 5(10) The rating formula

Paragraph 19(1) of the First Schedule makes provision for the application of s 5(10) in the determination of the normal tax payable by a taxpayer in a period of assessment. During that period:

- the taxpayer must have carried on farming operations or have derived income from farming operations;
- the taxpayer's taxable income derived during that period from farming must have exceeded his 'average taxable income from farming' as determined under para 19(2); and
- he must have made an election under para 19(5) that is binding upon him for that period.

If the farmer makes the election, the normal tax chargeable on his taxable income must be determined in accordance with the rating formula provided for in s 5(10):

The formula is as follows:

$$Y = \left(\frac{A}{B + D - C} \times B \right)$$

In this formula:

'Y' represents the amount of normal tax to be determined before rebates are taken into account;

'A' represents the amount of normal tax (as determined before the deduction of any rebate) calculated at the full rate of tax chargeable for the said year in respect of a taxable income equal to the amount represented by the expression 'B-C' in the formula;

'B' Taxpayer's taxable income (excluding any lump sum benefit) for the said year;

'C' the amount by which taxable income derived from farming for that year exceeds the farmer's average taxable income from farming (determined by para 19(2)).

'D' represents that portion of any current contribution to a pension, provident or retirement annuity fund, which is allowable only by reason of the inclusion in the taxpayer's income of that portion of irregular income under s 11F which the taxpayer would not have been allowed had he not received any of the irregular or exception types of payments dealt with under the headings specified;

SARS has taken the view that in performing this calculation, the balance of an assessed loss incurred in any previous year must not be deducted from the taxable income derived from farming in the current year of assessment. This approach is based upon the judgment in *CIR v Zamoyski*[4].

AVERAGE TAXABLE INCOME

If, in respect of any year of assessment, the average taxable income exceeds the actual taxable income from farming, the rating formula will not apply and tax at the normal rate will be levied on the farming income. The effect is that there is no risk or disadvantage in a farmer electing to be taxed according to the rating formula, and to a large extent the legislation in regard to who may make the election, is of no particular relevance, since it is always to the benefit of the farmer, who has the choice, to elect to be taxed according to the formula.

Consequently, para 19(1) is not an averaging provision in the true sense of the word, but rather a means of extending to farmers a lower overall effective rate of tax than is borne by other taxpayers.

Section 5(10)(*d*)(iv), in turn, provides that when para 19(1) applies in a year of assessment the amount by which his actual taxable income from farming exceeds his average taxable income from farming will, together with any other receipts or accruals that are subject to the rating concession, be represented by the term 'C' in the formula in s 5(10).

In other words, for the purpose of the calculation of the *rate* of normal tax, the average farming taxable income is substituted for the actual farming taxable income *if* the actual income exceeds the average. The wording of para 19(1) makes it clear that in a year in which the actual income is equal to or less than the average, the rating concession will not apply.

In broad outline, the system provides that the average of the taxable income from farming for the current year of assessment and the preceding four years of assessment will be used as a standard to determine the rate of normal tax to apply for the current year of assessment.

[4] 1985 (3) SA 145 (C), 47 SATC 50.

If, for example, the taxable income from farming for the current year is R20 000 and the average for the five years is R7 000, R20 000 will be taxed at the rate of normal tax applicable to an income of R7 000.

In other words, for the purposes of the calculation of the rate of normal tax for the current year there must be substituted for the current year's taxable income derived from farming the annual average taxable income from farming over the years of assessment (including the year of assessment under charge) during which farming was carried on, calculated over five years.

Nevertheless, because the provisions of s 5(10) must be applied to the farmer's taxable income from farming only when this exceeds his average taxable income from this source, he will enjoy a lower effective rate of tax than other taxpayers in every year that his annual average taxable income from farming is less than his actual taxable income from that source, yet will not suffer a higher effective rate when his actual taxable income is less than the average.

In practice SARS allows a farmer's qualifying fund contributions and balance of assessed loss to be taken into consideration in the determination of item 'B' in the formula laid down by s 5(10) But in the determination of item 'C', these expenses and balance of assessed loss are disregarded. Interpretation Note 29 (issue 2) makes it clear that the attitude of SARS is that, for the purpose of the determination of item 'C', the balance of an assessed loss incurred in a previous year of assessment must not be deducted from the taxable income derived from farming in the current year.

The calculation of an amount of normal tax chargeable under the rating concession must be made without regard to the rebates provided by s 6 (para 19(4)).

Rating concession - average taxable income from farming

Farmer has commenced with farming

Paragraph 19(2) of the First Schedule sets out the basis for the determination of the taxpayer's 'average taxable income from farming' in relation to the relevant period, that is, the current year of assessment.

Paragraph 19(2)(*a*) applies in the situation in which the taxpayer or his spouse carried on farming operations before the commencement of the relevant period. The average taxable income from farming in relation to the relevant period is deemed to be an amount as represents the taxpayer's annual average taxable income from farming in the periods of assessment for which the taxpayer was assessable under the Act that fall within the period of five years ending on the last day of the relevant period during which farming operations were carried on or farming income was derived by the taxpayer. The Commissioner's discretionary power under para 19(2)(*a*) is subject to objection and appeal.

For example, if the taxable income from farming for year 5 is R20 000 and the taxable income from farming for the four previous years of assessment was R8 000 in year 4, R12 000 in year 3, R4 000 in year 2 and R6 000 in year 1, the annual average income for the five years being R10 000 (R50 000/5), the average taxable income from farming in relation to year 5 is deemed to be R10 000.

If the taxpayer commenced farming only in year 2, since he carried on farming during four periods of assessment falling within the period of five years ending on 28 February year 5, namely, years 2, 3, 4 and 5, the annual average taxable income for the four periods of assessment being R11 000 (R44 000/4), the average taxable income from farming in relation to year

5 is deemed to be R11 000.

If he commenced farming during year 4, since he carried on farming during two periods of assessment, namely, years 4 and 5, the average taxable income from farming in relation to year 5 is deemed to be R14 000 ((R20 000 + R8 000)/2).

If losses have been incurred during any of the relevant years, these must be set off against the taxable income from farming in order to arrive at the annual taxable income from farming.

For example, if for the five years in question the farmer derived profits of R8 000, R6 000 and R9 000 and losses of R3 000 and R4 000, the average taxable income from farming is 1/5(R8 000 + R6 000 + R9 000 - R3 000 - R4 000), or R3 200.

A period of assessment ranks as a year to be included in the calculation of the average even though farming was carried on for only part of the period, for example, when farming commenced or terminated during the period of assessment.

Farmer has not commenced with farming before the relevant period (new farmer)

Paragraph 19(2)(*b*) sets out the position when the taxpayer did not carry on farming operations before the commencement of the relevant period, that is, when he first commenced to carry on farming operations during the relevant period. In such a situation, the taxpayer's average taxable income from farming in relation to the relevant period is deemed to be an amount equal to two-thirds of his taxable income.

On this basis, if a taxpayer commenced farming for the first time during year 5 and derived a taxable income from farming of R30 000, the average taxable income is deemed to be R20 000 (2/3 × R30 000).

Paragraph 19(2)(*b*) is clear in its terms. It provides only for the 'new' farmer, that is, a person who has never farmed before. It does not include a farmer who ceased farming more than five years prior to the end of the relevant period and again commenced farming during the relevant period. Such a farmer may not claim the benefit of para 19(2)(*b*).

If the determination of the taxpayer's annual average taxable income from farming is a negative amount as a result of an excess of losses over profits, the average is taken as being zero. The expression 'average taxable income' clearly envisage a positive amount of taxable income.

It will be observed that the rating concession relates only to taxable income from farming. Other, non-farming, taxable income, for example, investment income, is not subject to the rating concession.

Insolvent farmers

The second proviso to para 19(2)(*a*) provides that any farming operations carried on by an insolvent person prior to his insolvency, any income derived by him from those operations, and any deductions allowable against that income under the Act will, for the purposes of para 19(2)(*a*), as far as the estate is concerned, be deemed respectively to be operations, income and deductions of the estate, and the annual average taxable income derived by the estate from farming will be determined accordingly. The estate of an insolvent person is expressly included as a person for tax purposes (definition of a 'person' in s 1), which means that the insolvent estate is a taxpayer separate from the person whose estate has been sequestrated. The trustee or administrator of an insolvent estate is the representative taxpayer in respect of the income received

by, or accrued to, the insolvent estate (para (*f*) of the definition of a 'representative taxpayer' in s 1, read with s 153(1) of the Tax Administration Act).

It is also provided, in the first proviso to para 19(2)(*a*), that any 'excess farming profits' derived by the taxpayer in any of the five relevant periods of assessment on the sale of his farming undertaking to any of the bodies referred to in para 20 must not be taken into account in the determination of his annual average taxable income from farming.

Rating concession - who may make the election

Only the following persons may elect to benefit from the provisions of para 19 of the First Schedule:

- A person who is a natural person whose taxable income for any period of assessment consists of or includes taxable income derived from farming operations carried on by him for his own benefit or by his spouse for her own benefit.
- A person who is the executor of the estate of any deceased person or the trustee of the insolvent estate of a natural person who, in his capacity as such, has during the period of assessment commencing immediately after the death or insolvency of that person, continued farming operations commenced by that person prior to his death or insolvency.

(Paragraph 19(5).)

Paragraph 19 is meaningless in so far as it refers to an insolvent estate, since an insolvent estate has been found not to be a taxable entity

The above persons may within three months after the end of any period of assessment or within such further time as the Commissioner may approve and in such form as the Commissioner may prescribe elect that the provisions of para 19 be applicable to them.

An election is binding upon the person or estate in the period of assessment in respect of which it is first made and every succeeding period of assessment and cannot be revoked. Since the rating concession cannot operate to the disadvantage of the farmer, his election can only benefit him.

It is expressly provided that no election may be made by any person if his or her income for the period of assessment is in terms of s 7(2) deemed to be income accrued to the other spouse (proviso (i) to para 19(5)). It is also provided that when an election has been made by a person in respect of any period of assessment prior to marriage, and his or her income for any succeeding period of assessment is in terms of s 7(2) deemed to be income accrued to the other spouse, the election will cease to have any force or effect with effect from the succeeding period (proviso (ii) to para 19(5)).

Exclusion of companies and trusts

The rating concession applies only to individuals (natural persons) and executors of deceased estates and trustees of insolvent estates. Trusts and artificial persons such as companies are excluded, and it would seem from para 19(5) that when a trust carries on the farming the beneficiaries, who are entitled to the net income only, are not entitled to the benefit of the rating concession, since they are not carrying on the farming operations. It is considered, however, that when such a beneficiary is also farming on his own account he will be entitled to make the election, and the farming income derived through the trust will be added to his other farming income for purposes of the determination of the average. Only a person who carries on farming may make an election under para 19(5), and the rating concession may apply only to a year of assessment in which the taxpayer carries on farming (para 19(1)), but the taxpayer may either have carried on farming or have derived farming income in the other years to be taken into account in the determination of the average taxable income from farming (para 19(2) (*a*)(*bb*)). In the circumstances described above, it is submitted that the beneficiaries derive farming income even though it is the trust that carries on farming operations.

DROUGHT, STOCK DISEASE, DAMAGE TO GRAZING BY FIRE OR PLAGUE AND LIVESTOCK-REDUCTION SCHEMES

Paragraph 13 of the First Schedule provides relief to farmers who are compelled to dispose of livestock owing to drought, stock disease, damage to grazing by fire or plague (para 13(1)(*a*)) or livestock-reduction schemes organized by the government (para 13(1)(*b*)).

When a farmer has

- *(a)* in any year of assessment sold livestock on account of drought, stock disease or damage to grazing by fire or plague and has within four years after the close of that year of assessment purchased livestock to replace the livestock sold; or
- *(b)* in any year of assessment sold livestock by reason of his participation in a livestock-reduction scheme organized by the government and has within nine years after the close of that year of assessment purchased livestock to replace the livestock sold,

he will be allowed, when restocking his farm, to elect whether he will:

- deduct the cost of the livestock so purchased from the income in the year of purchase or
- from the income for the year in which he disposed of his livestock.

If the farmer wishes to deduct the cost in the year of disposal of the livestock, the claim must:

- when item (*a*) above applies, be made within five years after the close of the year in which he was compelled to dispose of the livestock, or,
- when item (*b*) applies, within ten years after the close of that year.

If the cost of livestock purchased in a year subsequent to that of the sales of livestock is allowed as a deduction in the year of the sales, it will not be allowed again in the year of purchase (para 13(2)).

A farmer who desires to claim the deduction in the year of sale must notify the Commissioner accordingly in the prescribed form and within the prescribed time for the year of assessment in which he sold the livestock and obtain and retain full particulars of the livestock sold (para 13(3)).

In practice the livestock bought to replace the livestock sold is not required to be of the same breed or type of animals as those sold, but SARS insists that the replacement livestock be of the same category; that is, that cows be replaced with cows, bulls with bulls and so forth. The maximum deduction that SARS is prepared to allow is the purchase price of an equal number of livestock of the same categories as were disposed of in the forced sale. It follows, therefore, that the deduction may exceed the proceeds realized on the forced sale. Any expenditure in excess of this maximum is deductible in the year of purchase.

The replaced livestock, although its cost is deductible in the year of the forced sales, cannot be regarded as livestock on hand at the end of that year since it was not 'held and not disposed of' at the end of that year. It will, however, be regarded as livestock on hand at the end of the year in which it was purchased, provided that it has not been sold.

The purpose of para 13, no doubt, is to ensure that the refund of tax may be used to finance the restocking. The ultimate benefit to the farmer is, however, problematical. If rates of tax are lower in the year when restocking takes place than in the

year in which the bulk sales took place, a saving of tax may result if the farmer decides to make an election in terms of para 13. On the other hand, if rates of tax have increased, the farmer may be worse off if he makes the election. The size of the farmer's income in the relevant years may also be material. Each situation must be decided on its own merits before an election is made.

A farmer is entitled to claim the benefit both of para 13 and of para 19 when he has disposed of livestock owing to drought, stock disease or damage to grazing by fire or plague. But he may not claim the benefit of para 13 when he has disposed of livestock owing to a livestock- reduction scheme organized by the government in a year of assessment in which his normal tax chargeable is determined under para 19 (para 13(1)(*a*) (i) and (*b*)(i)).

The provisions of para 13 do not apply to the cost of any livestock bought to replace livestock sold if the proceeds derived from the sale of the livestock have been dealt with under para 13A (para 13(5)), which provides an alternative form of relief in times of drought.

Proceeds from sale deposited into the Land Bank

Paragraph 13A applies when a farmer has on or after 1 March 1982 disposed of any livestock on account of drought and the whole or any portion of the proceeds of the disposal has as soon as possible, but in any event within three months, after its receipt by the farmer been deposited by him in an account in his name with the Land and Agricultural Bank of South Africa (the 'Land Bank'). To the extent that the proceeds are deposited with the Land Bank, they are deemed not to be gross income derived by the farmer. This provision applies notwithstanding the provisions of s 23(*e*) of the Act, which prohibits the deduction of income 'carried to any reserve fund or capitalized in any way', but subject to the provisions of para 13A(3) (see below). (Paragraph 13A(1).)

The whole or any portion of the amount deposited in the account with the Land Bank will be deemed to be gross income of the farmer derived from the disposal of livestock:

- If it is withdrawn from the account before the expiry of a period of six months after the last day of the year of assessment in which the disposal took place, on the date of the disposal.
- If it is withdrawn from the account after the expiry of a period of six months but before the expiry of a period of six years after the last day of the year of assessment in which the disposal took place, on the date of the withdrawal.
- In the event of the taxpayer's death or insolvency before the expiry of the period, on the day before the date of his death or insolvency.
- If it is not so withdrawn and the farmer does not die or become insolvent before the expiry of the period, on the last day of the period.

(Paragraph 13A(3).)

These provisions effectively prevent a farmer from postponing the taxation of the proceeds of the disposal of livestock disposed of on account of drought for a year simply by placing those proceeds on deposit with the Land Bank for a short term ending less than six months after the end of the year of assessment in which those proceeds were derived.

A farmer who desires that the proceeds derived by him from the disposal of his livestock be dealt with under the provisions of para 13A must notify the Commissioner accordingly in the prescribed form and within the time prescribed by the Commissioner (para 13A(2)).

PLANTATION FARMERS (PARA 14 TO 16)

The cultivation, maintenance and harvesting of timber with a view to profit plainly constitute farming operations. Special provisions affecting plantation farmers are to be found in paras 14, 15, 16 and 20 of the First Schedule. Apart from these special provisions, plantation farmers are subjected to tax in a manner identical with all other farmers.

The term 'plantation' is defined for the purposes of paras 14, 15 and 20 and in para 16. It means any artificially established tree as ordinarily understood or any forest of such trees, and includes any natural extension of such trees. But it does not include a tree of the nature described in para 12(1)(*g*). Pine trees, gum trees and wattle trees clearly fall within the definition, being 'trees' as the word is ordinarily understood, but pineapple, sugar-cane and nut trees, for example, are excluded since they fall within para 12(1)(*g*).

On a proper construction of the Act, citrus and fruit trees were to be regarded as constituting an orchard and not a plantation. This view is now fortified by the provisions of paras 12(1)(*g*) and 16. “Plantation” usually refers to trees grown in order to produce the trees themselves any the by-products that can be derived from trees. This differs from an orchard where the tress are grown to produce fruit.

“Forest produce” is defined as trees and anything derived from those tress, including timber, wood, bark, leaves, gum, resin and sap.

Paragraph 14(1) provides that any amount received by or accrued to a farmer in respect of the disposal of a plantation (not the land), whether the plantation is disposed of separately or with the land on which it is growing, forms part of his gross income and will be deemed not to be a receipt or an accrual of a capital nature. However, this will be so only if it was the taxpayer, and not some other person, who was carrying on the plantation farming, and 'there must be conduct by the taxpayer apart from disposing of a plantation previously acquired by the taxpayer in order to constitute the carrying on by him of farming operations'. This means that para 14 of only applicable to taxpayers conducting farming operations.

Paragraph 14(2) sets out the basis for the valuation of a plantation when it is disposed of by the farmer together with the land on which it is growing. If the parties to the transaction agree upon the amount that is to represent the consideration payable for the disposal of the plantation, the amount upon which they agree is included in the gross income of the farmer. If they fail to reach such an agreement, the amount to be included in the gross income of the farmer on account of the disposal of the plantation represents the consideration payable for the plantation alone.

Paragraph 15(1)(*a*) permits the deduction in the determination of the taxable income of a farmer of any expenditure incurred by him during a year of assessment in respect of the establishment and maintenance of plantations. Thus the actual cost of the trees, the cost of planting them and all subsequent expenditure incurred in the tending, cultivating and maintenance of the trees, including expenditure on thinning and weeding, rank as a deduction in the year in which the expenditure is incurred even though no income has been derived during that year.

It has been held that the expenditure incurred by a farmer on the construction of roads was so closely associated with the actual planting of the trees that it had to be regarded as expenditure incurred in respect of the establishment of the plantation and was therefore deductible

In practice expenditure incurred in cleaning, clearing and breaking up the land preparatory to the planting of the trees is regarded as forming part of the cost of the establishment of the plantation. The cost of trees acquired for the purpose of renewing or replacing a plantation is allowable as a deduction, as is expenditure incurred in stumping a plantation with the purpose of replacing it. It is irrelevant whether one class of tree is replaced by another or the new plantation is more valuable than the one replaced.

The cost of establishment and maintenance of a plantation that is deductible under para 15(1)(*a*) may be set off against any other taxable income that the farmer may derive, for example, from another business.

Acquisition of a plantation

Para 15(1)(*b*)(i) provides that the amount allowed to be deducted in respect of the cost of *acquisition* of a plantation purchased by a farmer may not exceed for any year of assessment the gross income derived from the plantation for that year of assessment. The cost of acquisition is carried forward from year to year, and is allowable as a deduction each year according to the gross income derived in that year from the disposal of the plantation. The aggregate of the deductions allowed under para 15(1)(*b*) in respect of plantations may not exceed the cost of acquisition of the plantations (para 15(1)(*b*)(ii)). If a farmer did not acquire the plantation but established the plantation himself, then the limitation will not apply.

It should be noted that the deduction is allowed solely against the gross income derived from the particular plantation purchased: the cost of one plantation may not be deducted from the gross income of some other plantation. The limit of the deduction is clearly the 'gross income' derived, that is, the income derived before the deduction of any expenditure incurred in the earning of that income. Once the deduction in respect of the expenditure incurred on the purchase is determined, it is deductible in the usual way together with any other permissible deductions. There is nothing in para 15(1)(*b*) preventing a farmer from establishing a loss in respect of a particular plantation.

The word 'purchased' as used in para 15(1)(*b*) means 'purchased' in its ordinary, everyday mercantile sense, that is, bought for money under a contract of sale.

When a plantation is acquired by a farmer together with the land on which it is growing, para 15(2) provides that the cost of acquisition of the plantation itself must be determined mutatis mutandis in accordance with para 14(2) (see above). In other words, if the parties to the transaction agree upon the amount that is to represent the consideration payable for the acquisition of the plantation, the amount upon which they agree is taken as the cost of acquisition of the plantation. If they fail to reach such an agreement, the cost of acquisition of the plantation must be determined by the Commissioner, who is required to express his opinion on what portion of the aggregate consideration for the land and plantation represents the consideration payable for the plantation alone. This discretionary power of the Commissioner has not been made subject to objection and appeal.

Plantation farmers - averaging provision

Paragraph 15(3) of the First Schedule provides that if in any year of assessment the income of a farmer other than a company includes income derived from the disposal of plantations or forest produce and the taxable income derived by him in that year from the disposal of plantations and forest produce (determined as though that income were his only income) exceeds the annual average taxable income derived by him from that source (as so determined) over the *three years* of assessment immediately preceding the year of assessment, the normal tax chargeable for the year of assessment must be determined in accordance with the provisions of s 5(10).

It is provided in s 5(10)(*d*)(ii) that the amount by which the taxable income derived by the farmer in that year from the disposal of plantation and forest produce exceeds the annual average taxable income derived by him from that source over the three years of assessment immediately preceding that year of assessment must, together with any other receipts or accruals that are subject to the rating concession, be represented by the term 'C' in the formula in s 5(10).

In other words, for the purpose of the calculation of the normal tax rate there is substituted for the current year's taxable income derived from plantations and forest produce the annual average taxable income derived from plantations and forest produce over the previous three years of assessment. It must follow that if no taxable income was derived from plantations and forest produce during the three previous years, the whole of the current year's taxable income from this source must be excluded for the purpose of the determination of the rate of tax in the current year.

It must be emphasized that the concession aims at a reduction in the rate of normal tax owing to the abnormal accrual of income in the current year. It does not relieve a farmer from liability for tax on any portion of his taxable income (para 15(3)(iv)).

The concession will not apply if the normal tax chargeable for the relevant year is required to be determined under the provisions of para 19 of the First Schedule (para 15(3)(v)).

Paragraph 15(3) applies only if the disposal of plantations or forest produce in the current year forms part of the normal farming operations of the farmer (para 15(3)(i)). It is submitted that the disposal of a plantation by a farmer together with his farm does not form part of his normal farming operations and that the concession provided by para 15(3) therefore does not apply. Nevertheless, it is understood that in practice SARS is prepared to apply the averaging provision under para 15(3) even when a farmer sells his farm together with the standing plantation and then discontinues his farming operations. But it must be clear that the disposal of the plantation or forest produce would normally form part of the farming operations of the farmer concerned.

If a farmer has derived any 'excess plantation farming profits' determined under para 20(3)(*g*) in the current or the three previous years of assessment, the excess plantation farming profits derived during the current year must be excluded from his taxable income derived in that year from the disposal of plantations and forest produce, and the excess plantation farming profits derived during the three previous years of assessment must not be taken into account in the determination of his average taxable income derived from the disposal of plantations and forest produce during those three years (para 15(3)(ii)).

Sugar-cane farmers - disposal of sugar-cane damaged by fire

Paragraph 17 of the First Schedule provides that the normal tax payable by a farmer other than a company whose taxable income for a particular year of assessment includes taxable income derived from the disposal of sugar-cane as

a result of a fire in his canefields that, but for the fire, would not have been derived by him in that year must be determined under s 5(10).

That provision, in turn, ensures that, for such a farmer, an amount equal to so much of his taxable income that has been derived from the disposal of sugar- cane as a result of the fire in his canefields that but for the fire would not have been derived by him in that year, together with any other receipts or accruals subject to the rating concession, will be represented by the term 'C' in the formula in s 5(10) (s 5(10)(*d*)(iii)).

The effect of s 5(10) is to exclude from the taxable income of the farmer, for the purpose of the calculation of the rate of normal tax only, any abnormal accrual to him as a result of the disposal of sugar-cane damaged by fire.

The relief aims at a reduction in the rate of normal tax in consequence of the abnormal accrual of income in the current year and does not relieve a farmer from liability for tax on any portion of his taxable income.

It will be observed that the amount of taxable income derived from the disposal of the sugar-cane is not merely the *proceeds* derived from the disposal of sugar-cane as a result of the fire: it is so much of that taxable income derived from the disposal of the damaged sugar-cane that, but for the fire, would not have been derived by him in the relevant year. In practice the approach of SARS is, first, to determine the actual taxable income for the year, bringing into account the full proceeds of the fire-insurance claim and deducting, in addition to the normal farming expenses, the costs applicable to the reaping of the burnt cane. Thereafter it will determine what the taxable income would have been if no fire had occurred during the year, and for this purpose it will take into account the tonnage of cane the farmer would have reaped had there been no fire, as well as fixed and variable expenses, and will deduct, in addition to the normal farming expenses, the costs applicable to all additional cane that would have been reaped if no fire had occurred. There must be taken into account both income that would not have accrued and expenditure that would not have been incurred if there had been no fire.

Should the liability to normal tax of the farmer be required to be determined under para 19 in a year of assessment, the provisions of para 17 will not apply to the farmer in that year (para 17).

GAME FARMERS

Interpretation note 69 (issue 2) issues by SARS addresses game farming and organized hunting expeditions on game farms. The Note points out that a large number of farmers are carrying on game farming in addition to other farming operations, and that it is almost impossible to distinguish between the two activities. It observes that the same tests used to determine whether a person is carrying on normal farming operations are applicable to game farming. For example, the activities of a person who owns land and occasionally allows hunters to cull the game on the land cannot on their own be accepted as constituting farming with game. Such a person will have to convince the Commissioner that game is purchased, sold, bred and otherwise dealt with on a regular basis before his activities may be regarded as bona fide farming operations.

Income

Income from the fortuitous sale of game, game carcasses, skins and the like by a farmer is regarded as income from farming operations. Income derived from persons to whom the right is granted to hunt game on the farm is also regarded as income from farming operations. But income from the following activities is not regarded as such income:

- Accommodation and catering.
- Admission of persons to spend holidays on the farm.
- Provision of guides for holiday makers or hunters.
- Fees paid for game drives

Stock

Because of the practical difficulties encountered in establishing the actual number of game livestock on hand at any given time, in practice game livestock is excluded from opening and closing stock by being given a value of NIL.

The limitation imposed by para 8 of the First Schedule applies equally to game livestock acquired. The purpose of para 8 is to 'ring-fence' a farmer's deduction of the cost of his purchases of livestock, that is, to limit his deduction to his farming income .

Expenditure

The following expenditure is regarded as farming expenditure:

- Equipment: vehicles, fire-arms, meat saws and two-way radios (depreciation to be claimed under s 12B)
- Facilities: slaughter rooms, meat rooms, cooling rooms, biltong rooms, skin rooms and trophy rooms (allowable in terms of para 12(1) of the First Schedule).
- Services: butchers, trackers, professional hunters (deductible under s 11(*a*) .
- Promotion and advertising: travelling costs (overseas), advertising material (deductible under s 11(*a*)).
- Other: ammunition and fuel (deductible under s 11(*a*)).

Improvements

Expenditure incurred by a game farmer on dams, boreholes, pumping plant and fencing qualifies as a deduction in terms of para 12(1) of the First Schedule. Expenditure on improvements on buildings and the construction of roads and bridges will be allowed as a deduction only if these assets are being used in connection with farming operations. Expenditure on facilities that are used to accommodate visitors and hunters will not qualify as expenditure on improvements.

Expenditure on residential facilities such as bedrooms, dining rooms and sitting rooms that are made available to safari-goers and hunters is not farming expenditure considered to be deductible under para 12(1). The wear-and-tear allowance (s11(e)) on beds, furniture, refrigerators and stoves will be allowed as a deduction against camping fees, accommodation fees and visitors' fees.

CAPITAL ALLOWANCES

WEAR AND TEAR ALLOWANCE (S11(E))

In terms of s 11(*e*) a deduction is allowed of such sum as represents the amount by which the value of any machinery, implements, utensils and articles used for purposes of trade has been diminished by reason of wear and tear or depreciation during the year of assessment. The allowance does not apply to machinery, plant, implements, utensils and articles in respect of which the allowance under ss 12B, 12C, 12DA, 12E(1), 12U or 37B is available.

The words 'machinery, plant, implements, utensils or articles' are wide-ranging. This does not apply to livestock used in farming operations. The allowance may be claimed only if the asset is owned by the taxpayer or if ownership will be acquired as purchaser under an instalment credit agreement. Furthermore, no allowance can be claimed by a person who remains the owner of an asset which has been sold by him in terms of an instalment credit agreement. These two restrictions prevent the claiming of allowances by both parties. The deduction is subject to the following additional qualifications:

(*a*) . . .

(*b*) in no case is an allowance made for the depreciation of buildings or other structures or works of a permanent nature;

(*c*) where any machinery, plant, implement, utensil or article qualifying for the wear and tear allowance is mounted on or affixed to a concrete or other foundation or supporting structure, that structure is not regarded for this purpose as a structure or work of a permanent nature, and is deemed to be a part of the article mounted on or affixed to it. This applies only if-

- (i) the foundation or supporting structure is designed for the article concerned and constructed in such a manner that it is, or should be regarded as being, integrated with that article;
- (ii) the useful life of the foundation or supporting structure is or will be limited to the useful life of the article concerned;

(*d*) . . .

(*e*) no allowance is made in respect of any machinery, implement, utensil or article of which the cost has been allowed as a deduction under s 24D;

(*f*) . . .

(*g*) the value of any machinery, implements, utensils or articles must be increased by the amount of any expenditure (other than expenditure allowed as deductions under s 11(*a*)) incurred in moving such machinery or implements from one location to another. The period over which such increase in value is to be written off is presumably the remaining period of write-off of the asset itself;

(*h*) where the value of any such machinery, implements, utensils and articles acquired by the taxpayer is for the purposes of the provision to be determined having regard to its cost, that cost is deemed to be the cost which a person would, if he had incurred it under a cash transaction concluded at arm's length on the same date, have incurred in respect of the direct cost of the acquisition of the asset in question, including the direct cost of the installation or erection.

(*i*) where the assets concerned were used in a trade whose income was not subject to tax - typically in a non-South African trade prior to the introduction of the residence basis of taxation - the cost base must be reduced taking that prior period into account. For example, if an asset normally qualifies for a 10% straight line rate of allowance and has already been used for two years when the residence basis commences, the rate will continue at 10% on actual cost, but over a remaining period of eight years;

(*j*) where a deduction or allowance was previously granted to a connected person in relation to the taxpayer under certain designated sections, the allowance is calculated on the basis of the cost of the article to the connected person, or the market value of that article on the date on which it was acquired by the taxpayer, whichever is the lesser. The

limitation applies irrespective of whether or not the article was actually acquired by the taxpayer from the affected person concerned - it is sufficient that a deduction or allowance was previously granted to that person. It is not enough that an allowance or deduction was available - it must actually have been granted, under one or more of the following sections:

(i) s 11(*e*) itself;

(ii) s 11B(3);

(iii) s 11D(2);

(iv) s 12B(1), which deals with the capital allowance;

(v) s 12C(1), dealing with the 20% straight-line allowance;

(vi) s 12E, dealing with the small business allowance; and

(vii) s 27(2)(*d*), dealing with the special machinery initial allowance previously available to co-operatives.

The limitation described applies irrespective of the quantum of the allowance previously granted to the connected person;

(*k*) ***the deduction does not apply to plant, machinery, implements, utensils and articles used in carrying on farming operations if an allowance has been claimed in terms of section 12B.***

The amount to be allowed as a deduction in respect of wear and tear or depreciation is determined from the date of promulgation of the Taxation Laws Amendment Act 2015 by reference to a public notice issued by the Commissioner in relation to the periods of use to be taken into account. Prior to that date the amount (and the periods of use) was at the discretion of the Commissioner.

As has been indicated above, the cost of an asset usually forms the basis of the allowance. Where an asset was acquired for no consideration, for example by dividend *in specie,* donation or inheritance, the Commissioner takes the market value of the asset into account for the purpose of determining the allowance.

If the asset concerned is constructed by the taxpayer, the cost for this purpose should include both material and labour costs, provided that an accurate figure for the latter can be produced.

No allowance can be made in respect of depreciation of buildings or other structures or works of a permanent nature. The following have been held to be structures or works of a permanent nature which did not qualify for the allowance. However they may qualify under other specific allowances:

(*a*) a railway siding;

(*b*) a hot water system installed in a building, in its entirety, even though certain parts were recoverable;

(*c*) a window lighting installation;

(*d*) wood and iron buildings housing a trading business;

(*e*) fencing; and

(*f*) a partition erected to protect the goods of the taxpayer from the adverse effects of chemical processes taking place in another part of the building in which the taxpayer was a tenant.

The provision requires that the assets concerned be used by the taxpayer for the purposes of his trade, not wholly and exclusively for that purpose. As a result the practice is to calculate the allowance with reference to the proportion of time for which an asset is used for the purposes of trade, if also used for some other purpose.

Small items, for example loose tools, which cost less than R7000 per item may be written off in full during the year of acquisition. A small item is regarded as an item which normally functions in its own right and is not an individual item that forms part of a set. Accordingly, a set cannot be divided into individual independent items, each costing less than R7000.

MANUFACTURING, FARMING AND OTHER CAPITAL ALLOWANCES ON MACHINERY, PLANT AND EQUIPMENT - SS 12B AND 12C

Section 12B applies only to:

- farming equipment, machinery, implements, utensils and articles (but not livestock);
- machinery, plant and equipment used by the taxpayer in the production of bio-diesel or bio-ethanol products;
- machinery, plant, implements, utensils or articles used by the taxpayer in the generation of electricity from wind, sunlight, gravitational water forces (in the case of electricity production of not more than 30 megawatts), and biomass comprising organic wastes, landfill gas or plants;
- .improvements (other than repairs) to any of the items mentioned above that are used as contemplated; and
- Other machinery, plant and equipment is covered by the provisions of s 12C.

SECTION 12B - FARMING AND THE PRODUCTION OF RENEWABLE ENERGY (50:30:20 ALLOWANCE)

In all but one instance this allowance is granted at the rate of 50 per cent, 30 per cent and 20 per cent of the cost of the asset concerned or the improvements thereto, in the year of assessment in which the asset is brought into use and the two succeeding years respectively. In the case of assets for photovoltaic solar energy not exceeding one megawatt, the allowance is 100% of the cost in the year brought into use.

It is important to note that the wear and tear allowance is not available in respect of assets on which this allowance may be claimed, and that the deductions allowed by way of the capital allowance cannot in aggregate exceed the cost to the taxpayer of the asset concerned.

The allowance may be claimed only if the asset is owned by the taxpayer or if ownership will be acquired as purchaser under an instalment credit agreement.

Furthermore, no allowance can be claimed by a person who remains the owner of an asset which has been sold by him in terms of an instalment credit agreement. These two restrictions prevent the claiming of allowances by both parties.

The allowance is available in respect of the cost of qualifying assets brought into use for the first time by the taxpayer and used by him in

- the carrying on of his farming operations with the exception of motor vehicles of which the sole or primary function is the conveyance of persons, caravans, aircraft (except those used solely or mainly for the purpose of crop-spraying) and office furniture or equipment;[1] or
- the production of bio-diesel or bio-ethanol products;
- the production of electricity from;
- wind power;
- photovoltaic solar energy of more than 1 megawatt (50:30:20);

- photovoltaic solar energy of up to 1 megawatt (100%);
- concentrated solar energy;
- hydropower to produce electricity of not more than 30 megawatts;
- biomass comprising organic wastes, landfill gas or plant material.

Where the machinery, plant, implement, utensil, article or improvement referred to above is affixed to any concrete or other foundation or supporting structure and that structure, foundation, etc., is designed for such equipment in such a manner that it should be regarded as been integrated with that equipment, and the foundation etc. has the same useful life as the equipment, then it can be regarded as part of the equipment and subject to the same allowance.

The allowance does not apply only to new assets of the nature described, but can be granted only once on the same assets in the hands of any one taxpayer. The cost of the asset to be taken into account for the purposes of the allowance is the lesser of the actual expense incurred and cost a person would have incurred in respect of the direct cost of acquisition of that asset, including the direct cost of installation and erection, had he acquired it by way of a cash transaction concluded at arm's length on the date on which the actual transaction for the acquisition of the asset was concluded.

The section contains a number of qualifications aimed at limiting the exploitation of the allowance:

(*a*) The allowance is not available in respect of any asset which has been let by a taxpayer under a lease other than an operating lease, unless the lessee concerned derives income in the carrying on of his trade, and the lease period is at least five years or such shorter period as is shown by the taxpayer to be the useful life of the asset. If the lessor disposes of a whole or a portion of his interest in the lease, or his right to receive rent under the lease within the period referred to, an amount equal to the capital allowance granted is included in income for the year of assessment during which the disposal is made. The amount so included in income must be reduced proportionately to the expired portion of the lease, or in respect of the portion of the interest or right which has not been disposed of;

(*b*) the allowance is not available in respect of any asset brought into use by any company during any year of assessment if that asset was previously brought into use by any other company during that year, both companies are managed, controlled or owned by substantially the same persons, and the capital allowance or an initial allowance was previously granted to the company which used the asset previously. This applies only if the asset is brought into use by the two companies in the same year of assessment, and not if this occurs in different years of assessment;

(*c*) the allowance is not available in respect of any asset which has been disposed of by the taxpayer during any previous year of assessment;

(*d*) the allowance is calculated on the lesser of cost of a qualifying asset to a connected person and the market value thereof as determined on the date on which the asset was brought into use by the connected person, if the asset is brought into use by the taxpayer during the year of assessment, and was previously brought into use by that connected person. This applies only where a deduction in respect of the capital allowance, initial allowance or co-operative special machinery initial allowance has been granted in respect of the asset concerned to the connected person, in the current or any previous year of assessment. For this purpose the general definition of 'connected person' applies;

(*e*) any asset in respect of which an allowance has been granted to the taxpayer under s 12E (small business corporations).

SECTION 12C
Manufacturing plant and Machinery

- New and unused: 40/20/20/20
- Used: 20/20/20/20/20

SECTION 13
Manufacturing buildings: 5%

SECTION 13 SEX
Residential units

As of 12 October 2008, para 12 in the first schedule no longer applicable to expenses incurred in respect of housing for farm employees.

Section 13 *sex* permits an annual allowance if:

a) The unit or improvement is used by the taxpayer solely for the purposes of a trade carried on by the taxpayer; and
b) The unit is situated in the Republic; and
c) The taxpayer owns at least 5 residential units within the Republic; which are used by the taxpayer solely for trade purposes

The annual allowance is 5% of the cost to the taxpayer of the unit, with an additional 5% if the unit falls within the definition of a "low-cost" residential unit.

The units must be new and unused and owned by the taxpayer

Low-cost

- The cost of an apartment does not exceed R350 000
- The cost of a building does not exceed R300 000
- And in respect of both of the above the owner does not charge monthly rental in excess of 1% of the cost (ie apartment R3 500, building R3 000)

VAT

Tax periods

It is a common misconception that all farmers may be, or are required to be registered on Category D (six-monthly or bi-annual tax period). This is not true as a farming enterprise is required to make a written application to the Commissioner to be registered on Category D. Further, vendors who qualify for the Category D tax period must meet the following criteria:

- The enterprise must consist solely of agricultural, pastoral or farming activities.
- The total turnover from all farming activities must not exceed R1,5 million per consecutive period of 12 months.

Where the value of taxable supplies exceed R1,5 million in any consecutive period of 12 months, the Commissioner will allocate either a Category A or B tax period to the vendor (two-monthly tax period).

Where the value of taxable supplies exceeds R30 million per consecutive period of 12 months, the vendor will be obliged to pay over the VAT and submit monthly returns per Category C tax period.

Diesel refund scheme

Should you consume diesel in carrying on an enterprise involved in primary production activities such as agriculture, mining, fishing and coastal shipping, you can also register for the Diesel Refund Scheme which is currently administered through the VAT system. VAT registration is a pre-requisite for participation in the scheme.

If the person is already registered for VAT as a vendor, then registration for the Diesel Refund Scheme can be made by completing and submitting a VAT 101D form.

If the person is not registered for VAT as a vendor, then registration for VAT as a vendor and registration for the Diesel Refund Scheme can be made simultaneously by completing and submitting a VAT 101 and VAT101D forms, respectively. Note that these registrations still depend on whether the other remaining requirements for VAT registration and the Diesel Refund Scheme are complied with.

Note that refunds under the Diesel Refund Scheme are merely processed by utilising the VAT administrative system. The concession is actually granted to certain qualifying purchasers under the Customs and Excise Act. The diesel refunds are therefore offset against any VAT which may be payable for the tax period concerned, or alternatively, will increase any VAT refund if the input tax for the period exceeds the output tax liability.

It is important that all the relevant documentation is kept relating to diesel purchases as well as the various log book entries or other records which indicate the actual amounts of diesel drawn from stock for eligible and non-eligible use during the tax period. Vendors must also remember that a refund of the fuel levy included in the price of the diesel can only be claimed as a deduction against the output tax due on the VAT201 return to the extent that the diesel is actually used during the tax period for eligible purposes.

Any diesel refund which is found to be incorrectly deducted and paid would have to be paid back to SARS, together with any interest and/or forfeiture, which may be applicable, hence it is important to make sure that you actually qualify for the Diesel Refund Scheme before registering.

Customs and Excise Act Schedule 6 Part 3 “Eligible Activities”

A. …………………………..

B. includes the following activities:

(AA) Growing crops and harvesting and storing crops on the farming property.

(BB) Horticulture, pasturage and apiculture.

(CC) The breeding of fish in dams and the farming of oysters.

(DD) The breeding and caring for animals and reptiles.

(EE) The breeding and caring for race and show horses and the transportation thereof.

(FF) The shearing or cutting of hair or fleece of livestock, or the milking of livestock.

(GG) The transport of livestock to a farming property for the purpose of rearing.

(HH) The rounding up or herding of livestock. (IJJ) Baling of hay.

(KK) The planting or tending of fruit trees.

(LL) Any activity undertaken for the purpose of soil or water conservation.

(MM) The carrying out of fire fighting activities.

(NN) The construction or maintenance of fences.

(OO) The construction or maintenance of firebreaks.

(PP) The service, maintenance or repair of vehicles or equipment for use in a farming activity if it is carried out at the place where farming is carried on.

(QQ) The construction or maintenance of sheds, pens, silos or silage pits for use in a farming activity.

(RR) The construction or maintenance of dams, water tanks, water troughs, water channels, irrigation systems or drainage systems including water pipes and water piping for use in a farming activity carried out on the farming property.

(SS) The carrying out of earthworks for the purpose of a farming activity, carried out on the farming property.

(TT) Searching for ground water solely for use in a farming activity, or the construction or maintenance of facilities for the extraction of such water, solely for that use.

(UU) The pumping of water solely for use in farming if the pumping is carried out on a farming property.

(VV) The supply of water solely for use in farming if the supply is to a farming property and the water is supplied from that property or a place adjacent to that property.

(WW) The storage of farming products.

(XX) The packing, or prevention of deterioration of farming products, if the packing or the prevention of deterioration of the products is carried out on a farming property.

(YY) Weed, pest or disease control.

(ZZ) Hunting or trapping that is carried on as part of farming operations including the storage of any carcasses or skins.

(AAA) Game farming, excluding leisure activities such as game viewing and lodging.

(BBB) Generating electricity or the use of other farm equipment for domestic purposes.

(CCC) Use of locomotives for the carriage of goods by rail on the farming property.

(DDD) Flood management on farming property

PROPOSED DIESEL REFUND SCHEME

- Second draft released SARS website 9 Feb 2021
- Public comments closed 24 March 2021
- Main proposals
  - Registration claimant via the Customs and Excise (C&E) Act
  - Need to register/re-register- DA 185 application form
  - Not required to be a VAT vendor
  - New DSL 201 Excise claim form
- Completed and submitted monthly on SARS e-filing
- Exhaustive list of qualifying and non-qualifying activities, exhaustive list of qualifying assets
- Agriculture has its own list, farmers must ensure activities and assets qualify
- Monthly storage logbook required, template to be provided
- Monthly usage logbook required, template will be provided
- Logbook relief
  - A monthly simplified usage logbook (template to be provided) suggested in respect of fuel used to directly power qualifying equipment and vehicles
- Small scale sugarcane producers
  - Average production less than 1800 tons of sugarcane per year
  - Request sugar mills to which produce delivered to act as agents on their behalf
  - Sugar mill obtain refund using an average fuel usage

ZERO-RATED SUPPLIES

Zero-rated supplies are taxable supplies on which VAT is levied at a rate of 0%. The application of the zero-rate must be supported by documentary proof acceptable to the Commissioner. Vendors making zero-rated supplies are still able to deduct input tax in full on the goods or services acquired in the making of the zero-rated supplies. The documentary requirements are set out in Interpretation Notes 30 and 31 “Documentary Proof Required for the Zero-Rating of Goods or Services” respectively.

CERTAIN BASIC FOODSTUFFS

The zero rating in respect of items 11 to 19 applied with effect from 7 April 1993.

Item 1 Brown bread as defined in Regulation 1 of the regulation in terms of Government Notice R.577 (published in *Government Gazette* 13074 of 15 March 1991) i.e. a dough made from brown wheaten meal and water, with or without other ingredients, that has been fermented by yeast or otherwise leavened and which has been baked in any form, size or shape, provided it is marketed and sold under the description brown bread, the dough consists of at least 50% brown bread meal and the mass of the loaf exceeds 100 grams (see Practice Note 12).

Item 2 Maize meal graded as super maize meal, special maize meal, sifted or unsifted maize meal, not further processed other than by the addition of minerals and vitamins not exceeding one per cent by mass of the final product, solely for the purpose of increasing nutritional value.

Item 3 Samp, not further prepared or processed.

Item 4 Mealie rice, not further prepared or processed.

Item 5 Dried silo screened mealies or dried mealies not further prepared or processed or packaged as seed, but excluding pop corn (*zea mays everta*) (see also Practice Note 15).

Item 6 Dried beans, whole, split, crushed or in powder form but not further prepared or processed or where packaged as seed.

Item 7 Lentils, dried, whole, skinned or split.

Item 8 Pilchards or sardinella supplied in tins or cans consisting mainly of such products regardless of whether flavoured, seasoned or preserved in oil, but excluding such products as are supplied as pet food or sardines supplied in tins or cans.

Item 9 Milk powder: unflavoured, being the powder obtained by the removal of water from milk and which falls under the following classifications determined by the Minister of Agriculture under the Marketing Act 59 of 1968, or any regulation under that Act-

- high-fat milk powder;
- full-fat milk powder;
- medium-fat milk powder;
- low fat milk powder;
- fat-free milk powder,

provided that fat or protein content of such milk powder consists solely of milk fat or milk protein.

Item 10 Dairy powder blend, being any dairy powder blend which falls under the following classifications determined by the Minister of Agriculture under the Marketing Act of 1968, or any regulation under that Act-

- high-fat dairy powder blend;
- full-fat dairy powder blend;
- medium-fat dairy powder blend;
- low-fat dairy powder blend;
- fat-free dairy powder blend.

Item 11 Rice, whether husked, milled, polished, glazed, parboiled or broken.

Item 12 Vegetables, not cooked or treated in any manner except for the purpose of preserving such vegetables in their natural state, but excluding dehydrated, dried, canned or bottled vegetables or such vegetables as are described under separate Items.

Item 13 Fruit, not cooked or treated in any manner except for the purposes of preserving such fruit in its natural state, but excluding dehydrated, dried, canned or bottled fruit and nuts.

Item 14 Vegetable oil, marketed and supplied for use in the process of cooking food, but excluding olive oil.

Item 15 Milk, including high-fat, full-fat, low-fat or fat-free milk, being the milk of cattle, sheep or goats that has not been concentrated, condensed, evaporated, sweetened, flavoured, cultured or subjected to any other process other than homogenisation or preservation by pasteurisation, ultra-high temperature treatment, sterilisation, chilling or freezing or the addition of minerals, vitamins, enzymes and other similar additives not exceeding one per cent by volume of the final product, solely for the purpose of increasing the nutritional value.

Item 16 Cultured milk, being cultured milk as classified under the Marketing Act 59 of 1968, with the following class designation-

- cultured high-fat milk;
- cultured full-fat milk;
- cultured low-fat milk;
- cultured fat-free milk.

Item 17 Brown wheaten meal, being pure, sound wheaten meal, but excluding separated wheaten bran, wheaten germ and wheaten semolina.

Item 18 Eggs, being raw eggs laid by hens of the species *gallus domesticus*, whether supplied in their shells or in the form of egg pulp being raw pulp consisting of the yolk and white which is obtained from such eggs after the shells have been removed.

Item 19 Edible legumes and pulse of leguminous plants, dried, whole, split, crushed, skinned or in powder form, but not further prepared or processed or where packaged as seed or such pulse as are described under separate Items.
(Schedule 2 Part B.)

With regard to Item 12 above, SARS regards herbs (e.g. parsley), spices (e.g. ginger), green peppers, green mealies, garlic, chillies and mushrooms as vegetables, and as such they may be supplied at the zero rate unless dried, canned, bottled or cooked. Slices of vegetables cut up as a soup mix (either fresh or frozen) may also, as per SARS, be sold at the zero rate, but not when mixed with standard-rated items. Furthermore, peanuts (if not roasted, salted or mixed with other nuts or raisins) may be sold at the zero rate.

The zero rate will not apply where –

Zero-rated foodstuffs are prepared for immediate consumption for example –

- a glass of milk served in a restaurant;
- a pre-packed salad with salad dressing purchased at a supermarket;
- sandwiches and other take-away foods.

A standard rated product or ingredient is supplied together with a zero-rated foodstuff for example –

- a punnet of vegetables seasoned with herbs and including a stick of butter;

- a pack of rice or beans containing a sachet of flavouring;
- a gift hamper consisting of a basket of fruit with chocolates and nuts.

FARMING GOODS

Many of the products which are produced or consumed in the course of conducting a farming enterprise are zero-rated, or exempt from VAT on importation. However the zero- rating will be repealed from a date to be determined by the Minister and published by way of a notice in the Government Gazette.

The changes to the law from the effective date will affect farmers as follows:

- Zero-rating – The zero-rating under section 11(1)(g) will no longer apply in respect of the purchase of agricultural, pastoral or other goods described in Part A to Schedule 2.
- Exemption on importation – The exemption from VAT in Paragraph 7 to Schedule 1 in regard to the importation of the goods mentioned in Part A to Schedule 2 will no longer apply.

Until the concessions discussed above are repealed, the goods listed in Part A of Schedule 2 may be purchased locally at the zero-rate or imported exempt from VAT, subject to the conditions prescribed in the said Schedule.

Some examples of these goods are –

- stock licks;
- fertiliser;
- seed;
- pesticide;
- remedies or medicines (but not in respect of other items charged such as syringes or vet's fees);
- animal, poultry, fish or game feed (this includes any vitamins, bone products or maize products); and
- plants – this includes trees, bulbs, roots, cuttings or similar plant products used for cultivation.

In order to be able to purchase the above goods at the zero rate, the following requirements must be met:

- The vendor must be in possession of a Notice of Registration or a VAT registration certificate (VAT103) indicating the vendor's entitlement to acquire the goods at the zero rate. (The VAT 103 registration certificate included a clause no. 7 confirming that the main business is a farming, agricultural or pastoral enterprise and that the vendor may purchase certain farming inputs at the zero rate) With the implementation of the single registration process, the VAT103 was replaced with the new Notice of Registration which is a standard notice of registration across all tax types (except Customs and Excise).
- The Notice of Registration or the VAT103 form must be presented to the supplier (for example co-operatives and abattoirs) who will then keep a record of certain particulars appearing thereon to justify the application of the zero rate on supplies made to the purchaser as contemplated in Interpretation Note 31;
- The VAT registration number of the purchaser must appear on the tax invoice.
- The goods supplied must be specified in Part A of Schedule 2 to the VAT Act.

If it is found by SARS that the above conditions have not been met, the supplies in question will be standard rated on assessment.

Note that the zero rate of the above agricultural products will not apply where –

- other goods or services not listed above are supplied to the agricultural industry for example, it will not apply to the consultation fee charged by a vet to attend to a sick animal, nor would it apply to the goods or services acquired to install a new irrigation system on your farm;
- the sale of the goods concerned is prohibited under section 7bis of the Fertilisers, Farm Feed Agricultural Remedies Act 36 of 1947, for example, the sale of a banned substance such as dichlor-diphenyl-trichloroethane (DDT); or
- such products are purchased for purposes of resale.

Part B of Schedule 2 to the VAT Act lists the basic foodstuffs which are subject to the zero- rate. Many of these products are sold by farming enterprises for example, raw fruit and vegetables, maize, milk, eggs, beans, mealies etc. Please remember to show the total amount received in field 2 on your VAT return – failure to do so will result in unnecessary audits.

Also remember that a farmer who receives income from a harvest (crop sharing), must pay VAT at the standard rate on that portion of the proceeds unless the supplies are zero-rated under any of the items in Schedule 2 to the VAT Act as discussed above.

THE SUPPLY OF COMMERCIAL ACCOMMODATION

Paragraph (a) of "commercial accommodation" as defined in section 1(1) includes lodging or board and lodging which is systematically supplied, together with domestic goods or services. Before 1 April 2016, the total annual receipts from making the said supplies had to exceed, or be reasonably expected to exceed R60 000 in order to constitute the supply of commercial accommodation. From 1 April 2016 the total annual receipts have to exceed R120 000. Specifically excluded from the said paragraph of "commercial accommodation" is a dwelling supplied in terms of an agreement for the letting and hiring thereof.

The VAT Act defines a "dwelling" as any building, structure, premises or any other place which is mainly used as a residence of a natural person. Typically, commercial accommodation establishments refer to those which supply short-term business and leisure type accommodation as their core business activity.

The VAT Act defines "domestic goods or services" to include –

- cleaning and maintenance
- electricity, gas, air conditioning or heating
- a telephone, television set, radio or other similar article
- furniture and other fittings
- meals
- laundry
- nursing services
- water

As stated from 1 April 2016 the total annual receipts from the activity of supplying commercial accommodation must exceed R120 000 or be reasonably expected to exceed that amount in a period of 12 months, for the activity to be an enterprise.

Value of supply

Commercial accommodation

The supply of commercial accommodation is a taxable supply. Commercial accommodation includes board or board and lodging supplied together with domestic goods and services (for example, meals, laundry services, the use of a telephone) in a house, flat, apartment, room, hotel, guest house etc. Commercial accommodation excludes the letting or hiring of a dwelling which constitutes the place of residence of a natural person or the supply of employee housing, both of which are exempt supplies.

Should a person stay in an establishment which provides commercial accommodation for an unbroken period of more than 28 days, only 60% of the all-inclusive charge for the accommodation and the domestic goods and services is subject to VAT at the standard rate. The full amount charged is subject to VAT at the standard rate when a person stays for a period less than 28 days. Any domestic goods and services which are charged separately and are not included in the all-inclusive tariff for the accommodation, are also taxed in full at the standard rate. See the VAT 411 – Guide for Entertainment Accommodation and Catering for more information.

SALE OF FIXED PROPERTY

The phrase 'fixed property' is defined as:

land (together with improvements affixed thereto), any unit as defined in the Sectional Titles Act of 1986 (Act No. 95 of 1986), any share in a share block company which confers a right to or an interest in the use of immovable property, and, in relation to a property time-sharing scheme, any time-sharing interest as defined in the Property Time-Sharing Control Act of 1983 (Act No. 75 of 1983), and any real right in such land, unit, share or time-sharing interest (section 1).

Where a supply of fixed property is made, the consideration for the supply is the amount subject to VAT.

Where fixed property is disposed of under a sale agreement the sale is deemed to take place-

- On the date of registration in a deeds registry; or
- On the date on which any payment is made in respect of the consideration for the sale. (Payment in this context would exclude any deposit which has not as yet been 'applied' as consideration for the supply and has not been forfeited by the purchaser. Only when the deposit is forfeited by the purchaser, or is released and set off against the purchase price by the seller, would a 'payment' be made) (section 9(3)(*d*)) whichever is the earlier.

Notwithstanding these time of supply rules:

- Output tax only has to be accounted for to the extent that the seller of fixed property has received payment of the purchase price (s16(4)(a)(ii) of the Vat Act).
- Input tax may only be claimed to the extent that the purchaser has made payment of the price (ss16(3)(iiA) of the VAT Act)).

SUPPLY OF GOODS OR SERVICES - NO PRICE INITIALLY DETERMINED

Where goods are supplied under an agreement, other than an instalment credit agreement or rental agreement, to a recipient who appropriates the goods in circumstances where the consideration cannot be determined at the time they are appropriated, the VAT on the supply need only be brought to account by the supplier as and to the extent that payments become due or are received or any invoice is issued, whichever is the earliest (section 9(4)).

For example, a farmer may sell his produce to a market middleman. No invoices are issued. The price to be received by the farmer may well be a fixed percentage of what the middleman in turn is able to obtain for the sale of the produce. The farmer only has to account for output tax on the sale as and when he receives payment, or when payment is due from the middleman, whichever is the earlier date.

Similarly, where services are supplied where the consideration is dependent upon some future uncertain event, then the supply is deemed to take place when and to the extent that any payment is due or is received or an invoice is issued, whichever is the earlier.

SECTION 9HA DISPOSAL TO AND FROM DECEASED ESTATE

APPLICABLE TO PERSONS DYING <u>ON OR AFTER</u> 1 MARCH 2016

DISPOSAL BY A DECEASED PERSON: SECTION 9HA

In terms of section 9HA, a person who dies on or after 1 March 2016 is deemed to have disposed of his or her assets at the date of the persons death for an amount received or accrued equal to the market value of the assets at that date (market value as per para 31 in the Eighth schedule). Excluded from the deemed disposal at market value are assets bequeathed to a resident surviving spouse

If any asset which is deemed to have been so disposed of is transferred directly to an heir or legatee of the deceased (other than a resident surviving spouse), that heir or legatee is deemed to have acquired the asset for an amount of expenditure equal to the market value of the asset at the date of death of the deceased.

Exclusions from deemed disposal

The following assets are *<u>not deemed</u>* to have been disposed of :

- A long term insurance policy of the deceased if any capital gain or loss that would have been determined in respect of a disposal that resulted in proceeds of that policy being received by or accruing to the deceased would have been disregarded in terms of para 55 (see Annexure B) of the Eighth Schedule, and
- An interest of the deceased in a pension, pension preservation, provident, provident preservation or retirement annuity fund (in or outside the Republic), if any capital gain or loss that would have been determined in respect of a disposal of that interest that resulted in a lump sum benefit being received by or accruing to the deceased would have been disregarded in terms of para 54 (see Annexure B) of the Eighth Schedule.

Recoupment of allowances previously claimed

The effect of the deemed disposal provisions of section 9HA is that recoupments may be included in the gross income of the deceased person in terms of section 8(4)(a). The deemed disposals will also have the CGT effect that were previously created by para 40 in the Eighth Schedule.

Section 9H(2) Assets bequeathed to resident surviving spouse

In terms of this section, a deceased is deemed to have disposed of assets to a **<u>resident</u>** surviving spouse if those assets are acquired by the surviving spouse in terms of the will of the deceased, the laws of intestate succession or a re-distribution agreement in terms of section 3 of the Matrimonial Property Act (1984).

Section 9HA(2)(b)

The deemed disposal of an asset to a resident surviving spouse will be for an amount received or accrued (to the deceased) that is equal to, in the case of:

- Trading stock, or livestock or produce as contemplated in the First Schedule, the amount that was allowed as a deduction in respect of that asset for the purposes of determining that persons taxable income, before the inclusion of ant taxable gain, for the year of assessment ending on or after the date of that person’s death; or
- Any other asset, the base cost of the asset as determined in terms of para 20 of the Eighth Schedule.

As a result there will be no recoupment in the hands of the deceased in respect of trading stock or other business assets (on which capital allowances were claimed) transferred to a surviving spouse, while the capital gain or loss in respect of an asset is rolled over to the surviving spouse, resulting in a capital gain for the deceased of NIL.

Summary

- Asset transferred to heir or legatee (not *resident* surviving spouse), deceased treated as having disposed of asset at market value: If the market value of the asset at date of death of deceased was R300 000, and the base cost R100 000, a capital gain of R200 000 (proceeds of R300 000 less base cost of **R100 000**) would have to be taken into account in the deceased person's last assessment.
- Same asset as above transferred to a resident surviving spouse, deceased treated as having disposed of asset at an amount equal to the base cost of the asset: Proceeds from the disposal will be R100 000 less the base cost of the asset R100 000, and the capital gain will be NIL

The deceased person will also be entitled to

- An exclusion of R300 000 in the year of death
- The personal use asset exclusion
- The primary residence exclusion, and
- Potential small business asset relief in terms of para 57

DEATH OF A FARMER

When a farmer dies in a year of assessment it is necessary to determine his taxable income from farming operations from the start of the year of assessment to the date of death.

The value of livestock or produce held in the name of the deceased must in terms of section 9HA be included in income. The value of the livestock or produce at the start of the year of assessment must be allowed as a deduction (para 3 read with para 1).

Other than assets left to a surviving spouse, the deceased farmer will be treated as having disposed of his livestock or produce to his deceased estate along with his other assets for proceeds equal to the market value of the assets at the date of death of the farmer(s9HA). The deceased estate will be deemed to acquire the livestock, produce and other assets at a cost equal to the same market value.

Therefore the market value of the livestock and produce (harvested) owned by a deceased farmer at his date of death will be included in the income of the farmer on death. The value of the livestock held at the beginning of the year will be deductible, however the livestock must be valued at its standard value. Produce will be valued at its cost of production.

Depreciable assets held by the farmer at date of death will give rise to a recoupment and possible capital gain, thereby increasing the income of the farmer in the year of death. Non-depreciable assets held by the farmer at date of death will give rise to a capital gain.

TAXATION OF DECEASED ESTATES

PERSONS DYING ON OR AFTER 1 MARCH 2016

An amended section 25 will apply to a person who dies on or after 1 March 2016.

The amended section 25: Taxation of deceased estate

In terms of section 25(1) the following amounts will be treated as income of the deceased estate of the deceased person:

- Any income received by or accrued to or in favour of any person in his or her capacity as the executor of the estate of the deceased person, and
- Any amount received by or accrued to or in favour of any person in his or her capacity as the executor of the deceased estate which would have been income in the hands of the deceased person had that amount been received or accrued to or in favour of that deceased person during his or her lifetime.

The income amounts mention above will therefore no longer be taxed in the hands of an ascertained beneficiary but in the hands of the deceased estate.

Section25(2)

This section determines the amount at which the deceased estate is deemed to acquire assets from the deceased:

- Assets other than those contemplated in section 9HA(2) (assets that have been transferred to a *resident* surviving spouse) are treated as having been acquired by the deceased estate for an amount of expenditure equal to the market value of those assets at the date of death of the deceased
- Asset contemplated in section 9HA(2) are treated as being acquired by the deceased estate for an amount of expenditure incurred equal to the amount contemplated in section 9HA(2)(b)

Section 25(3) Heirs or legatees

This section deals with the situation where the deceased estate disposes of an asset to an heir or legatee of the deceased person:

- The deceased estate is treated as having disposed of that asset for an amount received or accrued equal to the amount of expenditure incurred by the deceased estate in respect of that asset (this will be the market value of the asset at the date of death of the deceased)
- The heir or legatee is treated as having acquired that asset for an amount of expenditure incurred equal to the amount of expenditure incurred by the deceased estate (the market value of the asset at the date of death of the deceased).

The effect is that there will be no increase or loss of income and no capital gain or loss on assets that are transferred from the deceased estate to an heir or legatee of the deceased. The deceased estate will acquire the asset from the deceased for an amount of expenditure that will be equal to the proceeds received by the deceased estate when the asset is transferred to the relevant heir or legatee of the deceased.

The heir or legatee will inherit the asset for an amount of expenditure equal to the market value of the asset at the date of death of the deceased.

Section 25(4)Surviving spouse

This section deals with the disposal of an asset by the deceased estate to the resident surviving spouse of the deceased.

- The surviving spouse is treated as having acquired the asset on the date that the deceased acquired the asset
- The surviving spouse is treated as having incurred expenditure in respect of that asset of an amount equal to the expenditure incurred by the deceased person as well as any expenditure incurred by the deceased estate. The expenditure is deemed to have been incurred by the surviving spouse on the same date and in the same currency in which it was incurred by the deceased person or the deceased estate, as the case may be.
- The surviving spouse is treated as having used the asset in the same manner as the manner in which that asset had been used by the deceased person and the deceased estate.

The effect of the provision above is that the asset which is transferred to the surviving spouse is merely “rolled over” to the surviving spouse of the deceased. Stated differently, the surviving spouse simply steps into the shoes of the deceased and assumes the entire history of the asset in question from the date of acquisition of the asset by the deceased.

Section25(5)

The deceased estate must be treated as if the estate were a natural person. The deceased estate will however not qualify for the section 6 rebates (primary, secondary and tertiary rebates) and the section 6A and 6B medical credit rebates. The general exemption for local interest available to “natural persons” in section 10(1)(i) is not expressly excluded from section 25(5) and should be available to the deceased estate.

Section 25(6)

This section provides for the situation where an heir or legatee who would have received an asset out of a deceased estate which now has to be sold by the deceased estate in order for the estate to be able to pay capital gains tax as a result of the deemed disposal rules, can elect to receive the asset if the heir or legatee pays a portion of the CGT within a period of three years after the estate became distributable. Section 25(6) is subject to very specific limitations and requirements.

DEATH OF GAME FARMER (NEW IN 69 ISSUE 2)

Deceased person

The taxable income of a person upon death must be determined for the period from the beginning of the year of assessment to the date of death.

Under section 9HA(1) the farmer is deemed to dispose of the game livestock at its market value on the date of death, except when the livestock is disposed of to a resident surviving spouse. This deemed disposal results in an inclusion in the farmer's gross income in the final year of assessment equal to the market value of the game livestock. Before 1 March 2016 the deemed disposal on date of death applied only for CGT purposes while the game livestock was included in closing stock at a standard value of nil for purposes of the First Schedule. As a result of the deemed disposal, the game livestock is no longer held on the date of death and hence is no longer included in closing stock. The difference between the pre- and post-1 March 2016 positions is that before 1 March 2016 the market value of the game livestock would have been included in proceeds under paragraph 35 of the Eighth Schedule, with a base cost of nil, giving a capital gain equal to the market value of the game livestock. On or after 1 March 2016 the market value of the game livestock is included in the farmer's gross income on date of death with the result that it will give rise to proceeds of nil (NB "proceeds" are Nil for the purposes of CGT, as the amount from the disposal has been included in the gross income of the deceased as a revenue receipt) and hence neither a capital gain nor a capital loss. In other words, the deemed sale is now on revenue account while previously it was on capital account.

In the year of assessment in which a game farmer dies, the value of game livestock held at the beginning of the year of assessment is included in opening stock at a standard value of nil. Purchases of livestock from the beginning of the final year of assessment until the date of death are deductible by the deceased under section 11(a).

Any unused balance of livestock expenditure ring-fenced under paragraph 8 and carried forward to the final year of assessment under paragraph 8(2) will be claimable on the date of death by the deceased under paragraph 8(3)(a), since the game livestock is no longer held and not disposed of at the end of the final year of assessment. Any such brought-forward expenditure will need to be allocated between livestock disposed of to a resident surviving spouse and other heirs or legatees. The portion relating to the resident surviving spouse is subject to roll-over treatment under section 9HA(2)(b) for the deceased person and section 25(4)(b)(iii)(aa) for the resident surviving spouse. The portion of the expenditure relating to other heirs or legatees will be claimable against the market value of livestock included in the farmer's gross income under section 9HA(1).

No roll-over from the deceased person to a non-resident surviving spouse is permitted, regardless of the nature of the asset, because section 9HA(2) refers only to a surviving spouse who is a resident. .

Deceased estate

When a person dies, that person's year of assessment comes to an end and a new entity comes into existence, namely, the deceased estate. In reality a deceased estate is not a person but simply an aggregate of assets and liabilities of the deceased person administered by an executor. This common-law position is varied by the Act in that a deceased estate is deemed to be a person as defined in section 1(1) and the executor is deemed to be its representative taxpayer, also as defined in section 1(1).

Section 25(5) provides that a deceased estate must be treated as if it were a natural person, other than for purposes of the primary, secondary and tertiary rebates under section 6, the medical scheme fees tax credit under section 6A and the additional medical expenses tax credit under section 6B. It, however, remains a separate taxpayer in its own right and is not deemed to be the same natural person as the deceased person.

The first return for the deceased estate commences on the day after the date of death and ends on the last day of February or, if earlier, on the date on which the liquidation and distribution account becomes final. For subsequent years of assessment the executor of a deceased estate must continue to submit returns of income for each year of assessment until the liquidation and distribution account becomes final.

Under section 25(1)(a) income received by or accrued to or in favour of any person in the capacity as the executor of a deceased estate must be treated as income of the deceased estate. Under section 25(1)(b) income includes amounts received or accrued which would have been income in the hands of the deceased person had it been received by or accrued to or in favour of the deceased person during his or her lifetime. The disposal of game livestock by the deceased estate will therefore result in an inclusion in its gross income, even if it could be argued that it is not carrying on farming operations.

Acquisition of livestock by the deceased estate [section 25(2)]

Paragraph 4(1)(a)(ii)(aa) and 4(1)(b)(ii)(aa) deem livestock "acquired by such person during the year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations" to be included in opening stock at market value. Before 1 March 2016 these rules enabled a farmer to obtain an opening stock deduction for inherited livestock. On or after 1 March 2016 section 25(2)(a) and (b) deem the deceased estate to have incurred expenditure in respect of assets acquired from the deceased person. The quantum of the deemed expenditure is elaborated on below. In order to avoid any conflict between section 25(2) and paragraph 4(1) it is submitted that the expenditure deemed to be incurred under section 25(2) should be regarded as having been incurred under a purchase transaction, which will have the effect of making paragraph 4(1) inapplicable, thus avoiding any conflict between the two provisions. Even if there should be a conflict, section 25(2) is the later provision and should prevail.

Under section 25(2)(a) a deceased estate is deemed to acquire an asset from the deceased person (other than an asset disposed of to a resident surviving spouse) for an amount of expenditure incurred equal to the market value of the asset on the date of death.

Under section 25(2)(b) the deceased estate is deemed to acquire an asset disposed of to a resident surviving spouse for an amount of expenditure incurred equal to the amount contemplated in section 9HA(2)(b), namely, in the case of –

trading stock, or livestock or produce contemplated in the First Schedule, the amount that was allowed as a deduction in respect of that asset for purposes of determining that person's taxable income, before the inclusion of any taxable capital gain, for the year of assessment ending on the date of that person's death; or

any other asset, the base cost of that asset, as contemplated in the Eighth Schedule, as at the date of that person's death.

Thus, game livestock transferable to a resident surviving spouse is acquired by the deceased estate at standard value of nil if the deceased person had acquired it in a year of assessment before the year of death, or at cost price if it was acquired by the deceased person in the year of death.

There will be no expenditure for game livestock acquired by the deceased estate by natural increase after date of death, since such livestock is acquired at a cost of nil.

Although unlikely to occur frequently in practice, the executor could purchase additional game livestock after death. The expenditure in respect of such purchases would be determined under section 11(a).

Any game livestock still on hand at the end of the deceased estate's first year of assessment will be included in closing stock at a standard value of nil, and the same applies to amounts to be included in its opening and closing stock in subsequent years of assessment. The deceased estate will be subject to the livestock ring- fencing provisions of paragraph 8 until it has disposed of the relevant game livestock to a third party, an heir or legatee.

Disposal of game livestock to heirs or legatees [section 25(3)(a)]

Under section 25(3)(a) an asset awarded to an heir or legatee is treated as being disposed of by the deceased estate for an amount received or accrued equal to the amount of expenditure incurred by the deceased estate in respect of that asset. As discussed above, such expenditure could comprise the deemed expenditure under section 25(2) for game livestock acquired from the deceased person or under section 11(a) if the executor purchased more game livestock after the date of death. The amount of the deemed expenditure will depend on whether the game livestock is bequeathed to an heir or legatee (section 25(2)(a)] or to a resident surviving spouse [section 25(2)(b)]. The intention of section 25(3)(a) is to leave the deceased estate in a tax-neutral position, so that the amount included in its gross income is equal to the amount of expenditure incurred or deemed to be incurred by it.

Capital or revenue nature of game livestock and capital gains tax

Since a deceased farmer would have held game livestock as floating capital at the date of death, the amount deemed to be received by or accrued to the farmer for such livestock under section 9HA(1) and (2) will be of a revenue nature and included in the farmer's gross income.

Any amount that would have constituted income in the hands of the deceased person will constitute income of the deceased estate under section 25(1)(b). Thus the disposal of game livestock by the deceased estate will also be on revenue account.

Under section 25(4)(b)(iv) a resident surviving spouse is treated as having used game livestock in the same manner that it was used by the deceased person and the deceased estate. Since both those persons used the game livestock as floating capital, the resident surviving spouse is deemed to use game livestock acquired from the deceased person and the deceased estate as floating capital. There can therefore be no question of the game livestock giving rise to a receipt of a capital nature in the hands of the resident surviving spouse, even if that surviving spouse does not carry on farming operations. Under section 26(2) such game livestock would continue to be held on revenue account until disposed of, even if farming operations were discontinued.

Game livestock will also comprise floating capital and be on revenue account in the hands of an heir or legatee (other than a resident surviving spouse) who is a farmer and brings the inherited livestock into a farming operation.

The amount received by or accrued to an heir or legatee (other than a resident surviving spouse) disposing of game livestock acquired by inheritance will be of a capital nature provided that it was disposed of at the earliest opportunity and not made part of a farming operation.

The Eighth Schedule eliminates receipts and accruals of a revenue nature on disposal from proceeds under paragraph 35(3)(a). Likewise, expenditure of a revenue nature is eliminated from base cost under paragraph 20(3)(a). The disposal of game livestock held as floating capital should not, therefore, give rise to capital gains or losses.

It remains then to consider the CGT position of an heir or legatee other than a resident surviving spouse who disposes of inherited game livestock on capital account. The capital gain or loss on such a disposal will be determined by subtracting the base cost from the proceeds in the normal way. The base cost would comprise the expenditure deemed to be incurred by the heir or legatee under section 25(3)(b), namely, market value on date of death plus any further purchase costs incurred by the executor. The proceeds will comprise the amount received or accrued on the disposal under paragraph 35 of the Eighth Schedule.

PRIMARY RESIDENCE

An individual is entitled to deduct R2 million from any capital gain computed in relation to 'the primary residence of that person'. The same rule applies to a special trust whose beneficiary occupies the trust's property. A capital loss on a primary residence must also be reduced by R2 million. The exclusion applies each time an individual disposes of a primary residence. It is therefore neither an annual nor a cumulative exclusion and if an individual were to dispose of consecutive primary residences in each of four years, the total possible exclusion would be R8 million (subject to the limitations discussed in this chapter).

This basic rule is qualified by a number of provisos, namely:

- Where a primary residence is jointly owned (typically by a husband and wife), the R2 million is apportioned between the capital gains or losses accruing to each individual.
- The maximum extent of a primary residence qualifying for the R2 million exclusion is two hectares. If the property which is used as a primary residence exceeds that size, the proceeds of an area not exceeding two hectares must be determined as the limit against which the R2 million may be set off.

  Where a house is situated on a separate erf from, for example, its gardens, the exclusion only applies to so much of the separate erven as is disposed of at the same time and to the same person as the residence itself. So, for example, if an individual were to subdivide his property so that the residence and a small garden stood on one plot and were to sell off the subdivided vacant plot to a person other than the purchaser of his residence, no exclusion would apply to the gain computed in respect of the plot. Similarly, even if both residence and plot were disposed of to the same person, the sale must be at the same time in order for the plot to enjoy participation in the R2 million exclusion - in this context 'at the same time' effectively means in the same sale agreement.

Where an individual has not been continually resident in his primary residence through the period of ownership from 1 October 2001 or acquisition (whichever is the later) to the date of disposal, then an apportionment of the gain from the disposal may be required:

The R2 million exclusion is applied to that portion of the gain or loss attributable to:

- the period (if any) during which the residence was used wholly for business/rental purposes; *and*
- the proportion of the residence that was used mainly for business purposes.

Definition of primary residence

Only one residence can be a 'primary residence' of a natural person or of a special trust at any one point in time. This is expressly provided for, notwithstanding that the word 'primary' on its own would tend to suggest that conclusion.

A 'residence' means:

'Any structure, including a boat, caravan or mobile home which is used as a place of residence by a natural person, together with any appurtenance belonging thereto and enjoyed therewith.'

Furthermore, where adjacent land (ie. a separate erf) is used mainly for domestic or private purposes together with the residence, then it, too, is included, provided that it is sold together with and to the same person as the residence itself.

A primary residence can be owned directly or jointly with another person who need not necessarily hold their share also as a primary residence - in other words the enquiry is made in respect of the particular owner or part-owner concerned, without reference to the status of other part-owners. But in relation to the person concerned, it must be used by that person as their

main residence in which they ordinarily reside or resided.

Generally, it will be fairly easy to determine whether a particular person occupies a property as his or her primary residence together with their spouse. Note that occupation by children and other dependants is irrelevant, so that if the owner of a residence moves away and allows their children to use it, the primary residence status will lapse in the same way as it would if let or otherwise used for business purposes. In such a case, the basic exemption is applied against that portion of the gain that is attributable to the period during which the residence was occupied in a qualifying manner after 1 October 2001.

On the other hand, if a person uses a property as his primary residence and allows another person to live in the premises at the same time, whether a child, relative or friend, then provided no commercial (trade) use is made of the premises, it continues to qualify as a primary residence and there is no reduction of the gain qualifying for exclusion.

INTRODUCING MEASURES TO PREVENT ESTATE DUTY AND DONATIONS TAX AVOIDANCE THROUGH THE USE OF INTEREST FREE OR LOW INTEREST LOANS TO A TRUST

Insertion of section 7C in Act 58 of 1962

7C. Loan or credit advanced to a trust by a connected person.—(1) This section applies in respect of any loan, advance or credit that—

(a) a natural person; or

(b) at the instance of that person, a company in relation to which that person is a connected person in terms of paragraph (*d*) (iv) of the definition of connected person,

directly or indirectly provides to—

(i) a trust in relation to which—

(*aa*) that person or company; or

(*bb*) any person that is a connected person in relation to the person or company referred to in item (*aa*),

is a connected person; or

(ii) a company if at least 20 per cent of—

(*aa*) the equity shares in that company are held, directly or indirectly; or

(*bb*) the voting rights in that company can be exercised,

by the trust referred to in subparagraph (i) or by a beneficiary of that trust. [*Sub-s. (1) amended by s. 5 (1) (a) of Act No. 17 of 2017 deemed to have come into operation on 19 July, 2017 and applicable in respect of any amount owed by a trustor a company in respect of a loan, advance or credit provided to that trust or that company before, on or after that date.*]

(1A) If a person acquires a claim to an amount owing by a trust or a company in respect of a loan, advance or credit referred to in subsection (1), that person must for purposes of this section be treated as having provided a loan, advance or credit to that trust or company—

(a) on the date on which that person acquired that claim; or

(b) if that person was not a connected person on that date in relation to—

(i) that trust; or

(ii) the person who provided that loan, advance or credit to that trust or company,

on the date on which that person became a connected person in relation to that trust or person, that is equal to the amount of the claim so acquired.

[*Sub-s. (1A) inserted by s. 5 (1) (b) of Act No. 17 of 2017 deemed to have come into operation on 19 July, 2017 and applicable in respect of any amount owed by a trust or a company in respect of a loan, advance or credit provided to that trust or that company before, on or after that date.*]

(1B) Where—

(a) a natural person; or

(b) at the instance of a natural person, a company that is a connected person in relation to that natural person in terms of paragraph (d)(iv) of the definition of 'connected person',

subscribes for a preference share in a company in which 20 per cent or more of the equity shares are held (whether directly or indirectly) or the voting rights can be exercised by a trust that is a connected person in relation to that natural person or to that company, whether alone or together with any person who is a beneficiary of that trust—

(i) consideration received by or accrued to that company for the issue of that preference share shall be deemed to be a loan for the purposes of subsection (3); and

(ii) any dividend or foreign dividend accrued in respect of that preference share shall be deemed to be interest in respect of the loan contemplated in paragraph (i).

(TLAA 2020 WEF 1 January 2021, applicable to any dividend of foreign dividend accruing during any year of assessment commencing on or after that date)

(2) No deduction, loss, allowance or capital loss may be claimed in respect of—

(a) a disposal, including by way of a reduction or waiver; or

(b) the failure, wholly or partly, of a claim for the payment,

of any amount owing in respect of a loan, advance or credit referred to in subsection (1).

(3) If a trust or company incurs—

(a) no interest in respect of a loan, advance or credit referred to in subsection

(1) , (1A) or (1B)

(b) interest at a rate lower than the official rate of interest,

an amount equal to the difference between the amount incurred by that trust or company during a year of assessment as interest in respect of that loan, advance or credit and the amount that would have been incurred by that trust or company at the official rate of interest must, for purposes of Part V of Chapter II, be treated as a donation made to that trust by the person referred to in subsection (1) (*a*), (1A) or (1B) on the last day of that year of assessment of that trust.

(4) If a loan, advance or credit was provided by a company to a trust or another company at the instance of more than one person that is a connected person in relation to that company as referred to in paragraph (*b*) of subsection (1), each of those persons must be treated as having donated, to that trust or company, the part of that amount that bears to that amount the same ratio as the equity shares or voting rights in that company that were held by that person during that year of assessment bears to the equity shares or voting rights in that company held in aggregate by those persons during that year of assessment.

(5) Subsections (2) and (3) do not apply in respect of any amount owing by a trust or company during a year of assessment in respect of a loan, advance or credit referred to in subsection (1) if—

(a) that trust or company is a public benefit organisation approved by the Commissioner in terms of section 30 (3) or a small business funding entity approved by the Commissioner in terms of section 30C;

(b) that loan, advance or credit was provided to that trust by a person by reason of or in return for a vested interest held by that person in the receipts and accruals and assets of that trust and—

(i) the beneficiaries of that trust hold, in aggregate, a vested interest in all the receipts and accruals and assets of that trust;

(ii) no beneficiary of that trust can, in terms of the trust deed governing that trust, hold or acquire an interest in that trust other than a vested interest in the receipts and accruals and assets of that trust;

(iii) the vested interest of each beneficiary of that trust is determined solely with reference and in proportion to the assets, services or funding contributed by that beneficiary to that trust; and

(iv) none of the vested interests held by the beneficiaries of that trust is subject to a discretionary power conferred on any person in terms of which that interest can be varied or revoked;

(c) that trust is a special trust as defined in paragraph (*a*) of the definition of a special trust;

(d) that trust or company used that loan, advance or credit wholly or partly for purposes of funding the acquisition of an asset and—

(i) the person referred to in subsection (1) (*a*) or the spouse of that person used that asset as a primary residence as contemplated in paragraph (*b*) of the definition of ―primary residence‖ in paragraph 44 of the Eighth Schedule throughout the period during that year of assessment during which that trust or company held that asset; and

(ii) the amount owed relates to the part of that loan, advance or credit that funded the acquisition of that asset;

(e) that loan, advance or credit constitutes an affected transaction as defined in section 31 (1) that is subject to the provisions of that section;

(f) that loan, advance or credit was provided to that trust or company in terms of an arrangement that would have qualified as a sharia compliant financing arrangement as contemplated in section 24JA, had that trust or company been a bank as defined in that section;

(g) Loan advance or credit subject to section 64E(4)

(h) …………………………………………

OFFICIAL RATE OF INTEREST

The “official rate” is now defined in section 1 of the Income Tax Act is specifically linked to the repurchase rate (repo rate). The official rate is adjusted at the beginning of the month following the month during which the Reserve Bank changes the repurchase rate.

- ***Debt in Rands:***

  Rate of interest equal to the SA Repo rate plus 100 basis points

  - 1 Aug 2017-31 March 2018: **7.75%**
  - 1 April 2018-30 November 2018: **7.5%**
  - 1 December 2018-31 July 2019: **7.75%**
  - 1 August 2019 – 31 January 2020 **7.5%**
  - 1 February 2020 -31 March 2020 **7.25%**
  - 1 April 2020 – 30 April 2020 **6.25%**
  - 1 May 2020 – 31 May 2020 **5.25%**
  - 1 June 2020 – 31 July 2020 **4.75%**
  - 1 August 2020 – until the repo rate changes **4.5%**

- ***Debt in foreign currency***

  Rate of interest that is the equivalent of the SA repo rate applicable in that currency plus 100 basis points

***Example* deemed donation 2020 YOA**

Assume a resident natural person made an interest free loan to a Trust of R5 million. The natural person is a connected person to the trust. Assume the natural person made no other donations during the 2020 YOA.

Deemed donation at 29 February 2020:

5000 000 x 7.75% x 5/12 = 161 458

5000 000 x 7.5% x 6/12 = 187 500

5000 000 x 7.25% x 1/12 = 30 208

Total	379 166
Less (s56(2)(b))	(100 000)
Total deemed donation	**279 166**

Donations tax payable by 31 March 2020

279 166 x 20% = R55 833

NATURE AND EXTENT OF BENEFICIARY'S RIGHTS

The origin and nature of the trust beneficiary's rights are determined by the kind of trust and the particular trust instrument that created the trust.

Personal right against the trustee for the proper management of the trust

Every trust beneficiary enjoys a personal right against the trust's trustee for the administration of the trust in accordance with the proper discharge of his office.

A trust beneficiary's right with regards to trust income/capital

The beneficiary may enjoy a personal right to claim trust income/capital at a destined time. In the case of an *inter vivos bewind* trust the beneficiary's right to claim the corpus of the trust is usually exercisable against the trust's founder. In the case of a testamentary *bewind* trust against the executor the founder's deceased estate.

The beneficiary may have a vested or a contingent right.

Vested right

The beneficiary has a guaranteed unconditional right to claim payment of the income of the trust from the trustee as soon as that income becomes distributable, that is immediately or at a future date.

If the trust instrument provides that a beneficiary is immediately entitled to trust income/ and or capital, the beneficiary obtains a vested personal right against the trustee to claim payment of the income/capital as soon as it becomes distributable or at the discretion of the trustees. In the case of a testamentary trust such a personal right vests upon the creation of the trust at the death of the testator. A vested right is an asset in the right-holder's estate , however it need not constitute an immediately enforceable right, enforcement may be postponed until sometime after the vesting.

In general terms a vested or vesting trust refers to a trust where the beneficiaries have vested rights to the income or capital of the trust, in other words the trustees have no discretion as to whether to distribute the income or capital to them. A vested trust does not mean that the ownership of the trust assets vests in the beneficiaries. Ownership of the assets still vests in the trustees. Vesting trusts must not be confused with *bewind* trusts in which the ownership of the assets vests in the beneficiaries.

Example

A must receive 50% of the trust income annually. The first payment must occur six months after my death, and then on a yearly basis thereafter for a period of 10 years.

This provision will bestow a vested right of 50% of the trust's income on A at the death of the trust's founder. Such a right will be an asset in the estate of A from the date of the inception of the trust. A will however only be able to enforce his right by claiming 50% of the trust income at the time when the income becomes distributable, namely six months after the death of the founder and from then on, on an annual basis. Should A die at any time in the 10 year period, the vested right will devolve to his nominated successor who will then enjoy the right to claim income from the trust for the remainder of the 10 year period.

Contingent right

The right of the trust beneficiary to claim payment of income/capital from the trust is not immediate but rather contingent or conditional upon the occurrence of an uncertain future event. The right to the income from the trust will only vest in the beneficiary if and when the contingency has taken place or the condition has been fulfilled. Before this time, the beneficiary enjoys only a contingent right, that is no more than an expectation or *spes* which does not constitute and asset in the hands of the beneficiary. The happening of the future event without anything more must bestow the vested right.

Example

A will be awarded trust income on the attainment of a law degree. The obtainment of the degree, without anything else, will ensure that the right to income becomes vested in the beneficiary

Discretionary versus non-discretionary trusts

If the trust deed makes provision for the trustees to decide how the income and capital will be distributed, the trust is regarded as a discretionary trust. In a discretionary trust there is no vesting until the trustees exercise their discretion. The vesting that occurs as a result of the trustees exercising their discretion must not be confused with a distribution.

If the trust deed stipulates exactly how the income and capital of the trust are to be dealt with, it is a non-discretionary trust, the Trustees have no discretion and the income and/or capital vest in the hands of the beneficiary.

Beneficiary loan accounts

The capital or revenue profit of a trust that has *vested* in a beneficiary is an unconditional liability that the trust has to pay the amount to the beneficiary at some future date (eg date as stipulated in the trust deed or date determined by the exercise of the discretion of the trustees). The liability of the trust can be reflected by crediting a liability account, “Amount vested not yet payable”. Capital or revenue profit that has been *distributed* to a beneficiary must be reflected by debiting the capital or revenue profit and crediting a separate beneficiary’s loan account. Both of these scenarios can only arise if the trust deed and trustees resolutions that permit or give rise to these transactions are in place. The accounting entries merely reflect the consequences arising from the trust deed and/or trustees resolutions.

However, if, for example, the trust has accumulated accounting losses that exceed the trust profit, it is doubtful whether such a distribution can occur because the profit would have been absorbed by the losses, and it would be imprudent for a trustee to create further liabilities for the trust (by crediting a beneficiary loan account) when the trust in fact cannot service existing liabilities due to solvency issues.

In respect of a “credit beneficiary loan account”, should the beneficiary not charge the trust interest at a market related rate, the loan account may be viewed as a “disposition” for the purposes of section 7.

RING-FENCING OF ASSESSED LOSSES OF CERTAIN TRADES (SECTION 20A)

This section applies to individuals in the top tax bracket only. Section 20 (set-off of assessed losses) is subject to the provisions of section 20A.

- In terms of section 20A(2), the '**taxed at the maximum marginal tax rate-requirement'** should be tested for by comparing the following amounts:
  - **the sum of the taxpayer's taxable income** (as defined in section 20A(2)) **(determined without having regard to any other provisions of this section) and any assessed loss and balance of assessed loss which were set off in terms of section 20 in determining that taxable income** and
  - the amount at which the maximum marginal tax rate for individuals for the year under review becomes applicable

  Thus, we look at taxable income after deducting the current years and previous years' assessed losses. Assessed losses so deducted, are then added back again. Thus, the net effect is that losses from other trades are in essence ignored for the purposes of the "taxed at the marginal rate-requirement". It is however taken into account for the purposes of calculating as the qualifying donation deduction (section 18A).

- Once an assessed loss is ring-fenced, it stays ring-fenced even if the person is not taxed at the maximum marginal tax rate in a subsequent year of assessment (section 20A(5)).

- Any balance of an assessed loss carried forward, to which section 20A applied in any prior year of assessment, may not be set off against any income other *than income derived from that specific trade*. Income derived from any trade includes: recoupment's in terms of section 8(4) and any amount derived from the disposal, after the cessation of that trade, of any asset used in carrying on that trade (section 20A(6)).

- All farming activities carried on by a taxpayer shall be deemed to constitute a single trade (section 20A(7)).

- If the provisions of section 20A(2) (being "taxed at the maximum marginal rate-requirement") apply, the taxpayer must indicate the nature of the business in his tax return (section 20A(8)).

- It is a commonly held view that separate business activities (other than farming) will constitute separate trades.

Natural person carrying on a **trade** that incurred an **assessed loss**

Yes

"Taxed at the maximum marginal rate-requirement" - Taxable income for current year exceeds the amount at which maximum marginal tax rate for individuals becomes applicable. (s 20A(2))

Yes

"3 out of 5 year-rule"
During the previous 5 years of assessment (current and previous 4 years) incurred an assessed loss in at least 3 of the years of assessment in carrying on that trade (do calculation separately for each year without taking into account an assessed loss from the previous year) (s 20A(2)(*a*))

OR

Suspect trade
The trade in respect of which the assessed loss was incurred, constitutes one of the following so-called suspect trades (s 20A(2)(*b*))

1. Any sport practiced by taxpayer or relative
2. Dealing in collectables by taxpayer or relative
3. Rental of residential accommodation, unless at least 80% is not used by relatives for at least 6 months of the year of assessment
4. Rental of vehicles, aircraft or boats as defined in the Eighth Schedule, unless at least 80% are not used by relatives for at least 6 months of the year of assessment
5. Animal showing by taxpayer or relative
6. Farming or animal breeding, unless it is carried on, on a full-time basis
7. Any form of performing or creative arts practised by taxpayer or relative.
8. Any form of gambling or betting practised by taxpayer or relative

(*Relative* is defined as your spouse, parent, child, stepchild, brother, sister, grandchild or grandparent)

Yes

Assessed loss incurred is in respect of a ***business*** that has a ***reasonable*** **prospect of deriving taxable income** (excluding a taxable capital gain) **within a *reasonable* period** (s 20A(3)).
(R*easonable* will be evaluated based on the stipulations in section 20A(3)(*a*) – (3)(*f*))

No → **Ring-fencing** (section 20A(1)) **applies**➔ The assessed loss incurred from the trade cannot be set-off against income from any other trade.

Yes

Is it a **suspect trade (excluding farming)** which meets the "**6 out of 10 year-requirement**"? It is if during the 10 years ending at the end of the current year of assessment, an assessed loss was incurred in carrying on that trade in at least 6 of the 10 years (s 20A(4)).

(*Remember:* Exclude any balance of assessed losses carried forward when doing a specific year's calculation. Only 2005 and later years of assessment are taken into account.)

Yes → Ring-fencing applies

No → Loss from trade **not ring- fenced**