



*SOUTH AFRICAN REVENUE SERVICE*

**INTERPRETATION NOTE NO. 21**

DATE: 9 March 2004

<b>ACT</b>	<b>:REGIONAL SERVICES COUNCILS ACT, No.109 of 1985 (RSC Act)</b>
<b>SECTION</b>	<b>:Section 1: definition of “enterprise” :Section 12(1) :Section 12(1A)</b>
<b>REGULATIONS</b>	<b>:Government Notice No. R340 of 17 February 1987, as amended (the Regulations)</b>
<b>PARAGRAPHS</b>	<b>:Paragraph 1:definition of “financial enterprise”, “consideration” and “leviable transaction”, :Paragraph 5 :Paragraph 6 :Paragraph 13(5)</b>
<b>SUBJECT</b>	<b>:THE APPLICABILITY OF THE REGIONAL ESTABLISHMENT LEVY TO DIVIDENDS RECEIVABLE BY A HOLDING COMPANY</b>

**1. Purpose**

The purpose of this note is to interpret the above-mentioned provisions of the RSC Act and the Regulations in light of the Supreme Court of Appeal judgment, delivered on 15 May 2003. The issue is: under what circumstances are dividends received by a holding company from its subsidiaries or associate companies, subject to the regional establishment levy.

## **2. Background**

Tiger Oats Limited is an investment holding company that included dividends received from subsidiaries in the leviable amount on which it pays the “regional establishment levy” in terms of the RSC Act. It decided to reconsider this position by requesting a refund of the levy paid in respect of the dividends as it was of the opinion that it was not liable in terms of the provisions of the RSC Act.

The basis of its contention was that it did not carry on a “financial enterprise” (as defined in the Regulations) which meant that the dividends that it received could not arise from “leviable transactions” (as defined in the Regulations) and could not constitute “consideration” (as defined in the Regulations).

The municipal council, to which the levy was paid, declined the request for the refund and referred the matter to SARS when Tiger Oats Limited lodged an objection to its decision.

SARS agreed with the decision of the council, which resulted in Tiger Oats Limited lodging an appeal to the Gauteng Special Court (*ITC 1705 63 SATC 266*). The appeal was dismissed on 30 May 2000.

Tiger Oats Limited then took the case on appeal to the Transvaal Provincial Division (*63 SATC 473*). The appeal was upheld on 08 August 2001.

SARS responded by taking the matter on appeal to the Supreme Court of Appeal (case no: 108/2002), which upheld the appeal by setting aside the orders of the Transvaal Provincial Division and reinstating the judgment by the Gauteng Special Court.

## **3. The facts under consideration**

- Tiger Oats Limited is listed on the Johannesburg Stock Exchange.

- The main objective of this listed public company in terms of its memorandum and articles of association is to 'carry on the business of an investment holding company'.
- Its income consists of dividends, interest and management fees.
- The investments of the company comprise mainly long term equity investments in subsidiary and associated companies.
- It has no employees and no fixed assets.
- Loans are made to subsidiary and associate companies at interest rates lower than market-related interest rates.
- Loans made to subsidiaries are intended to fund long-term working capital or capital expenditure to facilitate the efficient deployment of capital and reserves of the holding company for the benefit of the group as a whole.
- All loans are unsecured and no term for repayment is fixed.
- Management fees are earned by its board of directors who are also directors in subsidiaries and associated companies.
- It is the holding company's policy that the non-executive directors of its subsidiary and associate companies must account to it for all directors' fees paid to them.

#### 4. The law

##### 4.1 Section 1 of the RSC Act includes the following definition:

“**enterprise**’ means any trade, business, profession or other activity of a continuing nature, whether or not carried on for the purpose of deriving a profit, but excluding any religious, charitable or educational activity carried on by any religious, charitable or educational institution of a public character;...”

##### 4.2 Section 12(1)(a)(ii) of the RSC Act states:

“Subject to the provisions of section 4(1), a council shall levy and claim from-

- (i) every employer who ...
- (ii) every person carrying on or deemed to be carrying on an enterprise within its region, a regional establishment levy.”

#### 4.3 Section 12(1)(b) of the RSC Act states:

“The Minister of Finance may from time to time, after consultation with the Council for the Co-ordination of Local Government Affairs established by section 2 of the Promotion of Local Government Affairs Act, 1983 (Act No. 91 of 1983), and by notice in the *Gazette*, determine the manner in which the regional services levy and the regional establishment levy shall be calculated and paid.”

#### 4.4 Section 12(1A)(b) of the RSC Act states:

“The Minister of Finance may in any notice contemplated in subsection (1)(b)—

- (a) determine circumstances in which an employee....;
- (b) determine circumstances in which a person shall be deemed to be carrying on an enterprise within a region;...”

#### 4.5 The Regulations include the following definitions:

“**financial enterprise**’ means any banking institution, building society, unit trust, long-term insurer, short-term insurer, pension fund, provident fund, retirement annuity fund, benefit fund, medical benefit fund, financier, buying association or similar institution, or any enterprise in the course of which financial assets are traded in or any company which carries on business as an investor of money.” (underlining for emphasis).

“**consideration**’ in relation to any leviable transaction, means the whole or any portion of-

- (a) ...-
- (b) ...
- (c) ....
- (d) in the case of any leviable transaction concluded in the carrying on of a financial enterprise-
  - (i) ...
  - (ii) the gross amounts of interest or dividends receivable on any funds invested...”

“**leviable transaction**’ means-

- (a) ....
- (b) in the case of a financial enterprise ...
  - (i) the granting of any loan, advance or credit, including the granting of credit under a credit agreement ...;
  - (ii) the investment of funds by such enterprise;...”  
(underlining for emphasis)

**4.6 Paragraph 5 of the Regulations states:**

“(5) Levy of Regional Establishment Levy-

Subject to the provisions of paragraph 7, the regional establishment levy shall be calculated and paid on the amount (in this Schedule referred to as the leviable amount) determined under paragraph 6 in relation to leviable transactions in respect of any month commencing on or after the date of commencement of a notice contemplated in the definition of ‘regional establishment levy’ in section 1 of the Act, whereby the rate at which the regional establishment levy is to be calculated is first published in the Gazette in respect of the relevant region.”

**4.7 Paragraph 6 of the Regulations states:**

“(6) Leviable amounts-

For the purposes of this schedule, the leviable amount in relation to leviable transactions in respect of any month shall be the sum of-

- (a) all amounts of consideration in respect of leviable transactions received by or accrued to the levypayer during the month ...”

**4.8 Paragraph 13(5) of the Regulations states:**

“13(5) The Commissioner may as and when he deems it expedient, furnish a council with a ruling or directive on the interpretation of any provision of the Act or this Schedule, and in such case the council shall be obliged to apply such ruling or directive.”

## **5. Application of the law by the Gauteng Income Tax Special Court**

### **5.1 Judgment**

- It was held that Tiger Oats had conducted a “business” as an investor of money, which falls within the definition of a “financial enterprise” and within the definition of “enterprise”.
- It is accordingly liable for the “regional establishment levy” on its dividend and interest income, both being leviable transactions concluded in the carrying on of its business as an investor of money.

### **5.2 Basis of the judgment**

- The court found that it was impossible to state that the different activities of Tiger Oats Limited were not part of one business amounting to an “enterprise”.
- “Leviable transactions” relate to both an “enterprise” and a “financial enterprise”.
- The group traded extensively both nationally and internationally.
- A business need not be carried on for the purpose of deriving a profit since the definition of “financial enterprise” includes pension, provident, retirement annuity, benefit, medical benefit funds or a buying association, which can hardly be regarded as businesses conducted for the purpose of deriving a profit.
- The appellant is in control of the group and its role goes far beyond merely passively holding investments.
- The role played by its highly talented board of directors is that of extensive monitoring of business activities for which it earns management fees.
- It is the financier of the group and this is not done passively since it promotes the business efficiency and operation of the members of the group.
- The purpose of the provisions of the Regulations cannot be seen as a broadening of the Act in terms of the definition of ‘enterprise’. Leviable transactions relate to both “enterprise” and “financial enterprise”. The provisions of the Regulations must as far as

possible be reconciled with and interpreted in light of the provisions of the Act.

- 'Business' in the definition of "enterprise" has a wide enough connotation to conclude that the appellant is conducting a business and not merely holding investments. This was supported by reference to the following cases:
  - *Smith vs Anderson*, 15 Ch D 247;
  - *Cape Town Municipality vs Clarensville (Pty)(Ltd)*, 1974 (2) SA 138(C);
  - *Webb vs Conelee Properties Ltd*, 1982 STC 913;
  - *Burgess vs Commissioner for Inland Revenue*, 1993(4) SA 161 (AD) 236(5) ;  
and
  - *Commissioner for Inland Revenue vs De Soutter Bros Ltd*, 29 TC 155

## **6. Application of the law by the Transvaal Provincial Division**

### **6.1 Judgment**

- The taxpayer was not carrying on an "enterprise", as defined in the RSC Act nor was it carrying on a "financial enterprise", as defined in the Regulations.
- The taxpayer's investments in the shares in issue did not constitute the carrying on of a business at all and in particular did not carry on a business as an investor of money within the definition of "financial enterprise" in the Regulations.

### **6.2 Basis of the judgment**

- There was nothing before the court which indicated that the activities of the holding company in relation to its share investments that would remove it from the category of an investor and place it within the category of a person carrying on a business in relation to its share investments.
- The mere purchasing and holding of an asset does not constitute the carrying on of a business or an activity of a continuing nature.
- The holding company may have been carrying on a business in respect of making loans or providing management services but this

did not mean that its investment in subsidiaries for which it earned dividend income constituted the carrying on of an enterprise.

## 7. Application of the law by the Supreme Court of Appeal (SCA)

### 7.1 Judgment

- The decision of the Special Court should be reinstated and that the SCA was not in agreement with the decision of the Full Bench (Provincial Division).
- Investment holding companies that are engaged in continuous commercial activity within the area of a regional council should contribute towards the cost of its establishment.

### 7.2 Basis of the judgment

- The holding company is not merely an investor of money, but is conducting a 'business' as such.
- The main object of this listed public company is to 'carry on the business of an investment holding company'. This immediately negates any suggestion that the making of its investments is unrelated to its other business activities.
- The suggestion that the making of investments was **not intended to be 'an activity of a continuing nature'** cannot be accepted.
- Owing to the constant monitoring of the investments by way of new investments, further investment as well as disinvestments, the company is actively involved in share movements and is not a mere passive investor.
- There is an element of **continuity**, which is a characteristic feature of **carrying on a business**.
- The principal business is that of an investment holding company unlike in *ITC 512 SATC 246* where the taxpayer's **principal business** was an auctioneer whilst investment in mortgages was **secondary** to its main business.
- The purpose of the definition of "financial enterprise" was not to assign a different meaning to the word "enterprise" than that which



section 1 of the RSC Act required to be assigned to it. It is quite apparent that, when the two definitions are compared, no attempt has been made by the Minister to provide a competing definition of the word "enterprise". All of the entities listed in the definition of "financial enterprise" fit comfortably within the definition of "enterprise" in section 1 of the RSC Act.

- The Minister of Finance did not purport to be exercising the deeming powers conferred upon him by section 12 (1A)(b) of the RSC Act. While that provision empowers him to determine circumstances in which a person shall be deemed to be carrying on an "enterprise" within a region, it does not empower him to deem an entity to be an "enterprise" where it does not fall within the definition of "enterprise" in Section 1 of the RSC Act. The Minister was aware of this distinction.

#### **8. SARS' interpretation and application of the law**

The purpose of the Regulations is not meant to address situations independently of the provisions of the RSC Act, especially if such situations are sufficiently catered for in the provisions of the RSC Act. The Regulations must, as far as possible, be reconciled with and interpreted in light of the provisions of the RSC Act. The definition of "financial enterprise" in the Regulations must, therefore, be interpreted as an extension of the definition of "enterprise" in the RSC Act.

In light of the above, a holding company will not merely be regarded as a passive investor of money where it operates on the same basis as Tiger Oats Limited. Such a company will be considered to be actively conducting a 'business' of an investment holding company, which means that its dividend and interest income will be subject to the regional establishment levy.

Any suggestion by the company to the effect that the making of investments was not intended to be "an activity of a continuing nature", or that "the making of investments is unrelated to its other business activities", will not be accepted

as a basis for excluding its dividend income from the regional establishment levy.

A holding company will either be viewed as an 'active' investment holding company or a 'passive' investment holding company, but not both for the purposes of apportioning its liability for the regional establishment levy. In circumstances where it has been established that the company is an 'active' investment holding company, it will be regarded as carrying on the business of an investor of money, as contemplated in the definition of "financial enterprise" in the Regulations. It follows that the gross amount of its interest and dividends will be included in its "consideration" for the purposes of calculating the regional establishment levy.

#### **8.1 Test to assist with the determination of a holding company's liability for the regional establishment levy**

SARS will make use of certain indicators to form an overall impression as to whether the holding company is actively conducting a 'business' of an investment holding company. These indicators are summarised in a dominant impression test grid in the Annexure. However, the impression created by the outcome of the test is not meant to be a final result. The test is merely a practical tool to assist in determining whether the holding could be liable for the RSC levy. This means that it must be followed up with a more detailed technical analysis to apply the provisions of the RSC Act to the specific facts of the case.

#### **8.2 Exclusion from liability where the company is a "passive conduit"**

Where it is found that a holding company is a "passive conduit" in relation to its subsidiaries and associated companies and not carrying on a business, it will not be liable for the regional establishment levy.

A holding company will be regarded as a "passive conduit" in the group holding structure where it merely holds its investments as a "nominee" for its shareholders and not as a company investing funds in its own right or for its own benefit. It must also pass all investment income available for distribution on to its shareholders.

As a point of illustration, SARS will not view a company like Tiger Oats Limited as being a mere passive conduit based on the manner in which it actively carries out its business of investing funds.

SARS' application and interpretation of the law will also include other principles that were relied on by the Supreme Court of Appeal in arriving at the judgment that Tiger Oats Limited is liable for the establishment levy (see point 7 of this note).

**9. Interpretation of the RSC Act and its Regulations**

This note is issued in terms of paragraph 13(5) of the Regulations, which means that municipal councils are obliged to comply with SARS' application of the law, as stated in the note. It also takes precedence over any previous SARS' rulings that may be in conflict with its contents.

**Law Administration**  
**SOUTH AFRICAN REVENUE SERVICE**

**Annexure**

The following test may be used to formulate an overall impression as to whether an investment holding company could be liable for the regional establishment levy on dividends receivable from its subsidiaries and associated companies. In formulating the overall impression, it must be noted that the test is structured such that certain indicators carry more weight than others i.e. some are near conclusive, some are persuasive, whilst others are merely relevant. The impression created by the outcome of this test is not meant to be a final decision for the holding company to be liable. It is merely a practical tool to assist in determining whether the holding company could be liable. The test must therefore be followed up with a more detailed technical analysis to apply the provisions of the RSC Act to the specific facts of the case.

	<b>INDICATOR</b>
<b>NEAR CONCLUSIVE</b>	1. There is a presence of the element of continuity of activity, which is said to be a characteristic feature of "carrying on a business".
	2. The main object of the company is to carry on the business of an investment holding company as per its memorandum and articles of association.
	3. The holding company participates in the affairs of its subsidiaries or associated companies.
<b>PERSUASIVE</b>	4. The performance of the subsidiaries or associated companies is enhanced by the participation of the holding company in their affairs.
	5. The holding company invests in its subsidiaries or associated companies other than by shareholding.
	6. The holding company advances low-interest or interest-free loans to its subsidiaries or associated companies.
	7. Loans to subsidiaries or associated companies are used to fund or are intended to fund working capital with the intention of facilitating the efficient deployment of capital and reserves for the benefit of the group as a whole.
	8. The holding company has control over the appointment of the directors of its subsidiaries or associated companies.
	9. The holding company monitors the investments of its subsidiaries or associated companies with a view to making new investments, further investments or disinvestments.
	10. The holding company acts as the banker of its subsidiaries or associated companies e.g. it makes decisions on how the cash funds of the subsidiaries or associated companies should be managed.
	11. The projected budgets and strategic plans of the group take into account the holding company's available resources for deployment to its subsidiaries or associated companies.
	12. The shareholding of the holding company in its subsidiaries or associated companies changes during the year.
	13. The holding company recovers costs e.g. management fees, from its subsidiaries or associated companies.
<b>RELEVANT</b>	14. The holding company makes use of the services of the directors of its subsidiaries or associated companies.
	15. The subsidiaries or associated companies make use of the services of the directors of the holding company.
	16. The subsidiaries or associated companies account to the holding company for fees paid to non-executive directors.