

**INTERPRETATION NOTE: NO. 29 (Issue 2)**

DATE: 19 February 2013

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)**  
**SECTION : SECTION 5(10) AND PARAGRAPH 19 OF THE FIRST SCHEDULE TO THE ACT**  
**SUBJECT : FARMING OPERATIONS: EQUALISED RATES OF TAX**

***Preamble***

In this Note unless the context indicates otherwise –

- “**paragraph**” means a paragraph of the First Schedule to the Act;
- “**section**” means a section of the Act;
- the terms “**taxpayer**” and “**farmer**” are used interchangeably; and
- any word or expression bears the meaning ascribed to it in the Act.

**1. Purpose**

This Note provides guidelines with regard to the method applied in the calculation of the rating amount applicable to farmers who elected that their tax be calculated at equalised rates of tax under paragraph 19(5) of the First Schedule to the Act.

Issue 1 of this Note, issued on 30 March 2005, is hereby replaced.

**2. Background**

A person, deriving income from farming operations may, under paragraph 19(5), elect to be subject to tax according to the rating formula set out in section 5(10). The rating concession is applied due to the abnormal accrual of income occurring in one year of assessment in comparison with another year. Farming income may fluctuate on an annual basis because of, for example, an extended period between sowing and eventual crop yields – in other words, periods of little or no income followed by periods of inflated income.

This rating concession applies only to individuals (natural persons), executors of deceased estates and trustees of insolvent estates. Once the option has been exercised to adopt the equalised rates, this election will be binding on the taxpayer for the current year as well as all future years of assessment, irrespective of the fact that farming operations may be terminated. No provision is made in the Act for a variation either by the farmer or by the Commissioner.

### 3. The law

For ease of reference, the actual legislation is provided in the **Annexure**.

The following persons may elect to make use of the provisions of paragraph 19:

- **Any natural person** (individual) whose taxable income for any year or period of assessment consists of or includes taxable income derived from farming operations carried on for the person's own benefit.
- The **executor of the estate** of any deceased person or the **trustee** of the insolvent estate of any natural person, in that person's capacity as such, who has continued farming operations in the year of assessment immediately succeeding the year of assessment in which that person died or became insolvent and are merely a continuance of the operations carried on by that person before date of death or insolvency.

Paragraph 19(5) provides that a taxpayer must elect that the normal tax to be levied on farming income must be determined under this paragraph. This election must be made within **three months** after the end of the year or period of assessment. The three-month period may be extended if the taxpayer has not made an election during this prescribed period. In practice, extension will be granted up to a date before the raising of the assessment. An application form for this election is available in the ITR12 comprehensive guide on the SARS eFiling website [www.sarsefiling.co.za](http://www.sarsefiling.co.za). Once an election has been made, and the applicable declaration endorsed, that declaration must be kept by the taxpayer and produced upon request from SARS. This application should not be submitted with the annual tax return, as was required in the past, but should be kept for future reference.

As indicated previously, the rating concession aims at a reduction in the rate of normal tax due to the abnormal accrual of income in the relevant year. The provisions of paragraph 19(4) state that the use of the rating formula does not relieve a farmer from tax on any portion of the farmer's taxable income.

The taxpayer forfeits entitlement to use the following provisions of the First Schedule to the Act where the averaging provisions have been adopted, and apply in that specific year:

- **Paragraph 13(1)(b)** (provisions related to the replacement of livestock sold as a result of the person's participation in a livestock reduction scheme organised by government);
- **Paragraph 15(3)** (rating formula on taxable income derived from plantations); and
- **Paragraph 17** (rating formula arising as a result of abnormal receipts from the disposal of sugar cane damaged by fire).

A farmer must make the election in terms of the provisions in paragraph 19(5). The normal tax payable by the taxpayer during any year of assessment must then be determined in accordance with the provisions of section 5(10), in which the formula in the **Annexure** must be applied.

#### 4. Application of the law

Paragraph 19(2) provides that the average taxable income from farming in relation to the relevant period must be determined as follows:

- **The taxpayer carried on farming operations before the commencement of the current year of assessment**

The taxpayer's annual average taxable income from farming is determined with regard to the current and four previous years of assessment, during which the farming operations were carried on. The average will be determined over that applicable period if the taxpayer carried on farming operations for less than four years before the current year of assessment.

- **The taxpayer never carried on farming operations before the commencement of the current year of assessment**

The taxpayer's average taxable income from farming in the first year is deemed to be an amount equal to two-thirds of such taxable income.

For the purposes of determining symbol "C" in the formula, 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 practice is supported by the judgment handed down in *CIR v Zamoyski* (47 SATC 50) where the court attached an interpretation to the words "taxable income...derived from farming operations" for the purpose of paragraph 12(3).

#### Example 1 – Average taxable farming income

*Facts:*

Y, a farmer, under 65 years of age, commenced farming in tax year 1.

	<b>Total taxable income</b>	<b>Farming taxable income</b>
	R	R
Year 1	300 000	100 000
Year 2	290 000	200 000
Year 3	400 000	20 000
Year 4	120 000	15 000
Year 5	700 000	<u>500 000</u>
		<u>835 000</u>

*Result:*

The average taxable income from farming for year 5 is R167 000 (R835 000 / 5). Had the farmer not carried on farming operations in years 4 or 5, the average taxable income from farming for year 3 would be R106 667 [(R100 000 + R200 000 + R20 000) / 3].

### *Retirement annuity fund (RAF) contributions*

In terms of section 11(n) a person may deduct contributions made to an RAF. There are various limits to this deduction. Section 11(n)(i)(aa)(A) states that the deduction will be limited to 15% of non-retirement funding income, excluding any “retirement fund lump sum benefit”, “retirement fund withdrawal benefit” and any “severance benefit” as defined. Taxable income derived from farming operations is non-retirement funding income. Symbol “D” in the formula refers to contributions to an RAF that are deductible under section 11(n)(i)(aa)(A), with regard to taxable income on which 15% is calculated, and where taxable income includes any amount –

- that represents special remuneration received by mineworkers for certain special tasks;
- of income from plantation farming that qualifies for special treatment under paragraph 15;
- of income from sugar cane farming that qualifies for special treatment under paragraph 17; and
- that qualifies for the rating concession under paragraph 19.

The effect is that contributions to an RAF cannot be used to reduce a person’s taxable income from other sources that do not qualify for special treatment and, in so doing, reduce the overall tax liability.

#### **Example 2 – Symbol “D”**

##### *Facts:*

X contributed R150 000 to an RAF during the year of assessment. He derived taxable income from the following sources:

	R
Farming operations	400 000
Taxable interest	160 000
Special remuneration relating to mining	<u>500 000</u>
	<u>1 060 000</u>

The average taxable income from farming for purposes of paragraph 19 was R300 000.

The maximum deduction for contribution to an RAF is 15% x R1 060 000 = R159 000, but limited to the actual contributions of R150 000. Thus –

	R
15% x R500 000 (Special remuneration)	75 000
15% x R400 000 (Taxable farming income)	60 000
15% x R160 000 (Taxable interest)	<u>24 000</u>
	<u>159 000</u>
Limited to actual contributions of	<u>150 000</u>

The Act does not make provision for the apportionment of the actual contributions; apportionment may therefore be made to income that is not influenced by the formula first and thereafter to those affected by the formula, the excess farming income being the portion of farming income that exceeds the average taxable income from farming.

*Result:*

“D” in the example is therefore determined as follows:

	R
15% x R300 000 (Average taxable farming income)	45 000
15% x R160 000 (Taxable interest)	<u>24 000</u>
	<u>69 000</u>

The portion of contributions affected by the formula is equal to R150 000 (allowable contributions) **less** R69 000. Symbol “D” is, therefore, equal to R81 000. Effectively, the R81 000 represents the portion that was allowed as a deduction solely by inclusion in taxable income of special remuneration and actual taxable farming income (as opposed to the average farming income).

**Example 3 – Equalised rates***Facts:*

G carried on farming operations and elected that the provisions of paragraph 19 be applied. She is 65 years of age. Her taxable income from farming operations for the current year (year 5) and for the four previous years of assessment were as follows:

<b>Taxable income or assessed loss from farming</b>	<b>R</b>
Year 1	600 000
Year 2	500 000
Year 3	70 000
Year 4	(50 000)
Year 5	<u>400 000</u>
	<u>1 520 000</u>

The taxable income from farming in year 5 excludes the loss incurred in year 4. The average taxable income from farming for purposes of year 5 is therefore R304 000 (R1 520 000 / 5).

During the current year of assessment (year 5) she derived taxable income from the following sources:

<b>Source</b>	<b>R</b>
Taxable farming income	400 000
Taxable interest	100 000
Pension	<u>120 000</u>
Taxable income before deductions	<u>620 000</u>

The following deductions were incurred:

<b>Deductions</b>	<b>R</b>
Retirement annuity fund contributions	90 000
Medical expenses	<u>30 000</u>
Total allowable deductions	<u>120 000</u>

She has not incurred any capital development expenditure that will be allowable against taxable farming income during the current year or previous year of assessment.

*Result:*

### Step 1

Determine the values of symbols "B" and "C"

$$\begin{aligned} \text{"B"} &= \text{Taxable income} = \text{R}620\,000 - \text{R}120\,000 \\ &= \underline{\text{R}500\,000} \end{aligned}$$

$$\begin{aligned} \text{"C"} &= \text{Excess of current farming income over average farming income} \\ &\quad (\text{R}400\,000 - \text{R}304\,000) \\ &= \underline{\text{R}96\,000} \end{aligned}$$

### Step 2

Determine the value of "D"

The maximum deduction on contributions to an RAF is  $15\% \times \text{R}620\,000 = \text{R}93\,000$ , but limited to the actual contributions of  $\text{R}90\,000$ . Thus –

	R
15% x R120 000 (Pension)	18 000
15% x R400 000 (Farming income)	60 000
15% x R100 000 (Taxable interest)	<u>15 000</u>
	<u>93 000</u>
Limited to actual contributions of	R90 000

"D" in the example is determined as follows:

	R
15% x R304 000 (Average taxable farming income)	45 600
15% x R100 000 (Interest)	15 000
15% x R120 000 (Pension)	<u>18 000</u>
	<u>78 600</u>

The portion of contributions affected by the formula is therefore equal to  $\text{R}90\,000$  (allowable contributions) **less**  $\text{R}78\,600$ . Symbol "D" is, therefore, equal to  $\text{R}11\,400$ . In other words, although  $\text{R}90\,000$  will indeed be allowed as a deduction on RAF contributions, for purposes of the rating formula,  $\text{R}11\,400$  will be added back, as this is regarded as the excess contributions.

### Step 3

Determine the rating amount

$$\begin{aligned} B + D - C &= \text{R}500\,000 + \text{R}11\,400 - \text{R}96\,000 \\ &= \underline{\text{R}415\,400} \end{aligned}$$

### Step 4

Determine the normal tax payable on the rating amount

$$\begin{aligned} A &= \text{Normal tax before any rebate calculated on } B + D - C \\ &= \text{R}80\,100 + [(\text{R}415\,400 - \text{R}346\,000) \times 35\%] \\ &= \text{R}80\,100 + \text{R}24\,290 \\ &= \underline{\text{R}104\,390} \end{aligned}$$

**Note:** Assume the tax rates and rebates applicable to the 2013 year of assessment apply.

**Step 5**

Calculate "Y", amount of normal tax, in the formula

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

$$Y = \left[ \frac{R104\,390}{R415\,400} \right] \times R500\,000$$

$$= \underline{R125\,649,95}$$

	R
Normal tax payable	125 649,95
Less: Primary rebate	(11 440,00)
Secondary rebate (65 and older)	<u>(6 390,00)</u>
Normal tax liability	<u>107 819,95</u>

**Example 4 – Equalised rates**

*Facts:*

X, aged 61, is a livestock farmer. During the 2013 year of assessment, he had a taxable farming income of R250 000. X also receives a living annuity of R150 000 a year. In addition to these two incomes, he received R20 000 taxable interest (after exemptions) from a local bank, on a fixed deposit. X also contributed R65 000 to an RAF.

X's taxable income from farming for the previous four years of assessment, was as follows:

Year of assessment	Taxable farming income
	R
2013	250 000
2012	26 000
2011	18 500
2010	(10 500)
2009	<u>33 000</u>
Total	<u>317 000</u>

X has yet to decide on making a paragraph 19 election. *For the 2013 year of assessment:*

- (a) Determine *the net normal tax due by X should he not elect paragraph 19.*
- (b) Determine *the net normal tax due by X should he elect paragraph 19.*

*Result (a):*

	R
Taxable farming income	250 000
Other income: Annuity	150 000
Taxable interest	<u>20 000</u>
Income	420 000
Less: RAF contributions limited to 15% of R420 000	<u>(63 000)</u>
Taxable income*	<u>357 000</u>
Normal tax on R357 000	83 950
Less: Primary rebate	<u>(11 440)</u>
Net normal tax	<u>72 510</u>

*Result (b):*

Average farming income for current and 4 preceding years:

$$R317\,000 / 5 = \underline{R63\,400}$$

### Step 1

Determine the values of symbols "B" and "C"

$$\begin{aligned} \text{"B"} &= \text{Taxable income} \\ &= \underline{R357\,000^*} \end{aligned}$$

$$\begin{aligned} \text{"C"} &= \text{Excess of current farming income over average farming income:} \\ &\quad R250\,000 - R63\,400 \\ &= \underline{R186\,600} \end{aligned}$$

### Step 2

Determine the value of symbol "D"

The deduction for retirement annuity contributions has already been determined above. The claim of R65 000 would be limited to a maximum of R63 000.

"D" would be determined on all non-retirement funding income, as follows:

	R
15% of R63 400 (Average taxable farming income)	9 510
15% of R150 000 (Annuity)	22 500
15% of R20 000 (Taxable interest)	<u>3 000</u>
	<u>35 010</u>

The portion affected by the formula is therefore equal to R63 000 less R35 010 = R27 990.

$$\text{"D"} = \underline{R27\,990}$$

### Step 3

Determine the rating amount

$$\begin{aligned} B + D - C &= R357\,000 + R27\,990 - R186\,600 \\ &= \underline{R198\,390} \end{aligned}$$



**Step 4**

Determine the normal tax payable on the rating amount

$$\begin{aligned}
 A &= \text{Normal tax (before any rebate) on } B + D - C \\
 &= \text{Normal tax on R198 390} \\
 &= \text{R28 800} + 25\% \text{ of } (\text{R198 390} - \text{R160 000}) \\
 &= \text{R28 800} + \text{R9 597,50} \\
 &= \underline{\text{R38 397,50}}
 \end{aligned}$$

**Step 5**

Calculate "Y" which is the normal tax based on the formula

$$\begin{aligned}
 Y &= \left[ \frac{A}{B + D - C} \right] \times B \\
 Y &= \left[ \frac{\text{R38 397,50}}{\text{R198 390}} \right] \times \text{R357 000} \\
 &= \underline{\text{R69 095,74}}
 \end{aligned}$$

	R
Normal tax payable	69 095,74
Less: Rebates	<u>(11 440,00)</u>
Net normal tax	<u>57 655,74</u>

**5. Revision of assessments [Paragraph 19(3)]**

Note that, where the taxpayer's assessment for a relevant period has, under section 100 of the Tax Administration Act No. 28 of 2011 become final and conclusive, the Commissioner shall not, merely by reason of the fact that the average taxable income from farming [as determined under paragraph 19(2)(a)] is incorrect, be required to make any further assessment upon the taxpayer for such period under section 99 of that Act or to authorise a refund under section 190 of that Act of any tax overpaid during such period, unless it appears that such annual average taxable income from farming should be increased or reduced by at least R600. This means, for example, that if the assessment has become final and conclusive, but it can be proven that the annual average taxable income from farming should be increased or reduced by at least R600, only then will that particular assessment be considered for revision and any subsequent taxes recovered or refunded.

**6. Conclusion**

The rating concession is available to certain taxpayers engaged in farming operations, and is designed to provide some relief to taxpayers who experience abnormal accruals of income from one year to the next. Once the concession is elected by that taxpayer, it is binding from that current year of assessment and any subsequent year thereafter.

**Annexure – The law**  
**Section 5(10)**

(10) Where any taxpayer's income includes any special remuneration, or where the provisions of paragraph 15(3), 17 or 19 (1) of the First Schedule are applicable in the case of the taxpayer in respect of any year of assessment, the normal tax (excluding tax on any lump sum benefit or severance benefit) payable by the taxpayer in respect of such year (as determined before the deduction of any rebate) shall be determined in accordance with the formula—

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

in which formula—

- (a) "Y" represents the amount of normal tax to be determined;
- (b) "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 taxable income equal to the amount represented by the expression "B + D - C" in the formula;
- (c) "B" represents the taxpayer's taxable income (excluding any lump sum benefit) for the said year;
- (d) "C" represents an amount equal to the sum of—
  - (i) the amount of any special remuneration (as defined in subsection (9)) which is included in the taxpayer's income for the said year;
  - (ii) where the provisions of paragraph 15(3) of the First Schedule are in the case of the taxpayer applicable in respect of the said year, an amount determined in accordance with those provisions as being the amount, if any, by which the taxable income derived by the taxpayer during the said year from the disposal of plantations and forest produce exceeds the annual average taxable income derived by the taxpayer from that source over the three years of assessment immediately preceding the said year;
  - (iii) where the provisions of paragraph 17 of the First Schedule are in the case of the taxpayer applicable in respect of the said year, an amount equal to so much of the taxable income of the taxpayer for such year as has been derived from the disposal of sugar cane as a result of fire in the taxpayer's cane fields and but for such fire would not have been derived by the taxpayer in that year; and
  - (iv) where the provisions of subparagraph (1) of paragraph 19 of the First Schedule are in the case of the taxpayer applicable in respect of the said year, the amount by which the taxpayer's taxable income derived from farming for that year exceeds the taxpayer's average taxable income from farming as determined in relation to that year in accordance with subparagraph (2) of the said paragraph; and
- (e) "D" represents an amount equal to so much of any current contribution to a retirement annuity fund as is allowable as a deduction in terms of section 11(n)(i)(aa)(A) solely by reason of the inclusion in the taxpayer's income of any amount contemplated in paragraph (d)(i), (ii), (iii) or (iv):

Provided that in no case shall the amount of normal tax so payable be less than the amount of normal tax which would be chargeable at the relevant rate fixed in terms of subsection (2) in respect of the first rand of taxable income, and nothing in this section contained shall be construed as relieving any person from liability for taxation under this Act upon any portion of that person's taxable income.

### Paragraph 19 of the First Schedule to the Act

19. (1) If any taxpayer has made an election as provided in subparagraph (5) which is binding upon him in respect of any period of assessment (hereinafter referred to as the relevant period) during which he or his spouse has carried on farming operations or has derived income from farming operations, and his taxable income derived during the relevant period from farming exceeds his average taxable income from farming as determined in relation to the relevant period in accordance with subparagraph (2), the normal tax chargeable in respect of his taxable income for the relevant period shall, subject to the provisions of section 5 of this Act, be determined in accordance with section 5(10).

(2) For the purposes of subparagraph (1) the taxpayer's average taxable income from farming in relation to the relevant period shall be deemed to be—

- (a) where the taxpayer or his spouse carried on farming operations before the commencement of the relevant period, such amount as the Commissioner may determine as representing the taxpayer's annual average taxable income (if any) from farming in respect of the periods of assessment—
  - (aa) for which the taxpayer was assessable under this Act and which fall within the period of five years ending on the last day of the relevant period; and
  - (bb) during which such farming operations were carried on or farming income was derived by the taxpayer:

Provided that any excess farming profits derived by the taxpayer in any of the said periods of assessment, as determined by the Commissioner under paragraph 20(3)(a), shall not be taken into account in the determination of such annual average taxable income: Provided further that in the case of the estate of a deceased or insolvent person any farming operations carried on by such person prior to his death or insolvency, any income derived by him from such operations and any deductions allowable against such income under this Act shall, so far as such estate is concerned, be deemed for the purposes of this item to be respectively operations, income or deductions of such estate, and the annual average taxable income derived by such estate from farming shall be determined accordingly, but subject to such adjustments as the Commissioner may make; or

- (b) where the taxpayer is a person referred to in subparagraph (5)(a) and did not carry on farming operations before the commencement of the relevant period, an amount equal to two-thirds of such taxable income.

(3) Where the taxpayer's assessment for a relevant period has in terms of section 100 of the Tax Administration Act become final and conclusive, the Commissioner shall not, merely by reason of the fact that the amount determined under subparagraph (2)(a), as the taxpayer's annual average taxable income from farming in relation to such period is incorrect, be required to make a further assessment upon the taxpayer for such period in terms of section 99 of that Act or to authorize a refund under section 190 of that Act of any tax overpaid in respect of such period, unless it appears that such annual average taxable income from farming should be increased or reduced by at least six hundred rand.

(4) In determining under this paragraph any amount of normal tax which is or would be chargeable no regard shall be had to the deductions provided for in section 6 of this Act, and nothing in this paragraph contained shall be construed as relieving any person from liability for taxation under this Act upon any portion of that person's taxable income.

(5) Any person—

- (a) who is a natural person and 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 such spouse's own benefit; or
- (b) who is the executor of the estate of any deceased person or the trustee of the insolvent estate of a natural person and who in his capacity as such has during the period of assessment commencing immediately after the death or insolvency of the said person continued farming operations commenced by such deceased or insolvent person prior to his death or insolvency,

may, within three months after the end of such 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 normal tax chargeable in respect of his taxable income if item (a) is applicable or the taxable income of such estate if item (b) is applicable, be determined as provided in subparagraph (1), and such election shall be binding upon such natural person or estate, as the case may be, in respect of the said period of assessment and every succeeding period of assessment: Provided that—

- (i) no election may be made under this subparagraph by any person in respect of any period of assessment referred to in item (a) if during such period such person was married and such person's income for such period is in terms of section 7(2) of this Act deemed to be income accrued to such person's spouse;
- (ii) where an election has been made by such person in respect of any period of assessment referred to in item (a) and such person's income for any succeeding period of assessment is in terms of section 7(2) of this Act deemed to be income accrued to such person's spouse, such election shall, with effect from such succeeding period, cease to have any force or effect.

(6) . . . . .