

INTERPRETATION NOTE 137

DATE: 26 March 2025

ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTIONS 8(4)(a) and 8(4)(k)(iv)
SUBJECT : RECOUPMENT OF AMOUNTS DEDUCTED OR SET OFF WHEN AN ASSET COMMENCES TO BE HELD AS TRADING STOCK

Contents

Preamble	2
1. Purpose	2
2. Background.....	2
3. The law.....	3
4. Interpretation and application of the law	4
4.1 Introduction.....	4
4.2 Meaning of “asset” for the purposes of section 8(4)(k)(iv)	4
4.3. “Commenced”	4
4.4 Trading stock.....	5
4.4.1 Opening stock.....	5
4.4.2 Closing stock	6
4.5 Meaning of recovered or recouped	6
4.6 Interaction between section 8(4)(k)(iv) and section 8(4)(a)	7
4.7 “Market value”	11
5. Exclusions	12
6. Conclusion.....	13
Annexure – The law	14

Preamble

In this Note unless the context indicates otherwise –

- “**CGT**” means capital gains tax, being the portion of normal tax attributable to the inclusion in taxable income of a taxable capital gain;
- “**depreciable asset**” as defined in section 1(1) which means an asset as defined in paragraph 1 of the Eighth Schedule (other than any trading stock and any debt) in respect of which a deduction or allowance determined wholly or partly with reference to the cost or value of that asset is allowable in terms of this Act for purposes other than the determination of any capital gain or capital loss”;
- “**Eighth Schedule**” means the Eighth Schedule to the Act;
- “**gross income**” means “gross income” as defined in section 1(1);
- “**paragraph**” means a paragraph of the Eighth Schedule;
- “**section**” means a section of the Act;
- “**taxpayer**” means a “taxpayer” as defined in section 1(1);
- “**the Act**” means the Income Tax Act 58 of 1962; and
- any other word or expression bears the meaning ascribed to it in the Act.

The guide and interpretation note referred to in this Note are the latest versions, unless otherwise indicated, which are available on the SARS website at www.sars.gov.za or via eFiling at www.sarsefiling.co.za (guides only).

1. Purpose

This Note provides guidance on the interpretation and application of section 8(4)(k)(iv), which is relevant when a depreciable asset (not previously classified as trading stock) has had an amount allowed to be deducted or set off under a provision listed in section 8(4)(a) and subsequently commences to be held as trading stock.¹

2. Background

The Act allows for various deductions and allowances that reduce the cost price of an asset when determining its tax value. Disposing of such an asset for an amount that exceeds its tax value (but not its cost price) will typically result in a taxable recoupment of the difference. If the asset is disposed of for a consideration that surpasses its cost price, a capital gain may arise.

Section 8(4)(a) serves as a general recoupment provision, stipulating that any amount previously allowed as a deduction or set-off under sections 11 to 20, 24D, 24F, 24G, 24I, 24J, 27(2)(b), and 37B(2) (subject to certain exclusions) must be included in a taxpayer’s gross income if it has been recovered or recouped during the year of assessment.² This means that whenever a taxpayer claims a deduction or allowance under the specified sections and later recovers or recoups that amount, it must be added to their gross income.

¹ The *Comprehensive Guide to Capital Gains Tax* may be referred to for commentary on the capital gains tax implications when a depreciable asset commences to be held as trading stock.

² See section 8(4)(a) for the sections and provisions excluded from inclusion in income.

The application of section 8(4)(a) is limited to amounts recovered or recouped upon the disposal of an asset or when an expense is otherwise recovered.³ However, there are situations when a receipt or accrual of an amount equal to market value does not occur, or when the transaction does not constitute a disposal, leading to no recovery or recoupment despite a deduction or allowance having been granted for the relevant asset. Section 8(4)(k) addresses this by providing for a deemed disposal at market value under four specific circumstances. Before its amendment to include a fourth circumstance, the deemed disposal at market value under section 8(4)(k) applied only when, during any year of assessment, any person has –

- donated any asset;⁴
- in the case of a company, transferred any assets to another shareholder in that company in any manner or form;⁵ or
- disposed of any asset to a person who is a connected person in relation to that person.⁶

Notably, section 8(4)(k) did not consider situations when a depreciable asset was subsequently held as trading stock. Therefore, when a taxpayer ceases to hold a depreciable asset on capital account and begins to hold it as trading stock, the allowances or deductions previously granted are not recouped in the year of assessment in which the change in usage occurs or in any subsequent year of assessment.

Paragraph 12(2)(c) establishes a deemed disposal for CGT purposes when an asset, whether depreciable or non-depreciable, that is not held as trading stock commences to be held as trading stock. To create a similar deemed disposal rule for normal tax purposes, section 8(4)(k)⁷ was amended to include subparagraph (iv). This provision stipulates a deemed disposal at market value when a taxpayer starts to hold any allowance asset as trading stock (see 4.6 and 4.4).

The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019* provides the basis for the insertion of section 8(4)(k)(iv) as follows:⁸

“Currently, paragraph 12(2)(c) of the Eighth Schedule to the Act triggers a deemed disposal for capital gains tax purposes when an asset which was not held as trading stock commences to be held as trading stock. However, there is no similar deemed disposal and reacquisition rules in the recoupment provisions in section 8(4)(k) of the Act for allowance assets to trigger a recoupment of previous allowances. In order to address this anomaly, it is proposed that changes be made in the Act by inserting a new subparagraph (iv) in section 8(v)(k) of the Act.”

3. The law

The relevant sections of the Act and paragraphs of the Eighth Schedule are quoted in the **Annexure**.

³ An example is when a refund for expenditure incurred is received or accrued.

⁴ Section 8(4)(k)(i).

⁵ Section 8(4)(k)(ii).

⁶ Section 8(4)(k)(iii).

⁷ See Taxation Laws Amendment Act 34 of 2019 and applies to an asset that commenced to be held as trading stock on or after 15 January 2020.

⁸ Sub-clause (d) of Clause 6 of the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2019*.

4. Interpretation and application of the law

4.1 Introduction

Section 8(4)(a) is limited to amounts that have been recovered or recouped when an asset is disposed of or when an expense is otherwise recovered. However, there is no disposal of an asset when a taxpayer commences to hold a depreciable asset as trading stock. A deemed disposal at market value is triggered under section 8(4)(k)(iv) when –

- an asset;
- commences to be held as trading stock which was previously not held as trading stock.

When this provision applies, the asset is deemed to have been disposed of for an amount equal to its market value at the date of commencement. The purpose of this deemed disposal is to recover or recoup the allowances or deductions previously granted on the asset.

The requirements for the application of section 8(4)(k)(iv) are considered below.

4.2 Meaning of “asset” for the purposes of section 8(4)(k)(iv)

The word “asset” is not defined in section 1(1). Legally, an asset can be either movable or immovable, corporeal or incorporeal, or any right associated with these assets. For the purposes of section 8(4)(a), an “asset” is specifically limited to a depreciable asset.⁹

Consequently, section 8(4)(k)(iv) applies only to a depreciable asset that can be held by the taxpayer as trading stock (see **4.4**). Therefore, a non-depreciable asset does not fall within the scope of section 8(4)(k)(iv).

4.3 “Commenced”

During a year of assessment, a taxpayer may choose for various reasons to cease holding a depreciable asset as a capital asset and instead commence holding it as trading stock (see **Examples 1** and **2**).

Determining whether a change of intention and use occurred during the year of assessment is a factual question. The word “commence” is not defined in the Act. *Dictionary.com* defines it to mean “to begin” or “start”.¹⁰

Applying the ordinary meaning of “commence” or “commenced” (in the past tense) would require the taxpayer to have made a decision during the year of assessment to hold an asset as trading stock, which was previously not held in that manner. Whether such a decision has been made is a factual inquiry and must be based on the objective circumstances related to the asset in question and the taxpayer involved.

Several factors can be considered when determining the exact time the taxpayer commenced holding an asset as trading stock. These include the nature of the asset, the nature of the taxpayer’s trade or business, and the internal policies and procedures of the taxpayer’s business. For instance, if the taxpayer is already trading in the same or similar types of assets, starts a new trade or business, or embarks on a scheme to

⁹ See section 1(1).

¹⁰ www.dictionary.com/browse/commence [Accessed 26 March 2025].

sell assets for profit, and the specific asset is then incorporated into or used as trading stock, this would indicate the commencement of holding that asset as trading stock.¹¹

4.4 Trading stock

The definition of “trading stock” is broad, yet intended to be exhaustive despite the use of the word “includes”.¹² Essentially, it encompasses anything acquired or manufactured for the purpose of sale or that will be incorporated into another asset intended for sale. In *De Beers Holdings (Pty) Ltd v CIR*,¹³ it was noted that trading stock is typically acquired with the intent of resale at a profit.

Paragraphs (a)(i) and (ii) of the definition of “trading stock” read as follows:¹⁴

- “(i) everything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by the taxpayer or on behalf of the taxpayer;
- (ii) anything the proceeds from the disposal of which forms or will form part of the taxpayer’s gross income, otherwise than—
 - (aa) in terms of paragraph (j) or (m) of the definition of “gross income”;
 - (bb) in terms of paragraph 14(1) of the Eighth Schedule; or
 - (cc) as a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph (n) of the definition of “gross income;”

The above paragraphs of the definition of trading stock are relevant in determining whether an asset is held as trading stock for the purposes of section 8(4)(k)(iv). This is a factual enquiry and will depend on the particular facts of a case.

Section 22 aims to align the timing of the deduction of the cost of trading stock with the income from its sale. Consequently, it requires that trading stock held and not disposed of at the end of the year of assessment must be accounted for as closing stock in that year and opening stock in the immediately succeeding year of assessment.

Once it has been established that the requirements of section 8(4)(k)(iv) are met and the asset commences to be held as trading stock, its cost price for the purposes of section 22 must be determined. Section 22(3)(a) specifies how the cost price of trading stock should be established. The cost price incurred for trading stock that falls under paragraph (a)(i) of the definition of “trading stock” is determined under section 22(3)(a)(i). Under section 22(3)(a)(ii), the cost price of any trading stock treated under paragraph 12(2)(c) as having been acquired at a cost equal to the market value is that market value (see **Example 2**).

4.4.1 Opening stock

Section 22(2) determines the amount to be included in opening stock when calculating the taxable income derived by any person during a year of assessment from carrying on a trade (other than farming).

¹¹ See *John Bell & Co (Pty) Ltd v SIR* 1976 (4) SA 415 (A), 38 SATC 87 at 103.

¹² *De Beers Holdings (Pty) Ltd v CIR* 1986 (1) SA 8 (A), 47 SATC 229 at 256.

¹³ 1986 (1) SA 8 (A), 47 SATC 229 at 254.

¹⁴ Definition of “trading stock” in section 1(1).

The amount to be considered regarding the value of opening stock must be –

- if the trading stock was part of the closing stock held and not disposed of at the end of the immediately preceding year of assessment, then the value of that trading stock is determined by its value at the end of that year;¹⁵ or
- if the trading stock did not form part of the closing stock at the end of the immediately preceding year of assessment, its value is based on the cost price to the person holding it.¹⁶ However, if a person commences to hold an asset as trading stock that was previously not classified as such, section 22(3)(a)(ii) deems the market value at the date it became trading stock to be its cost.

4.4.2 Closing stock

Section 22(1) allows a person carrying on a trade to include the value of trading stock, excluding financial instruments held as trading stock,¹⁷ in his or her income, provided that the stock is held and not disposed of at the end of the year of assessment. The value of the closing stock to be included in income is –

- the cost price to the taxpayer; *less*
- any amount by which the value of the trading stock has decreased due to damage, deterioration, changes in fashion, decreases in market value, or any other reason deemed satisfactory by the Commissioner.¹⁸

The value of closing stock must be included in gross income¹⁹ and may not exceed its cost price.²⁰ If a taxpayer commences to hold an asset as trading stock that was previously not classified as such, and that asset is included in closing stock, the value of that item must be determined in accordance with section 22(1)(a).

4.5 Meaning of recovered or recouped

The words “recovered” and “recouped” are not defined in either the Act or in section 8, but they have been interpreted in several court cases. In ITC 1634, *Wunsh J* held as follows:²¹

“To recoup is to recover or get back what has been expended or lost or to compensate.”

In ITC 1678 the court held that –²²

“I am by no means certain, however, that it is either helpful, advisable, or even reliable to lay down rules to test whether there has been a recoupment. On the contrary, the question is one of hard fact, to be determined on the circumstances of each case, and in doing so the court will have regard to each and every relevant feature.”

¹⁵ Section 22(2)(a).

¹⁶ Section 22(2)(b).

¹⁷ Section 22(1)(b) stipulates that the value of financial instruments that are held as trading stock in respect of which a taxpayer has made an election under section 24J(9) will be equal to its market value.

¹⁸ Section 22(1)(a).

¹⁹ Paragraph (i) of the proviso to section 22(1)(a).

²⁰ Paragraph (ii) of the proviso to section 22(1)(a).

²¹ ITC 1634 (1997) 60 SATC 235 (T) at 242. See also *C: SARS v Pinestone Properties CC 2002 (4) SA 202 (N)*, 63 SATC 421.

²² ITC 1678 (1999) 62 SATC 288 (N) at 292.

Juta Law describes the words “recovered” or “recouped” as follows:²³

“The words ‘recovered or recouped’ are not terms of art, but must take their ordinary everyday meaning. The Oxford English Dictionary defines the word ‘recover’ as ‘to get back again into one’s own hands or possession; to regain possession of (something lost or taken away)’. The word ‘recoup’ is defined as ‘to make up for, compensate for, make good’ and the word ‘recoupment’ as ‘the act of recovering or recompensing; the act of being recouped for a loss or expense’.”

In *Omnia Fertiliser Ltd v C:SARS*,²⁴ the court held that to recover or recoup means to return an amount that had previously been expended to the taxpayer’s pocket.

Having regard to the above principles, it can be concluded that “recovered” or “recouped” refers to all amounts permitted to be deducted or set off under the provisions specified in section 8(4)(a) that have been regained, compensated for, or repossessed, and must be included in a taxpayer’s income. A recoupment under section 8(4)(a) is a factual matter, not a legal one. Each case must be considered and decided on its own merits.

Only amounts that were granted as a deduction or set off according to the specific sections of the Act listed in section 8(4)(a) must be included in the taxpayer’s income as a recoupment. The onus is on SARS to prove the fact that an amount previously allowed as a deduction has been recovered or recouped by the taxpayer.²⁵ There are certain exclusions when an amount recovered or recouped is not required be included in the taxpayer’s income (see 5).

4.6 Interaction between section 8(4)(k)(iv) and section 8(4)(a)

Before section 8(4)(k)(iv) came into effect on 15 January 2020, deductions and allowances granted on an asset were not recouped in the year of assessment when the asset commenced to be held as trading stock, as no deemed disposal was triggered for normal tax purposes. Deductions and allowances granted before the asset commenced to be held as trading stock could not be recouped and simply formed part of any capital gain determined when the asset became trading stock.

Example 1 – An allowance asset commences to be held as trading stock before 15 January 2020

Facts:

Company A purchased a machine for R100 000 on 1 January 2016 and claimed capital allowances totalling R60,000 over the next three years of assessment. On 31 December 2018, Company A ceased to hold the machine as a capital asset and commenced to hold it as trading stock. The market value of the machine on 30 December 2018 was R110 000. Company A’s year of assessment ends on 31 December, and at this date, the machine was classified as trading stock held and not disposed of. Company A sold the machine on 12 January 2020 for R130 000.

²³ D Davis *et al Juta’s Tax Library* [online] (Jutastat e-publications: 21 May 2021) in Commentary on Income Tax – section 8(4)(a).

²⁴ 2003 (4) SA 513 (SCA), 65 SATC 159.

²⁵ *CIR v Butcher Bros (Pty) Ltd* 145 AD 301, 13 SATC 21 and *C: SARS v Pinestone Properties CC* 2002 (4) SA 202 (N), 63 SATC 421.

The tax treatment was as follows:

	R
Cost of machine	100 000
Less: Capital allowances claimed [paragraph 20(3)(a)]	<u>(60 000)</u>
Tax value/base cost	<u>40 000</u>

CGT

	R
Proceeds [paragraph 12(2)(c)]	110 000
Less: Base cost	<u>(40 000)</u>
Capital gain	<u>70 000</u>

Paragraph 20(3) addresses the base cost, which should be reduced by any amount that has been recovered or recouped, provided that such amount is not accounted for as a recoupment under section 8(4)(a) or paragraph (j) of the definition of "gross income", or has not been applied to reduce an expenditure amount incurred in respect of trading stock as contemplated in section 19(3) or any other asset as contemplated in paragraph 12A(3). Therefore, to determine the capital gain, the cost price of R100 000 for the machine must be reduced by the capital allowances claimed of R60 000 for the purpose of calculating the base cost (R40 000).

Under paragraph 13(1)(g)(i), the deemed disposal under paragraph 12(1), read with paragraph 12(2)(c), occurs on the date immediately before the day that the event occurs.

A deemed disposal is triggered under paragraph 12(2)(c) on 30 December 2018, the day before Company A commenced holding the machine as trading stock. According to paragraph 12(1), the machine is deemed to be disposed of for an amount received or accrued equal to the market value of R110 000. The capital gain of R70 000 is taken into account under paragraph 8 to determine Company A's net capital gain.

Income tax

	R
Opening stock (2018 year of assessment)	(110 000)
Closing stock (2018 year of assessment)	110 000
Opening stock (2019 year of assessment)	(110 000)

Company A is allowed to claim a deduction of R110 000 under section 22(2)(b), read with section 22(3)(a)(ii), for the cost of acquiring the machine, which will be included in opening stock. Since the machine was held and not disposed of at the end of the year of assessment, it must be included in the valuation of closing stock on 31 December 2018. The value of opening stock on 1 January 2019 will be identical to the closing stock value of trading stock on 31 December 2018 (see 4.4).

Recoupment of allowances

The allowances of R60 000 granted to Company A before the asset being classified as trading stock will not be recouped, as they were accounted for as part of the capital gain of R70 000.

Disposal of machine

	R
Proceeds on disposal/gross sales	130 000
Less: Opening stock	<u>(110 000)</u>
Profit on sale of machine/taxable income	<u>20 000</u>

Once the machine commences to be held as trading stock, it no longer qualifies as an “asset” under the definition provided in paragraph 1 for the purposes of the Eighth Schedule.

Company A has already received a deduction for the machine at a market value of R110 000 under section 22(2)(b), read with section 22(3)(a)(ii), for its acquisition cost. The machine is sold in the 2020 year of assessment, and therefore it will not be included in the closing stock for that year. The allowances granted to Company A before the asset commenced to be held as trading stock will not be recouped, as they were accounted for as part of the capital gain of R70 000. The proceeds of R130,000 will be included in gross income, resulting in a taxable income of R20 000.

Section 8(4)(k) deems the asset to be sold at market value but does not regulate the recoupment or its amount. The latter is regulated under section 8(4)(a).

Paragraph 12 outlines several events that are regarded as disposals for the purposes of the Eighth Schedule. When an event described in this paragraph occurs, the individual will be treated as having –

- disposed of the asset for an amount received or accrued equal to the market value of the asset at the time of the relevant event, and
- immediately reacquired the asset at a cost equal to that market value.²⁶

Under paragraph 13(1)(g)(i) the time of the events in paragraph 12(2)(a), (b), (c), (d) or (e), 12(3) or 12(4) is the date immediately before the day that the event occurs.²⁷

On or after 15 January 2020 both capital gains and income implications arise as a consequence of the deemed disposal when a taxpayer commences to hold an asset as trading stock that was previously not held as trading stock. The tax implications are as follows:

- The disposal is deemed to occur for CGT purposes immediately before the day the deemed disposal is triggered.²⁸
- The taxpayer is deemed to have disposed of the asset for an amount received or accrued equal to the market value of the asset at the time of the event and to have immediately reacquired it at an expenditure equal to that market value (see 4.7).²⁹

²⁶ See *Comprehensive Guide to Capital Gains Tax* in paragraph 6.2.1.

²⁷ See *Comprehensive Guide to Capital Gains Tax* in paragraph 6.2.1.

²⁸ Paragraph 13(1)(g).

²⁹ Section 8(4)(k).

- A recoupment of amounts previously granted as a deduction is triggered under section 8(4)(k)(iv), read with section 8(4)(a), as at the date that the asset commences to be held as trading stock. It will be observed that the disposal for CGT purposes occurs on the day before the commencement, meaning that the disposal event under section 8(4)(k)(iv) does not correspond with the timing of the disposal under paragraph 13(1)(g)(i). However, this misalignment should not lead to double taxation because paragraph 35(3)(a) excludes from proceeds “any amount of the proceeds that must be or was included in the gross income of that person”. The phrase “must be” indicates futurity, resulting in any recoupment under section 8(4)(k) reducing the proceeds accounted for on the day before the change in usage.

Example 2 – Allowance asset commencing to be held as trading stock on or after 15 January 2020

Facts:

Company B acquired a machine for R100 000 on 1 March 2019 for its leasing division and claimed capital allowances on the machine amounting to R80 000 over the next four years. On 28 February 2023, Company B transferred the machine to its sales division, ceasing to hold it as a capital asset and commenced to hold it as trading stock. The market value of the machine on 27 February 2023 was R110 000. Company B's year of assessment ends on 28 February, at which point the machine comprised trading stock that had not been disposed of.

Result:

	R
Cost of machine	100 000
Less: Capital allowances [paragraph 20(3)(a)]	<u>(80 000)</u>
Tax value/ base cost	<u>20 000</u>

Recoupment

Deemed proceeds [section 8(4)(k)]	110 000
Less: Tax value	<u>(20 000)</u>
Profit on disposal of machine	<u>90 000</u>

The profit on the disposal of the machine, amounting to R90 000, includes a recoupment of capital allowances totalling R80 000 under section 8(4)(k)(iv) and a capital gain of R10 000. The recoupment is limited to the capital allowances claimed as a deduction of R80,000.

CGT³⁰

	R
Deemed consideration [paragraph 12(1)]	110 000
Less: Recoupment under section 8(4)(k)(iv) (paragraph 35(3)(a))	<u>(80 000)</u>
Proceeds under paragraph 35	30 000
Less: Base cost	<u>(20 000)</u>
Capital gain	<u>10 000</u>

³⁰ See the *Comprehensive Guide to Capital Gains Tax*, for detail on the application of CGT.

Trading stock

	R
Opening stock (1 March 2022)	(110 000)
Closing stock (28 February 2023)	110 000
Opening stock (1 March 2023)	(110 000)

The machine is deemed to have been disposed of for proceeds equal to its market value of R110 000 on 27 February 2023 under section 8(4)(k)(iv). After its transfer to the sales division, the machine was classified as trading stock. Section 22(3)(a)(ii) considers Company B to have reacquired the machine as trading stock at its market value of R110 000. Since the machine was not included in trading stock held by the taxpayer at the end of the immediately preceding year of assessment, it is included in opening stock as of 1 March 2022 under section 22(2)(b). As the machine constituted trading stock held and not disposed of on 28 February 2023, it is included in closing stock for the 2023 year of assessment. Company B must include the allowances claimed of R80 000 in its income and account for the capital gain of R10 000 in the 2023 year of assessment, during which the machine commenced to be held as trading stock.³¹

4.7 “Market value”

For purposes of recovery or recoupment under section 8(4)(a) (see 4.24.2), a taxpayer is deemed under section 8(4)(k)(iv) to have disposed of the asset for an amount equal to its market value on the date the asset commenced to be held as trading stock. The term “market value” is generally understood to be the price that could be obtained between a willing buyer and a willing seller negotiating at arm’s length in an open market. The phrase “acting at arm’s length” was considered in *Hicklin v SIR*, where Trollip JA stated the following:³²

“For ‘dealing at arms’ length’ is a useful and often easily determinable premise from which to start the inquiry. It connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself. ... Hence, in an at arms’ length agreement the rights and obligations it creates are more likely to be regarded as normal than abnormal”

The principle to be drawn from this is that for a transaction to be considered to have been concluded at “market value”, the parties involved must have acted in a manner aimed at achieving the maximum possible benefit from the transaction. This principle applies to section 8(4)(k)(iv) when an asset, previously not used as trading stock, commences to be held as trading stock.

The taxpayer bears the burden of proving the market value of an asset.

³¹ Section 8(4)(k)(iv) read with section 8(4)(a).

³² [1980] 1 All SA 301 (A) at 311-312.

5 Exclusions

Certain amounts that have been recovered or recouped are excluded under section 8(4)(a) from inclusion in the taxpayer's income. These exclusions arise when the amount is –

- included in the income of such taxpayer under paragraph (jA) of the definition of “gross income”;³³
- applied to reduce any cost or expenditure incurred by such taxpayer under section 19;³⁴ or
- previously taken into account as an amount deemed to have been recovered or recouped under section 19(4), (5), or (6).³⁵

Only the exclusion of a paragraph (jA) asset is relevant for purposes of section 8(4)(k)(iv). Such an asset is one that is manufactured, produced, constructed, or assembled by a person, and is similar to any other asset manufactured, produced, constructed, or assembled by that person for purposes of manufacture, sale, or exchange by that person or on that person's behalf.

Paragraph (jA) treats the asset as trading stock from its creation until its disposal, thereby preventing the application of section 8(4)(k)(iv) and paragraph 12(2)(c) during any change in use (see 4.4).

Example 3 – Excluded from recoupment paragraph (jA) assets

Facts:

Company C carries on the trade of manufacturing motor vehicles which it sells to motor vehicle dealers. Some of the motor vehicles manufactured are used by Company C's sales personnel as demo vehicles. Company C has a policy of disposing of these demo vehicles after one year. In the year of assessment, Company C claimed a deduction for the costs incurred in manufacturing these vehicles.

Result:

All motor vehicles manufactured by Company C comprise trading stock under paragraph (a)(ii) of the definition of “trading stock” regardless of the fact that some of the vehicles were utilised as capital assets by the sales personnel before disposal. The proceeds from the sale of the demo vehicles will constitute gross income under paragraph (jA) upon their disposal. Consequently, the expenditure incurred to manufacture these vehicles, which has been claimed as a deduction, would be excluded from recoupment under proviso (i) to section 8(4)(a). Furthermore, since the vehicles remain trading stock from the time of their manufacture until their disposal, neither paragraph 12(2)(c) nor (3) applies (deemed disposal when an asset commences or ceases to be trading stock).

³³ Section 8(4)(a)(i).

³⁴ Section 8(4)(a)(ii).

³⁵ Section 8(4)(a)(iii).

6 Conclusion

Section 8(4)(a) provides for the recoupment of all amounts allowed to be deducted or set off under specified sections of the Act when an asset is disposed of or when an expense is otherwise recovered or recouped.

On or after 15 January 2020, section 8(4)(k)(iv) triggers a deemed disposal for the purposes of section 8(4)(a) when an allowance asset commences to be held as trading stock. This does not apply to an asset contemplated in paragraph (jA) of the definition of “gross income”, as such an asset remains trading stock from inception, regardless of whether it is subsequently used as a capital asset.

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Annexure – The law

Section 1(1) – Definition of “trading stock”

“trading stock”—

(a) includes—

- (i) everything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by the taxpayer or on behalf of the taxpayer;
- (ii) anything the proceeds from the disposal of which forms or will form part of the taxpayer’s gross income, otherwise than—
 - (aa) in terms of paragraph (j) or (m) of the definition of “gross income”;
 - (bb) in terms of paragraph 14(1) of the Eighth Schedule; or
 - (cc) as a recovery or recoupment contemplated in section 8(4) which is included in gross income in terms of paragraph (n) of the definition of “gross income”; or
- (iii) any consumable stores and spare parts acquired by the taxpayer to be used or consumed in the course of the taxpayer’s trade; but

(b) does not include—

- (i) a foreign currency option contract; or
- (ii) a forward exchange contract,

as defined in section 24I(1);

Section 8(4)(a)

(a) There shall be included in the taxpayer’s income all amounts allowed to be deducted or set off under the provisions of sections 11 to 20, inclusive, section 24D, section 24F, section 24G, section 24I, section 24J, section 27 (2) (b) and section 37B (2) of this Act, except section 11 (k), 11 (n), 11 (p) and (q), section 11F, section 12 (2) or section 12 (2) as applied by section 12 (3), section 12A (3), section 13 (5), or section 13 (5) as applied by section 13 (8), or section 13bis (7), section 15 (a) or section 15A, or under the corresponding provisions of any previous Income Tax Act, whether in the current or any previous year of assessment which have been recovered or recouped during the current year of assessment: Provided that the provisions of this paragraph shall not apply in respect of any such amount so recovered or recouped which has been—

- (i) included in the gross income of such taxpayer in terms of paragraph (jA) of the definition of “gross income”;
- (ii) applied to reduce any cost or expenditure incurred by such taxpayer in terms of section 19; or
- (iii) previously taken into account as an amount that is deemed to have been recovered or recouped in terms of section 19 (4), (5) or (6).

Section 8(4)(k)

(k) For the purposes of paragraph (a), where during any year of assessment any person has—

- (i)
- (ii)
- (iii)
- (iv) commenced to hold any asset as trading stock which was previously not held as trading stock,

in respect of which a deduction or an allowance has been granted to such person in terms of any of the provisions referred to in that paragraph, that person shall be deemed to have disposed of that asset for an amount equal to the market value of that asset as at the date of that donation, transfer or disposal.

Section 22(3)(a)

(3) (a) For the purposes of this section the cost price at any date of any trading stock in relation to any person shall—

- (i) subject to subparagraphs (iA) and (ii), be the cost incurred by such person, whether in the current or any previous year of assessment in acquiring such trading stock, plus any further costs incurred by such person, in terms of IFRS (in the case of a company), up to and including the said date in getting such trading stock into its then existing condition and location, but excluding any exchange difference as defined in section 24(1) relating to the acquisition of such trading stock;
- (iA)
- (ii) in the case of any trading stock which is in terms of paragraph 12(2)(c) of the Eighth Schedule treated as having been acquired at a cost equal to the market value, be that market value; or
- (iii)

The Eighth Schedule – Paragraphs 12(1) and 12(2)(c)

12 Events treated as disposals and acquisitions. —(1) Where an event described . Where an event described in subparagraph (2) occurs, a person must, subject to paragraph 24, be treated for the purposes of this Schedule as having disposed of an asset described in subparagraph (2) for an amount received or accrued equal to the market value of the asset at the time of the event and to have immediately reacquired the asset at an expenditure equal to that market value, which expenditure must be treated as an amount of expenditure actually incurred for the purposes of paragraph 20 (1) (a).

- (2) Subparagraph (1) applies, in the case of—
 - (a)
 - (b)
 - (c) assets that are held by a person otherwise than as trading stock, when they commence to be held by that person as trading stock;

The Eighth Schedule – Paragraph 20(3)

(3) The expenditure contemplated in subparagraph (1) (a) to (g), incurred by a person in respect of an asset must be reduced by any amount which—

- (a)
 - (i) is or was allowable or is deemed to have been allowed as a deduction in determining the taxable income of that person; and
 - (ii) is not included in the taxable income of that person in terms of section 9C (5), before the inclusion of any taxable capital gain; or
- (b) has for any reason been reduced or recovered or become recoverable from or has been paid by any other person (whether prior to or after the incurral of the expense to which it relates), to the extent that such amount is not—
 - (i) taken into account as a recoupment in terms of section 8 (4) (a) or paragraph (j) of the definition of “gross income”;
 - (ii) reduced in terms of section 12P; or
 - (iii) applied to reduce an amount of expenditure incurred in respect of—
 - (aa) trading stock as contemplated in section 19 (3); or
 - (bb) any other asset as contemplated in paragraph 12A (3); or
- (c) is exempt from tax in terms of section 10 (1) (yA) and is granted or paid for purposes of the acquisition of that asset.

The Eighth Schedule – Paragraph 35(3)(a)

(3) The proceeds from the disposal, during a year of assessment, of an asset by a person, as contemplated in subparagraph (1) must be reduced by—

- (a) any amount of the proceeds that must be or was included in the gross income of that person or that must be or was taken into account when determining the taxable income of that person before the inclusion of any taxable capital gain;