

**DRAFT INTERPRETATION NOTE**

DATE:

**ACT : INCOME TAX ACT 58 OF 1962**  
**SECTION : SECTION 12Q**  
**SUBJECT : EXEMPTION OF INCOME RELATING TO SOUTH AFRICAN SHIPS  
 USED IN INTERNATIONAL SHIPPING**

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### **Preamble**

In this Note unless the context indicates otherwise –

- **“international shipping”** means “international shipping” as defined in section 12Q(1);<sup>1</sup>
- **“international shipping company”** means “international shipping company” as defined in section 12Q(1);<sup>2</sup>
- **“international shipping income”** means “international shipping income” as defined in section 12Q(1);<sup>3</sup>
- **“section”** means a section of the Act;
- **“Ship Registration Act”** means the Ship Registration Act 58 of 1998;
- **“South African-registered ship”** means a ship registered in South Africa under the Ship Registration Act as contemplated in paragraph (a) of the definition of “South African ship” in section 12Q(1);
- **“South African ship”** means a “South African ship” as defined in section 12Q(1) and includes a “South African-registered ship” and a “temporary replacement ship”;<sup>4</sup>
- **“TA Act”** means the Tax Administration Act 28 of 2011;
- **“temporary replacement ship”** means another ship used temporarily as a result of a South African-registered ship being subject to repair or maintenance as contemplated in paragraph (b) of the definition of “South African ship” in section 12Q(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.

All guides and interpretation notes referred to in this Note are available on the SARS website at [www.sars.gov.za](http://www.sars.gov.za). Unless indicated otherwise, the latest issue of these documents should be consulted.

## **1. Purpose**

This Note provides guidance on the interpretation and application of section 12Q, which provides for an exemption from normal tax, capital gains tax, dividends tax and withholding tax on interest for an international shipping company meeting the requirements of the section.<sup>5</sup>

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<sup>1</sup> See 4.1.2.

<sup>2</sup> See 4.1.3.

<sup>3</sup> See 4.1.4.

<sup>4</sup> See 4.1.1.

<sup>5</sup> The content of the Merchant Shipping Bill, 2020 has not been considered for purposes of this Note.

## 2. Background

As part of the National Transport Policy,<sup>6</sup> government aims to promote the development of an efficient and productive South African maritime industry capable of competing internationally and to encourage ships to carry the South African flag. To give effect to this strategic objective, section 12Q was inserted with effect from 1 April 2014 and applies to years of assessment commencing on or after that date,<sup>7</sup> providing certain tax relief for qualifying international shipping companies.

The issue of double taxation and the application of various double tax treaties is not dealt with in this Note since double taxation relief measures vary from treaty to treaty.

## 3. The law

### Section 12Q

**12Q. Exemption of income in respect of ships used in international shipping.—**

(1) For the purposes of this section—

“**international shipping**” means the conveyance for compensation of passengers or goods by means of the operation of a South African ship mainly engaged in international traffic;

“**international shipping company**” means a company that is a resident that operates one or more South African ships that are utilised in international shipping;

“**international shipping income**” means the receipts and accruals of a person derived from international shipping mainly from the operation of one or more ships contemplated in paragraph (a) of the definition of “South African ship”;

“**South African ship**” means a ship—

- (a) which is registered in the Republic in accordance with Part 1 of Chapter 4 of the Ship Registration Act, 1998 (Act No. 58 of 1998); or
- (b) another ship or ships used temporarily in lieu of the ship contemplated in paragraph (a) by virtue of that ship being subject to repair or maintenance.

(2) (a) There must be exempt from normal tax any international shipping income of any international shipping company.

- (b) Any capital gain or capital loss in respect of any year of assessment of any international shipping company determined in respect of a South African ship engaged in international shipping must be disregarded in determining the aggregate capital gain or aggregate capital loss of that international shipping company.

(3) The rate of dividends tax contemplated in section 64E that is paid by an international shipping company on the amount of any dividend derived from international shipping income must not exceed zero per cent of the amount of that dividend.

(4) There must be exempt from the withholding tax on interest any amount of interest if that amount is paid to any foreign person, as defined in section 50A, by an international shipping company in respect of debt utilised to fund the acquisition, construction or improvement of a South African ship utilised for international shipping.

<sup>6</sup> The White Paper on the National Transport Policy, 1996.

<sup>7</sup> Inserted by section 41(1) of the Taxation Laws Amendment Act 31 of 2013. See also amendments effected by the Taxation Laws Amendment Act 17 of 2017 and the Taxation Laws Amendment Act 23 of 2018.

## **4. Application of the law**

### **4.1 Definitions [section 12Q(1)]**

In order to qualify for the tax relief under section 12Q, a company must be a resident and operate one or more South African ships that are used in international shipping for international transportation of passengers or goods for compensation. The various definitions in section 12Q(1) form the basis for the application of section 12Q.

#### **4.1.1 South African ship**

The term “South African ship” is defined in section 12Q(1) as –

- a ship registered in South Africa in accordance with Part 1 of Chapter 4 of the Ship Registration Act; or
- another ship or ships used temporarily in lieu of the ship contemplated above by virtue of that ship being subject to repair or maintenance.

The two categories of a South African ship for purposes of section 12Q(1) are examined below.

##### **(a) Ships registered in accordance with Part 1 of Chapter 4 of the Ship Registration Act (paragraph (a) of the definition of “South African ship”)**

The Ship Registration Act provides for the registration of ships in South Africa. Part 1 of Chapter 4 of the Ship Registration Act, which encompasses sections 15 to 19 of that Act, dictates the requirements of registering a ship as a South African ship,<sup>8</sup> the refusal of registration<sup>9</sup> and prohibition of dual registration.<sup>10</sup>

Section 15 of the Ship Registration Act provides that for purposes of the registration of a ship –

- the property in a ship is divided into 64 shares;
- the number of persons registered as owners of a ship may not at any time exceed 64 and when a share in a ship is jointly owned or two or more shares in a ship are jointly owned by the same persons, the joint owners of that share or of those shares, as the case may be, must be regarded as one person;
- any number of persons not exceeding five may be registered as joint owners of a ship or of one or more shares in a ship;
- a joint owner of a ship or of one or more shares in a ship may not dispose of that joint owner’s interest separately;
- a person may not be registered as the owner of a fractional part of a share in a ship;
- a body corporate is registered as an owner by its corporate name; and
- a trust is registered as an owner in the name of the trust.

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<sup>8</sup> Sections 15, 16 and 17 of the Ship Registration Act.

<sup>9</sup> Section 18 of the Ship Registration Act.

<sup>10</sup> Section 19 of the Ship Registration Act.

Under section 16 of the Ship Registration Act the following ships are entitled to be registered:

- South African-owned ships.
- Small vessels,<sup>11</sup> other than fishing vessels, that are—
  - wholly owned by South African residents or South African residents and South African nationals;<sup>12</sup> or
  - operated solely by South African residents or South African nationals or both such residents and such nationals.
- Ships on bareboat charter<sup>13</sup> to South African nationals.

The definition of “South African resident” for purposes of the Ship Registration Act differs from the definition of “resident” in section 1(1). Section 1(1) of the Ship Registration Act defines “South African resident” as –

- “(a) a natural person whose permanent place of abode is in the Republic, whether or not he or she is from time to time temporarily absent from the Republic;
- (b) a natural person whose domicile is in the Republic, unless his or her permanent place of abode is outside the Republic;
- (c) a body corporate, wherever incorporated, that has its principal place of business in the Republic; and
- (d) a trust in which—
  - (i) the majority of trustees having the controlling power at any given time are South African residents referred to in paragraphs (a), (b) and (c); and
  - (ii) a majority of the beneficial interests are held by such South African residents;”.

Section 1(1) of the Ship Registration Act defines “South African national” as –

- “(a) a South African citizen in terms of the South African Citizenship Act, 1995 (Act No. 88 of 1995);
- (b) a body corporate established in terms of a law of the Republic with a place of business in the Republic;
- (c) a trust in which—
  - (i) the majority of trustees having the controlling power at any given time are South African nationals referred to in paragraphs (a) and (b); and
  - (ii) a majority of the beneficial interests are held by such South African nationals; and
- (d) the Government of the Republic;”.

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<sup>11</sup> The term “small vessel” is defined in section 1(1) of the Ship Registration Act as “a vessel of less than (sic) 25 gross tons and of more than three metres in length”.

<sup>12</sup> The terms “South African resident” and “South African national” are defined in section 1(1) of the Ship Registration Act.

<sup>13</sup> The term “bareboat charter” is defined in section 1(1) of the Ship Registration Act.

Section 1(1) of the Ship Registration Act defines “bareboat charter” of a ship to mean “the charter of the ship for a fixed period on terms that give the charterer possession and control of the ship, including the right to appoint the master and crew”. Thus, a ship that is on bareboat charter to a South African national may be registered as a South African ship in accordance with Part 1 of Chapter 4 of the Ship Registration Act despite the fact that the ship is not owned by the South African national.

Section 18 of the Ship Registration Act provides for a number of circumstances in which a ship may be denied registration under that Act, amongst others, when there is a concern with regards to the safety, health and welfare of persons employed or engaged on the ship.

Under section 19 of the Ship Registration Act, a ship may not be registered under that Act if the ship is registered under the law of another state. However, some exceptions and requirements are provided for under that section.

**(b) Ship used temporarily in lieu of a South African-registered ship by virtue of that ship being subject to repair or maintenance (paragraph (b) of the definition of “South African ship”)**

The second category under the definition of “South African ship” is another ship used temporarily while the South African-registered ship is undergoing repair or maintenance.

This second category was included effective for years of assessment commencing on or after 1 April 2019.<sup>14</sup> The amendment to the definition of “South African ship” was in conjunction with an amendment to the definition of “international shipping income” (see 4.1.4).

The amendments to the two definitions were necessary because the limitation of the relief to the operation of South African-registered ships in order to prevent abuse of the tax relief, created unintended consequences. Often a temporary replacement ship has to be brought into use temporarily as a replacement ship owing to the South African-registered ship being unavailable while undergoing repair or maintenance. This restriction resulted in the international shipping company not qualifying for the tax relief under section 12Q.

The amendment to the definition of “South African ship” caters for an exception to the policy intent to attract ships to be flagged under the South African register and therefore provides relief only if the replacement ship is used temporarily while repair or maintenance is effected to a South African-registered ship.

Since the words “temporarily”, “repair” and “maintenance” are not defined in the Act, they should be interpreted according to their ordinary meaning as applied to the subject matter with regard to which they are used, unless there is something which obliges them to be read in a sense that is not in their ordinary sense in the English language as so applied.<sup>15</sup>

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<sup>14</sup> Definition of “South African ship” substituted by section 31(1)(b) of the Taxation Laws Amendment Act 23 of 2018.

<sup>15</sup> See EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworths at 224, citing *Lion Insurance Association v Tucker* (1883) 12 QB 176 at 186.

In *Dictionary.com* “temporarily” is defined as –<sup>16</sup>

“only for a while or for the time being; not permanently.”

No specific timeframe such as a number of months can be prescribed for purposes of determining what is meant by “temporarily” under paragraph (b) of the definition of “South African ship”. However, the use of the temporary replacement ship should be for a limited period of time and not permanent. The time that the temporary replacement ship is used should correspond with the duration of the repairs to or maintenance of the affected South African-registered ship which could include waiting times for parts or supplies necessary for the repair or maintenance. The nature and extent of the repair or maintenance will in each case dictate the period of time that the receipts and accruals from the use of the temporary replacement ship will be eligible for the tax relief.

The *Cambridge Dictionary*<sup>17</sup> defines “repair” as –

“to put something that is damaged, broken or not working correctly, back into good condition, or make it work again”.

In ITC 617 the court considered the meaning of “repair” and examined various court cases from which the following principles were extracted:<sup>18</sup>

- Repair is restoration by renewal or replacement of subsidiary parts of the whole. Renewal as distinguished from repair is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion.
- In the case of repairs effected by renewal, it is not necessary that the materials used should be identical with the materials replaced.
- Repairs are to be distinguished from improvements. The test for this purpose is has a new asset been created resulting in an increase in the income-earning capacity or does the work undertaken merely represent the cost of restoring the asset to a state in which it will continue to earn income as before?

These principles are intended to provide some basic guidance to the taxpayer in determining what constitutes a “repair”. Each matter must, however, be considered on the facts of the case.

Owners of ships are often legally required to effect certain changes to the ship to maintain registration or be allowed to operate. Expenditure incurred to effect the compulsory changes is generally considered to constitute a repair or maintenance and not an improvement. By making the compulsory changes to the ship, the owner is not creating a new asset resulting in an increase in the income-earning capacity, but rather undertaking repairs to allow the ship to continue earning income.

The distinction between a “repair” and an “improvement” is not always clear. The South African courts have developed a number of tests for distinguishing between repairs and improvements, which are considered in Interpretation Note 74 “Deduction and Recoupment of Expenditure Incurred on Repairs” but ultimately the facts and circumstances of each case must be taken into account when making the distinction.

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<sup>16</sup> [www.dictionary.com/browse/temporarily](http://www.dictionary.com/browse/temporarily) [Accessed 31 October 2022].

<sup>17</sup> [www.dictionary.cambridge.org/dictionary/english/repair](http://www.dictionary.cambridge.org/dictionary/english/repair) [Accessed 31 October 2022].

<sup>18</sup> (1946) 14 SATC 474 (U) at 476.

The *Cambridge Dictionary* defines “maintenance” as –<sup>19</sup>

“the work needed to keep a road, building, machine, etc. in good condition”.

A South African-registered ship undergoing improvement will not be considered as being subject to repair or maintenance, since “improvement” does not constitute “repair” or “maintenance” in the ordinary meaning of the words. Work done to a South African-registered ship having the effect of bringing a new ship into existence or which results in the ship having an increased income-earning capacity will constitute an improvement and not repair or maintenance. For example, an improvement would arise if more passenger cabins were added to a passenger ship, or a tanker vessel is converted to a bulk carrier.

If the ship is being restored to its original state to generate income, the work completed will constitute repairs and maintenance. In the case of a South African-registered ship undergoing repair or maintenance and simultaneously undergoing improvements, the taxpayer must determine the period for which the South African-registered ship undergoes repair or maintenance and during such period the use of a temporary replacement ship may qualify under paragraph (b) of the definition of “South African ship”. If the period for which the South African-registered ship undergoes improvements exceeds the period for repair or maintenance, the temporary replacement ship will not qualify under paragraph (b) of the definition of “South African ship” for the period that the South African-registered ship undergoes improvements.

During periods of economic downturn, it is common for owners of ships to layup their vessels, that is, the temporary cessation of the use of a ship. A layup can be any period between a few weeks to a couple of years. If a temporary replacement ship is used as replacement for a laid-up South African-registered ship, the replacement ship will not qualify as a South African ship since the reason for replacing the ship is not for repair or maintenance.

The second category of the definition of “South African ship” has strict requirements and each case will be determined on the facts and circumstances.

#### 4.1.2 International shipping

Section 12Q(1) defines “international shipping” as the conveyance for compensation of passengers or goods by means of the operation of a South African ship mainly engaged in international traffic. Ownership by the international shipping company of the South African ship is not a requirement. The ship can therefore be operated by a lessee. The international shipping company could, for example, enter into a time charter, voyage charter<sup>20</sup> or bareboat charter agreement with the owner of another ship and use that ship for purposes of carrying on international shipping.

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<sup>19</sup> [www.dictionary.cambridge.org/dictionary/english/maintenance](http://www.dictionary.cambridge.org/dictionary/english/maintenance) [Accessed 31 October 2022].

<sup>20</sup> See Glossary of Maritime Terms available at <https://africaports.co.za/glossary/> which defines “time charter” as “a form of charter party wherein owner lets or leases his vessel and crew to the charterer for a stipulated period of time. The charterer pays for the bunkers and port charges in addition to the charter hire.”. The term “voyage charter” is defined as “a contract whereby the shipowner places the vessel at the disposal of the charterer for one or more voyages, the shipowner being responsible for the operation of the vessel.”.



The conveyance of passengers or goods must be for compensation, otherwise this requirement of the definition of “international shipping” will not be met. Should the type of operation of a ship change under which it is no longer used for the conveyance of passengers or goods for compensation, the ship will from that period onwards not qualify as being used for the purposes of international shipping.

An international shipping company that charters (lets) its South African-registered ship to another company will not meet the definition of “international shipping” in respect of that ship since it is used by that company for chartering (leasing) and not for the “conveyance for compensation of passengers or goods”.

In the context of the definition of “international shipping”, “mainly” is interpreted to mean “more than 50%”.<sup>21</sup> Therefore, a South African ship must be engaged in international traffic more than 50% of the time.<sup>22</sup>

The implication of the words “mainly engaged in international traffic” is that if a taxpayer operates in international and domestic traffic, the domestic traffic portion will be incidental to the international traffic on the condition that the South African ship is engaged in international traffic more than 50% of the time.

The term “international traffic” is not defined in the Act and should be interpreted according to its ordinary meaning as applied to the subject matter with regard to which it is used, unless there is something which obliges it to be read in a sense which is not its ordinary sense in the English language as so applied.<sup>23</sup>

The ordinary meaning of –

- “international” as an adjective is “between or among nations; involving two or more nations”;<sup>24</sup> and
- “traffic” is “the movement of ships, trains, or aircraft between one place and another”. Traffic also refers to the people and goods that are being transported”.<sup>25</sup>

In order to determine whether the South African ship is involved in international traffic, regard must be had to the definition of “Republic” in section 1(1). The term “Republic” means the Republic of South Africa and in a geographical sense –

“includes the territorial sea thereof as well as any area outside the territorial sea which has been or may be designated, under international law and the laws of South Africa, as areas within which South Africa may exercise sovereign rights or jurisdiction with regard to the exploration or exploitation of natural resources”.

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<sup>21</sup> *SBI v Lourens Erasmus (Edms) Bpk* 1966 (4) SA 434(A), 28 SATC 233.

<sup>22</sup> See also Interpretation Note 96 “Exemption from Income Tax: Remuneration derived by a person as an officer or crew member of a South African ship”.

<sup>23</sup> See EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworths at 224, citing *Lion Insurance Association v Tucker* (1883) 12 QB 176 at 186.

<sup>24</sup> [www.dictionary.com/browse/international](http://www.dictionary.com/browse/international) [Accessed 31 October 2022].

<sup>25</sup> [www.collinsdictionary.com/dictionary/english/traffic](http://www.collinsdictionary.com/dictionary/english/traffic) [Accessed 31 October 2022].

Under section 4 of the Maritime Zones Act 15 of 1994 (the MZA) “territorial waters” means the sea within a distance of 12 nautical miles from the baselines.<sup>26</sup>

An area that has been designated as an area within South Africa is the Prince Edward Islands, consisting of Marion Island and Prince Edward Island. These islands form part of the territory of South Africa and traffic between the South African mainland and these islands is not regarded as international traffic.

The definition of “Republic” also includes areas beyond the territorial sea which have been designated under international or domestic law as areas where South Africa may exercise sovereign rights *in respect of the exploration or exploitation of natural resources*.

Under section 7 of the MZA, the exclusive economic zone (EEZ) is a distance of 200 nautical miles from the baselines. Subject to any other domestic law, the EEZ has, in respect of all natural resources in the EEZ, the same rights and powers as it has in respect of its territorial waters.

A South African ship trafficking between a South African port and an area in the EEZ, even though for the purpose of conveying passengers or goods for compensation, will not be involved in international traffic since the EEZ is part of the extended geographical area of South Africa.

Accordingly, “international traffic” in the context of section 12Q includes the movement of a South African ship between –

- South Africa and a foreign nation;
- two foreign nations; and
- two different ports of the same foreign nation.

A South African ship used *mainly* for domestic purposes will not be engaged in international shipping when it sails between two different ports within South Africa or sails from and returns to the same port in South Africa, even if during that journey the ship sails outside South African territorial waters.<sup>27</sup>

Not all South African ships undertaking international traffic carry on international shipping, for example, fishing vessels operating in international waters. The South African ship engaged in international traffic must be conveying passengers or goods for compensation in order to qualify under the definition of “international shipping”.

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<sup>26</sup> This definition is aligned with what constitutes a State’s territorial sea under international law, specifically Articles 2 and 3 of the United Nations Convention on the Law of the Sea (UNCLOS), signed by the Republic of South Africa on 5 December 1984 and ratified on 23 December 1997.

<sup>27</sup> Section 4 of the Maritime Zones Act 15 of 1994. This definition is aligned with what constitutes a state’s territorial sea under international law, specifically Articles 2 and 3 of the United Nations Convention on the Law of the Sea, signed by South Africa on 5 December 1984 and ratified on 23 December 1997.

**Example 1 – International shipping***Facts:*

Company A operates a South African ship, a cruise liner, for the conveyance of passengers for compensation. Passengers board the cruise liner at the Durban port. The South African ship then sets sail for international waters and does not stop at any ports. The South African ship returns to the Durban port after 2 days. Company A neither operates nor owns any other South African ship.

*Result:*

The conveyance of passengers is not between two or more nations and as a result, there is no international traffic as required by the definition of “international shipping”. Company A therefore does not qualify for the exemption under section 12Q.

**4.1.3 International shipping company**

Section 12Q(1) defines “international shipping company” as a company that is a resident that operates one or more South African ships that are used in international shipping.

The term “resident” is defined in section 1(1). For purposes of section 12Q, the part of the definition relating to a natural person is irrelevant, since the definition of “international shipping company” deals only with a company.

The term “company” is defined in section 1(1) and includes, amongst others, companies incorporated under the Companies Act 71 of 2008 and companies incorporated, formed or established under the laws of a country other than South Africa.

A person other than a natural person will be a “resident” if it –

- is incorporated, established or formed in South Africa; or
- has its place of effective management in South Africa.

The definition of “resident” excludes any person that is deemed to be exclusively a resident of another country for purposes of the application of any tax treaty.

A company incorporated in South Africa is a “resident” as defined before considering the application of an applicable tax treaty. For companies not incorporated, established or formed in South Africa, their place of effective management is relevant in determining whether they are resident in South Africa.

Generally, a company’s place of effective management is the place where key management and commercial decisions for the business are made. There are no definitive rules to determine the place of effective management, and, as such, all the relevant facts and circumstances of each case must be considered. For a detailed commentary on “resident” and “place of effective management”, see Interpretation Note 6 “Resident – Place of effective management (Companies)”.

An international shipping company is thus a company that is a resident, operating one or more South African ships, mainly engaged in international traffic, that are used in the conveyance for compensation of passengers or goods.

#### 4.1.4 International shipping income

The exemption under section 12Q was previously limited to international shipping companies that derived income from the operation of South African-registered ships for purposes of international traffic. As stated in 4.1.1, this limitation created unintended consequences in situations when a temporary replacement ship (non-flagged ship) was brought into use temporarily by an international shipping company as a replacement ship because a South African-registered ship was unavailable while undergoing repair or maintenance. Since the replacement ship is not a South African-registered ship, the international shipping company did not qualify for the exemption from normal tax as a result of temporarily making use of a replacement ship.

In order to address the above concerns, amendments were made to the definitions of “South African ship” and “international shipping income” in section 12Q(1) to take into account income derived by a qualifying international shipping company that temporarily makes use of a replacement ship for purposes of international traffic during the period that the South African-registered ship is unavailable owing to it undergoing repair or maintenance.

The amended section 12Q(1)<sup>28</sup> defines “international shipping income” as the receipts and accruals of a person derived from international shipping mainly from the operation of one or more South African-registered ships contemplated in paragraph (a) of the definition of “South African ship”.

The terms “received by” and “accrued to” have been considered in numerous cases and are briefly discussed for purposes of this Note.

In *Geldenhuys v CIR* Steyn J stated that “received by” means –<sup>29</sup>

“received by the taxpayer on his own behalf for his own benefit”.

Schreiner JA stated the following in *CIR v Genn & Co (Pty) Ltd*:<sup>30</sup>

“It certainly is not every obtaining of physical control over money or money's worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income.”

These cases confirm that amounts received by a taxpayer on the taxpayer's own behalf and for the taxpayer's own benefit are “received by” the taxpayer for purposes of international shipping income and that an amount received on behalf of a third party must not be included in the taxpayer's international shipping income, since it was received on behalf of another party.

In *WH Lategan v CIR*<sup>31</sup> it was held by Watermeyer JA (as he then was) that “accrued to” means “to which he has become entitled”.

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<sup>28</sup> The amendments to section 12Q effected by section 31 of the Taxation Laws Amendment Act 23 of 2018 came into operation on 1 April 2019 and apply to years of assessment commencing on or after that date.

<sup>29</sup> 1947 (3) SA 256 (C), 14 SATC 419 at 430.

<sup>30</sup> 1955 (3) SA 293 (A), 20 SATC 113 at 123.

<sup>31</sup> 1926 CPD 203, 2 SATC 16 at 20. The entitlement principle was confirmed in *CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9 at 19.

The meaning of “entitled to” was extended to “unconditionally entitled to” in *Ochberg v CIR*<sup>32</sup> and *Mooi v SIR*.<sup>33</sup>

Accordingly, if the right to an amount is subject to specified conditions which have not been fulfilled, the taxpayer will not be unconditionally entitled to it and it will not have accrued to the taxpayer.

In *Western Platinum Ltd v C: SARS*<sup>34</sup> the Supreme Court of Appeal had to decide under what circumstances interest may be characterised as “income derived from mining operations”. The court confirmed the finding of the court *a quo* that in order to qualify as mining income, the income had to be directly connected to the mining source. The same test should be applied to determine whether income derived by an international shipping company is directly from international shipping and therefore “international shipping income”.

The definition of “international shipping income” refers to “mainly”. Therefore, the receipts or accruals of a person derived from international shipping must be more than 50% from the operation of one or more ships contemplated in paragraph (a) of the definition of “South African ship”. If, for example, an international shipping company derives income from the carrying on of international shipping, 55% with a South African-registered ship and 45% with a temporary replacement ship, the entire income will be exempt, since it is derived mainly from the operation of a ship contemplated in paragraph (a) of the definition of “South African ship”.

The income of an international shipping company that derives more than 50% of its receipts and accruals from the operation of one or more temporary replacement ships (contemplated in paragraph (b) of the definition of “South African ship”), will not meet the definition of “international shipping income” since this will not be a ship contemplated in paragraph (a) of the definition of “South African ship”. The reference in the definition of “international shipping income” to a ship contemplated in paragraph (a) of the definition of “South African ship” is to give effect to the policy intent to attract ships to be flagged under the South African register and limit the use of replacement ships to a short duration.

The chartering of a ship may occur under a bareboat, time or voyage charter basis. Amounts received by or accrued to an international shipping company from the chartering of a ship for a purpose other than the conveyance of passengers or goods do not fall within the definition of “international shipping income. The chartering income from such transactions will thus be subject to normal tax.

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<sup>32</sup> 1933 CPD 256, 6 SATC 1.

<sup>33</sup> 1972 (1) SA 675 (A), 34 SATC 1.

<sup>34</sup> [2004] 4 All SA 611 (SCA), 67 SATC 1.

**Example 2 – International shipping income***Facts:*

Company D, an international shipping company, operates two South African-registered ships, Ship A and Ship B, which are used to transport goods for compensation between South Africa and India. Company D has a year of assessment ending 28 February. During the 2022 year of assessment, Ship A was not operational for eight months while it underwent repairs. Thus Company D made use of a temporary replacement ship, Ship C (Panamanian-registered), during the period in question. During the 2022 year of assessment, Company D also operated a South African-registered ship, Ship D, which was used to transport goods between the ports of Durban and Port Elizabeth.

The receipts and accruals from these ships for the 2022 year of assessment were as follows:

	R
Ship A	1 500 000
Ship B	3 500 000
Ship C	3 000 000
Ship D	<u>500 000</u>
	<u>8 500 000</u>

*Result:*

The compensation received by Company D met the definition of “international shipping income”, since the receipts and accruals from international shipping for the 2022 year of assessment were mainly from the operation of one or more South African-registered ships (Ship A [R1,5 million] + Ship B [R3,5 million] = R5 million). The total receipts and accruals derived from Ship A and Ship B was more than 50% of the total receipts and accruals from international shipping  $[(R5 \text{ million} / R8,5 \text{ million}) \times 100 = 58,82\%]$ . The receipts and accruals derived from Ship C had to be excluded from the numerator, since Ship C was a temporary replacement ship and does not fall under paragraph (a) of the definition of “South African ship”. Since Company D’s receipts and accruals from international shipping for the 2022 year of assessment were mainly from the operation of South African-registered ships, the total amount of R8,5 million was subject to the exemption under section 12Q(2)(a) (see 4.2).

**Example 3 – International shipping income***Facts:*

Company Q, an international shipping company, operates only one South African ship, Ship X, which is used to transport passengers for compensation between South Africa and Madagascar. Company Q has a year of assessment ending 28 February. During the 2022 year of assessment, Ship X was not operational for seven months while it underwent repairs. During that time, Company Q made use of a temporary replacement ship, Ship Z (Liberian-registered).

The receipts and accruals derived from these ships for the 2022 year of assessment were as follows:

	R
Ship X	2 000 000
Ship Z	<u>3 000 000</u>
	<u>5 000 000</u>

*Result:*

The receipts and accruals derived by Company Q did not meet the definition of “international shipping income”, since the receipts and accruals from international shipping were not mainly from the operation of one or more South African-registered ships. More specifically, Company Q did not derive income mainly from the operation of a ship contemplated in paragraph (a) of the definition of “South African ship”. The receipts and accruals from Ship X were less than 50% of the total receipts and accruals from international shipping [(R2 million / R5 million) × 100 = 40%]. The compensation received for Ship Z had to be excluded from the numerator, since Ship Z was a temporary replacement ship. Consequently, the total receipts and accruals of R5 million was not subject to the exemption under section 12Q(2)(a) (see 4.2) and therefore taxable.

#### 4.2 Exemption from normal tax of any international shipping income received by or accrued to any international shipping company [section 12Q(2)(a)]

Section 12Q(2)(a) provides that any international shipping income of any international shipping company must be exempt from normal tax.

The above requirement for exemption can be expanded by substituting the contents of the definitions of “international shipping income” and “international shipping company” for those defined terms. Thus, under section 12Q(2)(a), –

- the receipts and accruals of a person derived from international shipping mainly from the operation of one or more South African-registered ships,
- of a company that is a resident that operates one or more South African ships that are utilised in international shipping,

must be exempt from normal tax.

#### **Example 4 – Exemption from normal tax of any international shipping income received by or accrued to any international shipping company**

*Facts:*

Company H is a resident and operates a South African ship, Ship Z, which transports goods for compensation between South Africa and Australia. Company H also operates for compensation a South African ship, Ship X, a cruise liner, which departs from Durban and arrives at Port Louis, Mauritius after three days. Company H also operates a South African ship, Ship Y, which transports goods for compensation between the ports of Cape Town and Durban. Company H has a year of assessment ending 31 January.

The three ships spent the following number of days carrying out their respective voyages:

	Days
Ship Z	280
Ship X	245
Ship Y	<u>180</u>
	<u>705</u>

The compensation received in respect of these ships for the 2022 year of assessment was as follows:

	R
Ship Z	4 500 000
Ship X	6 000 000
Ship Y	<u>1 500 000</u>
	<u>12 000 000</u>

*Result:*

The compensation received by Company H meets the definition of “international shipping income”, since the receipts and accruals from international shipping are mainly from the operation of one or more ships contemplated in paragraph (a) of the definition of “South African ship” (Ship Z, Ship X and Ship Y).

Company H also meets the definition of “international shipping company” since the company is a resident and conveys by means of a South African ship for compensation both passengers (with Ship X) and goods (with Ship Z and Ship Y) and its ships are mainly engaged in international traffic  $[(280 \text{ days} + 245 \text{ days}) / 705 \times 100 = 74,47\%]$ .

Thus, the international shipping income of R12 million received by Company H is exempt from normal tax.

International shipping companies often use a currency more suitable to an international environment than the local currency of residence. Section 25D(1) provides that any amount received by or accrued to, or expenditure or loss incurred by, a person during any year of assessment in foreign currency must be translated to rand at the spot rate<sup>35</sup> on the date on which the amount was received or accrued or the expenditure or loss was incurred.<sup>36</sup> Section 25D(6) and (7) provide relief from section 25D(1) when an international shipping company uses a currency other than the rand as its functional currency.<sup>37</sup> An international shipping company must determine taxable income in its functional currency and translate that amount to rand using the average exchange rate for the year of assessment.<sup>38</sup> When amounts are received or accrued or expenditure is incurred in a currency other than the company’s functional currency, those amounts must be translated to the company’s functional currency and translated to rand using the average exchange rate.<sup>39</sup> Section 25D(6) does not state how the translation to the

<sup>35</sup> The term “spot rate” is defined in section 1(1) and means “the appropriate quoted exchange rate at a specific time by any authorised dealer in foreign exchange for the delivery of currency”.

<sup>36</sup> For guidance on section 25D, see Interpretation Note 63 “Rules for the Translation of Amounts Measured in Foreign Currencies other than Exchange Differences governed by Section 24I and the Eighth Schedule”.

<sup>37</sup> The term “functional currency” is defined in section 1(1).

<sup>38</sup> Section 25D(7).

<sup>39</sup> Section 25D(6).



international shipping company's functional currency must be performed. As a practical matter, it will be acceptable to SARS if the spot rate is used.

The provisions of section 9D for determining foreign business establishment relief for international shipping companies were too narrow, and this gave rise to inadvertent controlled foreign company income. It was not intended for international shipping companies to lose the benefit of this relief merely because of occasional visits to South Africa. As a result, the definition of "foreign business establishment" in section 9D(1) includes a South African ship engaged in international shipping.<sup>40</sup>

#### *Expenditure relating to exempt income*

In determining a person's taxable income derived from carrying on any trade, section 11(a) allows a deduction against the income so derived for expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature.

Section 23(f) provides that no deduction shall be made if an expense is incurred that relates to an amount received or accrued which does not constitute "income" as defined in section 1(1).

The term "income" is defined in section 1(1) and means –

"the amount remaining of the gross income of any person for any year or period of assessment after deducting therefrom any amounts exempt from normal tax under Part I of Chapter II".

The expenditure incurred by the international shipping company relating to the income exempted under section 12Q(2)(a) will therefore be prohibited as a deduction under section 23(f). This treatment is of relevance since an international shipping company may have both non-exempt income and exempt income.

Expenditure paid as a single amount relating to non-exempt income and exempt income must be apportioned *pro rata* between these two categories. The basis of apportioning an expense will depend on the nature of the expense.

General expenditure incurred not specifically relating to a particular source of income, but which can be attributed to various sources, must be apportioned on a *pro rata* basis by applying the ratio that a particular source of receipts and accruals bears to the total receipts and accruals derived by the international shipping company.<sup>41</sup> Examples of such expenses are bank charges and accounting fees.

South African-registered ships engaged in international traffic of the conveyance for compensation of passengers or goods do not qualify for capital allowances. Other ships potentially qualify for capital allowances over five years of assessment at the rate of 20% a year, starting with the year of assessment in which the ship is brought into use.<sup>42</sup>

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<sup>40</sup> See paragraph (f) of the definition of "foreign business establishment" in section 9D(1).

<sup>41</sup> See *C: SARS v Mobile Telephone Networks Holdings (Pty) Ltd* 2014(5) SA 366 (SCA), 76 SATC 205.

<sup>42</sup> See section 12C(1)(g) and the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2013*.

### 4.3 Capital gain or capital loss of any international shipping company in respect of a South African ship engaged in international shipping [paragraphs 6 and 7 of the Eighth Schedule and section 12Q(2)(b)]

Under section 12Q(2)(b) any capital gain or capital loss in respect of any year of assessment of any international shipping company determined in respect of a South African ship engaged in international shipping must be disregarded in determining the aggregate capital gain or aggregate capital loss of that international shipping company.<sup>43</sup>

The terms “aggregate capital gain” and “aggregate capital loss” are defined in section 1(1) to mean an amount determined under paragraphs 6 and 7 of the Eighth Schedule, respectively.

Paragraphs 6 and 7 of the Eighth Schedule provide that a person’s aggregate capital gain or aggregate capital loss for a year of assessment is the aggregate of all capital gains and capital losses for that year of assessment. Any other capital gains required to be taken into account in the determination of the aggregate capital gain or aggregate capital loss of a person must also be included, for example, a capital gain of another person which is attributed to that person.

#### **Example 5 – Capital loss in respect of a South African ship engaged in international shipping**

*Facts:*

Company Z is an international shipping company operating a cruise liner. The cruise liner is a South African ship that conveys passengers for compensation from Durban to Port Louis in Mauritius.

Company Z has a year of assessment ending 28 February. During the 2022 year of assessment, Company Z sold the South African ship and a building, and derived the following capital gains and capital losses:

	R
South African ship	(10 750 000)
Building	1 500 000

*Result:*

South African ship [Disregarded under section 12Q(1)(b)]	Nil
Building	<u>1 500 000</u>
Aggregate capital gain (para 6)	<u>1 500 000</u>

Under section 12Q(2)(b) the capital loss of R10 750 000 on disposal of the South African ship must be disregarded in determining the aggregate capital gain or aggregate capital loss of Company Z.

<sup>43</sup> For more information see the *Comprehensive Guide to Capital Gains Tax*.

#### 4.4 Dividends paid by an international shipping company [sections 64D to 64N and section 12Q(3)]

Section 64E(1) provides that dividends tax is levied on dividends paid by companies (other than headquarter companies).<sup>44</sup>

Under section 64E(1), dividends tax must be levied at the rate of 20%<sup>45</sup> of the amount of the dividend paid. In some instances, a reduced rate<sup>46</sup> is levied or the dividend may be exempt from dividends tax.<sup>47</sup>

Section 12Q(3) provides that the rate of dividends tax<sup>48</sup> that is paid by an international shipping company on the amount of any dividend derived from international shipping income must not exceed 0% of the amount of that dividend.

The terms “international shipping income” and “international shipping company” are considered extensively in 4.1.4 and 4.1.3, respectively. These definitions and the respective commentaries must be considered to determine whether the reduced rate of dividends tax of 0% under section 12Q(3) applies.

The reduced rate of dividends tax of 0% under section 12Q(3) applies only to dividends derived from international shipping income and accordingly the amount of any dividend derived from **other income** of an international shipping company is potentially liable to dividends tax at the rate of 20% under section 64E(1).

A dividend that is paid by an international shipping company out of international shipping income and other income not directly connected to the international shipping source must be apportioned to determine the amount of the dividend that is subject to dividends tax at the rate of 0% and 20%.

To calculate the amount of a dividend that is paid out of international shipping income, the following formula must be used:

$$\text{Total amount of dividend paid by international shipping company} \times \frac{\text{International shipping income net of expenses}}{\text{Total income net of expenses}}$$

To calculate the amount of a dividend that is paid out of **other income** not directly connected to international shipping income, the following formula must be used:

$$\text{Total amount of dividend paid by international shipping company} \times \frac{\text{Other income}^{49} \text{ net of expenses}}{\text{Total income net of expenses}}$$

<sup>44</sup> For more information, see the *Comprehensive Guide to Dividends Tax*.

<sup>45</sup> This rate increased from 15% to 20% for dividends paid on or after 22 February 2017.

<sup>46</sup> For example, paragraph 3(1) of the Tenth Schedule provides that the rate of dividends tax contemplated in section 64E paid by an oil and gas company on the amount of any dividend derived from oil and gas income must not exceed 0% of the amount of that dividend.

<sup>47</sup> For more information see the *Comprehensive Guide to Dividends Tax*.

<sup>48</sup> Under section 64E(1).

<sup>49</sup> Other income not derived from international shipping income net of expenses.

**Example 6 – Dividend paid by an international shipping company***Facts:*

Company A is an international shipping company that derived net income from international shipping of R150 million net of expenses and interest of R25 million net of expenses, not directly connected to its international shipping activities, during its 2022 year of assessment ending on 30 June. Company A paid a dividend of R7 million on 30 June 2022 to holders of its shares who are all residents and natural persons.

*Result:*

Under section 12Q(3) the amount of the dividend paid by Company A from net income from international shipping is subject to dividends tax at a rate of 0% and is calculated as follows:

‘Total amount of dividend paid by international shipping company × net income from international shipping / total income net of expenses’

R7 million × R150 million / R175 million = R6 million.

Dividends tax at 0% = nil.

The amount of the dividend paid by Company A from interest income is subject to dividends tax at the rate of 20% under section 64E(1) and is calculated as follows:

‘Total amount of dividend paid by international shipping company × interest income / total income net of expenses’

R7 million × R25 million / R175 million = R1 million.

Dividends tax at 20% = R200 000.

**4.5 Interest paid by an international shipping company [sections 50A to 50H and section 12Q(4)]**

Section 50B(1) imposes withholding tax on interest<sup>50</sup> at the rate of 15% of the amount of interest that is paid by any person to or for the benefit of a foreign person<sup>51</sup> to the extent that the amount is regarded as having been received or accrued from a source within South Africa under section 9(2)(b). A foreign person to whom an amount of interest is paid is liable for the withholding tax on interest.<sup>52</sup>

The withholding tax on interest must generally be withheld by the person making the payment to or for the benefit of the foreign person and be paid over to the Commissioner.<sup>53</sup>

The withholding tax on interest is a final tax<sup>54</sup> and an annual return of income does not, therefore, have to be submitted provided the interest received by the foreign person is the only income received from a South African source.

<sup>50</sup> The applicable legislation is contained in Part IVB of Chapter II of the Act and applies to interest that is paid or becomes due and payable on or after 1 March 2015. For more information see Interpretation Note 115 “Withholding Tax on Interest”.

<sup>51</sup> The term “foreign person” is defined in section 50A(1) and means any person that is not a resident.

<sup>52</sup> Section 50C(1).

<sup>53</sup> Section 50E.

<sup>54</sup> Section 50B(3).

An amount withheld by a person denominated in any currency other than the rand must be translated to rand at the spot rate on the date on which that amount was so withheld.<sup>55</sup>

Interest paid to a non-resident may be exempt from withholding tax on interest provided the requirements of section 50D are met.

Section 12Q(4) applies to interest received or accrued from a source within South Africa under section 9(2)(b) on or after 1 January 2015<sup>56</sup> and provides for an exemption from the withholding tax on interest on any interest paid by an international shipping company to any foreign person in respect of debt used to fund the acquisition, construction or improvement of a South African ship utilised for international shipping.

The words “acquisition”, “construction” and “improvement” are not defined in the Act. The ordinary meanings of these words are considered below.

*Dictionary.com* defines “acquisition” as –<sup>57</sup>

“1. the act of acquiring or gaining possession”.

*Dictionary.com* defines “construction” as –<sup>58</sup>

“3 something that is constructed; a structure”.

Whether the debt was used to fund the construction<sup>59</sup> of a South African ship will depend on the exact facts and circumstances.

In the *Concise Oxford English Dictionary* “improvement” is defined as follows:<sup>60</sup>

“An addition or alteration which increases the quality or value of something.”

An “improvement” must be distinguished from a “repair”. For commentary on the distinction between repairs and improvements see **4.1.1(b)**.

Section 12Q(4) would, accordingly, apply to an international shipping company that pays interest to a foreign person in respect of a debt, for example, a loan or financing arrangement, for the acquisition, construction or improvement of a South African ship that is used for international shipping.

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<sup>55</sup> Section 50H.

<sup>56</sup> Inserted by section 42(1) of the Taxation Laws Amendment Act 31 of 2013.

<sup>57</sup> [www.dictionary.com/browse/acquisition](http://www.dictionary.com/browse/acquisition) [Accessed 31 October 2022].

<sup>58</sup> [www.dictionary.com/browse/construction](http://www.dictionary.com/browse/construction) [Accessed 31 October 2022].

<sup>59</sup> Reference can also be made to the International Convention for the Safety of Life at Sea, 1974 (commonly referred to as SOLAS) contained in the Second Schedule to the Merchant Shipping Act 57 of 1951.

<sup>60</sup> 11 ed (2006) Oxford University Press.

**Example 7 – Interest paid by an international shipping company***Facts:*

Company A is an international shipping company that acquired a new container ship from Company Z for \$150 million in July 2021. The new container ship is registered as a South African ship mainly engaged in international traffic and used for conveyance of goods for compensation.

To finance the purchase of the container ship, Company A entered into a loan agreement of \$120 million with XYZ Bank, a bank resident in Germany. Company A paid interest of R2 million on 30 June 2022 to XYZ Bank in respect of the loan agreement with XYZ Bank. Company A has a year of assessment ending on 30 June.

*Result:*

Under section 12Q(4) the interest of R2 million paid by Company A to XYZ Bank is exempt from the withholding tax on interest, since the interest is paid to a foreign person on debt used to fund the acquisition of a South African ship used for international shipping.

**5. Conclusion**

Section 12Q provides for an exemption from normal tax, capital gains tax, dividends tax and withholding tax on interest for international shipping companies if the requirements of the section are met. In determining whether an international shipping company qualifies for these exemptions, the definitions of “South African ship”, “international shipping”, “international shipping company” and “international shipping income” should be considered and applied to the relevant tax under section 12Q.