

INTERPRETATION NOTE 69 (Issue 2)

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ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTIONS 9HA, 25, 25C, 26 AND FIRST SCHEDULE
SUBJECT : GAME FARMING

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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;
- “**First Schedule**” means the First Schedule to the Act;
- “**game**” means wild animals, birds or fish;
- “**paragraph**” means a paragraph of the First Schedule to the Act;
- “**section**” means a section of the Act;
- “**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.

1. Purpose

This Note provides guidance on the application of selected sections of the Act and paragraphs of the First Schedule to persons carrying on game-farming operations, with its primary focus being the provisions applicable to livestock. It is not intended to deal with farming in general.

The changes in this note focus mainly on the legislative amendments affecting deceased persons and deceased estates which came into operation on 1 March 2016 and apply to persons dying on or after that date.

2. Background

Section 26(1) stipulates that the taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as the income is derived from such operations, be determined in accordance with the Act but subject to the First Schedule. The First Schedule deals with the computation of taxable income derived from pastoral, agricultural or other farming operations.

The taxable income from farming operations is combined with the taxable income from other sources to arrive at the taxpayer’s taxable income for the year of assessment.

The First Schedule applies regardless of whether a taxpayer derives an assessed loss or a taxable income from farming operations. The Schedule may also apply even after farming operations have been discontinued.¹

¹ See section 26(2).

Section 26 and the First Schedule apply to game farming, since it comprises farming operations.

3. The law

The relevant sections of the Act are quoted in the **Annexure**.

4. Application of the law

4.1 Farming operations

The First Schedule applies to any person who derives taxable income from carrying on pastoral, agricultural or other farming operations. Such a person can include an individual (whether farming alone or in partnership), a deceased estate, an insolvent estate, a company, a close corporation or a trust.

The expression “farming operations” 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.²

Whether a person is carrying on farming operations is a question of fact³ and must be decided considering all the facts of a particular case.

The word “agriculture” is defined in the *Merriam-Webster Dictionary*⁴ as –

“the science, art, or practice of cultivating the soil, producing crops, and raising livestock and in varying degrees the preparation and marketing of the resulting products”.

However, every activity in the nature of farming will not constitute “farming operations”. This principle was confirmed by Heher AJA in the Supreme Court of Appeal in *C: SARS v Smith* when he stated the following:⁵

“In ordinary parlance the phrase ‘carrying on farming operations’ is capable of several meanings. In the context of s 26(1) it could mean simply ‘a particular form or kind of activity’ or it could bear a more commercial nuance, ‘a business activity or enterprise’.

The Act is directed to the taxation of profit-making activities. There is no apparent reason why the legislature should have intended a taxpayer who farms as a hobby or who dabbles in farming for his own satisfaction to receive the benefits conferred by the First Schedule.”

An example of the above principle can be found in ITC 1324⁶ in which it was held that a grower who merely intended to sell crops surplus to his needs was not carrying on farming operations.

Thus, in order to fall within the First Schedule a farming operation needs to be a trade of the taxpayer and there must be an overall profit-making intention.

² EA Kellaway *Principles of Legal Interpretation of Statutes, Contracts and Wills* (1995) Butterworth’s at 224.

³ ITC 1319 (1980) 42 SATC 263 (EC) at 264, cited with approval in *CIR v D & N Promotions (Pty) Ltd* 1995 (2) SA 296 (A), 57 SATC 178 at 183.

⁴ www.merriam-webster.com/dictionary/agriculture [Accessed 23 November 2017].

⁵ 2002 (6) SA 621 (SCA), 65 SATC 6 at 9 and 10.

⁶ (1980) 42 SATC 288 (Z).

It is now settled law that the test for determining whether a taxpayer is carrying on farming operations is a subjective one, that is, one based on the taxpayer's intention. This was held to be the case in the *Smith case above* in which Heher JA stated that –⁷

“a taxpayer who relies on s 26(1) is (over and above proof that he is engaged in an activity in the nature of farming) only required to show that he possesses at the relevant time a genuine intention to carry on farming operations profitably. All considerations which bear on that question including the prospect of making a profit will contribute to the answer, none of itself being decisive”.

The court went on to cite ITC 1185 in which Miller J stated the following:⁸

“It is no difficult matter to say that an important factor is: what was the taxpayer's intention when he bought the property? It is often very difficult, however, to discover what his true intention was. It is necessary to bear in mind in that regard that the *ipse dixit*⁹ as to his intent and purpose should not lightly be regarded as decisive. It is the function of the court to determine on an objective review of all the relevant facts and circumstances, what the motive, purpose and intention of the taxpayer were . . . This is not to say that the court will give little or no weight to what the taxpayer says his intention was, as is sometimes contended in argument on behalf of the Secretary in cases of this nature. The taxpayer's evidence under oath and that of his witnesses, must necessarily be given full consideration and the credibility of the witnesses must be assessed as in any other case which comes before the court. But direct evidence of intent and purpose must be weighed and tested against the probabilities and the inferences normally to be drawn from the established facts.”

In evaluating the genuineness of the taxpayer's intention the nature and extent of the enterprise will be relevant. The following examples of factors to be considered were provided by Erasmus J in ITC 1698:¹⁰

“[T]he size and location of the property on which the operation is being conducted, the portion of that property being used for that purpose, capital expenditure, turnover, labour, the regularity and purposefulness of the activity, the time and effort spent thereon by the taxpayer in relation to his other gainful activities, if any, and the existence of a real prospect of profit (or lack thereof). The list is not exhaustive and the permutations of such activities are infinite. None of these considerations is necessarily in itself decisive.”

Regard can also be had to the factors set out in section 20A(3) – see **4.8**.

It is not a requirement that a person has to own the land on which the farming operations are carried on but the person must have a right to the land and the yield from it. This principle was illustrated in ITC 1548¹¹ in which the court found that the shearing and harvesting activities undertaken by a farmer on behalf of others on their land was not farming and neither were the transport services the farmer provided. The farmer in question was performing a service for other farmers and did not have a right to those farmers' land or the yield from it.

⁷ Above at 65 SATC 13.

⁸ (1972) 35 SATC 122 (N) at 123–4.

⁹ According to the *Glossary of foreign terms* by J Silke and Justice MM Corbett which forms part of the South African Tax Cases Reports published by LexisNexis, the expression “*ipse dixit*” means “He himself said it; a bare assertion or statement without proof, resting on the authority of the person who made the assertion or statement”.

¹⁰ (2000) 63 SATC 161 (SEC) at 170.

¹¹ (1991) 55 SATC 26 (C).

The factors referred to above are not exhaustive and whether farming operations are being conducted will depend on all the facts and circumstances of each case.

The same principles for determining whether a person is carrying on farming operations apply to game farming.

Having regard to the above general principles, the activity of breeding and running game on a farm for the purpose of marketing the live animals, hunting the animals for a fee or slaughtering them for the meat, falls within the ambit of game farming.¹² A land owner who occasionally allows hunters to, for example, cull the game on the land, is unlikely to be regarded on such activities alone to carry on game-farming operations. The person would have to convince the Commissioner that game is being raised with a genuine profit intention before the activities would be regarded as carrying on farming operations. An occasional culling is, in isolation, unlikely to indicate and support a contention that there was a genuine intention to carry on farming activities profitably.

Raising livestock generally involves purchasing, breeding and selling or using the particular animals. The facts and circumstances of a particular case are critical because, for example, in some cases the regular purchasing of breeding stock will be required and in other cases regular purchasing will not be required. In addition, the degree of day-to-day, hands-on involvement of a game farmer in raising livestock is likely to vary depending on the particular species of game. In all instances, however, there would be a level of active involvement appropriate to the particular species and farming operations.

4.2 Game-farming income

4.2.1 Income derived from game farming

Section 26(1) applies only to income derived from the carrying on of pastoral, agricultural or other farming operations. The Supreme Court of Appeal in *CIR v D & N Promotions (Pty) Ltd*¹³ considered the meaning of “derived from”. The court quoted with approval the explanation of the meaning of these words from the court *a quo*¹⁴ which held that –¹⁵

“the income and the source from which it arises, namely the farming operations, which embraces numerous agricultural activities, must be directly connected. An indirect connection or remote one will not suffice”.

Also in the court *a quo* Levinsohn J stated that –¹⁶

“the legislature intended farmers to be placed in a privileged position as far as their entitlement to deduct capital expenditure from farming income and hence the concept of income derived from farming operations ought to be strictly construed, see *Ernst v Commissioner for Inland Revenue* 1954(1) SA 318(A) at 323C–D.”

¹² ITC 1698 (2000) 63 SATC 161 (SEC); ITC 1414 (1986) 48 SATC 174 (T).

¹³ 1995 (2) SA 296 (A), 57 SATC 178.

¹⁴ *CIR v D & N Promotions (Pty) Ltd* 1993 (3) SA 33 (N), 55 SATC 89.

¹⁵ At 57 SATC 183.

¹⁶ At 55 SATC 97.

A taxpayer may earn income from distinct businesses, namely, farming operations and other operations – it is only the income which is directly connected to the farming operations which falls under the ambit of section 26(1). For example, in ITC 1285¹⁷ the court found that the prize money from racing horses, which the breeder had initially intended but had failed to sell, was not part of the taxpayer's stock farming and horse breeding business and did not therefore fall under section 26(1).

The same principle applies to game-farming operations. Some activities will generate income directly from the game-farming operations and will be regarded as game-farming income, while other activities and the income derived from them will not be regarded as such.

The following types of income are regarded as being derived directly from game-farming operations:

- Income from the sale of live game.
- Income from the slaughter and sale of game meat, carcasses and skins.
- Fees received from hunters to hunt the game.
- Income derived from supplying guides and trackers used in a hunting expedition.

4.2.2 Income not derived from game farming

The income earned from the following activities is not regarded as having the required direct connection to game-farming operations and accordingly will not be regarded as game-farming income:

- Accommodation and catering.
- Admission charges payable by persons spending holidays on the farm.

In determining whether a game-viewing fee (for example, a fee paid to partake in a game drive) constitutes income from game farming, it is necessary in the first instance to determine whether the particular taxpayer is conducting a farming operation. This determination will depend on the facts and circumstances of the particular case and will take into account whether the taxpayer has a genuine intention to make a profit from the raising of livestock and whether the objective review of all the facts supports that contention. For example, game viewing conducted in conjunction with other activities such as hunting and sale of game may be a part of a valid farming operation. By contrast, income from game viewing incidental to activities not comprising farming activities will not constitute income from farming operations. For example, certain eco-tourism operations may derive their primary source of income from tourism and accommodation while game viewing may serve as an attraction and be an incidental revenue generator.

¹⁷ ITC 1285 (1978) 41 SATC 73 (NC); *Rex v Porterville Ko-op Landbou Mpy Bpk* [1962] 1 All SA 278 (C).

Income derived from activities which give rise to income from game farming and those which do not will have to be accounted for separately, since specified deductions under the First Schedule are restricted to income derived from farming operations.¹⁸

4.3 Livestock

4.3.1 Meaning and nature of livestock

Meaning of "livestock"

Various paragraphs of the First Schedule apply to livestock. The word "livestock" is not defined in the First Schedule or the main body of the Act. The word is described in the *Shorter Oxford English Dictionary* as –¹⁹

"animals kept or dealt in for use or profit".

The above meaning was confirmed in relation to the First Schedule in *R Koster & Son (Pty) Ltd and another v CIR* in which Nicholas JA stated the following:²⁰

"Paragraph 2 of the First Schedule refers to all livestock. This is a general term which comprises any animals kept or dealt in for use or profit."

Livestock thus includes animals held for breeding purposes (often referred to as fixed capital assets) and those held for resale (often referred to as floating capital assets).

The livestock must be used in the farming operations to fall within the ambit of the First Schedule.

Nature

The general rule in paragraph 2 is that all farmers, including companies carrying on farming operations, are required to include in their tax returns the value of their livestock held and not disposed of at the beginning and at the end of each year of assessment. The value of *livestock held and not disposed of at the end of the year of assessment* ("closing stock") is included in income and the value of *livestock held and not disposed of at the beginning of the year of assessment* ("opening stock") is allowed as a deduction from income²¹ (see 4.3.2 for the determination of the values).

Once an animal is classified as livestock, any consideration received or accrued on its disposal must be included in the farmer's gross income regardless of whether it was acquired as fixed capital or floating capital. This principle was confirmed in *R Koster & Son (Pty) Ltd & another v CIR*²² in which the court cited with approval the following passage from *Farmer v COT*²³ in which the principle was upheld in relation to equivalent provisions of the Southern Rhodesia Income Tax Act:

"The main provision of this section is that every farmer is bound to include in the return rendered by him for income tax purposes, i.e., for the determination of his taxable income, the values of all livestock and produce held by him and not disposed of at the beginning and end of each year of assessment. The section has a wide embrace, both as to the farmer affected and the class of livestock. It makes no

¹⁸ For example, see paragraphs 8 (ring-fencing of livestock) and 12(3) (ring-fencing of capital development expenditure).

¹⁹ A Stevenson 6 ed (2007) Oxford University Press in vol 1.

²⁰ 1985 (2) SA 831 (A), 47 SATC 23 at 32.

²¹ Paragraph 3(1).

²² Above, 47 SATC 23 at 33.

²³ 1944 SR 80, 13 SATC 158 at 159.

distinction between ranching stock and dairy, sheep, pig or other livestock, and it treats livestock in the same category as produce; in other words, it abolishes the importance or necessity of inquiring into the purpose with which the farmer has acquired his livestock or what his scheme or method of profit making is, and treats all the farmer's livestock and produce as his floating capital. In respect of these two commodities the farmer is treated, willy nilly, as an ordinary trader for income tax purposes. Dependent upon the difference in the value of his livestock at the commencement and the close of each year, there is either an accrual or a loss of his floating capital; if the former this forms part of his income, if the latter the loss is deducted from his income. His sales during each year of his livestock of whatever category, whether of part or the whole of his herd, form part of his income and his losses, whether mortality or other losses, are deducted from his income. This basis of computation for income tax purposes has been imposed compulsorily upon the farmer by legislation, and the Commissioner of Taxes and the Courts are no longer concerned to inquire whether in a particular farming business the farming livestock can be treated as fixed capital, because it must now be treated as part of the stock in trade of his farming business."

The trade of farming is specifically excluded from the opening and closing stock provisions in section 22.²⁴ The opening and closing stock provisions in paragraph 3 deal only with livestock and not consumable stores. Accordingly, a farmer's consumable stores, which include items such as fuel, spare parts, fertilizer and packing materials, do not need to be brought into account in opening stock or closing stock.²⁵

Application to game farming

A game farmer (see 4.1) is generally involved in the activity of breeding and running game on a farm for the purpose of marketing the live animals, hunting the animals for a fee or slaughtering the animals for meat. Game forming part of farming operations clearly falls within the definition of livestock discussed above and is accordingly considered to be livestock for purposes of the First Schedule.²⁶

Animals which are not part of the farming operations, that is, animals which the farmer is not raising with the intention of exploiting commercially, will not fall within the scope of the First Schedule. For example, a game farmer may have hyenas, foxes or rodents on the farm which are not part of the farming operation and therefore do not fall within the First Schedule.

Under paragraph 2 a game farmer must include in the return of income the value of all livestock "held and not disposed of" at the beginning and end of each year of assessment.

²⁴ Amounts to be taken into account in respect of values of trading stock.

²⁵ Section 22(8) still applies to consumable stores of farmers, but does not apply to livestock and produce which are covered by paragraph 11.

²⁶ Before 1 March 1999 SARS did not treat game as livestock for purposes of all the paragraphs of the First Schedule – see *Income Tax Practice Manual* [A:F14] [online] (My LexisNexis: Archive) read with Practice Note 6 dated 30 July 1999 and Practice Note 27 dated 19 August 1994 (withdrawn).

In relation to the meaning of “held”, *Juta’s Tax Library* states the following:²⁷

“[I]t is therefore considered that a taxpayer holds stock for this purpose where that **stock is owned, and not merely physically held**. The owner, not the possessor, must therefore account for the stock. This view is shared by Meyerowitz (at 9.89). . . .”

(Emphasis added)

In ITC 1873²⁸ the court was called upon to decide on the meaning of “held and not disposed of” in the context of grapes that had been supplied to a co-operative by a farmer. The farmer’s grapes were crushed and mixed by the co-operative with the grapes and grape juice of other members as part of the initial wine-making process. The issue was whether the farmer still had produce that could be said to be held and not disposed of which could be brought to account as closing stock. Allie J stated the following:²⁹

“The word ‘held’ is supplemented and reinforced by the phrase ‘and not disposed of’ because the phrase is conjunctive. The complete phrase ‘held and not disposed of’ makes it patently clear that the produce must have formed part of the farmer’s farming produce and the farmer must still have a legal right to the produce as at the financial year-end.

It does not mean that the farmer must have had physical possession or control of the produce at the year-end. If that was what the legislature intended, it would have used words that clearly conveyed that meaning.”

On appeal in *Avenant v C: SARS*³⁰ the SCA held that “produce on hand and not disposed of” includes the fractional ownership of pooled produce and therefore included the taxpayer’s undivided share in the grapes that had been crushed and merged with the grapes of other farmers. As regards the issue of ownership and possession, the court concluded that –³¹

“in the present case where ownership is retained by the appellant [the taxpayer] but possession is not, the produce is clearly ‘held’ for the purposes of para 2 of the First Schedule”.

Once game livestock has been sold under an unconditional contract and the taxpayer no longer has legal ownership of it but is unconditionally entitled to the consideration for it (that is, the consideration constitutes gross income in the taxpayer’s hands), the game livestock will no longer be considered to be “held and not disposed of” for the purposes of the First Schedule. Game livestock disposed of under an instalment credit agreement which provides that ownership will pass only once the whole or a portion of the purchase price has been paid is regarded as having been disposed of and hence must be excluded from closing stock. In these circumstances, section 24(1) deems the purchase price to be included in gross income when the agreement is entered into.

The expression “held and not disposed of” therefore means livestock owned by the taxpayer which has not been disposed of.

²⁷ D Davis *et al* *Jutas Tax Library* [online] (Jutastat e-publications: RS 21, 2016) in *Commentary on Income Tax – section 22*.

²⁸ (2014) 77 SATC 93 (WC).

²⁹ At 103.

³⁰ [2016] JOL 36039 (SCA), 78 SATC 343.

³¹ *Above at SATC 356 in paragraphs 25 and 28.*

The question of ownership is particularly relevant to wild game because under the common law wild game are regarded as *res nullius*, that is, things owned by nobody but which can be owned. Ownership is established by taking control of the animal with the intention of being the owner. Typically in the game-farming context this is achieved by erecting fences around the farm. The common law position has been modified by the Game Theft Act 105 of 1991. This Act ensures that a farmer remains the owner of game that escapes from the farm. "Game" is defined in the Game Theft Act as follows:

“**[G]ame**’ means all game kept or held for commercial or hunting purposes, and includes the meat, skin, carcass or any portion of the carcass of that game.”

Section 2 of the Game Theft Act reads as follows:

“2. Ownership of game.—

(1) Notwithstanding the provisions of any other law or the common law—

(a) a person who keeps or holds game or on behalf of whom game is kept or held on land that is sufficiently enclosed as contemplated in subsection (2), or who keeps game in a pen or kraal or in or on a vehicle, shall not lose ownership of that game if the game escapes from such enclosed land or from such pen, kraal or vehicle;

(b) the ownership of game shall not vest in any person who, contrary to the provisions of any law or on the land of another person without the consent of the owner or lawful occupier of that land, hunts, catches or takes possession of game, but it remains vested in the owner referred to in paragraph (a) or vests in the owner of the land on which it has been so hunted, caught or taken into possession, as the case may be.

(2) (a) For the purposes of subsection (1)(a) land shall be deemed to be sufficiently enclosed if, according to a certificate of the Premier of the province in which the land is situated, or his assignee, it is sufficiently enclosed to confine to that land the species of game mentioned in the certificate.

(b) A certificate referred to in paragraph (a) shall be valid for a period of three years.”

For the reasons discussed above, all game livestock is dealt with on revenue account as if it were floating capital.

4.3.2 Opening and closing stock

As noted above, the value of closing stock is included in income and the value of opening stock is allowed as a deduction from income. The value of the livestock to be included in opening stock and closing stock is determined according to paragraphs 4 (opening stock) and 5 (closing stock).

Paragraph 5(1) stipulates that the value to be placed on the livestock for purposes of the First Schedule shall be the standard value applicable to that livestock. The standard value of any class of livestock of a farmer is generally either –

- the standard value of that class of livestock fixed by regulation under the Act, or
- another standard value adopted by the farmer (or company or the executor of the estate) when a particular class of livestock is adopted for the first time and such value is within 20% of the standard values fixed in the regulations or which, in certain circumstances, has been approved by the Commissioner.

Paragraph 4(1) provides that the value of the opening stock will be –

- the value of the closing stock at the end of the preceding year;
- the market value of livestock acquired during the current year of assessment otherwise than by purchase, natural increase or in the ordinary course of the farming operations carried on, for example, by donation;³² and
- the market value of livestock which was previously held, but not as part of the farming operations, becomes part of the farming operations.³³

Note: Any opening stock still on hand at the end of the year of assessment must be included in the closing stock at its standard value and not market value.

The regulations do not fix a standard value for game livestock. For the purpose of standard values the Commissioner accepts that game livestock may be allocated a standard value of nil.³⁴

4.3.3 The cost of acquiring game

The cost price of game livestock acquired by a person carrying on farming operations is deductible under section 11(a).

4.3.4 Limitation under paragraph 8 of the First Schedule

Paragraph 8 provides that the deduction of expenditure incurred during the year of assessment for the acquisition of livestock, which may be allowed under section 11(a) in respect of its cost price, is ring-fenced. The deduction available is limited to the sum of the income received and accrued from farming operations plus the value of the livestock held and not disposed of by the farmer at the end of the year of assessment less the value of livestock held and not disposed of by the farmer at the beginning of the year of assessment. Any amount not allowed as a deduction will be carried forward to the succeeding year of assessment and will be deemed to be expenditure incurred in that year (and hence subject to potential limitation in the succeeding year depending on the facts).

This potential limitation applies only to the deduction which may be allowed under section 11(a). Although opening stock forms part of the limitation calculation under paragraph 8, the opening stock deduction³⁵ is not itself subject to the paragraph 8 limitation.

See 4.3.2 for a discussion on the determination of the opening and closing stock values to be taken into account for game livestock – the values will often be nil.

The potential limitation is assessed on the totality of all the farmer's livestock regardless of its nature. For example, if a taxpayer conducted sheep farming and game farming, a single limitation calculation taking into account both the sheep and game livestock would be performed.

³² Paragraphs 4(1)(a)(ii) and 4(1)(b)(ii).

³³ Paragraphs 4(1)(a)(ii) and 4(1)(b)(ii).

³⁴ Paragraph 6(1)(b)(ii), (c)(ii) or (d)(ii) read with paragraph 6(3).

³⁵ Provided for under paragraph 3 and 4 – in the context of game farming this will often be nil but it could include, for example, a market value deduction for game livestock acquired by donation.

A taxpayer that can demonstrate that the cost of acquisition of a particular animal, which is no longer held and not disposed of at the end of the year of assessment, is included in the amount to be carried forward under paragraph 8 (for example, the animal purchased has been hunted and killed) may exclude the cost of that particular animal from the carried-forward amount and immediately claim it as a deduction. It is considered unlikely that this will apply frequently, if at all, in the context of game farming because it is often impracticable to accurately count and track particular game livestock.

In addition, a farmer will be entitled to an immediate deduction if the opening stock value of livestock plus the amount to be carried forward under paragraph 8 exceeds the market value of all livestock held and not disposed of at the end of the year of assessment. The amount of the deduction is equal to the amount of the excess and the onus rests on the taxpayer to substantiate the amount claimed. The amount to be carried forward under paragraph 8 must also be reduced by the excess.

Example 1 – Application of paragraph 8 limitation to game farmers

Facts:

Farmer A carries on game-farming operations. The following information relates to Farmer A's tax return at the end of the year of assessment:

	R
Farming income	50 000

Standard value of livestock at the end of the year of assessment:

Game	Nil
Other livestock	300
Value of produce at the end of the year of assessment	2 000

Standard value of livestock at the beginning of the year of assessment:

Game	Nil
Other livestock	279
Value of produce at the beginning of the year of assessment	Nil
Purchases of game livestock this year	300 000

Result:

Determination of taxable income of the farmer:

	R
Farming income	50 000

Closing stock

Livestock at standard value:

Game	Nil	
Other	300	
Value of produce	<u>2 000</u>	<u>2 300</u>
		52 300

<i>Less:</i>			
<i>Opening stock:</i>			
Livestock at standard value			
Game	Nil		
Other	279		
Produce	<u>Nil</u>		<u>(279)</u>
			52 021
<i>Less:</i>			
Allowable deduction – purchase of livestock [section 11(a) limited by paragraph 8 – see below]			<u>(50 021)</u>
Taxable income from the carrying on of farming operations			<u>2 000</u>
Limitation on the cost of acquisition of livestock (paragraph 8):			
Income received and accrued from farming operations			50 000
Value of livestock held and not disposed of at the end of the year			300
Value of livestock held and not disposed of at the beginning of the year			<u>(279)</u>
Maximum deduction permissible			<u>50 021</u>
Expenditure deductible under section 11(a) on the acquisition of game livestock			300 000
<i>Less:</i> Deductible amount current year			<u>(50 021)</u>
Amount of deduction carried forward to the following year			<u>249 979</u>

Example 2 – Application of paragraph 8 limitation to game farmers – cost of livestock exceeding market value

Facts:

The facts are the same as Example 1 except that Farmer A is able to show that the fair market value of all the livestock at year-end is R220 000.

Result:

Determination of taxable income of the farmer:

Farming income			50 000
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Standard value of livestock at the end of the year:

Game	Nil		
Other	300		
Value of produce at the end of the year of assessment	<u>2 000</u>		<u>2 300</u>
			52 300

Less:

Standard value of livestock at the beginning of the year:

Game	Nil		
Other	279		
Produce	<u>Nil</u>		<u>(279)</u>
Subtotal			52 021

<i>Less:</i>	
Allowable deduction – purchase of livestock [section 11(a) and paragraph 8]	(50 021)
Allowable deduction – excess above market value	<u>(30 258)</u>
Assessed loss from the carrying on of farming operations	<u>(28 258)</u>
Determination of the limitation on the acquisition of livestock:	
Income received and accrued from farming operations	50 000
Value of the livestock held and not disposed of at the end of the year	300
Value of livestock held and not disposed of at the beginning of the year	<u>(279)</u>
Subtotal	50 021
Expenditure deductible under section 11(a) on the acquisition of game livestock	300 000
<i>Less:</i> Deductible amount current year	(50 021)
Additional amount under paragraph 8(3)(b) (see below)	<u>(30 258)</u>
Amount of deduction carried forward to the following year	<u>219 721</u>
Determination of the additional amount to be allowed under paragraph 8(3)(b):	
	R
Expenditure disallowed (Example 1)	249 979
Value of opening stock	<u>279</u>
	250 258
<i>Less:</i> Market value	<u>(220 000)</u>
Additional amount allowable	<u>30 258</u>

4.4 Expenditure and allowances

Expenditure and losses incurred for purposes of trade not qualifying for deduction under the First Schedule may be claimed under other provisions of the Act provided they meet the requirements of those provisions.

Section 11(a) and section 23(g)

In determining a person's taxable income derived from carrying on any trade, the general deduction formula in section 11(a) requires that the expenditure and losses must be actually incurred in the production of income and must not be of a capital nature. In addition, expenditure and losses must be claimed during the year of assessment in which they are actually incurred.

Section 23(g) prohibits the deduction of moneys not expended for the purposes of trade.

Amounts generally deductible under section 11(a) by a game farmer include, for example –

- normal running expenses of the farming operation (for example, expenditure on ammunition, electricity, feed, fuel, livestock, wages & salaries, and veterinary fees);
- cost of butchers, trackers and professional hunters;
- advertising and promotion costs; and
- travelling costs (both local and overseas).

This list is not exhaustive and the facts of each case will dictate which items of expenditure qualify as a deduction under section 11(a).

Capital allowances

Capital expenditure not qualifying as a deduction under paragraph 12 (see 4.5) may qualify for a deduction under one of the other capital allowance provisions in the Act. Depending on the nature of the particular asset and the context in which it is used, the provisions which are likely to be of relevance in the context of game farming are section 12B, 12C or 11(e) and in respect of buildings, section 13*bis*, 13*quin* or 13*sept*.

The different capital allowance provisions are not discussed in detail in this Note. However given its particular relevance to farming operations, section 12B is briefly discussed below.

Section 12B provides for the deduction of a special depreciation allowance on machinery, implements, utensils or articles (other than livestock) which are –

- owned by the taxpayer or acquired under an instalment credit agreement;
- brought into use for the first time by that taxpayer; and
- used in the carrying on of farming operations.

The deduction under section 12B is –

- 50% of the cost to the taxpayer in the year of assessment during which the asset is brought into use;
- 30% of the cost to the taxpayer in the second year; and
- 20% of the cost to the taxpayer in the third year.

Equipment used by game farmers generally qualifying for the special allowance under section 12B includes, for example, vehicles, firearms, meat saws and two-way radios. This list does not limit the qualifying assets and each asset must be considered on its merits.

The following assets are specifically excluded from section 12B:

- Any motor vehicle the sole or primary function of which is the conveyance of persons.
- Any caravan.
- Any aircraft other than an aircraft used solely or mainly for the purpose of crop-spraying.
- Any office furniture or equipment.

An asset not qualifying under section 12B may still qualify for an allowance under another provision of the Act. For example, if a game farmer also runs a game-lodge business, the capital assets used in that business (such as beds, furniture, refrigerators and stoves) would not be considered to be used for farming operations and would not qualify for an allowance under section 12B. An allowance under section 12B would also not be available for certain assets used in the farming operations (such as aircraft used for the counting of game and office equipment), since those assets are specifically excluded. The taxpayer may, however, qualify for

a depreciation allowance under section 12C in some instances and in other instances under section 11(e).³⁶

The deductions allowed under sections 11(e), 12B and 12C are included in the income of the taxpayer if subsequently recovered or recouped under section 8(4)(a). These deductions must also be taken into account when determining whether any deduction under section 11(o) is available on the alienation, destruction or loss of a depreciable asset.³⁷

4.5 Capital development expenditure

Section 11(a) prohibits the deduction of expenditure of a capital nature. The First Schedule, however, provides an exception to this general rule for persons who carry on farming operations and have incurred expenditure of a capital nature as listed in paragraph 12. Paragraph 12 also applies to persons carrying on game-farming operations.

Amounts qualifying as a deduction under paragraph 12 include amongst others expenditure incurred for –

- the eradication of noxious plants and alien invasive vegetation;
- the prevention of soil erosion;
- dipping tanks;
- dams, irrigation schemes, boreholes and pumping plants;
- fences;
- erection of or extensions, additions or improvements (other than repairs) to buildings used in connection with farming operations, other than those used for domestic purposes;
- the building of roads and bridges used in connection with farming operations; and
- the carrying of electric power from the main transmission lines to the farm apparatus or under an agreement with the Electricity Supply Commission under which the farmer has undertaken to bear a portion of the cost incurred by the Commission in connection with the supply of electric power consumed by the farmer wholly or mainly for farming purposes.

The expression “in connection with” (see the sixth and seventh bullet points above) was considered by the Tax Court in ITC 885.³⁸ After an analysis of a number of cases dealing with the subject, the court concluded as follows:³⁹

“It seems to me that it is possible to extract from these judgments a number of guiding rules. One must give to the phrase “a wide and comprehensive meaning” but not as wide and comprehensive as to embrace a remote and indirect connection. There must be something in the nature of a direct connection and this must be subservient and ancillary to the particular business under consideration.”

³⁶ See Interpretation Note 47 (Issue 3) dated 2 November 2012 “Wear-and-Tear or Depreciation Allowance”.

³⁷ See Interpretation Note 60 (Issue 2) dated 29 September 2017 “Loss on Disposal of Qualifying Depreciable Assets”.

³⁸ (1959) 23 SATC 336 (C).

³⁹ At 338.

The direct connection to game-farming operations is important. Expenditure incurred on facilities like slaughter rooms, meat rooms, cooling rooms, biltong rooms, skin rooms and trophy rooms will generally have the required connection in order to qualify for deduction under paragraph 12.

In contrast, expenditure incurred on facilities used to accommodate visitors and hunters will not have the required connection and will not qualify for a deduction by a game farmer under paragraph 12. Similarly, the cost of buildings erected in connection with a canning or other industry run in conjunction with the farming operations will not be deductible under paragraph 12.

Expenditure on the construction of roads and bridges will also qualify as a deduction for a person carrying on game-farming operations only if they are used in connection with the farming operations.

The deduction available for capital development expenditure (excluding expenditure incurred on the eradication of noxious plants and alien invasive vegetation or the prevention of soil erosion) is ring-fenced. The deduction available in a particular year of assessment is limited to taxable income from farming before claiming the deduction.⁴⁰

The excess is carried forward and is deemed to have been incurred in the following year of assessment.⁴¹

Under paragraph 20A of the Eighth Schedule a farmer who ceases to carry on farming operations and subsequently disposes of the immovable property on which they were carried on, can, subject to the limitations specified in that paragraph, elect to treat any un-deducted balance of capital development expenditure as expenditure incurred and paid in respect of the immovable property. In this way the un-deducted balance of capital development expenditure may form part of the base cost of the farm property for CGT purposes.

The development expenditure under paragraph 12(1) is not subject to recoupment under section 8(4)(a) because that section, with some exceptions, applies only to the deductions under sections 11 to 20. Paragraph 12(1B) and (1C) contain special recoupment provisions for paragraph 12 assets that become movable assets.

4.6 Housing for guests and employees

Expenditure incurred on residential facilities such as bedrooms, dining rooms, sitting rooms and kitchen facilities made available to safari guests and hunters is not incurred directly in connection with farming operations and therefore does not qualify for deduction under the First Schedule (see 4.5). Such buildings may qualify for an allowance under section 13*bis* if the taxpayer is carrying on the trade of "hotel keeper" as defined in section 1(1). In order to qualify as a hotel keeper, the taxpayer would have to supply meals and sleeping accommodation.

Before 21 October 2008, the First Schedule provided for a person carrying on farming operations to deduct the expenditure incurred on the erection of dwellings for the person's farm employees. This deduction is no longer available under the First

⁴⁰ Technically the deduction is claimed and the excess above taxable income from farming is added back to taxable income.

⁴¹ Paragraph 12(3).

Schedule or under the main body of the Act. A deduction is, however, available under section 13sept for the sale of low-cost residential units on loan account to employees.

4.7 Cessation of farming operations

Farming operations can be discontinued for various reasons such as voluntary cessation, death or sequestration of the taxpayer. The cessation of farming operations has tax implications for the taxpayer. The treatment of livestock under these circumstances is considered below.

4.7.1 Voluntary cessation of farming operations

A taxpayer discontinuing farming operations can decide to either dispose of all livestock or to retain all or some of the livestock. The proceeds received from the disposal of the livestock during the discontinuation process will form part of the taxable income derived from farming operations.

The position of a taxpayer who discontinues farming operations, but retains livestock or has entered into a "sheep lease" or similar agreement, is governed by section 26(2). This section provides that certain provisions of the First Schedule will remain applicable until **all** such livestock retained has been disposed of.

Section 26(2) applies to livestock that has been taken into account and for which expenditure has previously been allowed as a deduction under the Act in the determination of the taxable income derived from farming operations. It applies to game livestock of a farmer, since the cost of the game would have been claimed under section 11(a) and the livestock would have been included in opening and closing stock albeit at a standard value of nil.

4.7.2 Death

(a) Introduction

A number of amendments affecting deceased persons and their deceased estates came into operation on 1 March 2016 and apply to persons dying on or after that date. For the position before 1 March 2016, see the previous issue of this Note.

The changes involved moving some of the rules in paragraphs 40, 41 and 67 of the Eighth Schedule into the main body of the Act by inserting section 9HA and substituting section 25.

The income tax and CGT consequences for the deceased person, the deceased estate and the heirs or legatees on the death of a game farmer are briefly discussed below in relation to game livestock.

(b) Deceased person

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

Under paragraph (a) of the proviso to section 66(13)(a) in the year of assessment in which a person dies, a return must be made for the period commencing on the first day of that year of assessment and ending on the date of death. Under section 6(4) the primary, secondary and tertiary rebates must be apportioned for a period of assessment of less than 12 months, which will usually apply to a deceased person in the year of death.

Under section 9HA(1) the farmer is deemed to dispose of the game livestock at its market value on the date of death, except when the livestock is disposed of to a resident surviving spouse. This deemed disposal results in an inclusion in the farmer's gross income in the final year of assessment equal to the market value of the game livestock. Before 1 March 2016 the deemed disposal on date of death applied only for CGT purposes while the game livestock was included in closing stock at a standard value of nil for purposes of the First Schedule. As a result of the deemed disposal, the game livestock is no longer held on the date of death and hence is no longer included in closing stock. The difference between the pre- and post-1 March 2016 positions is that before 1 March 2016 the market value of the game livestock would have been included in proceeds under paragraph 35 of the Eighth Schedule, with a base cost of nil, giving a capital gain equal to the market value of the game livestock. On or after 1 March 2016 the market value of the game livestock is included in the farmer's gross income on date of death with the result that it will give rise to proceeds of nil⁴² and hence neither a capital gain nor a capital loss. In other words, the deemed sale is now on revenue account while previously it was on capital account.

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

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

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

(c) Deceased estate

When a person dies, that person's year of assessment comes to an end and a new entity comes into existence, namely, the deceased estate. In reality a deceased estate is not a person but simply an aggregate of assets and liabilities of the deceased person administered by an executor.⁴³ This common-law position is varied by the Act in that a deceased estate is deemed to be a person as defined in section 1(1) and the executor is deemed to be its representative taxpayer, also as defined in section 1(1).

⁴² The proceeds are reduced to nil under paragraph 35(3)(a) of the Eighth Schedule, since the amount derived on the deemed disposal is included in gross income.

⁴³ *CIR v Emary NO 1961 (2) SA 621 (A)*, 24 SATC 129.

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

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

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

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

Paragraph 4(1)(a)(ii)(aa) and 4(1)(b)(ii)(aa) deem livestock “acquired by such person during the year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations” to be included in opening stock at market value. Before 1 March 2016 these rules enabled a farmer to obtain an opening stock deduction for inherited livestock. On or after 1 March 2016 section 25(2)(a) and (b) deem the deceased estate to have incurred expenditure in respect of assets acquired from the deceased person. The *quantum* of the deemed expenditure is elaborated on below. In order to avoid any conflict between section 25(2) and paragraph 4(1) it is submitted that the expenditure deemed to be incurred under section 25(2) should be regarded as having been incurred under a purchase transaction, which will have the effect of making paragraph 4(1) inapplicable, thus avoiding any conflict between the two provisions. Even if there should be a conflict, section 25(2) is the later provision and should prevail.⁴⁴

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

⁴⁴ Under the maxim *lex posterior derogat priori*. See, for example *R v Brener* 1932 OPD 45 at 51 “Where two inconsistent sections or provisions appear in a statute, the later one is usually taken to govern”.

Under section 25(2)(b) the deceased estate is deemed to acquire an asset disposed of to a resident surviving spouse⁴⁵ for an amount of expenditure incurred equal to the amount contemplated in section 9HA(2)(b), namely, in the case of –

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

Thus, game livestock transferable to a resident surviving spouse is acquired by the deceased estate at standard value of nil if the deceased person had acquired it in a year of assessment before the year of death, or at cost price if it was acquired by the deceased person in the year of death.⁴⁶

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

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

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

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

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

⁴⁵ Includes assets acquired by the resident surviving spouse by inheritance under a will or under the laws of intestate succession, through a redistribution agreement or as a result of the settlement of a claim under the accrual system applicable to a marriage out of community of property.

⁴⁶ Section 9HA(2)(b)(i) refers to the amount allowed as a deduction in the year of assessment in which the person dies.

Disposal of game livestock to third parties by the executor

Amounts derived from the disposal of game livestock by the executor of the deceased estate to third parties must be included in the gross income of the deceased estate under section 25(1). Deductions or allowances relating to game-farming operations conducted by the executor must likewise be claimed by the deceased estate.

Cessation of deceased estate

The deceased estate must account for transactions in its returns of income up to the date on which the liquidation and distribution account becomes final. The liquidation and distribution account is required to lie open for a period not less than 21 days for inspection by any person interested in the estate.⁴⁷ This period must be stipulated by the executor in the *Government Gazette* and in one or more newspapers circulating in the district in which the deceased was ordinarily resident.⁴⁸

The estate becomes distributable after the period stipulated in the notice assuming no objection has been lodged against the account, and it is at this point that the account becomes final.⁴⁹ Should objection be lodged against the account, the date on which it becomes final will depend on the facts. For example, if the objection is sustained and the revised liquidation and distribution account lies open for inspection for a further 21 days, the account will become final after that period assuming no further objection has been lodged against the revised account. If the Master dismisses the objection and the aggrieved party applies to court to have the Master's decision set aside, the account will become final only when the court process is completed.

On the reckoning of the 21-day period, section 4 of the Interpretation Act 33 of 1957 provides as follows:

4. Reckoning of number of days.—When any particular number of days is prescribed for the doing of any act, or for any other purpose, the same shall be reckoned exclusively of the first and inclusively of the last day, unless the last day happens to fall on a Sunday or on any public holiday, in which case the time shall be reckoned exclusively of the first day and exclusively also of every such Sunday or public holiday.

Thus, if the account was advertised in the *Gazette* on Tuesday 3 January 2017, the period of 21 days will end at midnight on Tuesday 24 January 2017.

(d) Heirs or legatees*Heirs or legatees other than a surviving spouse [section 25(3)(b)]*

Under section 25(3)(b) an heir or legatee is treated as having acquired an asset from the deceased estate for an amount of expenditure incurred equal to the expenditure incurred by the deceased estate in respect of that asset.

⁴⁷ Section 35(4) of the Administration of Estates Act 66 of 1965.

⁴⁸ Section 35(5)(a) of the Administration of Estates Act 66 of 1965.

⁴⁹ Section 35(12) of the Administration of Estates Act 66 of 1965.

An heir other than a resident surviving spouse would acquire game livestock from the deceased estate under section 25(3)(b) read with section 25(2)(a) at an expenditure equal to –

- its market value on the date of death plus any further costs incurred after the date of death when the deceased estate acquired it from the deceased person;
- its cost price to the deceased estate when it was acquired by purchase by the executor; or
- nil when it was acquired by the deceased estate by natural increase.

Resident surviving spouse

With a resident surviving spouse, a distinction needs to be drawn between game livestock that was –

- held by the deceased person on date of death [section 25(4)]; and
- acquired by the deceased estate after date of death (for example, through purchase or by natural increase) [section 25(3)(b)].

Acquisition of game livestock by resident surviving spouse from the deceased person [section 25(4)]

The acquisition of game livestock from the deceased person is regulated by section 25(4) which treats the resident surviving spouse, the deceased person and the deceased estate as one and the same person for purposes of determining any allowance or deduction to which that spouse may be entitled or that is to be recovered or recouped by or included in the income of that spouse in respect of that game livestock [section 25(4)(a)].

Section 25(4)(b) then treats the resident surviving spouse contemplated in section 25(4)(a) as one and the same person as the deceased person and deceased estate with respect to –

- the date of acquisition of the asset by that deceased person;
- any valuation effected by that deceased person as contemplated in paragraph 29(4) of the Eighth Schedule [not relevant to game livestock, since all consequences will be on income account and this valuation is for CGT purposes];
- the amount of any expenditure and the date on which and the currency in which that expenditure was incurred in respect of the asset –
 - by that deceased person as contemplated in section 9HA(2)(b); and
 - by that deceased estate, other than the expenditure contemplated in section 9HA(2)(b);
- the manner in which that asset had been used by the deceased person and the deceased estate; and
- any allowance or deduction allowable in respect of an asset to the deceased person and the deceased estate.

The expenditure taken over by the resident surviving spouse for game livestock is the amount referred to in section 9HA(2)(b). Section 9HA(2)(b)(i) deals with livestock and deals only with the year of assessment in which a person dies. The expenditure to be taken over by the resident surviving spouse is equal to the amount that was allowed as a deduction in respect of the asset for purposes of determining the deceased person's taxable income, before the inclusion of any taxable capital gain, for the year of assessment ending on the date of that person's death. Since the deceased's opening stock would have a nil value, the opening stock figure can be ignored. What is left is any expenditure actually incurred by the deceased from the beginning of the year of assessment until the date of death. Such expenditure could comprise –

- expenditure actually incurred by the deceased person under section 11(a) in purchasing game livestock during the year of death; and
- expenditure incurred in an earlier year of assessment which was ring-fenced under paragraph 8(1) and carried forward to the current year of assessment under paragraph 8(2). Such expenditure is deemed to be expenditure incurred by the farmer in acquiring livestock during the succeeding year of assessment.

No rule is provided for livestock acquired in earlier years of assessment because the deceased person would have claimed the relevant expenditure in those years, and to the extent that the expenditure was ring-fenced in those years, it is carried forward and deemed to be incurred in the year of death.

Game livestock acquired by natural increase during the year of death by the deceased person will have an expenditure of nil, since it does not have a cost price.

Under section 25(4)(b)(iii)(bb) the resident surviving spouse takes over any further expenditure incurred by the deceased estate in respect of game livestock it acquired from the deceased person. In the context of game livestock it is unlikely that such expenditure will be frequently encountered in practice. An example would be when the deceased person acquired game livestock under a contract and the purchase price was subject to a contingency, such as an amount equal to a percentage of future profits generated by the game livestock, such as stud fees.

Game livestock taken over by resident surviving spouse acquired by the deceased estate after date of death [section 25(3)(b)]

The executor may acquire game livestock after the date of death of the deceased person through purchase or by natural increase. The acquisition of such game livestock by the resident surviving spouse is not governed by section 25(4) because section 25(4)(a) refers to an asset contemplated in section 9HA(2), which is one disposed of by the deceased person.

Rather, the resident surviving spouse is treated in the same manner as any other heir or legatee and acquires such game livestock under section 25(3)(b) for an amount equal to the expenditure incurred by the deceased estate. For example, if the executor purchased a wildebeest for R10 000 after date of death, the resident surviving spouse will be deemed to have incurred expenditure of R10 000 when he or she becomes unconditionally entitled to the wildebeest, usually when the liquidation and distribution account becomes final.

The resident surviving spouse will not be entitled to any deduction in respect of game livestock acquired by the deceased estate through natural increase, since the executor would not have incurred any expenditure in acquiring such game livestock.

(e) Capital or revenue nature of game livestock and capital gains tax

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

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

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

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

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

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

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

4.7.3 Insolvency or liquidation

Section 25C deems the estate of a natural person before sequestration and that person's insolvent estate to be one and the same person for the purpose of determining –

- any allowance, deduction or set off to which that insolvent estate may be entitled;
- any amount which is recovered or recouped by or otherwise required to be included in the income of that insolvent estate; and
- any taxable capital gain or assessed capital loss of that insolvent estate.

The person before sequestration must submit a return of income for the period commencing on the first day of the year of assessment and ending on the date before the date of sequestration.⁵⁰ Game livestock will have a standard value of nil for closing stock purposes at the end of that person's year of assessment in the normal way.

The insolvent estate must submit a return of income for its first year of assessment from the date of sequestration until the end of that year and for all subsequent years of assessment until the estate is wound up.

The insolvent estate will have an opening stock of game livestock of nil based on the "one and the same person" principle because the closing stock of the person before sequestration was nil. Any assessed loss of the person before the date of sequestration will be brought forward into the insolvent estate. Game livestock will continue to have a standard value of nil for closing stock purposes in the first year of assessment of the insolvent estate and for the purposes of determining future opening and closing stock. Any amount received by or accrued to the insolvent estate from the disposal of the livestock must be included in the gross income of the insolvent estate.

For CGT purposes there is no deemed disposal on date of sequestration as a result of the "one and the same person" principle in section 25C. Given that game livestock is floating capital, there should be no CGT implications when game livestock is disposed of by the trustee of the insolvent estate.

A company that is being wound up or liquidated remains the same taxable entity until it is finally dissolved.⁵¹ In practice a company must submit an interim return of income for the period from the beginning of the year of assessment up to the date immediately before the date of liquidation and another return from the date of liquidation until the end of the year of assessment. Game livestock will have a standard value of nil for opening or closing stock purposes. Any amounts derived by the company after date of liquidation must be included in its gross income.

4.7.4 Cessation of farming owing to the sale of land to the state

Paragraph 20 provides for a concessionary rate of tax when a farmer's farming operations are wound up as a result of a sale of the farm land to the state and the farmer derives abnormal farming income. This situation could apply to, say, the

⁵⁰ Paragraph (b)(i) of the proviso to section 66(13)(a).

⁵¹ *Van Zyl NO v CIR* 1997 (1) SA 883 (C), 59 SATC 105.

expropriation of a game farm. Since this issue is not unique to game farmers, it is not explored in further detail in this Note.

4.8 Ring-fencing of assessed losses [section 20A]

Section 20A was introduced with effect from 1 March 2004. It is a ring-fencing provision which limits the use of an assessed loss from a tainted trade to income from that trade. It applies only to natural persons (individuals).

Section 20A is discussed in detail in the *Guide on the Ring-fencing of Assessed Losses from Certain Trades Conducted by Individuals* (Issue 2) (“ring-fencing guide”) which was issued on 8 October 2010 and is available from the SARS website. It is not the intention of this Note to deal comprehensively with section 20A, since that task is taken care of by the above guide. Rather, an overview of the main issues which are likely to affect game farmers, many of whom are natural persons who conduct their operations on a small scale on a part-time basis, will be provided. Inevitably when losses arise from game-farming operations and the taxpayer is a natural person, the issue will arise whether the loss from carrying on that trade may be set off against other taxable income.

Section 20A does not replace sections 11(a) and 23(g). Any expenditure which does not qualify under section 11(a) or which is denied as a deduction under section 23(g) will be permanently lost. By contrast, section 20A does not permanently deny a set-off of the affected assessed loss but merely ring-fences it by permitting it to be set off only against future taxable income from that trade.

Section 20A contains four steps which determine whether an assessed loss can be ring-fenced. These are as follows:

Step 1 [section 20A(2)] – The maximum marginal rate of tax pre-requisite

Under this step it is first necessary to adjust taxable income by adding back any assessed loss and balance of assessed loss carried forward from the previous year of assessment.

If the amount so determined falls within the highest tax bracket for individuals, the taxpayer will have met the first step in the potential ring-fencing process and must proceed to steps 2 to 4.

Conversely, if the adjusted taxable income is below the level at which the maximum marginal rate of tax becomes payable, the assessed loss may not be ring-fenced. There is then no need to proceed to steps 2 to 4.

Step 2 [section 20A(2)(a) and (b)] – The “three-out-of-five-years” pre-requisite or alternatively, the “listed suspect trade” pre-requisite

Step 2 is also a pre-requisite for the application of section 20A. It comprises two alternative tests – if either of these tests is passed section 20A will potentially apply, if neither of the tests is passed section 20A can be disregarded.

Under the “three-out-of-five-years” pre-requisite, a person who makes assessed losses from game farming in at least three out of five years will meet this requirement. The five year period includes the current and four previous years of assessment. This rule applies to persons carrying on game farming on a full-time basis (see below).

Under the “suspect trade” pre-requisite section 20A lists eight suspect trades. An assessed loss arising from any one of these trades will be subject to potential ring-fencing. Farming or animal breeding is listed as a suspect trade unless such activities (including activities of a similar nature) are carried out on a full-time basis.⁵² It follows that game farming which is conducted on a part-time basis will be subject to potential ring-fencing. While full-time farming is not listed as a suspect trade, it could be subject to potential ring-fencing if losses are made in three out of five years of assessment (see the “three-out-of-five years” pre-requisite above).⁵³

Step 3 [section 20A(3)] – The “facts and circumstances” test (the escape clause)

Step 3 is an escape clause. In other words, an assessed loss qualifying for potential ring-fencing under steps 1 and 2 can escape ring-fencing under step 3.

Under section 20A(3) the ring-fencing provisions will not apply to a trade that constitutes a business in respect of which there is a reasonable prospect of deriving taxable income (other than taxable capital gains) within a reasonable period. Special regard must be had to –

- the proportion of the gross income derived from the trade in the year of assessment in relation to the amount of the allowable deductions incurred in carrying on that trade during that year;
- the level of activities carried on by the person or the amount of expenses incurred by that person in respect of advertising, promoting or selling in carrying on that trade;
- whether the trade is carried on in a commercial manner, taking into account –
 - the number of full-time employees appointed for purposes of that trade (other than persons partly or wholly employed to provide services of a domestic or private nature);
 - the commercial setting of the premises where the trade is carried on;
 - the extent of the equipment used exclusively for purposes of carrying on the trade; and
 - the time that the person spends at the premises conducting the business;
- the number of years of assessment during which assessed losses were incurred in carrying on the trade in relation to the period from the date when that person commenced carrying on the trade and taking into account –
 - any unexpected events giving rise to any of those assessed losses; and
 - the nature of the business involved;
- the business plans of the person and any changes to those plans to ensure that taxable income is derived in future from carrying on the trade; and
- the extent to which any asset attributable to the trade is used, or is available for use, by the person or any relative of that person for private use (recreational purposes or personal consumption).

⁵² Section 20A(2)(b)(vi). See the ring-fencing guide for more detail.

⁵³ Under section 20A(2)(a).

For a detailed discussion on these special factors, see paragraph 7 of the ring-fencing guide.

Step 4 [section 20A(4)] – The “six-out-of-ten-years” requirement (the “catch all” provision)

Step 4 is a “catch all” provision that applies even if a taxpayer has escaped ring-fencing under step 3. However, it does not apply to farming operations. Thus, even if a game farmer incurs losses in six out of the last ten years, ring-fencing can be prevented if the taxpayer can satisfy SARS that a business is being carried on with a reasonable prospect of deriving taxable income within a reasonable period.

5. Conclusion

The same principles used to determine whether a person carries on farming operations apply to game farmers. The test for this purpose is based on the taxpayer’s intention.

Income from the sale of game, game meat, carcasses and skins and fees related to hunting constitutes farming income. However, income from accommodation, catering and admission charges is not farming income. Income not constituting farming income will be relevant when applying the ring-fencing provisions of paragraph 8 to game livestock. Game viewing fees may or may not constitute farming income depending on the facts and circumstances.

The rules governing the deduction of expenditure, including capital development expenditure, are similar to those applying to normal farming operations.

A farmer is required to bring to account the value of game livestock in opening and closing stock. No standard values have been prescribed by regulation for game livestock, but the Commissioner accepts that game livestock may be allocated a standard value of nil. Game livestock acquired by donation is included in opening stock in the year of acquisition at market value under paragraph 4.

The deduction under section 11(a) for the cost of livestock is ring-fenced under paragraph 8, while an assessed loss or balance of assessed loss from farming is subject to potential ring-fencing under section 20A.

A farmer ceasing to carry on game-farming operations must generally continue to deal with any game livestock under the First Schedule.

Special rules apply for income tax and CGT purposes upon the death or sequestration of a farmer.

Legal Counsel

SOUTH AFRICAN REVENUE SERVICE

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Annexure – The law

Section 9HA

9HA. Disposal by deceased person.—(1) A deceased person must be treated as having disposed of his or her assets, other than—

- (a) assets disposed of to his or her surviving spouse as contemplated in subsection (2);
- (b) & (c) [Not relevant],

at the date of that person's death for an amount received or accrued equal to the market value as contemplated in paragraph 31 of the Eighth Schedule of those assets as at that date.

(2) A deceased person must, if his or her surviving spouse is a resident, be treated—

- (a) as having disposed of an asset for the benefit of that surviving spouse if that asset is acquired by that surviving spouse—
 - (i) by *ab intestato* or testamentary succession;
 - (ii) as a result of a redistribution agreement between the heirs and legatees of that person in the course of liquidation or distribution of the deceased estate of that person; or
 - (iii) in settlement of a claim arising under section 3 of the Matrimonial Property Act, 1984 (Act No. 88 of 1984); and
- (b) as having disposed of that asset for an amount received or accrued that is equal to, in the case of—
 - (i) trading stock, or livestock or produce contemplated in the First Schedule, the amount that was allowed as a deduction in respect of that asset for purposes of determining that person's taxable income, before the inclusion of any taxable capital gain, for the year of assessment ending on the date of that person's death; or
 - (ii) any other asset, the base cost of that asset, as contemplated in the Eighth Schedule, as at the date of that person's death.

(3) If any asset that is treated as having been disposed of by a deceased person as contemplated in subsection (1) is transferred directly to an heir or legatee of that person, that heir or legatee must be treated as having acquired that asset for an amount of expenditure incurred equal to the market value as contemplated in paragraph 31 of the Eighth Schedule of that asset as at the date of that deceased person's death.

Section 25(1) to (5)

25. Taxation of deceased estates.—(1) Any—

- (a) income received by or accrued to or in favour of any person in his or her capacity as the executor of the estate of a deceased person; and
- (b) amount received or accrued as contemplated in paragraph (a) which would have been income in the hands of that deceased person had that amount been received by or accrued to or in favour of that deceased person during his or her lifetime,

must be treated as income of the deceased estate of that deceased person.

(2) Where the deceased estate of a person acquires an asset from that person, that deceased estate must, if that asset is an asset—

- (a) other than an asset contemplated in section 9HA(2), be treated as having acquired that asset for an amount of expenditure incurred equal to the amount contemplated in section 9HA(1); and
- (b) contemplated in section 9HA(2), be treated as having acquired that asset for an amount of expenditure incurred equal to the amount contemplated in section 9HA(2)(b).

(3) Where the deceased estate of a person disposes of an asset to an heir or legatee of that person—

- (a) that deceased estate must be treated as having disposed of that asset for an amount received or accrued equal to the amount of expenditure incurred by the deceased estate in respect of that asset; and
- (b) the heir or legatee must be treated as having acquired that asset for an amount of expenditure incurred equal to the expenditure incurred by the deceased estate in respect of that asset.

(4) (a) This subsection must be applied in respect of an asset acquired by a surviving spouse of a deceased person as contemplated in section 9HA(2) for purposes of determining the amount of any—

- (i) allowance or deduction to which that spouse may be entitled or that is to be recovered or recouped by or included in the income of that spouse in respect of that asset; or
- (ii) the amount of any capital gain or capital loss in respect of a disposal of that asset by that spouse.

(b) The surviving spouse contemplated in paragraph (a) must be treated as one and the same person as the deceased person and deceased estate with respect to—

- (i) the date of acquisition of that asset by that deceased person;
- (ii) any valuation of that asset effected by that deceased person as contemplated in paragraph 29(4) of the Eighth Schedule;
- (iii) the amount of any expenditure and the date on which and the currency in which that expenditure was incurred in respect of that asset—
 - (aa) by that deceased person as contemplated in section 9HA(2)(b); and
 - (bb) by that deceased estate, other than the expenditure contemplated in section 9HA(2)(b);
- (iv) the manner in which that asset had been used by the deceased person and the deceased estate; and
- (v) any allowance or deduction allowable in respect of that asset to the deceased person and the deceased estate.

(5) A deceased estate must, other than for the purposes of section 6, section 6A and section 6B, be treated as if that estate were a natural person.

Section 25C

25C. Income of insolvent estates.—For the purposes of this Act, and subject to any such adjustments as may be necessary the estate of a person prior to sequestration and that person's insolvent estate shall be deemed to be one and the same person for purposes of determining—

- (a) the amount of any allowance, deduction or set off to which that insolvent estate may be entitled;
- (b) any amount which is recovered or recouped by or otherwise required to be included in the income of that insolvent estate; and
- (c) any taxable capital gain or assessed capital loss of that insolvent estate.

Section 26

26. Determination of taxable income derived from farming.—(1) The taxable income of any person carrying on pastoral, agricultural or other farming operations shall, in so far as it is derived from such operations, be determined in accordance with the provisions of this Act but subject to the provisions of the First Schedule.

(2) In the case of any person who has discontinued carrying on pastoral, agricultural or other farming operations and is still in possession of any livestock or produce, or has entered into a “sheep lease” or similar agreement relating to livestock or produce, which has been taken into account and in respect of which expenditure under the provisions of this Act or any previous Income Tax Act has been allowed in the determination of the taxable income derived by such person when such operations were carried on, the provisions of this Act, but subject to the provisions of paragraphs 1, 2, 3, 4, 5, 6, 7, 9, or 11 of the First Schedule, shall continue to be applicable to that person in respect of such livestock or produce, as the case may be, until the year of assessment during which he disposes of the last of such livestock or produce, notwithstanding the fact that such operations have been discontinued.

First Schedule

Paragraphs 4 and 5

4. (1) The values of livestock and produce held and not disposed of at the beginning of any year of assessment shall, subject to the provisions of sub-paragraph (2), be deemed to be—

- (a) in the case of a farmer who was carrying on farming operations on the last day of the year immediately preceding the year of assessment, the sum of—
 - (i) the values of livestock and produce held and not disposed of by him at the end of the year immediately preceding the year of assessment; and
 - (ii) the market value of livestock or produce—
 - (aa) acquired by such farmer during the current year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations; or
 - (bb) held by such farmer otherwise than for purposes of pastoral, agricultural or other farming operations, which such farmer during such year of assessment commenced to hold for purposes of pastoral, agricultural or other farming operations; or
- (b) in the case of any person commencing or recommencing farming operations during the year of assessment, the sum of—
 - (i) the value of any livestock or produce held and not disposed of by him at the end of the day immediately preceding the date of such commencement or recommencement; and
 - (ii) the market value of livestock or produce (other than livestock or produce to which sub-item (i) refers)—
 - (aa) acquired by such person during the year of assessment otherwise than by purchase or natural increase or in the ordinary course of farming operations; or
 - (bb) held by such person otherwise than for purposes of pastoral, agricultural or other farming operations, which such person during such year of assessment commenced to hold for purposes of pastoral, agricultural or other farming operations.

(2)

(3)

5. (1) The value to be placed upon livestock for the purposes of this Schedule shall, subject to the provisions of paragraph 4(1) as respects livestock held and not disposed of at the end of the year of assessment, be the standard value applicable to the livestock.

(1A)

(2)

(3)

Paragraph 8

8. (1) Where any farmer has during any year of assessment incurred expenditure in respect of the acquisition of livestock, the deduction which may be allowed to him under section 11(a) of this Act in respect of the cost price of such livestock shall be limited to an amount which, together with the value of livestock held and not disposed of by him at the beginning of such year, does not exceed the income received by or accrued to him from farming during such year and the value of livestock held and not disposed of by him at the end of such year.

(2) Any amount which has been disallowed under the provisions of subparagraph (1) shall be carried forward and be deemed to be expenditure incurred by the farmer in respect of the acquisition of livestock during the succeeding year of assessment.

(3) The provisions of this paragraph shall not apply—

- (a) in any case where it is shown by the farmer that livestock the cost of which falls to be dealt with under such provisions is no longer held and not disposed of by him; and
- (b) to so much of any expenditure (including any amount which has been carried forward under the provisions of subparagraph (2)) which falls to be disallowed under subparagraph (1) as, together with the value of livestock held and not disposed of by him at the beginning of the year of assessment, exceeds such amount as is shown by him to be market value of all livestock held and not disposed of by him at the end of such year.