

INTERPRETATION NOTE 43 (Issue 8)

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ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 9C
**SUBJECT : CIRCUMSTANCES IN WHICH CERTAIN AMOUNTS RECEIVED OR
ACCRUED FROM THE DISPOSAL OF SHARES ARE DEEMED TO BE
OF A CAPITAL NATURE**

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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;
- “**Eighth Schedule**” means the Eighth Schedule to the Act;
- “**JSE**” means the exchange operated by JSE Ltd which facilitates trade in securities under the style of “Johannesburg Stock Exchange” and is licensed as an exchange under the Financial Markets Act 19 of 2012;
- “**paragraph**” means a paragraph of the Eighth Schedule;
- “**section**” means a section of the Act;
- “**Securities Transfer Tax Act**” means the Securities Transfer Tax Act 25 of 2007;
- “**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. Unless indicated otherwise, the latest issues of these documents should be consulted.

This Note reflects the income tax and tax administration legislation (as amended) at the time of publication and includes the following:

- The Taxation Laws Amendment Act 23 of 2020 which was promulgated on 20 January 2021 (as per *Government Gazette* 44083).
- The Tax Administration Laws Amendment Act 24 of 2020 which was promulgated on 20 January 2021 (as per *Government Gazette* 44080).
- The Rates and Monetary Amounts and Amendment of Revenue Laws Act 22 of 2020 which was promulgated on 20 January 2021 (as per *Government Gazette* 44082).

1. Purpose

This Note provides clarity on the interpretation and application of section 9C, which deems any amount received or accrued (other than a dividend or foreign dividend) or any expenditure incurred in respect of an equity share to be of a capital nature if that equity share had, at the time of the receipt or accrual of that amount or incurrance of that expenditure been held for a continuous period of at least three years.

2. Background

The first step in determining a person's income tax liability on the disposal of shares is to determine whether the amount received or accrued is of a capital or revenue nature. Any amount received or accrued of a capital nature is specifically excluded from a person's "gross income" as defined in section 1(1) unless specifically included.

The distinction between capital and revenue is fundamental to the tax system, but neither concept has proved capable of a satisfactory definition in the Act. The question whether shares are held as trading stock or as an investment will, to a large extent, depend on the intention of the taxpayer.

Despite guidelines laid down by case law, the determination of whether the amount received or accrued on the disposal of a share falls on capital or revenue account is often a contentious matter which can lead to costly and protracted legal disputes. For commentary on the capital *versus* revenue issue, see the *Tax Guide for Share Owners* and the *Comprehensive Guide to Capital Gains Tax* in Chapter 2.

While section 9C eliminates uncertainty over the capital nature of shares falling within its ambit, it does not apply to all types of shares, nor does it apply to disposals of shares within three years of acquisition or returns of capital or foreign returns of capital received or accrued within that period.

3. Effective date

The current section 9C came into operation on 1 October 2007 and applies to the disposal of a qualifying share on or after that date. The term "qualifying share" has since been deleted but on the current wording of section 9C, its equivalent is essentially an "equity share" as defined in section 9C(1).¹

4. Definitions [section 9C(1)]

4.1 The law

Section 9C(1)

9C. Circumstances in which certain amounts received or accrued from disposal of shares are deemed to be of a capital nature.—(1) For the purposes of this section—

"**connected person**" means a connected person as defined in section 1, provided that the expression "and no holder of shares holds the majority voting rights in the company" in paragraph (d)(v) of that definition shall be disregarded;

"**disposal**" means a disposal as defined in paragraph 1 of the Eighth Schedule;

"**equity share**", includes a participatory interest in a portfolio of a collective investment scheme in securities and a portfolio of a hedge fund collective investment scheme excluding a share which at any time prior to the disposal of that share was—

- (a) a share in a share block company as defined in section 1 of the Share Blocks Control Act;
- (b) a share in a company which was not a resident, other than a company contemplated in paragraph (a) of the definition of "listed company"; or

¹ The term "qualifying share" was deleted by section 12(1)(c) of the Taxation Laws Amendment Act 25 of 2015 with effect from years of assessment commencing on or after 1 January 2016 and the definition of "equity share" was amended by section 12(1)(b) of that Act with effect from the same date to incorporate the exclusions formerly contained in the definition of "qualifying share".

(c) a hybrid equity instrument as defined in section 8E;
“qualifying share”

4.2 Definition – connected person

The definition of “connected person” in section 9C(1) expands paragraph (d)(v) of the definition of “connected person” in section 1(1) in relation to a company.² More specifically, corporate holders of shares are viewed as connected persons in relation to the company in which they hold at least 20% of the equity shares (even if a holder of shares holds the majority, namely more than 50%, voting rights). This definition is applied for purposes of enforcing the three-year immovable property and bare *dominium* anti-avoidance rules in section 9C(3) (see 7).

4.3 Definition – disposal

Under section 9C(1) a disposal means a “disposal” as defined in paragraph 1.

Paragraph 1 defines “disposal” as follows:

“[D]isposal” means an event, act, forbearance or operation of law envisaged in paragraph 11 or an event, act, forbearance or operation of law which is in terms of this Act treated as the disposal of an asset, and **“dispose”** must be construed accordingly;

A disposal therefore includes a disposal under paragraph 11 and any event, act forbearance or operation of law which is under any other provision of the Act deemed to be the disposal of an asset (see below).

General disposals under paragraph 11

In the context of shares the disposal of a share under paragraph 11 could take a variety of forms, such as cancellation, cession, conversion, distribution, donation, exchange, extinction, redemption, sale, value-shifting arrangement and vesting. For a detailed discussion on paragraph 11 see the *Comprehensive Guide to Capital Gains Tax* in Chapter 6.

Deemed disposal under paragraph 12

A deemed disposal under paragraph 12 would occur, for example, when a taxpayer –

- that is not a resident transfers a share from a permanent establishment of that taxpayer in South Africa otherwise than by way of a disposal under paragraph 11, or transfers a share to such a permanent establishment otherwise than by way of an acquisition [paragraph 12(2)(b)];
- commences to hold shares as trading stock [paragraph 12(2)(c)]; or
- ceases to hold shares as trading stock otherwise than by way of a disposal under paragraph 11 [paragraph 12(3)].

For detailed commentary on when paragraph 12 will apply, see the *Comprehensive Guide to Capital Gains Tax* in Chapter 6.

² See Interpretation Note 67 “Connected Persons” for commentary on the definition of “connected person” in section 1(1).

Some of the implications of a deemed disposal under paragraph 12 include a deemed recoupment of previously allowed expenditure under section 9C(5) (see **10**), and the switching-off under section 9C(7) of the deemed inclusion in income under section 22(8) when shares cease to be held as trading stock (see **13**).

Events treated as disposals under the main body of the Act

In recent years there has been a tendency to move some provisions which were formerly contained in the Eighth Schedule to the main body of the Act. In this way the same section can be used to deal with allowance assets, trading stock and capital assets. Two of these provisions, which can trigger a disposal of shares, are considered here, namely sections 9H and 9HA.

Section 9H

Section 9H(2) and (3) deems a person to dispose of an asset at market value when –

- that person ceases to be a resident;
- a company becomes a headquarter company; or
- a controlled foreign company ceases, otherwise than by way of becoming a resident, to be a controlled foreign company during any foreign tax year of that controlled foreign company. The CGT consequences for a foreign company that ceases to be a CFC by reason of becoming a resident are addressed in paragraph 12(4).

While section 9H(4)(a) excludes immovable property from the deemed disposal rules in section 9H(2) and (3), this exclusion does not extend to a deemed interest in immovable property in paragraph 2(2), that is, amongst other interests, equity shares in a land-rich company.³ Paragraph 2(2) deems equity shares in a company to be an “interest in immovable property situated in the Republic” for purposes of paragraph 2(1)(b)(i) if –

- 80% or more of the market value of those equity shares at the time of their disposal is attributable directly or indirectly to immovable property held in South Africa or any interest or right of whatever nature to or in immovable property situated in South Africa including rights to variable or fixed payments as consideration for the working of, or the right to work mineral deposits, sources and other natural resources in South Africa; and
- that person (whether alone or together with any connected person in relation to that person), directly or indirectly, holds at least 20% of the equity shares in that company.

Under paragraph 2(1)(b)(i) a non-resident must account for a capital gain or capital loss on any “interest or right of whatever nature” of that non-resident to or in immovable property situated in the Republic.

For more commentary on section 9H, see the *Comprehensive Guide to Capital Gains Tax* in Chapter 6.

³ Section 9H(4)(b) excluded such an interest in immovable property from the deemed disposal rules in section 9H(2) and (3) but was deleted with effect from 12 December 2013.

Section 9HA

Under section 9HA(1) a natural person is deemed to dispose of all his or her assets at the date of death with the exception of assets disposed of for the benefit of his or her surviving spouse and other specified assets not relevant for present purposes. For more commentary on section 9HA, see the *Comprehensive Guide to Capital Gains Tax* in Chapter 16 and the draft Interpretation Note “Disposal of Assets by Deceased Person, Deceased Estate and Transfer of Assets between Spouses”.

4.4 Definition – equity share

4.4.1 Shares qualifying as equity shares

Section 9C applies to an “equity share” as defined in section 9C(1).

The Act defines “equity share” in section 1(1) as follows:

[E]quity share means any share in a company, excluding any share that, neither as respects dividends nor as respects returns of capital, carries any right to participate beyond a specified amount in a distribution;

A distribution could take the form of a dividend, foreign dividend, return of capital or foreign return of capital. As long as the right to participate in either –

- a dividend or foreign dividend; or
- a return of capital or foreign return of capital,

is unrestricted, the share will be an equity share. But if both the right to dividends and the right to capital are restricted, the share will not be an equity share.

A share with only restricted distribution rights that is convertible to one with unrestricted rights will not be an equity share until the date of conversion.

The Act defines “share” in section 1(1) as follows:

[S]hare means, in relation to any company, any unit into which the proprietary interest in that company is divided;

The definition of “company” in section 1(1) includes amongst other things a close corporation.⁴ A member’s interest in a close corporation comprises a “proprietary interest” for the purposes of the above definition.

The issued share capital of a company may consist of different classes of shares carrying different preferences, rights, limitations and other terms. Shares with limited dividend rights and rights to return of capital on liquidation (non-participating shares) do not comprise equity shares under section 9C, since their right to participate in the distribution of dividends and capital is restricted. A share will be an equity share if its right to participate in dividends is unrestricted even though its right to a return of capital on liquidation may be limited to, say, its issue price (that is, it contains at least one unrestricted right).

In some instances the right to participate in dividends may be limited to profits from a particular source.

⁴ Paragraph (f) of the definition of “company” in section 1(1).

The definition of “equity share” in section 9C(1) expands the definition of the same term in section 1(1) to include a participatory interest in a portfolio of a collective investment scheme in securities and a portfolio of a hedge fund collective investment scheme. A share in a “REIT” as defined in section 1(1) could potentially be an equity share provided it meets the requirements of the definition of that term.

The Act defines REIT in section 1(1) to mean –

- a resident company;
- the shares of which are listed –
 - on an “exchange” as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act; and
 - as shares in a “REIT” as defined in the listing requirements of an exchange approved in consultation with the Director-General of the National Treasury and published, after approval of those listing requirements by the Director-General of the National Treasury, by the appropriate authority, as contemplated in section 1 of the Financial Markets Act, under section 11 of that Act or by the Financial Sector Conduct Authority.

A participatory interest in a “portfolio of a collective investment scheme in property” as defined in section 1(1) falls outside section 9C, since it represents an interest in a form of a vesting trust and is neither an “equity share” nor is it deemed to be an equity share.

Example 1 – Equity share entitling holder to dividends from a particular source

Facts:

Holdco has three subsidiaries, Company A, Company B and Company C. The A class shares of Holdco are entitled to participate in the dividends from Company A, the B class shares are entitled to participate in the dividends from Company B and the C class shares are entitled to participate in the dividends from Company C.

Result:

The respective entitlements to dividends of each class of shares do not mean that the right to participate in dividends is restricted to a particular amount. The A, B and C class shares will accordingly comprise equity shares.

4.4.2 Exclusions

The term “equity share” as defined in section 9C(1) specifically excludes –

- a share in a “share block company” as defined in section 1 of the Share Blocks Control Act 59 of 1980;
- a share in a company which was not a resident, other than a company contemplated in paragraph (a) of the definition of “listed company”; or
- a “hybrid equity instrument” as defined in section 8E.

A share will be disqualified from section 9C if at any time before its disposal it constituted any of the above excluded shares.

(a) Exclusion – share in a share block company

A “share block company” as defined in the Share Blocks Control Act 59 of 1980 means a company the activities of which comprise or include the operation of a share block scheme.⁵ Under such a scheme the shares confer a right to or an interest in the use of immovable property.⁶ The main object of a share block company is to operate a share block scheme in respect of immovable property owned by it. A person that owns a share in a share block company is entitled to use and occupy a specific unit or portion of the immovable property owned by the share block company. A share in a share block company is excluded from the definition of “equity share” because the right of use attaching to the share represents an interest in immovable property.

(b) Exclusion – share in a non-resident company not listed in South Africa

Paragraph (b) of the definition of “equity share” in section 9C(1) excludes a share in a company which was not a resident, other than a company contemplated in paragraph (a) of the definition of “listed company” in section 1(1). Paragraph (a) of the definition of “listed company” means –

“a company where its shares or depository receipts in respect of its shares are listed on an exchange as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act”.

The JSE, ZARX (Pty) Ltd (ZAR X), 4 Africa Exchange (Pty) Ltd (4AX), A2X Markets (Pty) Ltd (A2X) and Equity Express Securities Exchange (Pty) Ltd (EESE) are currently licensed under section 9 of the Financial Markets Act 19 of 2012.

Thus, an equity share in a foreign company⁷ will be an “equity share” as defined in section 9C(1) only if it is listed on an exchange in South Africa.

The exclusion from the definition of “equity share” of shares in foreign companies (other than those listed on an exchange in South Africa) is justified in that for tax purposes shares in foreign companies are treated differently to shares in resident companies. For example, under specified circumstances, a capital gain or capital loss on disposal of 10% or more of the equity shares in specified foreign companies to a non-resident is excluded from CGT under paragraph 64B.

(c) Exclusion – hybrid equity instrument

Any “hybrid equity instrument” as defined in section 8E(1)⁸ is specifically excluded from being classified as an equity share because its participation rights (similar to a non-participating preference share) are effectively limited and it is in many ways more akin to debt than pure equity.

⁵ Definition of “share block company” in section 1 of the Share Blocks Control Act 59 of 1980.

⁶ Definition of “share block scheme” in section 1 of the Share Blocks Control Act 59 of 1980.

⁷ The Act defines “foreign company” in section 1(1) as any company which is not a resident.

⁸ It is beyond the scope of this Note to provide detailed commentary on the definition of “hybrid equity instrument”.

5. Amount received or accrued or expenditure incurred deemed to be of a capital nature [section 9C(2)]

5.1 The law

Section 9C(2)

(2) Any amount received or accrued (other than a dividend or foreign dividend) or any expenditure incurred in respect of an equity share must be deemed to be of a capital nature if that equity share had, at the time of the receipt or accrual of that amount or incurrance of that expenditure, been held for a period of at least three years.

5.2 Application of the law

5.2.1 Amount received or accrued or expenditure incurred on equity shares deemed to be of a capital nature

Section 9C(2) deems any amount (other than a dividend or foreign dividend) received or accrued or any expenditure incurred in respect of an equity share to be of a capital nature if that equity share had, at the time of the receipt or accrual of that amount or incurrance of that expenditure, been held for a period of at least three years.

Shares which were accounted for as trading stock under section 22 during the three years after their acquisition must nevertheless continue to be accounted for as trading stock until they are disposed of, since they still constitute “trading stock” as defined in section 1(1) (see **11**). At the time of disposal any expenditure previously allowed as a deduction (including the value of opening stock) will be included in income as a recoupment under section 9C(5) (see **10**). The qualifying portion of such recouped expenditure will form part of the base cost of the shares under paragraph 20 for the purposes of determining a capital gain or capital loss under the Eighth Schedule (see **11**).

The Act defines “dividend” and “foreign dividend” in section 1(1). Any dividend or foreign dividend received by or accrued to a person in respect of an equity share is specifically excluded from section 9C(2).

Since a dividend and a foreign dividend are specifically included in gross income under paragraph (k) of the definition of gross income in section 1(1), their exclusion from section 9C(2) is technically unnecessary. Nevertheless, their exclusion from being deemed to be of a capital nature does emphasise that such dividends and foreign dividends do remain gross income, and hence will not form part of proceeds for CGT purposes.

5.2.2 Mandatory application and impact on gains and losses

An amount received or accrued in respect of a share fulfilling the requirements of section 9C(2) will automatically be on capital account, even if the taxpayer held the share as trading stock. This result applies in determining a capital gain or capital loss on disposal of the share and to the treatment of a return of capital or foreign return of capital for CGT purposes. Under paragraph 76B a return of capital or foreign return of capital is applied in reduction of the base cost of the share. Should the base cost be exceeded, the excess is treated as a capital gain. See the *Comprehensive Guide to Capital Gains Tax* in Chapter 18 for commentary on paragraph 76B.

A share-dealer is therefore unable to elect out of section 9C in order to claim losses on disposal of equity shares on revenue account if the shares were held for at least three years.

5.2.3 Shares disposed of within three years

Section 9C(2) does not regulate the capital or revenue nature of shares disposed of within three years. Whether the disposal of a particular share is on capital or revenue account will depend on the facts and circumstances of the particular case and the application of principles laid down by case law (see **2**).

5.2.4 Three-year holding requirement

An amount received or accrued or expenditure incurred in respect of an equity share will be of a capital nature after the share has been held for at least three years. Examples of receipts or accruals “in respect of an equity share” include a return of capital or foreign return of capital and an amount derived on disposal of the share.

The word “year” is not defined in section 1(1), section 9C or the Interpretation Act 33 of 1957.

In this regard, Van der Westhuizen J stated the following in *Ex parte Minister of Social Development & others*:⁹

“This Court has as yet not considered the computation of time or time periods. The general common-law rule is that, in the calculation of time the civilian method is applicable, unless a period of days is prescribed by law or contracting parties intended another method to be used.

According to the civil computation method, a period of time expressed in months expires at the end of the day preceding the corresponding calendar day in the subsequent month. It is settled law that the commencement of a period of time in curial calculation is governed by the ordinary civilian method where any unit of time other than days is used.

It follows, therefore, that 18 months from the date of judgment on 6 September 2004 ended at midnight on 5 March 2006.”

Thus, if shares were acquired on 25 January of year 1, the three-year period referred to in section 9C(2) will end on 24 January of year 4.

The word “held” refers to beneficial ownership.¹⁰ The beneficial ownership during the three years following the date of acquisition must be uninterrupted except when section 9C makes specific provision for an interruption, as with a securities lending arrangement (section 9C(4) – see **8**), a collateral arrangement (section 9C(4A) – see **9**) and a substitution (section 9C(8) – see **14**).

⁹ 2006 (4) SA 309 (CC) at 316.

¹⁰ See, for example, cases dealing with beneficial entitlement such as *Geldenhuys v CIR* 1947 (3) SA 256 (C), 14 SATC 419; *SIR v Smart* 1973 (1) SA 754 (A), 35 SATC 1 and *Taxpayer v COT Botswana* (1980) 43 SATC 118.

(a) Partnerships

Under South African law a partnership is not a separate legal *persona* distinct from its members.¹¹ Should a partnership acquire shares, the three-year holding period applies to the individual partners and not the partnership. In other words, the date of acquisition of a share by a partner held in partnership occurs when that partner acquires a fractional interest in the share.

(b) Trusts and their beneficiaries

Section 9C(2) applies to shares held by a discretionary trust. The trust's three-year holding period is measured from the date of acquisition of the share until the date on which it is disposed of. Typically, the trust will dispose of its shares by selling them to a third party or by vesting them in a beneficiary.

A beneficiary's three-year holding period is measured from the date of vesting (the date of acquisition of the share by the beneficiary) until the date on which the beneficiary disposes of the share.

Not all so-called vesting trusts confer beneficial ownership of their assets on their beneficiaries. In some situations the trust merely provides that a beneficiary is entitled to the trust capital (assets less liabilities) and that the beneficiary will be entitled to the free residue of the trust only on the termination of the trust. In this situation the trust remains the beneficial owner of the equity shares until it disposes of them to a third party or a vesting event such as termination occurs. Section 9C(2) will therefore apply to the trust and will become applicable to the beneficiaries if and when they become the beneficial owners of the equity shares.

A *bewind* trust is a type of trust under which the beneficiaries remain the owners of the trust assets and the trustee acts merely as an administrator of those assets. Accordingly, the transfer of administrative control of equity shares by a beneficiary to a *bewind* trust will not interrupt the beneficiary's three-year holding period for the purposes of section 9C.

(c) Non-residents

The amount received by or accrued to a non-resident from the disposal of an equity share will be included in gross income only if the amount is neither of a capital nature nor deemed to be of a capital nature and is derived from a source within South Africa. Thus if a non-resident trades in shares on a South African exchange, it will first be necessary to determine the source of the amount derived in respect of the share. If the amount is from a source outside South Africa, section 9C will not apply. In determining the source of income derived from the disposal of shares, South African courts have considered it to be the place where the share-dealing business is being carried on. This source may be where the capital is employed or where the taxpayer's wits and labour are exercised.

¹¹ *Chipkin (Natal) (Pty) Ltd v C: SARS 2005 (5) SA 566 (SCA), 67 SATC 243.*

In *Overseas Trust Corporation Ltd v CIR*¹² the appellant carried on a business in South Africa of buying and selling shares and other securities. The company sold shares through brokers in Germany. The brokers received instructions from Cape Town to find buyers and to sell the shares at a specified price. The share certificates were forwarded to the German brokers. The court found that the company had acquired the shares in South Africa where its capital was employed and that it did not carry on a business in Germany. The transactions were fully controlled from South Africa and the brokers were merely agents of the appellant acting on its instructions. The profit was therefore held to be from a source within South Africa.

In *CIR v Black*¹³ the taxpayer, a Johannesburg-based stockbroker, carried on a business of buying and selling shares through a London broker. The broker was entitled to deal in shares without consulting the taxpayer. The court held that the source of the profits was in London because that was where a distinct business of buying and selling shares was being carried on.

In ITC 1779¹⁴ the appellant, a South African resident based in Cape Town, carried on a part-time business of dealing in foreign exchange. Although the taxpayer deposited funds in the United States of America with the organisation through which the activities were conducted, the court held that the taxpayer's wits and labour were exercised in South Africa, and it was therefore in South Africa from which the taxpayer's business was carried on.

Although the above cases involved residents, the same principles can be applied to non-residents carrying on share-dealing activities in South Africa. Thus, section 9C will apply to non-residents carrying on share-dealing businesses by employing their capital or wits and labour in South Africa. Any profits or losses on disposal of shares forming part of the trading stock of those businesses will be derived from a source in South Africa. Once the shares have been held for three years, any amounts received or accrued or expenditure incurred in respect of those shares will be of a capital nature. In order to be subject to CGT, the qualifying shares would either have to be attributable to a permanent establishment in South Africa [paragraph 2(1)(b)(ii)] or represent "an interest in immovable property situated in South Africa" contemplated in paragraph 2(2).

6. Venture capital company (VCC) shares [section 9C(2A)]

6.1 The law

Section 9C(2A)

(2A) Subsection (2) does not apply in respect of so much of the amount received or accrued in respect of the disposal of an equity share contemplated in that subsection, other than an equity share held for longer than five years, as does not exceed the expenditure allowed in respect of that share in terms of section 12J(2).

¹² 1926 AD 444, 2 SATC 71.

¹³ 1957 (3) SA 536 (A), 21 SATC 226.

¹⁴ (2004) 66 SATC 353 (C).

Section 12J(2) and (9)

(2) Subject to subsections (3), (3A), (3B) and (4), there must be allowed as a deduction from the income of a taxpayer in respect of a year of assessment expenditure actually incurred by that taxpayer in acquiring any venture capital share issued to that taxpayer during that year of assessment.

(9) Notwithstanding section 8(4), no amount shall be recovered or recouped in respect of the disposal of a venture capital share or in respect of a return of capital if that share has been held by the taxpayer for a period longer than five years.

6.2 Application of the law

The deduction under section 12J(2) read with section 12J(3), (3A), (3B) and (4) covers only the acquisition of newly issued VCC shares,¹⁵ in other words the deduction does not apply to secondary trading in VCC shares. No deduction will be granted under section 12J for VCC shares acquired after 30 June 2021.¹⁶

Any amount allowed as a deduction under section 12J(2) is recouped under section 8(4)(a) upon the disposal of shares or in respect of a return of capital if the shares were held in an approved VCC for a period of five years or less. Any amount recouped under section 8(4)(a) is included in the income of the person disposing of the shares, irrespective of its capital or revenue nature.

However, no amount must be recovered or recouped under section 8(4) on disposal of a VCC share or in respect of a return of capital if the shares were held by the taxpayer for a period longer than five years.¹⁷

Section 9C(2), which deems an amount received or accrued to be of a capital nature, does not apply to the extent that the amount received or accrued in respect of the disposal of VCC shares held for five years or less does not exceed the expenditure allowed as a deduction on those shares under section 12J(2).¹⁸

In other words, section 12J(2) permits an up-front deduction for the expenditure incurred in acquiring VCC shares under specified circumstances. Any amount received or accrued on disposal of the shares no later than five years from the time of acquisition which does not exceed the expenditure allowed as a deduction under section 12J(2) is subject to recoupment under section 8(4)(a) regardless of its capital or revenue nature. Section 9C(2) does not deem this amount to be of a capital nature. Any amount received or accrued in respect of disposal of VCC shares exceeding the expenditure allowed under section 12J(2) –

- held for less than three years represents an amount the capital or revenue nature of which must be determined using common law principles, since such amount falls outside section 9C(2); and
- after the shares have been held for at least three years, is treated as being of a capital nature under section 9C(2).

¹⁵ Definition of “venture capital share” in section 12J(1).

¹⁶ Section 12J(11).

¹⁷ Section 12J(9).

¹⁸ Section 9C(2A).

Once the shares have been held longer than five years, there will be no recoupm ent of the cost of the shares under section 8(4)(a) and any amount received or accrued on their disposal will be treated as being of a capital nature under section 9C(2).¹⁹

Example 2 – Application of section 9C(2A) to disposal of VCC shares

Facts:

Company A, which has a financial year ending on the last day of February, acquired shares in an approved VCC on 1 March year 1 for R400 000. On 30 September year 4 Company A sold the shares for R900 000.

Result:

Ordinary income

Year of assessment ending on 28 February year 2

Company A qualified for a deduction for the acquisition of the VCC shares of R400 000 under section 12J(2).

Year of assessment ending on 28 February year 5

Upon disposal of the shares, R400 000 is recouped under section 8(4)(a) [that is, the amount previously allowed as a deduction under section 12J(2)].

The amount deemed to be of a capital nature under section 9C is equal to the amount received or accrued on disposal of the VCC shares in excess of the amount recouped under section 8(4)(a), namely, R500 000 (R900 000 – R400 000). This amount is subject to CGT because the shares have been held for at least three years and not exceeding five years.

CGT

	R	R
Amount received or accrued		900 000
Less: Amount recouped under section 8(4)(a) [paragraph 35(3)(a)]	<u>(400 000)</u>	
Proceeds	500 000	
Less: Base cost		
Cost	400 000	
Less: Deduction under section 12J(2) [paragraph 20(3)(a)] <u>(400 000)</u>		-
Capital gain		<u>500 000</u>
Taxable capital gain (80% ²⁰ × R500 000)		<u>400 000</u>

¹⁹ See the *Guide on Venture Capital Companies* for detailed commentary on section 12J.

²⁰ The inclusion rate as per paragraph 10(1)(c).

7. Anti-avoidance measures applying to immovable property and so-called “bare dominium” schemes [section 9C(3)]

7.1 The law

- (3) The provisions of this section shall not apply to any equity share if at the time of the receipt or accrual of any amount (other than an amount constituting a dividend or foreign dividend) in respect of that share the taxpayer was a connected person in relation to the company that issued that share and—
- (a) more than 50 per cent of the market value of the equity shares of that company was attributable directly or indirectly to immovable property other than—
 - (i) immovable property held directly or indirectly by a person that is not a connected person in relation to the taxpayer; or
 - (ii) immovable property held directly or indirectly for a period of at least three years immediately prior to that receipt or accrual; or
 - (b) that company acquired any asset during the period of three years immediately prior to that receipt or accrual and amounts were paid or payable by any person to any person other than that company for the use of that asset while that asset was held by that company during that period.

7.2 Application of the law

The effective rate of income tax on capital gains is lower than that applicable to income. The potential abuse of section 9C necessitated the introduction of anti-avoidance provisions to prevent speculators in immovable property from converting their revenue profits into capital profits.

In the absence of section 9C(3), a person could buy immovable property and place it in a pre-existing company or close corporation in which that person has held the shares or member's interest for at least three years. The shares or member's interest could then be disposed of and the amount received or accrued on disposal of the shares or member's interest would have been deemed to be of a capital nature under section 9C(2).

Section 9C will not apply if the requirements of section 9C(3) are met. In such event, the capital or revenue nature of the amount received or accrued in respect of the share must be determined by applying the general principles laid down by the South African tax courts.

Before section 9C(3)(a) or (b) can be applied, the taxpayer must be a connected person in relation to the company that issued the shares at the time of the receipt or accrual of any amount (other than an amount constituting a dividend or foreign dividend) in respect of those shares. On the extended meaning of “connected person” see **4.2**.

7.2.1 Receipt or accrual of amounts in respect of equity shares in companies holding immovable property

Section 9C(3)(a) provides that section 9C does not apply to any equity share if at the time of the receipt or accrual of any amount (other than an amount constituting a dividend or foreign dividend) in respect of that share the taxpayer was a connected person in relation to the company that issued that share and more than 50% of the market value of the equity shares being disposed of was directly or indirectly attributable to immovable property. The words “immovable property” are not defined for the purposes of section 9C(3), but under Roman-Dutch law include land, buildings with foundations in the soil, trees, growing crops, real rights over immovable property (for example, a registered usufruct, a registered lease of not less than ten years, old and new order mineral rights, a registered praedial servitude and building restrictions).²¹

The reference to the market value of the equity shares being indirectly attributable to immovable property would include, for example, a situation in which the company, whose shares are disposed of, holds shares in another company which holds immovable property, or when the first-mentioned company is a lessee under a non-registered lease. In the latter case the lease right, which is not itself immovable property, derives its value from the immovable property of the lessor.

The words “market value” are neither defined in section 1(1) nor in section 9C and must accordingly be given their ordinary meaning for purposes of interpreting section 9C. The International Valuation Standards²² define “market value” as –

“the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion”.

In determining whether more than 50% of the market value of shares in a company is directly or indirectly attributable to immovable property, any liabilities in the company must be disregarded. In other words, the determination is made on the basis of the market value of the tainted immovable property compared to the market value of all assets, and not on the basis of net asset values. This interpretation is consistent with SARS’s interpretation of paragraph 2(2) and the OECD’s²³ interpretation of article 13(4) of the OECD model tax treaty, both of which contain similar wording.²⁴

Immovable property is excluded for the purposes of section 9C(3)(a) if it is held directly or indirectly –

- by a person that is not a connected person in relation to the taxpayer; or
- for a period of at least three years immediately before that receipt or accrual.

²¹ CG van der Merwe “Incorporeal Movables and Immovables” 27 (Second Edition Volume) LAWSA [online] (My LexisNexis: 31 January 2014) in paragraph 52, and F du Bois Wille’s Principles of South African Law 9 ed (2007) Juta & Co at page 167.

²² IVS 1 – Market Value Basis of Valuation, 7 Ed.

²³ Organisation for Economic Co-operation and Development.

²⁴ See the *Comprehensive Guide to Capital Gains Tax* in Chapter 4 and the *OECD Model Tax Convention on Income and on Capital: Condensed Version* (2017) OECD Publishing in paragraph 28.4 at page 298.

An example of the first bullet point above could arise if the company is a lessee under a non-registered lease and the holder of shares in that company is not a connected person in relation to the lessor.

Example 3 – Disposal of equity shares in a company holding tainted immovable property [section 9C(3)(a)]

Facts:

In year 1 X acquired all the equity shares of several shelf companies. In year 5, X provided one of these companies, Propco, with a guarantee so that it could acquire a block of flats. Bank Y provided Propco with a mortgage bond to finance the acquisition of the flats.

Six months after Propco acquired the flats X sold the shares in Propco.

Result:

X is a connected person in relation to Propco under the definition of “connected person” in sections 1(1) and 9C(1).

More than 50% of the market value of Propco’s shares is directly attributable to immovable property. The immovable property is tainted under section 9C(3)(a) because it has been held for less than three years. Section 9C(2) does not apply when X disposes of the shares in Propco. The capital or revenue nature of the amount derived on disposal of the Propco shares must be determined by applying the principles laid down by case law.

Example 4 – Disposal of equity shares in a company holding tainted and untainted immovable property [section 9C(3)(a)]

Facts:

Z has owned all the shares in ABC (Pty) Ltd (ABC) for ten years. ABC’s assets comprise Stand 1 and Stand 2, with market values of R400 000 and R600 000 respectively. The purchase of Stand 2 was financed by a mortgage bond, of which R350 000 is still outstanding.

Stand 1 is debt free. Stand 1 has been owned for four years, while Stand 2 has been owned for only three months. Z disposed of all the shares in ABC to a third party for R650 000.

Result:

Z is a connected person in relation to ABC under the definition of “connected person” in sections 1(1) and 9C(1).

Stand 1 is “untainted” since it has been held for at least three consecutive years. Stand 2 has been held for only three months and is, therefore, tainted under section 9C(3)(a) for the purposes of applying section 9C(3).

The market value of both properties is R1 million (R400 000 (Stand 1) + (R600 000 – Stand 2)). Since 60% ($R600\ 000 / R1\ \text{million} \times 100$) of the market value of the assets of ABC comprise tainted immovable property, 60% of the market value of the equity shares in ABC derive their value from such property. No regard is had to the bond of R350 000 in comparing the market values of the tainted and untainted assets.

Accordingly, section 9C(2) does not apply when Z disposes of the shares in ABC. The capital or revenue nature of the amount derived on disposal of the shares must be determined by applying the principles laid down by case law.

7.2.2 So-called “bare dominium” scheme

A “bare dominium” refers to the right of ownership in the underlying thing that is subject to a usufruct.²⁵

Section 9C(3)(b) provides that section 9C does not apply to any equity share if at the time of the receipt or accrual of any amount (other than an amount constituting a dividend or foreign dividend) in respect of that share the taxpayer was a connected person in relation to the company that issued that share and –

- that company acquired any asset during the period of three years immediately before that receipt or accrual; and
- amounts for the use of that asset were paid or payable to a person other than the company while that asset was held by that company during the three-year period.

Example 5 – So-called “bare dominium” scheme [section 9C(3)(b)]

Facts:

K has owned all the equity shares in XYZ (Pty) Ltd (XYZ) for five years. At the beginning of year 5 XYZ purchased the bare *dominium* in a luxury flat for R2 million, fully funded by a mortgage bond. The seller of the flat retained the lease rights for ten years.

XYZ's other assets comprise share investments and cash worth R4 million, funded by a shareholder's loan account. The bare *dominium* has a market value at the end of year 5 of R3,5 million. K sold the shares in XYZ at the end of year 5 for R1,5 million and ceded the loan account for its face value of R4 million.

Result:

K is a connected person in relation to XYZ under the definition of “connected person” in sections 1(1) and 9C(1).

Section 9C(3)(a) does not apply because less than 50% ($R3,5 \text{ million} / R7,5 \text{ million} \times 100 = 46,67\%$) of the market value of XYZ's assets comprise tainted assets.

However, section 9C(3)(b) applies because the bare *dominium* was acquired within three years of the receipt or accrual in respect of the disposal of the shares and the lease rentals were receivable by a person other than XYZ. Section 9C(2) therefore does not apply when K disposes of the shares in XYZ. The capital or revenue nature of the amount derived on disposal of the shares must be determined by applying the principles laid down by case law.

²⁵ See the *Comprehensive Guide to Capital Gains Tax* in Chapter 24 for commentary on the meaning of a “bare dominium”.

8. Securities lending arrangements [section 9C(4)]

8.1 The law

Section 9C(4)

(4) For purposes of this section, where any share has been transferred by a lender to a borrower in terms of a securities lending arrangement, and an identical share has been returned by the borrower to the lender, in terms of that securities lending arrangement, that share and that other share shall be deemed to be one and the same share in the hands of the lender.

8.2 Application of the law

Section 9C(4) applies when –

- any share has been transferred by a lender to a borrower under a securities lending arrangement; and
- an identical share has been returned by the borrower to the lender under that securities lending arrangement.

For purposes of section 9C, the share that was lent and the identical share that was returned are deemed to be one and the same share in the hands of the lender.

The Act defines “identical share” in section 1(1) as follows:

“[I]dentical share” means in respect of a share—

- (a) a share of the same class in the same company as that share; or
- (b) any other share that is substituted for a listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements or a corporate action as contemplated in the listings requirements of any other exchange, licensed under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange;

The Act defines “securities lending arrangement” in section 1(1) as a “lending arrangement” as defined in section 1 of the Securities Transfer Tax Act.

The term “lending arrangement” as defined in the Securities Transfer Tax Act applies to a “listed security”, which is defined in section 1 of that Act as “any security listed on an exchange”. A “security” is defined in the same Act under section 1 as follows:

“[S]ecurity” means—

- (a) any share or depository receipt in a company; or
- (b) any member’s interest in a close corporation,
- (c)

excluding the debt portion in respect of a share linked to a debenture;

In reality when a share is lent under a securities lending arrangement, ownership of the share passes from the lender to the borrower upon delivery of the share. In order to prevent income inclusions and capital gains and capital losses from arising under such transactions, the Act contains non-disposal and non-acquisition rules. These rules cover trading stock [section 22(4A) and (9)(a) and (b)] and CGT [paragraph 11(2)(h)]. For the purpose of determining the three-year period under section 9C(2), the lender is deemed to have enjoyed uninterrupted ownership of the shares during the lending period.

In order to qualify as a “securities lending arrangement”, the borrower must, amongst other things, return an “identical security” as defined in section 1(1) to the lender before the expiry of a 12-month period from the date the securities were initially transferred from the lender to the borrower.

Example 6 – Securities lending arrangement resulting in deemed uninterrupted ownership

Facts:

On 2 January year 1 Company A acquired 20 000 class B equity shares in Listco.

On 1 June year 2 Company A lent the 20 000 Listco shares to Company B under a securities lending arrangement. Company B gave Company A collateral in the form of cash, government securities and a letter of credit and undertook to compensate Company A for any distributions from the Listco shares that Company A would have been entitled to receive during the lending period had the arrangement not been entered into.

On 1 May year 3, Company B returned 20 000 class B equity shares in Listco to Company A.

On 3 January year 4 Company A disposed of the 20 000 Listco shares.

Result:

The lending arrangement will not comprise a disposal of shares because the transaction qualifies as a “securities lending arrangement” as defined in section 1(1). The requirements for a securities lending arrangement that were complied with included the fact that –

- the shares were returned within 12 months from the date of transfer to the borrower;
- each such share comprised an “identical share” as defined in section 1(1); and
- Company B was contractually bound to compensate Company A for any distributions received during the lending period.

Company A is therefore regarded as having held the shares for an uninterrupted period of at least three years and the amount received or accrued on disposal of the shares on 3 January year 4 is deemed to be of a capital nature under section 9C(2).

9. Collateral arrangements [section 9C(4A)]

9.1 The law

Section 9C(4A)

(4A) For purposes of this section, where any share has been transferred by a transferor to a transferee in terms of a collateral arrangement and an identical share has in turn been transferred by the transferee to the transferor in terms of that collateral arrangement, that share and that other share shall be deemed to be one and the same share in the hands of the transferor.

9.2 Application of the law

Section 9C(4A) applies when –²⁶

- any share has been transferred by a transferor to a transferee under a collateral arrangement; and
- an identical share has in turn been transferred by the transferee to the transferor under that collateral arrangement.

For purposes of section 9C, the share initially transferred and the identical share returned are deemed to be one and the same share in the hands of the transferor.

The Act defines “identical share” in section 1(1) as follows:

“[I]dentical share” means in respect of a share—

- (a) a share of the same class in the same company as that share; or
- (b) any other share that is substituted for a listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements or a corporate action as contemplated in the listings requirements of any other exchange, licensed under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange;

The Act defines “collateral arrangement” in section 1(1) as a collateral arrangement as defined in section 1 of the Securities Transfer Tax Act.

The Securities Transfer Tax Act in turn defines a “collateral arrangement” in section 1 as follows:

“[C]ollateral arrangement” means any arrangement in terms of which—

- (a) a person (hereafter the transferor) transfers a listed share or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic if that bond is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act to another person (hereafter the transferee) for the purposes of providing security in respect of an amount owed by the transferor to the transferee;

²⁶ Section 9C(4A) came into operation on 1 January 2016 and applies to any collateral arrangement entered into on or after that date.

- (b) the transferor can demonstrate that the arrangement was not entered into for the purposes of the avoidance of tax and was not entered into for the purposes of keeping any position open for more than 24 months;
- (c) that transferee in return contractually agrees in writing to deliver an identical share, as defined in section 1 of the Income Tax Act, or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic that is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act to that transferor within a period of 24 months from the date of transfer of that listed share or bond from the transferor to the transferee;
- (d) that transferee is contractually required to compensate that transferor for any distributions in respect of the listed share (or any other share that is substituted for that listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements) or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic that is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act, which that transferor would have been entitled to receive during that period had that arrangement not been entered into; and
- (e) that arrangement does not affect the transferor's benefits or risks arising from fluctuations in the market value of that listed share (or any other share that is substituted for that listed share in terms of an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements) or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange or any bond issued by the government of the Republic in the national or local sphere or any sphere of government of any country other than the Republic that is listed on a recognised exchange as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act,

but does not include an arrangement where the transferee has not transferred the identical share or bond contemplated in paragraph (b) to the transferor within the period referred to in that paragraph unless such failure to return such identical share or bond is due to an arrangement that is announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange;

The term "listed share" as defined in section 1 of the Securities Transfer Tax Act means any share or depository receipt in a company that is listed on an exchange.

In reality when a share is transferred under a collateral arrangement by way of an out-and-out cession, ownership of the share passes from the transferor to the transferee upon delivery of the share. In order to prevent income inclusions and capital gains and capital losses from arising under such transactions, the Act contains non-disposal and non-acquisition rules. These rules cover trading stock [section 22(4B) and (9)(c) and (d)] and CGT [paragraph 11(2)(n)]. For the purpose of determining the three-year period under section 9C(2), the transferor is deemed to have enjoyed uninterrupted ownership of the shares during the period in which the shares were provided as security.

A collateral arrangement will not exist if the transferee fails to transfer an identical share to the transferor within the required 24-month period unless that failure is due to a corporate action announced and released as a corporate action as contemplated in the JSE Limited Listings Requirements in the SENS (Stock Exchange News Service) as defined in the JSE Limited Listings Requirements or a corporate action as contemplated in the listings requirements of any other exchange, licenced under the Financial Markets Act 19 of 2012, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that corporate action complies with the applicable requirements of that exchange.

10. Recoupment of expenditure or losses [section 9C(5)]

10.1 The law

Section 9C(5)

(5) There shall in the year of assessment in which any equity share held for a period of at least three years is disposed of by the taxpayer be included in the taxpayer's income any expenditure or losses incurred in respect of such equity share and allowed as a deduction from the income of the taxpayer during that or any previous year of assessment in terms of section 11: Provided that this subsection must not apply—

- (a) in respect of any expenditure or loss to the extent that the amount of that expenditure or loss is taken into account in terms of section 8(4)(a) or section 19; or
- (b) to expenditure in respect of equity shares in a REIT or a controlled company, as defined in section 25BB(1), that is a resident except to the extent that such amount was taken into account in determining the cost price or value of trading stock under section 11(a), 22(1) or (2).

10.2 Application of the law

Under section 9C(5) any expenditure or losses allowed as a deduction under section 11 to a taxpayer in respect of an equity share held for at least three years must be recouped in the hands of the taxpayer in the year of assessment in which the share is disposed of.

This recoupment also includes any reduction in the cost price of a share allowed under section 22(1)(a) read with section 11(x) in determining the value of trading stock held at the end of a year of assessment. Section 11(x) allows as a deduction –

“any amounts which in terms of any other provision in this Part, are allowed to be deducted from the income of the taxpayer”.

“This Part” refers to Part I (Normal Tax) of Chapter II (The Taxes), covering sections 5 to 37G, and thus includes any write-down of a qualifying share by a natural person or trust under section 22(1)(a) during years of assessment commencing before 1 January 2011. For years of assessment commencing before 1 January 2011 section 22(1)(a) allowed natural persons and trusts to write down the cost price of shares held as closing stock if their value fell below cost. This deduction did not apply to shares held by a company in any other company. With effect from years of assessment commencing on or after 1 January 2011, it is no longer possible for any taxpayer to claim a deduction for the write-down of a financial instrument. The recoupment under section 9C(5) will accordingly cover any write-down by a natural person or trust of a share or a participatory interest in a collective investment scheme in securities during years of assessment commencing before 1 January 2011.

The amount of the deemed recoupment is made with reference to the amounts previously allowed as a deduction against income, and bears no relationship to any amount derived on disposal of the share. Thus, even if a share is disposed of at a capital loss, the recoupment remains unaffected.

Exclusion of sections 8(4)(a) and 19

Section 9C(5) does not apply to the extent that the expenditure or loss has been taken into account under section 8(4)(a) or section 19. The purpose of this exclusion is to prevent double taxation when the debt used to finance the purchase of the equity shares is wholly or partially waived. Such a waiver results in a reduction of the value of trading stock, and to the extent that the waiver exceeds that value the excess is included in the taxpayer’s income under section 8(4)(a).

Exclusion of shares in a REIT or controlled company

Section 9C(5) does not apply to expenditure in respect of equity shares in a REIT or a controlled company, as defined in section 25BB(1), that is a resident, except to the extent that such amount was taken into account in determining the cost price or value of trading stock under section 11(a), 22(1) or (2), for the reason set out below.

Dividends, other than dividends constituting a share buy-back, received by or accrued to a resident from a REIT or controlled company are not exempt from normal tax under paragraph (aa) of the proviso to section 10(1)(k)(i). Depending on the facts, expenditure incurred to produce taxable dividends may qualify as a deduction under section 11. Were section 9C(5) to apply to such shares, it would mean that any expenditure which qualified as a deduction against these taxable dividends would be recouped on disposal of the shares, which would be inappropriate. However, the cost price of such shares held as trading stock which was allowable as a deduction is subject to recoupment under section 9C(5).

Example 7 – Recoupment of share-dealing expenditure previously allowed under section 11(a)

Facts:

At the beginning of year of assessment (YOA) 1, Z bought shares in ABC Ltd, a JSE-listed company with the intention of selling them at a profit. Z incurred the following expenditure in YOA 1 to 6.

	YOA 1 R	YOA 2 R	YOA 3 R	YOA 4 R	YOA 5 R	YOA 6 R
Interest	500	700	900	700	500	400
Management fee	200	250	300	400	450	500
Other costs	600	200	300	500	300	400
Total costs	<u>1 300</u>	<u>1 150</u>	<u>1 500</u>	<u>1 600</u>	<u>1 250</u>	<u>1 300</u>

Z sold the shares during YOA 6.

Result:

The expenditure incurred in YOA 1 to 3 is allowable as a deduction under section 11(a).

The expenditure incurred in YOA 4 to 6 does not qualify for a deduction because –

- it is deemed to be of a capital nature under section 9C(2); and
- it was not incurred in the production of income, since the proceeds on disposal of the shares are deemed to be of a capital nature under section 9C(2).

Section 11(a) excludes expenditure of a capital nature and requires expenditure to be incurred in the production of income while section 23(f) prohibits a deduction for amounts which do not constitute income as defined in section 1(1). Under section 24J(2) no deduction will be granted for interest falling within the section unless it is incurred in the production of income.

The expenditure allowed in YOA 1 to 3 of R3 950 (R1 300 + R1 150 + R1 500) is recouped under section 9C(5) and must be included in Z's income in YOA 6, namely the YOA during which the shares are disposed of.

Example 8 – Share ceasing to form part of a permanent establishment after being held for three years

Facts:

ABC Plc operates a branch in South Africa for the purpose of carrying on share-dealing activities. At the beginning of year of assessment 1 the branch acquired 100 shares in XYZ Ltd, a JSE-listed company at a cost of R100. In year of assessment 4 ABC Plc decided to close down the branch and effectively manage the share-dealing activities from offshore. The XYZ Ltd shares were still held and had a market value of R120 at the time they ceased to form part of the assets of the branch.

Result:

The closure of the branch triggers a disposal under paragraph 12(2)(b)(ii) because an asset has ceased to form part of a non-resident's permanent establishment in South Africa. This deemed disposal is also a disposal for purposes of section 9C based on the definition of "disposal" in section 9C(1) and hence triggers a recoupment under section 9C(5).

Year of assessment 4**Ordinary income**

	R
Opening stock [section 22(2)]	(100)
Recoupment of opening stock allowed as a deduction [section 9C(5)]	<u>100</u>
Net effect on taxable income	—

CGT

Proceeds on deemed disposal under paragraph 12(2)(b)(ii) – market value	120
Less: Base cost [paragraph 20(1)(a)] (Note)	(100)
Capital gain on deemed disposal of the shares	<u>20</u>

Note:

Although the expenditure of R100 was allowable in year 1 under section 11(a) and in subsequent years as opening stock under section 22(2), paragraph 20(3)(a)(ii) prevents any reduction in the expenditure because it was recouped under section 9C(5).

Example 9 – Recoupment of expenditure despite disposal of shares at a capital loss
Facts:

At the beginning of year of assessment 1, X acquired 100 shares in ABC Ltd, a JSE-listed company at a cost of R100 000 with the intention of selling them at a profit. During years of assessment 1 to 3 X claimed interest expenditure under section 24J(2) of R60 000 as a deduction on funds used to purchase the shares. At the end of year of assessment 4 the shares were sold for proceeds of R70 000.

Result:**Year of assessment 4****Ordinary income**

	R
Recoupment under section 9C(5)	160 000
Less: Opening stock deductible under section 22(2)(a)	(100 000)
Net inclusion in income	<u>60 000</u>

The recoupment of R160 000 is made up of the opening stock of R100 000 and the interest expenditure of R60 000 claimed under section 24J(2) during years of assessment 1 to 3.

The capital loss on disposal of the shares is determined as follows:

	R	R
Proceeds on disposal of the shares	70 000	
Less: Base cost		(120 000)
Cost of acquisition [paragraph 20(1)(a)]	100 000	
Interest expense [paragraph 20(1)(g)] (Note)	<u>20 000</u>	
(R60 000 × 1 / 3)		
Capital loss on disposal of the shares		<u>(50 000)</u>

Note:

Under paragraph 20(1)(g) one-third of the interest contemplated in section 24J on money borrowed to finance the expenditure incurred on acquisition of a share listed on a recognised exchange is allowed.

Example 10 – Cancellation of debt used to finance the acquisition of equity shares
Facts:

On 1 March year 1 Individual A acquired JSE-listed equity shares as trading stock at a cost of R100 000. The acquisition was funded by a loan of R100 000 from Company B. On 1 June year 4 Company B cancelled the debt owing by Individual A because Individual A was unable to pay the amount outstanding. On 30 November year 4 Individual A disposed of the shares for R115 000.

Result:

As a result of the debt cancellation on 1 June year 4, the value of Individual A's opening stock reduced to nil under section 19(3) (opening stock of R100 000 – debt benefit of R100 000).

On 28 February year 4 the shares had been held for three years. Accordingly, under section 9C(2) the proceeds on disposal of the shares on 30 November year 4 were of a capital nature, since they comprised "equity shares" as defined in section 9C(1).

Since the amount of R100 000 has already been taken into account as a debt benefit under section 19(3), no further amount must be included in Individual A's income under section 9C(5).

The base cost of the shares is reduced to nil under paragraph 20(3)(a) because the expenditure of R100 000 was "allowable" at the time it was incurred under section 11(a) and no amount was included in income under section 9C(5). Individual A will therefore realise a capital gain on disposal of the shares of R115 000 (proceeds of R115 000 less base cost of nil).

11. Share-dealers

Section 9C draws no distinction between a share-dealer carrying on a distinct business of buying and selling shares for profit and a person who invests in shares as a long-term investment but speculates in some shares from time to time. The holding of shares by a share-dealer or the occasional speculator for at least three years converts the amount derived on disposal from income to an amount of a capital nature. Amounts previously allowed as a deduction (for example, opening stock or interest on monies borrowed to buy shares) must be recouped on disposal of the shares and a capital gain or capital loss determined as if the shares had been held on capital account from the date of acquisition.

Both categories of persons are subject to section 9C and do not have an option to elect out of the provision in order, for example, to claim revenue losses on shares held for three years or longer.

In the year of acquisition a share-dealer will be entitled to claim the cost of acquisition of shares under section 11(a). At the end of that year of assessment the value of the shares must be brought to account as closing stock under section 22(1). With effect from years of assessment commencing on or after 1 January 2011 the amount to be included in closing stock is the cost price of the shares, and no reduction is permissible if the market value of the shares is lower than cost.²⁷ Before the amendment to section 22(1)(a), only corporate holders of shares were prevented from writing down the value of shares held as closing stock.

The closing stock of a previous year of assessment becomes deductible as opening stock under section 22(2). This process continues even after the three-year period has passed, since the shares remain “trading stock” as defined in section 1(1). The definition of “trading stock” includes (apart from some exceptions not relevant for present purposes) –²⁸

“anything produced, manufactured, constructed, assembled, purchased or in any other manner acquired by a taxpayer for the purposes of manufacture, sale or exchange by the taxpayer or on behalf of the taxpayer”.

Equity shares held as trading stock are normally acquired for the purposes of sale and thus satisfy the above part of the definition.

For income tax purposes a share-dealer is entitled to deduct certain ongoing expenses incurred in respect of shares held as trading stock under section 11. Examples of such expenditure include –

- technical analysis software to manage trading portfolios;²⁹
- monthly download fees incurred for the above-mentioned software;
- bank charges;
- interest incurred on money borrowed to finance the acquisition of shares;
- internet access charges;
- scrip custody fees; and
- cost of telephone calls.

These expenses will be deductible during the three years following the date of acquisition of the shares to which they relate. However, as from the beginning of the fourth year any further expenditure of this nature will no longer qualify for deduction under section 11(a), since it will no longer be incurred in the production of income and is deemed to be of a capital nature under section 9C(2). At the beginning of year 4 any proceeds on disposal of the shares are deemed to be of a capital nature under section 9C(2).

²⁷ Section 22(1)(a) excludes the write-down of financial instruments.

²⁸ Paragraph (a)(i) of the definition of “trading stock” in section 1(1).

²⁹ See Interpretation Note 47 “Wear-and-Tear or Depreciation Allowance” for the write-off periods under section 11(e) for software.

In order for expenditure to be in the production of income, there must be a close causal relationship between the expense and the income to which it relates.³⁰ The recoupment under section 9C(5) of the value of opening stock finds its originating cause in the deduction of the acquisition cost of the shares at the beginning of year 1. The expenses incurred in year 4 and beyond have no impact on the generation of that recoupment and cannot increase its *quantum*. The expenses incurred after year 3 can therefore generate only a future receipt or accrual of a capital nature and are disqualified from deduction under section 23(f).

In the year of disposal of equity shares, a share-dealer must include in income under section 9C(5) the value of those shares included in opening stock and any other expenses pertaining to them which have been claimed as a deduction for income tax purposes in that year or any previous year of assessment.

Some of these recouped expenses will form part of the base cost of the qualifying shares for CGT purposes, provided that they meet the requirements of paragraph 20. Normally an amount which has been allowed as a deduction against income will not form part of the base cost of an asset, even if that amount has been recouped, because paragraph 20(3)(a) eliminates such amounts from base cost in order to prevent double deductions. However, paragraph 20(3)(a)(ii) excludes from this base cost reduction rule amounts recouped under section 9C(5). Not all amounts subject to recoupment under section 9C(5) will qualify to form part of the base cost of equity shares. For example, the interest incurred on amounts borrowed to fund the acquisition of shares listed on a recognised exchange or a participatory interest in a portfolio of a collective investment scheme must be reduced by two-thirds under paragraph 20(1)(g). While paragraph 20(1)(c)(i) allows broker's costs directly related to the acquisition or disposal of an asset, no provision is made for the inclusion of portfolio management fees in base cost.

A share-dealer may have difficulty in determining which expenses relate to –

- taxable income derived from share-dealing operations of equity shares;
- taxable income derived from share-dealing operations of non-equity shares; and
- exempt dividends.

In most instances the expenses would be incurred in the production of all the above. The Act does not prescribe a method of apportionment. Accordingly, any apportionment of expenditure must be made on a logical, fair and reasonable basis taking into account the facts and circumstances of the particular situation.³¹

³⁰ *Port Elizabeth Electric Tramway Company Ltd v CIR* 1936 CPD 241, 8 SATC 13.

³¹ See *SIR v Guardian Assurance Holdings (SA) Ltd* 1976 (4) SA 522 (A), 38 SATC 111 at 126; *CIR v Nemojim (Pty) Ltd* 1983 (4) SA 935 (A), 45 SATC 241 at 260 and *C: SARS v Mobile Telephone Networks Holdings (Pty) Ltd* 2014 (5) SA 366 (SCA), 76 SATC 205.

Return of capital or foreign return of capital

The Act defines “return of capital” and “foreign return of capital” in section 1(1).

A return of capital occurs when a resident company reduces its “contributed tax capital” as defined in section 1(1).³²

A foreign return of capital occurs when any amount that is paid or payable by a foreign company in respect of any share in that company is treated as a distribution or similar payment, other than a foreign dividend, in the first instance under the foreign income tax law of the country where the foreign company has its place of effective management, or failing the presence of such a law, under the company law of the country where the company is incorporated, formed or established.

In the absence of section 9C(2), a return of capital or foreign return of capital received by or accrued to a share-dealer would be of a revenue nature and included in the share-dealer’s gross income. This position prevailed for years of assessment commencing before 1 January 2016.³³

Section 9C(2) was amended for years of assessment commencing on or after 1 January 2016 to deem any amount received or accrued in respect of an equity share to be of a capital nature if at the time of that receipt or accrual the shares had been held for at least three years. The words “in respect of” include amounts causally related³⁴ to the shares and thus include not only proceeds on their disposal but also a return of capital or foreign return of capital. Such amounts will, therefore, after the effective date of the amendment, be of a capital nature if received or accrued after the shares have been held for three years and must be dealt with as a reduction in the base cost of the shares under paragraph 76B and as a capital gain to the extent that the amounts exceed the base cost.

Example 11 – Return of capital before and after years of assessment commencing on or after 1 January 2016

Facts:

Company K, which has a financial year ending on the last day of February, holds shares in X Ltd, a company listed on the JSE, which it acquired as trading stock on 1 March 2012 at a cost of R100 000. X Ltd awarded the following amounts of its contributed tax capital to Company K:

	R
31 January 2015	10 000
31 March 2015	15 000
30 June 2016	12 000

³² For commentary on the meaning of contributed tax capital, see the *Comprehensive Guide to Dividends Tax* in Chapter 2.

³³ Section 9C(2) as it then read could not apply to such an amount because a share became a “qualifying share” only once it had been disposed of. In these circumstances the definition of “gross income” in section 1(1) took precedence with the result that the amount would not also have to be accounted for as a reduction in base cost under paragraph 76B because there is a necessary implication against double taxation in the Act (*CIR v Delfos* 1933 AD 242, 6 SATC 92 at 112).

³⁴ ITC 1340 (1980) 43 SATC 210 (C).

Result:

The reductions in X Ltd's contributed tax capital comprise returns of capital for Company K.

The amount received on 31 January 2015 must be included in Company K's gross income, since at that stage the shares had been held for 35 months which is less than three years.

The amount received on 31 March 2015 was received after three years and one month which is longer than three years. However, since at that stage section 9C(2) did not deem a return of capital to be of a capital nature, the amount must be included in Company K's gross income. No adjustment must be made to the base cost of the X Ltd shares under the principle that there is a necessary implication against double taxation.

The amount received on 30 June 2016 was received after four years and four months and falls within the 2017 year of assessment commencing on 1 March 2016. Under section 9C(2) the amount is deemed to be of a capital nature for years of assessment commencing on or after 1 January 2016. Company K must therefore reduce the base cost of its shares under paragraph 76B by the return of capital to R88 000 (cost of R100 000 – return of capital of R12 000).

12. “First-in-first-out” method [section 9C(6)]

12.1 The law

Section 9C(6)

(6) Where the taxpayer holds shares of the same class in the same company which were acquired by the taxpayer on different dates and the taxpayer has disposed of any of those shares, the taxpayer shall for the purposes of this section be deemed to have disposed of the shares held by the taxpayer for the longest period of time.

12.2 Application of the law

Section 9C(6) deals with the situation in which a taxpayer has acquired shares of the same class in the same company on various dates and disposes of some of them. It then becomes necessary to identify which shares have been disposed of in order to determine whether they have been held for the qualifying three-year period. For this purpose section 9C(6) prescribes the “first-in-first-out” method.

This rule is not in conflict with the identification rules under paragraph 32 used for CGT purposes for determining the base cost of identical assets. Paragraph 32 permits the use of the specific-identification method, the “first-in-first-out” method or the weighted-average method. While it is appreciated that two different identification rules may apply for the same set of shares, the rules serve different purposes and need not be aligned. The identification rules in the Eighth Schedule are used for purposes of determining the base cost of shares for CGT purposes while the section 9C identification rule is used only for purposes of determining the holding period of shares that have been disposed of. On the question of non-alignment, while CGT allows for the weighted-average method in calculating the base cost of shares, this method cannot be applied for purposes of determining the time period for which shares were held because it disregards specific dates of acquisition and disposal. Consequently, it will be

necessary for a taxpayer who uses the specific-identification method or the weighted-average method to determine the base cost of shares for CGT purposes to also maintain a record of purchases and sales of shares on the “first-in-first-out” method in order to apply section 9C.

Example 12 – Application of the “first-in-first-out” method

Facts:

Individual X acquired shares in listed Company Z as trading stock in the following sequence:

- 1 February year 1: 20 000 shares @ R185 per share
- 1 January year 2: 10 000 shares @ R120 per share
- 1 February year 4: 15 000 shares @ R205 per share

On 1 March year 4 Individual X sold 15 000 shares @ R220 per share.

On 1 April year 4 Individual X sold 10 000 shares @ R230 per share.

Individual X adopted the specific-identification method for trading stock and CGT purposes and nominated the shares with the highest cost or base cost to have been disposed of.

Result:

Disposal – 1 March year 4

Under section 9C(6) the 15 000 shares sold are deemed to be sourced from the 20 000 shares acquired on 1 February year 1. More than three years have passed from that date, and the consideration received or accrued is therefore deemed to be of a capital nature under section 9C(2).

For the purposes of determining the base cost of the shares disposed of, the taxpayer would nominate the shares to have been acquired on 1 February year 4 at a cost of R205 per share, since this will result in the highest base cost. In other words, section 9C(6) merely determines whether the proceeds on disposal of the shares are of a capital nature. The taxpayer is not bound by section 9C(6) for the purpose of determining its cost or base cost.

CGT

	R
Proceeds ($15\ 000 \times R220$)	3 300 000
Less: Base cost ($15\ 000 \times R205$)	<u>(3 075 000)</u>
Capital gain	225 000

Disposal – 1 April year 4

Of the 10 000 shares disposed of, 5 000 are for the purposes of section 9C deemed under section 9C(6) to be from the shares acquired on 1 February year 1. These shares are therefore deemed to be disposed of on capital account under section 9C(2). After applying the “first-in-first-out” method, all remaining shares have been held for less than three years. Those remaining shares will be on revenue account because according to the facts they were acquired as trading stock.

For cost or base cost purposes, Individual X has already regarded the 15 000 shares acquired on 1 February year 4 as having been disposed of on 1 March year 4. The shares still on hand for cost-identification purposes with the next highest cost are the 20 000 shares acquired on 1 February year 1 at R185 per share.

CGT

	R
Proceeds ($5\ 000 \times R230$)	1 150 000
Less: Base cost ($5\ 000 \times R185$)	<u>(925 000)</u>
Capital gain	<u>225 000</u>

Ordinary income

Amount received or accrued ($5\ 000 \times R230$)	1 150 000
Less: Cost of sales ($5\ 000 \times R185$)	<u>(925 000)</u>
Inclusion in taxable income	<u>225 000</u>

13. Suspension of section 22(8) upon shares ceasing to be held as trading stock [section 9C(7)]

13.1 The law

Section 9C(7)

(7) The provisions of section 22(8) shall not apply on or after the date that an equity share has been held for a period exceeding three years.

13.2 Application of the law

Section 22(8) provides for a deemed inclusion in income when trading stock is applied in a manner other than by way of an arm's length sale. For example, this deemed inclusion would apply if shares were donated, disposed of other than in the ordinary course of trade for a consideration less than market value or distributed *in specie*.³⁵

Section 9C(7) prevents the application of section 22(8) once an equity share has been held for a period exceeding three years, thus ensuring that any consideration (including any deemed consideration) will be on capital account.

Example 13 – Exclusion of application of section 22(8) by section 9C(7)

Facts:

On 1 February year 1, Company A acquired 100 equity shares in Listco for R100 000, which it held as trading stock. On 1 March year 5, Company A distributed the 100 Listco shares as a dividend *in specie* to its holders of shares when their market value was R300 000.

³⁵ See Interpretation Note 65 "Trading Stock – Inclusion in Income when Applied, Distributed or Disposed of Otherwise than in the Ordinary Course of Trade".

Result [in the absence of section 9C(7)]:

In the absence of section 9C(7), a deemed disposal of trading stock at market value would be triggered on 1 March year 5 under section 22(8)(b)(iii). Company A would thus have had a net inclusion in taxable income of R200 000 determined as follows:

	R
Inclusion in income [section 22(8)(b)(iii)]	300 000
Less: Opening stock [section 22(2)]	<u>(100 000)</u>
Taxable income	<u>200 000</u>

Result [applying section 9C(7)]:

Ordinary income

Recoupment of opening stock [section 9C(5)]	100 000
Less: Opening stock [section 22(2)]	<u>(100 000)</u>
Net effect on taxable income	—

CGT

Proceeds (paragraph 75) (Note 1)	300 000
Less: Base cost [paragraph 20(1)(a) and 20(3)(a)(ii)] (Note 2)	<u>(100 000)</u>
Capital gain	<u>200 000</u>

Notes:

- (1) When a company makes a distribution of an asset *in specie* to a person holding a share in that company that company must be treated as having disposed of that asset to that person on the date of distribution for an amount received or accrued equal to the market value.
- (2) Under paragraph 20(3)(a)(ii) the base cost of the shares is not reduced by opening stock of R100 000 allowed as a deduction under section 22(2), since this amount was recouped under section 9C(5).

14. Consolidation and subdivision of shares and conversions under sections 40A and 40B [section 9C(8)]

14.1 The law

Section 9C(8)

(8) For the purposes of this section, where a company issues shares to a person in substitution of previously held shares in that company by reason of a subdivision, consolidation or similar arrangement or a conversion contemplated in section 40A or 40B, such share and such previously held shares shall be deemed to be one and the same share if—

- (i) the participation rights and interests of that person in that company remain unaltered; and
- (ii) no consideration whatsoever passes directly or indirectly from that person to that company in relation to the issued shares.

14.2 Application of the law

Taxpayers are not required to start a new time count for the period of shareholding when –

- shares are consolidated (for example, one class A ordinary share in Company X is received in return for every five pre-existing class A ordinary shares in Company X);
- shares are subdivided (for example, two ordinary shares in Company Y are received in return for every one pre-existing ordinary share in Company Y);
- a close corporation is converted to a company under section 40A; and
- a co-operative is converted to a company under section 40B

Under section 9C(8) the shares acquired in substitution of the previously held shares take their dates of acquisition from the previously held shares.

For purposes of the Eighth Schedule, the events described in section 9C(8) are treated as a non-disposal of an asset under paragraph 11(2)(l).

The section 9C(8) relief will not apply if the substituted shares carry different rights and entitlements to the pre-existing shares or if any consideration passes from the holder of shares to the company issuing the shares, whether directly or indirectly.

Capitalisation shares are not addressed by section 9C(8). Such shares will simply be acquired on the date of issue at a cost of nil and the period of holding will run from that date. However, in determining the capital or revenue nature of such shares under general principles, regard must be had to the intention with which the pre-existing shares were acquired and the length of time such shares were held.

Example 14 – Consolidation of shares acquired on different dates

Facts:

Taxpayer Y acquired the following equity shares in Company Z as trading stock:

- 200 ordinary shares acquired on 1 March year 1
- 100 ordinary shares acquired on 31 December year 9

On 28 February year 10 Company Z issued one new ordinary share in substitution for every four pre-existing ordinary shares. Taxpayer Y surrendered the 300 old ordinary shares and received 75 ($300 / 4$) new ordinary shares.

On 15 March year 10 Taxpayer Y disposed of the 75 new ordinary shares in Company Z.

Result:

50 ($200 / 4$) of the ordinary shares are deemed to have been acquired on 1 March year 1, while 25 ($100 / 4$) of the ordinary shares are deemed to have been acquired on 31 December year 9. Section 9C will apply only to the 50 shares with a deemed acquisition date of 1 March year 1.

15. Insolvency

Shares held as trading stock by a natural person on the date of sequestration are included in closing stock under section 22(1) read with the definition of “year of assessment” in section 1(1), section 22(6) and paragraph (ii)(aa) of the proviso to section 66(13)(a). To the extent that the shares were acquired as trading stock and they continue to be held as such, they will remain trading stock even after the elapse of a holding period of three years and must be included in closing stock on the date of sequestration. Since such shares would not be disposed of on the date of sequestration, there will be no recoupment under section 9C(5) of opening stock or the ongoing expenditure claimed during the initial three-year holding period under section 11 on that date.

Under section 25C(a), for the purposes of determining any deduction to which the insolvent estate of a natural person is entitled, that person's estate before sequestration and the insolvent estate are deemed to be one and the same person.

It follows that –

- the insolvent estate must account for any opening stock at the same value that the person before sequestration accounted for it as closing stock; and
- the insolvent estate is deemed to have acquired the trading stock on the same date that it was acquired by the person before sequestration.

Section 9C will thus apply to any disposal by the insolvent estate of shares held as trading stock and the three-year qualifying period will be measured from the date on which the shares were acquired by the person whose estate has been sequestrated. The insolvent estate must account for any recoupment under section 9C(5) of opening stock and any ongoing expenses claimed by the person before sequestration and by the insolvent estate [section 25C(b)].

16. Death

The commentary under this paragraph applies in respect of persons dying on or after 1 March 2016.

There will be implications for three separate persons when a person dies holding equity shares, namely –

- the deceased person;
- the deceased estate; and
- the heirs or legatees.

16.1 Deceased person

Under section 9HA(1) a person is, with some exceptions, deemed to dispose of all his or her assets on the date of death for an amount equal to their market value under paragraph 1. Paragraph 1 defines “market value” to mean “market value” as defined in paragraph 31. Paragraph 31 prescribes a number of rules for determining the market value of various assets, including shares. For example, the market value of a share on a specified date is, in the case of, –

- a share listed on a recognised exchange and for which a price was quoted on that exchange, the ruling price at close of business on the last business day before that date;

- a participatory interest in a collective investment scheme in securities carried on in South Africa which is not listed on a recognised exchange, the price at which a participatory interest can be sold to the management company of the scheme on that date;
- subject to paragraph 31(3), an unlisted share, the price which could have been obtained upon a sale of the asset between a willing buyer and a willing seller dealing at arm's length in an open market. Paragraph 31(3) contains a number of additional rules for valuing unlisted shares, such as disregarding any provision restricting the transferability of the shares or which specifies how the shares must be valued.

Section 9C(2) will apply to the deceased person should any equity shares acquired as trading stock have been held for at least three years at the time of death. The cost price of the shares claimed under section 11(a) or section 22(2) (opening stock) and any ongoing expenditure claimed under section 11 during the first three years following the date of acquisition will be subject to recoupment under section 9C(5).³⁶

16.2 Deceased estate

Under section 25(1)(b) any amount received by or accrued to the deceased estate which would have been income in the hands of the 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.

A hypothetical enquiry is, therefore, called for to determine whether an amount realised by the executor on disposal of an equity share to a third party would have been income in the hands of the deceased person had the deceased person still been alive at the time of disposal of the share by the deceased estate. In applying section 9C(2) to the deceased estate, the combined period of holding of the equity share by the deceased person and the deceased estate must therefore be taken into account.

The disposal by the deceased estate of an asset to an heir or legatee (including the surviving spouse) will not give rise to a gain or loss for the deceased estate regardless of whether the asset is held on capital or revenue account. Under section 25(3)(a) the deceased estate is treated as having disposed of such an asset for an amount received or accrued equal to the amount of expenditure incurred by the deceased estate in respect of the asset. The expenditure incurred by the deceased estate is determined under section 25(2), namely, the market value under paragraph 31 of the asset on the date of death, or if the asset was bequeathed to a surviving spouse, the expenditure contemplated in section 9HA(2)(b). Under these circumstances it is unnecessary to consider the holding period of equity shares acquired by the deceased estate for purposes of section 9C(2).

³⁶ The definition of "disposal" in paragraph 1 includes "an event, act, forbearance or operation of law which is in terms of this Act treated as the disposal of an asset", which includes a deemed disposal under section 9HA(1).

Example 15 – Disposal of equity share by deceased estate

Facts:

X, a share-dealer, passed away on 31 March year 4 holding the following shares as trading stock:

- Shares in ABC Ltd acquired at a cost of R100 000 on 31 March year 1 having a market value of R120 000 on the date of death. X's executor disposed of the shares on 31 July year 4 for R130 000.
- Shares in XYZ Ltd acquired at a cost of R500 000 on 31 March year 2 having a market value of R550 000 on the date of death. X's executor sold the shares on 31 August year 4 for R560 000.
- Shares in GHI Ltd acquired at a cost of R1 million on 30 September year 1 having a market value of R1,2 million on the date of death. X's executor sold the shares for R1,5 million on 31 October year 4.

Result:

ABC Ltd shares

Implications for X (Deceased person)

On the date of death X had held the shares in ABC Ltd for at least three years (31 March year 1 to 31 March year 4). Section 9C(2) therefore deems the amount received or accrued under section 9HA(1) to be of a capital nature. The opening stock of R100 000 is deemed to be recouped under section 9C(5).

Ordinary income

	R
Income inclusion under section 9C(5)	100 000
Less: Opening stock under section 22(2)(a)	<u>(100 000)</u>
Net inclusion in income	—

CGT

	R
Proceeds – Deemed disposal under section 9HA(1)	120 000
Less: Base cost (Note)	<u>(100 000)</u>
Capital gain	<u>20 000</u>

Note:

Under paragraph 20(3)(a)(ii) the base cost of the shares is not reduced by opening stock of R100 000 allowed as a deduction under section 22(2)(a), since this amount was recouped under section 9C(5).

Implications for X's deceased estate

Had X still been alive at the time of disposal, the shares would have been held for three years and four months (31 March year 1 to 31 July year 4) and any proceeds on disposal would have been of a capital nature under section 9C(2). Section 25(1)(b) therefore does not deem the amount received by or accrued to the deceased estate to be included in the estate's income.

	R
Proceeds on actual disposal	130 000
Less: Base cost [section 25(2)(a) read with paragraph 20(1)(a)]	<u>(120 000)</u>
Capital gain	<u>10 000</u>

Shares in XYZ Ltd

Implications for X (Deceased person)

At the time of death, X had held the shares for two years (31 March year 2 to 31 March year 4). Section 9C(2) therefore does not apply and X must include the market value of the shares of R550 000 in gross income on the date of death. The opening stock of R500 000 qualifies as a deduction under section 22(2)(a). The net effect on X's taxable income is thus an increase of R50 000 (market value of R550 000 – cost of R500 000).

Implications for X's deceased estate

X's estate is deemed to acquire the shares at a cost of R550 000 under section 25(2)(a). On 31 August year 4 when X's estate disposed of the shares, they had been held for a combined period of two years and five months (31 March year 2 to 31 August year 4) by X and X's estate. Had X still been alive on 31 August year 4, section 9C(2) would not have applied and the amount of R560 000 received by or accrued to the estate would have constituted income in X's hands. It therefore constitutes income of X's estate under section 25(1)(b). X's estate will be entitled to a deduction under section 11(a) read with section 25(2)(a) of R550 000. The net effect on X's deceased estate is an increase in taxable income of R10 000 (proceeds of R560 000 – deemed cost of R550 000).

Shares in GHI Ltd

Implications for X (Deceased person)

On the date of death X had held the shares for two years and six months (30 September year 1 to 31 March year 4) and as a result section 9C(2) does not apply. The amount deemed to be received by or accrued to X under section 9HA(1) of R1,2 million, namely the market value of the shares, must be included in X's gross income. X will be entitled to an opening stock deduction of R1 million under section 22(2)(a). The net effect on X's taxable income is thus as follows:

	R
Income inclusion under section 9HA(1)	1 200 000
Less: Opening stock under section 22(2)(a)	<u>(1 000 000)</u>
Net inclusion in income	<u>200 000</u>

Implications for X's deceased estate

X's deceased estate sold the shares on 31 October year 4, seven months after X's date of death, and three years and one month after X acquired them on 30 September year 1. The amount received by or accrued to X's deceased estate would therefore not have constituted income in X's hands had X still been alive on 31 October year 4 and the amount received by or accrued to X's deceased estate is therefore of a capital nature under section 9C(2).

X's deceased estate acquired the shares as trading stock on 31 March year 4 because they were held as trading stock by X on the date of death. Consequently, the disposal of the shares will trigger a recoupment of the deemed acquisition cost under section 9C(5).

<i>Ordinary income</i>	R
Inclusion in income under section 9C(5)	1 200 000
Less: Section 11(a) deduction read with section 25(2)(a)	<u>(1 200 000)</u>
Net effect on taxable income	-
 <i>CGT</i>	
Proceeds on disposal	1 500 000
Less: Base cost (Note)	<u>(1 200 000)</u>
Capital gain	<u>300 000</u>
 Note:	
Under paragraph 20(3)(a)(ii) the base cost of the shares is not reduced by trading stock of R1,2 million allowed as a deduction under section 11(a), since this amount was recouped under section 9C(5).	

16.3 Heirs or legatees

Section 25(3) provides that when a deceased estate disposes of an asset to an heir or legatee –

- the 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
- 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.

The date on which an heir or legatee is regarded as having acquired any equity share from the deceased estate will be relevant for determining whether an heir or legatee has met the three-year holding period contemplated in section 9C(2).

It is submitted that the deceased estate disposes of an asset to an heir or legatee (other than the surviving spouse) on the date on which the heir or legatee becomes unconditionally entitled to the asset. An heir or legatee becomes so unconditionally entitled when the liquidation and distribution account becomes final. An heir will not necessarily be entitled to all assets reflected in the liquidation and distribution account. For example, an heir will not be entitled to an asset that must be used to settle a creditor's claim. In the latter event the asset remains the property of the deceased estate until it is disposed of in order to settle the creditor's claim.

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.³⁷ 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.³⁸

³⁷ Section 35(4) of the Administration of Estates Act 66 of 1965.

³⁸ Section 35(5)(a) of the Administration of Estates Act 66 of 1965.

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.³⁹ Until the liquidation and distribution account is confirmed, no *dominium* in any asset vests in an heir or legatee.⁴⁰ Should objection be lodged against the account, the date on which an heir becomes entitled to an estate asset 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 of the High Court 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 Wednesday 2 January 2021, the period of 21 days will end at midnight on Wednesday 23 January 2021. The heir or legatee will thus acquire the shares for purposes of section 9C on 24 January 2021, even if they are actually distributed after that date.⁴¹

For purposes of section 9C(2), the date of acquisition of equity shares acquired by a surviving spouse is determined under section 25(4)(b)(i). Under that provision the surviving spouse is treated as having acquired any equity shares from the deceased estate on the same date that the shares were acquired by that person's deceased spouse.

17. Asset-for-share and unbundling transactions

The corporate restructuring rules in Part III of Chapter II of the Act contain roll-over rules which deem the date of acquisition of equity shares to be derived from other assets. These roll-over rules do not apply in determining the date of acquisition of an equity share for the purposes of section 9C in the case of –

- an asset disposed of under an asset-for-share transaction to a company, other than an equity share so disposed of, in exchange for equity shares in that company [section 42(2)(a)(ii)]; and
- unbundled shares acquired under an unbundling transaction [section 46(3)(a)(ii)].

³⁹ Section 35(12) of the Administration of Estates Act 66 of 1965.

⁴⁰ ITC 816 (1955) 20 SATC 496 (T) at 498; *Greenberg & others v Estate Greenberg* 1955 (3) SA 361 (A) at 366; *CIR v Estate CP Crewe & another* 1943 AD 656, 12 SATC 344 at 377.

⁴¹ On 24 January 2021 at one second after midnight, the heir will acquire a *jus in personam ad rem acquirendam* (personal right to claim delivery of the shares) and upon distribution will acquire a real right in the shares.

For the purposes of section 9C, the date of acquisition for equity shares acquired under the above circumstances will be the actual date of acquisition.

Asset-for-share transactions

The general rule is that in an asset-for-share transaction the shares issued to the transferor (of the assets) by the transferee company take on the same date of acquisition of the asset disposed of to the transferee company [section 42(2)(a)(ii)]. Section 42(2)(a)(ii) overrides this rule for the purposes of section 9C by blocking the date roll-over. The effect is that the date of acquisition of the equity shares issued by the transferee company will be the date of the asset-for-share transaction, except when the asset being transferred by the transferor comprises equity shares.

This rule prevents the equity shares in the transferee company from immediately becoming capital assets under section 9C(2). Thus, if trading stock such as land held by a developer, which has been held for at least three years, is sold to a company in exchange for equity shares in that company, any immediate disposal of the shares would not automatically be on capital account. The taxpayer would have to hold the equity shares for at least three years before section 9C(2) could apply.

The date roll-over under section 42(2)(a)(ii) nevertheless applies to a transfer of equity shares in exchange for an issue of equity shares by the transferee company.

Unbundling transactions

The general rule is that in an unbundling transaction the unbundled shares take on the same date of acquisition as the shares in the unbundling company [section 46(3)(a)(ii)]. However, this rule does not apply to the unbundled shares for the purposes of section 9C. Instead, they will for that purpose be regarded as having been acquired on the date of unbundling. This rule prevents an unbundling company (the shares of which had been held for at least three years) from acquiring trading stock, transferring it into a subsidiary, and then unbundling that subsidiary. Had section 46(3)(a)(ii) not been amended to exclude section 9C, the shares in the unbundled subsidiary would have been deemed to have been acquired on the same date as the shares in the unbundling company, thus allowing the shares in the unbundled subsidiary to immediately be disposed of on capital account even though the assets represented by those shares comprise trading stock.

18. Exclusion of shares acquired under employee share incentive plans

Section 8B (under specified circumstances) and section 8C recognise gains on shares acquired by virtue of a taxpayer's employment as being akin to remuneration. In order to preserve this policy objective, section 9C does not apply when determining an income gain under sections 8B and 8C, despite the shares having been held for at least three years.

18.1 Section 8B

Section 8B deals with amounts derived from broad-based employee share plans.⁴² An equity share acquired by an employee under such a plan that is held for at least five years will produce proceeds of a capital nature under section 9C(2) when it is disposed of.

Under section 8B(1) a person must include in income for a year of assessment any gain made by that person during that year from the disposal of any “qualifying equity share” as defined in section 8B(3) or any right or interest in such a share, which is disposed of by that person within five years from the date of grant of that share. This income inclusion does not apply when –

- the qualifying equity share is exchanged for another qualifying equity share as contemplated in section 8B(2); or
- the person dies or becomes insolvent.

Section 8B(1) applies “notwithstanding” section 9C, thus overriding section 9C. This exclusion from section 9C means that a share falling within section 8B that is disposed of between three and five years after the date of grant of that share will still result in an income inclusion despite section 9C.

The impact on section 9C on the three exclusions to section 8B is considered below.

Exchange of shares [section 8B(1)(a)]

Section 8B(2) provides roll-over treatment (that is, the replacement shares are deemed to be acquired on the same date as the previously held shares). For the purposes of determining the holding period of the replacement shares, the date of acquisition of the previously held shares must be used. The intention is thus not to trigger an income inclusion when shares are exchanged within the five-year holding period. It is accepted that this rule will also establish the date of acquisition of the replacement shares for the purposes of section 9C once the five-year period has elapsed.

Death [section 8B(1)(b)]

Under section 9HA(1) a person who dies is deemed, with some exceptions, to dispose of all his or her assets at their market value at the date of death. Were it not for the exclusion in section 8B(1)(b), an employee who died holding qualifying equity shares for less than five years would have faced an income inclusion under section 8B(1) read with section 9HA(1).

Another effect of the exclusion in section 8B(1)(b) is to make section 9C(2) potentially applicable to such an employee. Thus, an employee who dies after holding a qualifying equity share for at least three years will be deemed to derive an amount received or accrued of a capital nature under section 9C(2) in respect of the deemed disposal on date of death of that share under section 9HA(1).

⁴² Definition of “broad-based employee share plan” in section 8B(3).

Sequestration [section 8B(1)(c)]

Section 25C deems the person before sequestration and that person's insolvent estate to be one and the same person for income tax purposes. Consequently, no disposal of qualifying equity shares is triggered on the date of sequestration. However, the exclusion in section 8B(1)(c) will prevent an income inclusion under section 8B(1) in the insolvent estate when the trustee disposes of the shares within five years of the shares having been acquired by the insolvent employee. In addition, section 9C(2) applies to qualifying shares held for a combined period of at least three years by the employee and his or her insolvent estate and will ensure that any proceeds derived on disposal of such shares by the trustee will be of a capital nature.

Application of section 9C after five years

Once the five-year period under section 8B has elapsed, section 9C(2) will render the proceeds on a subsequent disposal of the shares to be of a capital nature.

18.2 Section 8C

Section 8C(1) provides for an inclusion in income when an "equity instrument" as defined in section 8C(7) "vests" in an employee or director (that is, becomes unrestricted). The income inclusion applies "notwithstanding" section 9C, meaning that a share that vests three years or longer after it was acquired will still produce an income inclusion upon vesting despite section 9C.

Once such a share has become unrestricted, section 9C will apply to a subsequent disposal of the share provided it has been held for at least three years. The date of acquisition for purposes of section 9C will be the date when the taxpayer became the owner of the share. This date is a question of fact and will depend on the terms of the particular share plan.

The base cost of the vested share is determined under paragraph 20(1)(h)(i), which provides that it is equal to the market value of the share or the amount received or accrued upon its disposal, as the case may be, that was taken into account in determining the amount of the income gain or loss (including a situation in which the gain and loss so determined was nil) under section 8C. By granting a step-up in base cost, paragraph 20(1)(h)(i) prevents double taxation, that is, it avoids subjecting the income gain under section 8C to CGT.

19. Listing of a security on an exchange outside South Africa

Section 9K(1)⁴³ stipulates that when a natural person or a trust that is a resident holds a security in a company and that security is delisted on an exchange in South Africa, and subsequent to that delisting that security is listed on an exchange outside South Africa, that person must be treated as having –

- disposed of that security for an amount received or accrued equal to the market value of that security as contemplated in the definition of “market value” in section 9H(1)⁴⁴ on the day that the security is listed on the exchange outside South Africa; and
- reacquired that security on the same day on which that security is treated as having been disposed of for expenditure in an amount equal to that market value.

The reasons for the introduction of section 9K was explained as follows in the *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2020*:⁴⁵

“As indicated in Annexure E of the 2020 Budget Review, Government proposes to review the current exchange control rules to be replaced by implementing a new capital flow management framework that is aimed at promoting investment, reducing unnecessary burdensome approvals by SARB and providing a modern, transparent and risk-based approvals framework for cross-border flows. One of the changes to the current exchange control rules is the phasing out of the approval requirement by SARB when a resident individual or company that owns a listed domestic security is exporting that listed domestic security abroad.”

A natural person or a trust that “transfers” such a security to an exchange outside South Africa will therefore have a deemed disposal at the time of transfer and an actual disposal when subsequently disposing of the security or a further deemed disposal, for example, when ceasing to be a resident under section 9H(2).

Under section 9K(2), for the purposes of determining whether the disposal of the security gives rise to a receipt or accrual of a capital nature under section 9C(2), a security that is listed on an exchange outside South Africa as contemplated in section 9C(1) must be treated as one and the same security that is delisted.

Example 16 – Transfer of a listed share from a South African exchange to an exchange outside South Africa

Facts:

B acquired 100 shares in ABC plc on the JSE at a cost of R1 000 a share on 1 March 2018 and held the shares as a capital asset. On 1 March 2021 the shares were transferred to the LSE.⁴⁶ On that day the shares were trading at R5 000 a share on the JSE.

⁴³ Section 9K applies to any security listed on an exchange outside South Africa on or after 1 March 2021.

⁴⁴ The definition of “market value” in section 9H(1) means the price which could be obtained upon a sale of an asset between a willing buyer and a willing seller dealing at arm’s length in an open market.

⁴⁵ In paragraph 5.5.

⁴⁶ London Stock Exchange.

On 30 April 2022 B disposed of the shares at £200 a share. Assume the exchange rate was £1 = R20. B elected⁴⁷ to use the spot rate to determine the capital gain or capital loss.

Result:

Deemed disposal on 1 March 2021

Under section 9K(1) B is deemed to dispose of and reacquire the shares on 1 March 2021 at market value of R500 000 ($100 \times R5\ 000$). The capital gain on the deemed disposal of the shares is determined as follows:

R
Proceeds on deemed disposal ($100 \times R5\ 000$)
<u>500 000</u>
Less: Base cost ($100 \times R1\ 000$)
<u>(100 000)</u>
Capital gain
<u>400 000</u>

Actual disposal on 30 April 2022

Since the shares were held for more than three years (1 March 2018 to 30 April 2022), the proceeds are of a capital nature under section 9C(2) read with section 9K(2).

The capital loss on disposal of the shares is determined as follows:

R
Proceeds on disposal ($100 \times £200 \times R20$)
<u>400 000</u>
Less: Base cost
<u>(500 000)</u>
Capital loss (Note)
<u>100 000</u>

Note:

Since the shares were acquired in rand but disposed of in a foreign currency, the calculation of the capital loss is determined under paragraph 43(1A).

20. Conclusion

Section 9C provides taxpayers with certainty that if they hold equity shares for at least three years, the gains and losses on disposal will be of a capital nature regardless of the intention with which the shares were originally acquired. Similarly, a return of capital or foreign return of capital will be regarded as being of a capital nature once the equity shares have been held for at least three years.

Not all types of shares qualify under section 9C. For example, non-participating preference shares, shares in foreign companies (other than shares listed on a South African exchange) and participatory interests in portfolios of collective investment schemes in property fall outside section 9C.

⁴⁷ Paragraph 43(1A)(a).

The application of section 9C is mandatory and no election is required or even possible. The wider ambit of section 9C has necessitated the inclusion of a number of anti-avoidance measures. The capital or revenue nature of shares disposed of within three years of acquisition will continue to be determined according to principles laid down by case law.

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