

REPUBLIC OF SOUTH AFRICA
OFFICE OF THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE
SERVICE

PRACTICE NOTE: NO 8

DATE: 26 MARCH 2001

INCOME TAX - EXEMPTION FROM INCOME TAX IN TERMS OF
SECTION 10(1)(e) OF THE INCOME TAX ACT, 1962

1. INTRODUCTION

Section 10(1)(e) of the Income Tax Act has been amended by section 18(1)(d) of the Revenue Laws Amendment Act 1999, (No. 53 of 1999). This amendment is applicable in respect of years of assessment commencing on or after 24 November 1999.

2. BACKGROUND

- 2.1 Prior to the amendment, the specific legislation was very broad and provided for the exemption of the receipts and accruals of a body which derived profits and gains solely from transactions with or on behalf of its individual members. The effect was that the body was taxed only on its investment income. The section also provided that the investment income could not be taxed at an amount greater than what would have been the case if the exemption in respect of other income had not applied. This proviso presented numerous difficulties and problems in the calculation of the taxable income and the allowable loss to be set-off against the investment income.
- 2.2 It had been the practice of the South African Revenue Service to apply the provisions of section 10(1)(e) of the Act to bodies corporate established in terms of the Sectional Titles Act, 1986 (Act 95 of 1986) and share block companies established in terms of the Share Blocks Control Act, 1980 (Act 59 of 1980). Prior to its amendment, section 10(1)(e) was, if strictly applied, not applicable to those types of entities. Associations not for gain, established in terms of section 21 of the Companies Act, which were

established for managing and administering the expenditure applicable to common immovable property, did not qualify for exemption from income tax in terms of section 10(1)(e), as the provisions of this section prohibited the distribution of profits and gains to any person other than to members. The provisions of section 21 of the Companies Act on the other hand, prohibit the distribution of profits and gains to any person or member, and, on dissolution of the company the remaining assets must be distributed to an organisation with similar objects.

2.3 Furthermore, difficulties were being experienced with the assessing of bodies corporate and share block companies which included the application of the proviso, that the entity should not, as a result of the exemption, be placed in a worse situation in comparison to if it were in a taxpaying situation. This allowed the entity to claim excess expenditure over the levy income against the investment income and resulted in the calculation of a "shadow loss". This effectively permitted a claim of private housing expenditure against investment income. This exceptional dual annual tax calculation added to the complexity of administering the exemption.

3. THE AMENDED SECTION 10(1)(e)

3.1 The existing section 10(1)(e) has therefore been amended to regularise the matter by excluding the possibility of claiming losses against investment income. Section 10(1)(e) has been deleted in its entirety and replaced by a new section 10(1)(e), the effect of which is as follows:

3.1.1 Section 10(1)(e)(i) – exempts the levy income received by or accrued to any body corporate, established in terms of the Sectional Titles Act, from its members.

3.1.2 Section 10(1)(e)(ii) – exempts the levy income received by or accrued to a share block company established in terms of the Share Blocks Control Act, from its shareholders.

- 3.1.3 Section 10(1)(e)(iii) – exempts the levy income received by or accrued to any association of persons from its members. Such an association, however:
- excludes a company registered or deemed to be registered under the Companies Act, any co-operative formed and incorporated or deemed to be formed and incorporated under the Co-Operatives Act, 1981, any close corporation and any trust,
 - includes associations or companies (incorporated under section 21 of the Companies Act) which have been formed to promote the publicity of a specific building, shopping/office complex including the common facilities relating to such immovable property.

3.1.4 The Commissioner has a discretion in approving the exemption in terms of subparagraph (iii) and may prescribe conditions and requirements to ensure that:

- the association has been formed solely for purposes of managing the collective interests common to the members, which includes the expenditure applicable to the common property and the collections of levies for which such members are liable; and
- the association is not permitted to distribute any of its funds to any person other than a similar association of persons.

Certain of these conditions are :

- The sole object of the association must be to manage the collective interests common to all its members, which includes expenditure applicable to the common property of such members and the collection of levies for which such members are liable.
- The association is not permitted to distribute its funds to any person other than to a similar association of persons.

- On dissolution the remaining assets must be distributed to a similar association of persons which is also exempt from income tax in terms of section 10(1)(e)(iii) of the Act.
- Any amendments to the memorandum and articles of association/ constitution must be submitted to the Commissioner for the South African Revenue Service for approval.
- Funds available for investment may only be invested with registered financial institutions as defined in section 1 of the Financial Institutions (Investment of Funds) Act, 1984, and in securities listed on a stock exchange as defined in section 1 of the Stock Exchanges Control Act, 1985 (Act No. 1 of 1985).

4. ACTIVITIES NOT PERMITTED

A general proviso has been added which specifies that none of the above bodies, companies or associations may be involved in any transaction, operation or scheme of which the main purpose is or was the reduction, postponement or avoidance of liability for any tax, duty or levy under the Income Tax Act or any other law administered by the Commissioner.

5. APPROVAL OF EXEMPTION

5.1 The exemption in respect of the bodies corporate and share block companies in terms of section 10(1)(e)(i) and (ii) must be approved by the relevant branch office in which area such entity is located.

5.2. All applications for exemption in terms of section 10(1)(e)(iii) must be submitted to the Commissioner's office, together with copies of:

5.2.1 The letter applying for the exemption.

5.2.2 The memorandum of association or constitution.

5.2.3 The latest set of financial statements, if available, of the association.

5.2.4 Motivated reasons why it is considered that the body falls within the ambit of this particular paragraph.

6. DETERMINATION OF TAXABLE INCOME

- 6.1 In determining the taxable income of the above bodies, the levy income received by the association from its members, for the sole purpose of paying certain expenditure applicable to common property for which such members share the responsibility and are liable, will not be taxable in the hands of the body. The expenditure relating to such levy income will not be an allowable deduction and any expenditure in excess of the levy income cannot be set off against other taxable income of the body.
- 6.2 The body will be taxable on all other income including investment income. Expenditure directly related to such other income will be allowed as a deduction in terms of the Act. A deduction of a fixed percentage of the general or total expenditure is not acceptable. A proportionate share of accounting, audit and bank charges will be allowed against the taxable income. (Taxable income in relation to total income).
- 6.3 In the case of bodies corporate or share block companies, ancillary business activities are frequently conducted (especially by those bodies providing holiday accommodation). These activities may include restaurants, or other catering facilities providing refreshments, renting out of equipment; renting of facilities such as squash courts; tennis courts; other sporting facilities; laundry facilities; parking space etc. Income, (less any expenditure directly attributable to such activities) from these activities constitute taxable income.
- 6.4 Income received for services rendered, for example administration fees, will also be subject to tax.
- 6.5 Additional levies as a result of late payment will be subject to tax as such amounts are paid to the body in lieu of the loss of income as a result of the late payment.
- 6.6 The exemption in respect of the interest income as provided for in section 10(1)(l)(xv) of the Act relates only to a natural person. The bodies covered by section 10(1)(e) and this Practice Note are not regarded as natural persons and this exemption is accordingly not applicable to such bodies.

- 6.7 The calculation of the "shadow loss" created by excess expenditure over levy income, was merely taken into account in the determination of the taxable income by applying the provisions of the previous section 10(1)(e) and was not reflected as an assessed loss on the notice of assessment. The amended provision of section 10(1)(e) does not provide for such a "loss" situation, in the determination of the taxable income. Consequently any such loss will not be taken into account from any year of assessment commencing on or after 24 November 1999.

for COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE
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