

BINDING GENERAL RULING (INCOME TAX) 60

DATE: 22 February 2022

ACT: INCOME TAX ACT 58 OF 1962

SECTION: SECTION 12R(4)(b)

SUBJECT: DISQUALIFICATION AS A QUALIFYING COMPANY UNDER SECTION 12R(4)(b)

Preamble

For the purposes of this ruling –

- **“BGR”** means a binding general ruling issued under section 89 of the Tax Administration Act 28 of 2011;
- **“Government Gazette”** means *Government Gazette* 39930 issued on 15 April 2016;
- **“qualifying company”** means a “qualifying company” as defined in section 12R(1);
- **“section”** means a section of the Act;
- **“SEZ”** means a “special economic zone”, as defined in the Special Economic Zones Act 16 of 2014, that is approved for the purposes of section 12R by the Minister of Finance under section 12R(3);
- **“SIC Code”** means version 7 of the Standard Industrial Classification Code as issued by the Statistics South Africa;
- **“the Act”** means the Income Tax Act 58 of 1962;
- any other word or expression bears the meaning ascribed to it in the Act.

1. Purpose

This BGR provides guidance on the interpretation and application of the excluded activities under section 12R(4)(b) conducted by a qualifying company located within an SEZ. It does not address any aspect of the accelerated building allowance available under section 12S. This ruling sets out SARS’s view.

2. Background

The South African government introduced the SEZ’s regime as a means of promoting foreign direct investment, growth and especially job creation in the South African manufacturing and industrial sector, and to encourage the exportation of value-added

commodities by specific industries situated within a designated SEZ.¹ An income tax incentive in the form of a reduced corporate income tax rate is available to qualifying companies located within an SEZ. Although a company may be classified a “qualifying company” as defined in section 12R(1), it may be disqualified from participating in the income tax incentive if it conducts an activity listed in either section 12R(4)(a) or an activity listed in the SIC Code as gazetted by the Minister of Finance under section 12R(4)(b). In this regard the Minister of Finance issued a *Government Gazette* listing the activities from the SIC Code that constitute a disqualifying activity by a qualifying company. The problem arises in that some of the activities listed in the *Government Gazette* may constitute ancillary activities to the main business of the qualifying company. Because the qualifying company may conduct any of these activities, it could be disqualified from participating in the income tax incentive.

This BGR provides clarity on the interpretation and application of the excluded activities under section 12R(4)(b).

3. Discussion

The disqualified activities under section 12R(4)(a) relate to certain specific manufacturing activities that are not targeted as part of the income tax incentive. Section 12R(4)(b) allows for the Minister to proclaim through the issuing of a gazette certain further non-manufacturing activities to constitute a disqualifying activity. The list of non-manufacturing activities in the gazette relate mainly to ancillary activities that support the main trade of a qualifying company.

Both, subsections 12R(4)(a) and (b) refer to “a company that conducts any activity” and “is not a qualifying company”. Applying the same strict interpretation under both paragraphs, as is required following the judgement in *Western Platinum Ltd v C: SARS*,² would result in a qualifying company being disqualified to participate in the income tax incentive as it is conducting a disqualified activity under section 12R(4)(b), which may only be an ancillary activity to the main trade of the qualifying company.

Such an interpretation creates an absurdity as some of the activities listed in the *Government Gazette* are required to be undertaken as part of most business processes. The proper approach to the interpretation of statutes was decided in the case of *Natal Joint Municipal Pension Fund v Endumeni Municipality*³ in which the judgment confirmed that it is incorrect to simply apply a purposive interpretation if the ordinary meaning does not give rise to an absurd or ambiguous result. In the case of an absurd or ambiguous result, a sensible and businesslike interpretation taking into account the purpose of the legislation should be adopted.

The courts also noted that it is important when giving words and expressions their ordinary meaning, to consider the context in which such words or expressions is contained. Since the purpose of the SEZ regime is to promote investment in certain under-capitalised manufacturing and industrial sectors and thereby create jobs, a businesslike interpretation must be adopted. This interpretation would mean that, if an

¹ A summary of the objectives of SEZ’s as contained in the Department of Trade and Industry “*the dti’s Special Economic Zone Tax Incentive Guide*” available online at www.thedtic.gov.za/wp-content/uploads/SEZ_Guide.pdf [Accessed 22 January 2022] and “*SEZ Performance Monitoring and Evaluation Framework* available online at www.thedtic.gov.za/wp-content/uploads/SEZ_framework.pdf [Accessed 22 February 2022].

² [2004] 4 All SA 611 (SCA), 67 SATC 1 at 6.

³ 2012 (4) SA 593 (SCA) at paragraph 18.

activity listed in the said *Government Gazette* is ancillary to the manufacturing or industrial process undertaken by the qualifying company, then the qualifying company would not be disqualified from the income tax incentive under section 12R(4)(b). However, if any activity under section 12R(4)(b) is a separate income-earning activity that is conducted on a continuous basis, then that activity would result in the disqualification of that company as a qualifying company.

Example 1: An excluded ancillary activity conducted by a qualifying company

Facts:

Company M, a qualifying company, carries on the trade of manufacturing electronic appliances in a designated SEZ. Company M packages the final manufactured product for its safe and secure transport. Customers are invoiced for the final product and not separately for the cost of packaging.

Result:

The activity of packaging is listed as an excluded activity in *Government Gazette* 39930.⁴ The packaging activity is a necessary activity in support of the manufacturing trade of Company M and is not conducted as a separate income-earning activity. As the packaging activity is ancillary to the income-earning activity, Company M will not be disqualified from participating in the income tax incentive by virtue of the application of section 12R(4)(b).

Example 2: Excluded activity conducted by a qualifying company as a separate income-earning activity

Facts:

Company D, a qualifying company, carries on the trade of manufacturing motor vehicles in a designated SEZ. Company D owns and operates a fleet of customised vehicles to transport the vehicles it manufactures to the harbour which is several hundred kilometres away, for export. On the return trip Company D, on behalf of other motor vehicle manufacturers situated in the SEZ, transports vehicles imported by such other companies for a fee.

Result:

The activity of land transport is listed as an excluded activity in *Government Gazette* 39930.⁵ The activity by Company D of transporting the vehicles it manufactures to the harbour will be considered a necessary activity in support of its manufacturing activity and will not be disqualified from participating in the income tax incentive under section 12R. However, the activity of transporting vehicles imported by other vehicle manufacturers is not a necessary activity in support of its manufacturing activity and will be considered as one of the dual-trades of Company D. Company D will be disqualified as a qualifying company under section 12R, as it conducts an excluded activity as envisaged under section 12R(4)(b), and is therefore not entitled to the income tax incentive for that year of assessment.

⁴ *Government Gazette* 39930, Section N: Administration and support activities, Division 82.

⁵ *Government Gazette* 39930, Section H: Land transport and transport via pipelines, Division 49.

4. Ruling

A qualifying company will be disqualified from the income tax incentive under section 12R for that year of assessment if it conducts any activity listed in the *Government Gazette*. However, where that activity is an integral part of the manufactured product to protect or transport the final product, it is accepted that it is not disqualified, provided the secondary product is not sold separately.

This ruling constitutes a BGR under section 89 of the Tax Administration Act 28 of 2011.

5. Period for which this ruling is valid

This BGR applies from date of issue until it is withdrawn, amended or the relevant legislation is amended.

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