SOUTH AFRICAN REVENUE SERVICE

INTERPRETATION NOTE: NO. 9 (ISSUE 5)

DATE: 14 October 2009

ACT : INCOME TAX ACT, NO. 58 OF 1962 (the Act)
SECTION : SECTION 12E
SUBJECT : SMALL BUSINESS CORPORATIONS

Preamble

In this Note–

- a **"company"** includes a "close corporation" or a "co-operative";
- a **"shareholder"** includes a "member of a close corporation" or "a shareholder of a co-operative";.
- **"the Commissioner"** means the Commissioner for SARS;
- **"SARS"** means the South African Revenue Service; and
- legislative references to **"sections"** and **"Schedules"** are to sections of and Schedules to the Act and unless the context indicates otherwise, any word or expression in this Note bears the meaning ascribed to it in the Act.

1. Purpose

This Note provides guidance as to the application of the provisions of section 12E with reference to the requirements that have to be met in order to qualify as a Small Business Corporation (SBC). Due to various amendments since the introduction of section 12E, it will be necessary to consult previous issues for the rates and requirements applicable to years of assessment before 1 April 2009. Previous issues of this Note can be accessed from the SARS website **www.sars.gov.za**. This Note takes into account the changes up to and including those of the Taxation Laws Amendment Act, No. 17 of 2009.

2. Background

Section 12E provides for a special dispensation applicable to SBCs. The benefits that emanate from qualifying as an SBC are as follows:

- An SBC which carries on a process of manufacture (or any other process which in the opinion of the Commissioner is of a similar nature) may deduct the full cost of the expenditure incurred on or after 1 April 2001 for the acquisition of plant or

machinery (assets) in the year of assessment, in which the assets are brought into use for the first time by the taxpayer.[1]

- An SBC may elect an accelerated allowance for any machinery, plant, implement, utensil, article, aircraft or ship (other than plant or machinery used in a manufacturing or similar process) acquired on or after 1 April 2005. The accelerated allowance is 50% of the cost of that asset in the year of assessment during which that asset was brought into use for the first time, 30% in the first succeeding year and 20% in the second succeeding year.
- The rate of normal tax on the taxable income of an SBC is considerably lower than the rate of normal tax (28%) for companies in general **(see paragraph 6)**. A company pays normal tax at the rate of 28% on taxable income, whilst an SBC will pay 0% normal tax on the first R54 200 of taxable income, 10% of the amount by which taxable income exceeds R54 200 but does not exceed R300 000 and R24 580 plus 28% of the amount by which taxable income exceeds R300 000. This rate of normal tax structure is applicable for any year of assessment ending during the period 1 April 2009 to 31 March 2010.

3. The law

For ease of reference, the relevant sections of the Act are quoted in **Annexure A**.

4 Application of law

Inherently the definition of a "small business corporation" focuses on the various legal entities and the requirements that they have to meet in order to qualify as an SBC as well as exclusions from the said definition. These requirements are discussed below.

4.1 Legal entities – section 12E(4)(*a*)

An SBC is limited to –

- a close corporation registered under the Close Corporation Act, No. 69 of 1984;
- a "co-operative" as defined in section 1 of the Co-operatives Act, No. 14 of 2005; or
- a company registered as a private company under the Companies Act, No. 61 of 1973.

A company registered under foreign legislation will therefore not qualify.

4.2 Shareholder's requirements – section 12E(4)(*a*)

All the shareholders or members of the company, close corporation or co-operative must, at all times during the relevant year of assessment, be natural persons [section 12E(4)(*a*)].

The other requirement (as discussed in **4.4**) is that none of the shareholders or members, at any time during the year of assessment of the company, close corporation or co-operative holds any shares or has any interest in the equity of any other company, other than those as specified in section 12E(4)(*a*)(ii).

[1] The plant, machinery, utensil, implement, article, aircraft or ship must be owned by the taxpayer or acquired by the taxpayer as purchaser in terms of an agreement contemplated in paragraph (*a*) of an "instalment credit agreement" as defined in section 1 of the Value-Added Tax Act, No. 89 of 1991.

4.3 Gross income limitation – section 12E(4)(*a*)(i)

The gross income of an SBC may not exceed R14 million during the year of assessment. The definition of the term "gross income" in section 1 refers to the total amount, in cash or otherwise, received or accrued, excluding receipts or accruals of a capital nature, but includes the amounts mentioned in paragraphs (*a*) to (*n*) (whether of a capital nature or not) of that definition. Gross income includes income that is exempt from normal tax, for example, dividends from a South African source. Any taxable capital gain is not included in gross income, as section 26A specifically makes provision for the inclusion of the taxable capital gain in taxable income.

The limitation on gross income refers to the total amount received or accrued for a full period of 12 months, that is, the full year of assessment. An SBC that commenced or ceased trading during the year of assessment, must reduce the amount of R14 million proportionately in order to determine whether the gross income for the relevant period in question would have exceeded R14 million, had such company or close corporation traded for the full period of 12 months.

Note:

In terms of section 12E(4)(*a*)(i), a part of a month is reckoned as a full month.

Amounts either received or accrued, whichever occurs first are included in gross income.

Example 1 – Gross income limitation

Facts:

A company with a year of assessment ending 30 June started trading activities on 17 December 2007. Gross income for the six and a half-month period (17 December 2007 to 30 June 2008) amounted to R9 million.

Result:

As the company's year of assessment commenced on 17 December 2007 which is after 1 January 2007, the limitation of R14 million applies. The R14 million must be reduced proportionately in order to determine whether the company's gross income for the seven-month period would not have exceeded the R14 million limitation, had the company traded for the full 12-month period.

$$\text{R14 million} \times \frac{\text{full months actually traded}}{\text{12 months}}$$

$$= \text{R14 million} \times \frac{7}{12}$$

$$= \text{R8.16 million}$$

The gross income of the company may therefore not exceed the amount of R8.16 million for the seven-month period in which it traded. The actual gross income for the seven-month period, however, amounts to R9 million. The non-compliance with the gross income limitation disqualifies the company to be an SBC for the relevant year of assessment.

4.4 Limitation on shares held by shareholders – section 12E(4)(*a*)(ii)

The shareholders may not at any time during any year of assessment hold any shares or have any interest in the equity of any other company, except in those companies specifically excluded, as mentioned below. A share or interest held in another company or close corporation as trustee or as nominee will generally not be regarded as the holding of any shares or interest in the equity of any other company for purposes of this section, provided the shareholder or member will not be entitled to any profits, income or capital in the other company, or close corporation.

Any shares or interest in any other company not specifically excluded, even if for one day during the relevant year of assessment, will disqualify the company to be an SBC. In this regard, it is worthy to note the effective dates of the exclusions where it was previously a ground for disqualification.

Permissible shareholding	Effective for years of assessment ending on or after
A listed company [section 12E(4)(*a*)(ii)(*aa*)] (Note 1)	13 December 2002
Any portfolio in a collective investment scheme in securities [section 12E(4)(*a*)ii)(*bb*)] (Note 2)	13 December 2002
A body corporate as contemplated in section 10(1)(*e*)(i) [section 12E(4)(*a*)(ii)(*cc*)]	22 December 2003
A share block company as contemplated in section 10(1)(*e*)(ii) [section 12E(4)(*a*)(ii)(*cc*)] (Note 3)	22 December 2003
A company incorporated under section 21 of the Companies Act, No. 61 of 1973 or entity as contemplated in section 10(1)(*e*)(iii) [section 12E(4)(*a*)(ii)(*cc*)] (Note 3)	22 December 2003
Less than 5% interest in a social or consumer co-operative or co-operative burial society [section 12E(4)(*a*)(ii)(*dd*)](Note 4)	1 January 2008
Any "friendly society" as defined in the Friendly Societies Act, No. 25 of 1956 [section 12E(4)(*a*)(ii)(*ee*)] (Note 5)	7 February 2007
Less than 5% interest in a primary savings co-operative bank or a primary savings and loans co-operative bank that provides services as outlined in section 12E(4)(*a*)(ii)(*ff*) (Note 6)	8 January 2008
A "venture capital company" as defined in section 12J [section 12E(4)(*a*)(ii)(*gg*)] (Note 7)	1 July 2009
A dormant or shelf company subject to certain requirements [section 12E(4)(*a*)(ii)(*hh*)](Note 8)	1 January 2010

Note 1: A company of which the shares or depository receipts for its shares are listed on an "exchange" as defined in section 1 and licensed under section 10 of the Securities Services Act, No. 36 of 2004 [section 12E(4)(*a*)(ii)(*aa*) read with paragraph (*a*) of the definition of a "listed company" in section 1].

Note 2: Any portfolio comprised in any collective investment scheme in securities as contemplated in Part IV of the Collective Investment Schemes Control Act, No. 45 of 2002 or any arrangement or scheme carried on outside the Republic of

South Africa where investors hold a participatory interest through shares, units or any other form of participatory interest [section 12E(4)(*a*)(ii)(*bb*) read with paragraph (*e*) of the definition of a "company" in section 1];

Note 3: Any body corporate established under the Sectional Titles Act, No. 95 of 1986 or share block company established under the Share Block Control Act, No. 59 of 1980 or any other association of persons (other than companies registered or deemed to be registered under the Companies Act, No. 61 of 1973, any co-operative, close corporation and trust, but including a company incorporated under section 21 of the Companies Act, 1973 [section 12E(4)(*a*)(ii)(*cc*) read with section 10(1)(*e*)(i), (ii) or (iii)].

Note 4: The specified co-operatives must be registered as one of the following:

- A social co-operative, that is, a non-profit co-operative which engages in the provision of social services to its members, such as care for the elderly, children and the sick (for example, child nursery facilities).
- A consumer co-operative, that is, a co-operative that procures and distributes goods or commodities to its members and non-members and provides services to its members (for example, consumer buy-aids).
- A co-operative burial society, that is, a co-operative that provides funeral benefits, including funeral insurance and other services to its members and their dependants.

A co-operative will not qualify as an SBC if the shareholders hold more than 5% interest in any of the abovementioned three categories of co-operatives during any year of assessment ending on or after 1 January 2008.

Membership of the following co-operatives will continue to exclude an SBC from qualifying:

- Housing
- Worker
- Agricultural
- Financial services (to a certain extent)
- Marketing and supply
- Service.

Note 5: A friendly society is an entity established for the mutual assistance of its members, and must be registered as such under the Friendly Societies Act No. 25 of 1956.

Note 6: The specified co-operative banks are discussed below:

i. *Primary savings co-operative bank*

This means a co-operative registered as a primary co-operative under the Co-operatives Act, 2005 and as a primary savings co-operative bank under the Co-operative Banks Act, 2007. A primary co-operative is a co-operative formed by a minimum of five natural persons whose objective is to provide employment or services to its members and to facilitate community development.

Primary savings co-operative banks provide banking services and in addition, perform the following limited functions:

(a) Solicit and accept deposits from its members.

(b) Open savings accounts for its members, in the name of each member, into which that member may deposit or withdraw money and from which that member may instruct the co-operative to transfer or pay money.

(c) Borrow money from the agency and members, other than deposits referred to in (a) above, up to a percentage of the assets held by it, as prescribed by the Minister of Finance.

(d) Open a savings or cheque account in the name of that co-operative bank with any banking institution.

(e) Make, draw, accept, endorse or negotiate negotiable instruments that are paid to the order of or made out and endorsed by that co-operative bank.

(f) Provide trust or custody services to members.

(g) Conduct any additional banking services as may be prescribed by the Minister of Finance.

(h) Invest money deposited with it in investments prescribed by the Minister of Finance.

ii. *Primary savings and loans co-operative bank*

This means a co-operative registered as a primary co-operative under the Co-operatives Act, 2005 and as a primary savings and loans co-operative bank under the Co-operative Banks Act, 2007 that may provide banking services and perform functions permissible under that Act.

A primary savings and loans co-operative bank is limited to provide the following functions:

(a) Any of the banking services provided, participated in or undertook by a primary savings co-operative bank.

(b) Grant secured and unsecured loans to members to a maximum aggregate value prescribed by the Minister of Finance.

(c) Conduct any additional banking services and invest money deposited with it in any investments prescribed by the Minister of Finance, in addition to those provided, participated in or undertook by a primary savings co-operative bank.

Note 7: A venture capital company is a vehicle established to pool together the investments of small investors. The venture capital company then acts as a financier to small businesses by using the funds of the small investors to invest in small business companies. The venture capital company must be approved as such by the Commissioner under section 12J(5).

Note 8: For the purposes of section 12E, a company , close corporation or co-operative will be considered to either be a dormant or shelf company, if the company has not during any year of assessment carried on any trade and has not during any year of assessment owned assets with a total market value of which exceeds R5 000.

Example 2 – Limitation on shares held by shareholders

Facts:

Company A, which renders information technology (IT) services to a number of clients, has two shareholders (both are natural persons) as well as four full-time employees (other than the two shareholders), who throughout the year of assessment were involved in rendering the IT services. Company A's gross income for the year of assessment was R5.6 million. Shareholder No. 1 is the holder of a number of shares (allocated to an apartment purchased by him) in a share block company. Shareholder No. 2 is the holder of shares in company Z, which was listed on the JSE. Company Z was delisted during the year of assessment.

Result:

Company A complied with the following requirements:

1. The shares in Company A are all held by natural persons.
2. The gross income does not exceed R14 million.
3. Although Company A renders a "personal service" as defined, it employs three or more full-time employees (excluding the shareholders) who, throughout the year of assessment, also render IT services.
4. The shares held, in the share block company, by Shareholder No. 1 are permitted under section 12E(4)(*a*)(ii)(*cc*).

Company A is, however, disqualified to be an SBC for the following reason:

Section 12E(4)(*a*)(ii)(*aa*) indicates that a shareholder or member may not hold any shares or have any interest in any company other than a company contemplated in paragraph (*a*) of the definition of a "listed company" in section 1. Shares held in any other company (that is, a company whose shares or depository receipts for its shares are not listed on an "exchange" as defined in section 1 and licensed under section 10 of the Securities Services Act, 2004) are prohibited. The shares held by Shareholder No. 2 in the delisted company, does not qualify Company A as an SBC for the year of assessment.

4.5 Limitation on investment income and income from rendering a personal service – sections 12E(4)(*a*)(iii) and (4)(*d*)

A maximum of 20% of the company's total receipts and accruals (including all capital gains but excluding amounts of a capital nature) may consist collectively of "investment income" as defined in section 12E(4)(*c*), and income from the rendering of a "personal service" as defined in section 12E(4)(*d*). The aggregate income from investment and personal services should therefore not exceed 20% of the company's total receipts and accruals. The personal service income may not exceed 20% of the receipts and accruals if a company, for example, has no investment income. The investment income may not exceed 20% of the company's total receipts and accruals if the service rendered by a company is not regarded as personal service. However, if the service rendered is regarded as personal service, the 20% limitation must be applied to the income attributable to the personal service and the investment income collectively.

Investment income

Section 12E(4)(*c*) defines "investment income" as any income derived from dividends, royalties, rental derived from immovable property, annuities or income of a similar nature, interest as contemplated in section 24J (other than any interest earned by an SBC which is a co-operative bank), any amount contemplated in section 24K, any other income subject to the same treatment as income from money lent and any proceeds derived from investment or trading in financial instruments, marketable securities or immovable property.

The investment income for purposes of section 12E refers mainly to amounts that represent the return on investments.

Personal service

In general terms, a personal service refers to a service rendered and for which the income derived is mainly a reward for the personal efforts or skills of an individual. However, the term is capable of expansion or limitation depending on the scope of the specific law in which it used. Section 12E(4)(*d*) (as quoted below) defines "personal service" which merely lists a class of activities that would be regarded as a personal service. For the sake of clarity, the ordinary, grammatical meaning is to be ascribed to each word. Accordingly, each of these entries is to be construed in their widest possible sense.

Section 12E(4)*(d)*

> (*d*) **"personal service"**, in relation to a company or close corporation, means any service in the field of accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, broking, commercial arts, consulting, draftsmanship, education, engineering, entertainment, health, information technology, journalism, law, management, performing arts, real estate, research, secretarial services, sport, surveying, translation, valuation or veterinary science, if—
>
> (i) that service is performed personally by any person who holds an interest in that company or close corporation; and
>
> (ii) that company or close corporation does not throughout the year of assessment employ three or more full-time employees (other than any employee who is a shareholder of the company or member of the close corporation, as the case may be, or who is a connected person in relation to a shareholder or member), who are on a full-time basis engaged in the business of that company or close corporation of rendering that service.

Provided all the other necessary requirements have been met, an SBC, which is primarily engaged in the provision of any personal service, will be able to qualify as an SBC, if –

- the company or close corporation, throughout the year of assessment, employs three or more full-time employees who are on a full-time basis engaged in its business of rendering that service;
- the personal service in relation to a company or close corporation is not performed personally by any person who holds an interest in that company or close corporation; and
- the investment income of the SBC does not exceed 20% of its total receipts and accruals (including all capital gains but excluding amounts of a capital nature).

The 20% limitation will ***only*** be applicable to any investment income received by or accrued to the company during the year of assessment if the activity carried on by a company is one of the activities listed under the definition of a "personal service", but the company employs three or more full-time employees (excluding shareholders and connected persons to the shareholders) who throughout the year of assessment render the specific service. The 20% limitation is, therefore, not applied to income from services rendered if the services cannot be regarded as "personal service". The 20% limitation for investment income will similarly be applicable if the activity carried on by the company is not one of the activities listed under "personal service" as defined, irrespective of the number of persons employed by the company.

The Act does not prescribe any specific method of record-keeping in calculating the 20% limitation for personal service income. The fact that the personal service income does not exceed 20% of the company's total receipts and accruals (including all capital gains but excluding amounts of a capital nature) must, however, be substantiated and this may be done either by means of a charge-out system per hour or per job or any other method used by the taxpayer.

Calculation of 20% limitation

The 20% limitation for the receipts and accruals attributable to investments and personal service income is calculated as follows:

Example 3 – Calculation of limitation on investment income and income from rendering a personal service

Facts:

For the year of assessment ending 31 March 2009, a close corporation, which renders consulting services to a large number of clients, has two members and two full-time employees. The two full-time employees have no interest in the close corporation and are engaged in the business of the close corporation, that is, the rendering of consulting services. Consulting services is one of the listed activities under the definition of a "personal service".

The requirement that the close corporation should, throughout the year of assessment, employ three or more full-time employees (excluding members or connected persons to the members) so as not to fall within the definition of a "personal service" has not been met. The service rendered by the close corporation is therefore regarded as a personal service and the 20% limitation for receipts or accruals attributable to personal service and investment income must be applied.

The close corporation's total of all receipts and accruals [for purposes of section 12E(4)(*a*)(iii)] for the year of assessment from 1 April 2008 to 31 March 2009 consists of:

	R
Income from services rendered by two full-time employees	3 900 000
Income from services rendered by members	1 100 000
Royalties received	23 000
Benefit received under a will (capital receipt)	950 000
Total of all receipts and accruals	5 973 000
Capital gain on disposal of an SBC asset *	40 000

Result:

***** The capital gain is in respect of the sale of a depreciable asset. This capital gain cannot be deferred as the close corporation indicated that it did not intend acquiring any replacement asset. An election to defer the gain under paragraph 65 or 66 of the Eighth Schedule is therefore not available in this instance.

The total of all receipts and accruals and all capital gains for the purposes of calculating the 20% limitation is R5 063 000 (R5 973 000 – R950 000 + R40 000). (The capital receipt of R950 000 is excluded from total receipts and accruals and the capital gain of R40 000 is added to the net result.)

The investment income (royalties) and income from the rendering of personal service expressed as a percentage of the total of all receipts and accruals and all capital gains is calculated as follows:

[(R23 000 + R1 100 000)/R5 063 000] x 100 = 22.18%.

Investment income and income from the rendering of a personal service ***exceed*** the 20% limitation for the relevant year of assessment and the close corporation will not qualify as an SBC, despite the fact that the members' interest (ownership) and gross income requirements may have been met.

Note: If the above close corporation had employed three or more full-time employees (excluding the members or connected persons to the members) throughout the year of assessment to render the consulting services, the 20% limitation for the income from rendering a personal service would not have been required, as the service would not be regarded as a personal service. The 20% limitation would, however, have to be applied to any investment income received or accrued during the year of assessment, as follows:

The following is assumed:

The close corporation employed three full-time employees who also render consulting services. The following income and capital gain was received for the financial year ending 31 March 2009:

	R
Income from services rendered by employees (3)	2 800 000
Income from services rendered by members	1 000 000
Royalties received	1 113 000
Benefit received under a will (capital receipt)	950 000
Capital gain on disposal of an asset	40 000
Total of all receipts and accruals and capital gains	5 903 000

The services rendered by the close corporation do not fall within the definition of a "personal service" as the close corporation employed three full-time employees (excluding the members or connected persons to the members) throughout the year of assessment to render the consulting services. Any income attributable to services rendered by the members is therefore not subject to the 20% limitation. The 20% limitation must, however, be applied to all investment income received or accrued.

The total of all receipts and accruals and capital gain for the purposes of calculating the 20% limitation is R4 953 000 (R5 903 000 – R950 000).

The investment income (royalties) expressed as a percentage of the total of all receipts and accruals (including the capital gain) is R1 113 000/R4 953 000 x 100 = 22.47%.

The investment income exceeds the 20% limitation for the relevant year of assessment and the close corporation will not qualify as an SBC, despite the fact that the services rendered do not constitute the rendering of a personal service and the ownership and gross income requirements have been met.

4.6 The company may not be a personal service provider

Section 12E(4)(*a*)(iv) effectively excludes a "personal service provider", as defined in paragraph 1 of the Fourth Schedule, from the SBC definition. However, such a company[2] may still qualify as an SBC if the company, throughout the year of assessment, employs three or more full-time employees who are engaged on a full-time basis in the business of the company of rendering the relevant service.

The terms "personal service" and "personal service provider" are both defined in the Act and therefore have different meanings. A "personal service" is defined in section 12E(4)(*d*) and concerns a specific category of activities that are performed by the shareholders of the company.

Definition of a "personal service provider" – paragraph 1 of the Fourth Schedule

"personal service provider" means any company or trust, where any service rendered on behalf of such company or trust to a client of such company or trust is rendered personally by any person who is a connected person in relation to such company or trust, and—

(*a*) such person would be regarded as an employee of such client if such service was rendered by such person directly to such client, other than on behalf of such company or trust; or

(*b*) where those duties must be performed mainly at the premises of the client, such person or such company or trust is subject to the control or supervision of such client as to the manner in which the duties are performed or are to be performed in rendering such service; or

(*c*) where more than 80 per cent of the income of such company or trust during the year of assessment, from services rendered, consists of or is likely to consist of amounts received directly or indirectly from any one client of such company or trust, or any associated institution as defined in the Seventh Schedule to this Act, in relation to such client

A company that falls within the above definition of a "personal service provider" will, therefore, not qualify as an SBC. Should that company, however, employ three or more full-time employees (excluding shareholders or any persons connected to the shareholders) throughout the year of assessment and these employees are engaged in the business of the company in rendering the specific service, that company may qualify as an SBC.

5. SBC assets – sections 12E(1) and (1A)

(1) Where any plant or machinery (hereinafter referred to as an asset) owned by a taxpayer which qualifies as a small business corporation or acquired by such a taxpayer as purchaser in terms of an agreement contemplated in paragraph (*a*) of an "instalment credit agreement" as defined in section 1 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991),—

[2] Although the definition of a "personal service provider" refers to companies and trusts, for purposes of SBCs, trusts are ignored

(*a*) is brought into use for the first time by that taxpayer on or after 1 April 2001 for the purpose of that taxpayer's trade (other than mining or farming); and

(*b*) is used by that taxpayer directly in a process of manufacture (or any other process which in the opinion of the Commissioner is of a similar nature) carried on by that taxpayer,

a deduction equal to the cost of such asset shall be allowed in the year that such asset is so brought into use.

(1A) Subject to subsection (1), where any machinery, plant, implement, utensil, article, aircraft or ship in respect of which a deduction is allowable under section 11(*e*) ('the asset') is acquired by a small business corporation under an agreement formally and finally signed by every party to the agreement on or after 1 April 2005, the amount allowed to be deducted in respect of the asset must, at the election of the small business corporation and subject to the provisions of that section, be either—

(*a*) the amount allowable in terms of and subject to that section; or

(*b*) an amount equal to 50 per cent of the cost of the asset in the year of assessment during which it was first brought into use, 30 per cent in the first succeeding year and 20 per cent in the second succeeding year.

(2) For the purposes of this section the cost to a taxpayer of any asset shall be deemed to be the lesser of the actual cost to the taxpayer to acquire that asset or the cost which a person would, if he had acquired the said asset under a cash transaction concluded at arm's length on the date on which the transaction for the acquisition of the said asset was in fact concluded, have incurred in respect of the direct cost of acquisition of the asset, including the direct cost of the installation or erection thereof or, where the asset has been acquired to replace an asset which has been damaged or destroyed, such cost less any amount which has been recovered or recouped in respect of the damaged or destroyed asset and has been excluded from the taxpayer's income in terms of section 8(4)(*e*), whether in the current or any previous year of assessment.

5.1 Assets used directly in a process of manufacture or process of a similar nature – section 12E(1)

In terms of section 12E(1) an SBC that carries on a process of manufacture or a process which in the opinion of the Commissioner is of a similar nature, may deduct the full cost of an asset during the year of assessment in which such asset is brought into use for the first time. This deduction is subject to the following requirements:

- The asset must be brought into use for the first time by the SBC on or after 1 April 2001.
- The asset must be used directly in a process of manufacture or a process regarded by the Commissioner as being of a similar nature.
- A cost should have been incurred in acquiring the asset (an asset acquired for no consideration will, as a result, not qualify).
- The asset must be owned by the SBC or the SBC should have acquired the asset as purchaser under an "instalment credit agreement" as defined in section 1 of the Value-Added Tax Act, 1991.

The asset does not need to be a new asset. An asset which qualifies for a deduction under section 12E(1) will not qualify for any other allowance available under the Act. As the cost of an asset, used in a process of manufacture (or any other process of a similar nature), is deducted in full in the year in which the asset is brought into use for the first time, such asset will not qualify for a scrapping-allowance under section 11(*o*). On disposal thereof, the asset will be subject to the recoupment provisions under section 8(4)(*a*).

5.2 Other assets – section 12E(1A)

An SBC that makes use of assets other than those used directly in a process of manufacture (or any other process of a similar nature), may elect to claim either –

- the amount allowable in respect of those assets under section 11(*e*) (the wear and tear allowance); or
- an amount over three years at the following rates -
  - 50% in the year of assessment in which the asset is or was brought into use for the first time (first year);
  - 30% in the second year; and
  - 20% in the third year.

In this regard, the SBC may elect to use section 11(*e*) [section 12E(1A)(*a*)] if it presents a more favourable allowance than the three year spread under section 12E(1A)(*b*). The election may be done on a per asset basis.

The assets must be acquired by an SBC under an agreement formally and finally signed by every party to the agreement on or after 1 April 2005, for the deductions under section 12E(1A) to be effective (see **Example 5**). The deduction under section 12E(1A) is based on the cost of acquisition of the asset and the asset which was acquired for no consideration will, as a result, not qualify for any deduction under section 12E(1A) (see **5.3**).

5.3 The cost of an asset – section 12E(2)

In terms of section 12E(2), the cost of an asset is for the purposes of both sections 12E(1) [assets used directly in a process of manufacture or process of a similar nature] and 12E(1A) [other assets] deemed to be the lesser of –

- the actual cost to the taxpayer to acquire that asset;
- the direct acquisition cost that a person would have incurred if the asset had been acquired under an arm's length cash transaction on the date on which the transaction was in fact concluded; or
- where the asset has been acquired to replace an asset which has been damaged or destroyed, the actual cost less the deferred recoupment which has been excluded from the taxpayer's income under section 8(4)(*e*).

The above cost excludes interest and finance charges, but includes the direct cost of installation or erection of the asset.

Note: No deductions will be available under either section 12E(1) or section 12E(1A) if the taxpayer acquired an asset for no consideration, because the deductions for SBC assets are based on the ***cost*** to the taxpayer to acquire that asset. A wear and tear allowance based on the value of the asset will be allowed under section 11(*e*) if that asset is acquired for no consideration, for example, by means of a donation, inheritance or as a dividend *in specie*.

5.4 Cost in moving an asset – section 12E(3)

Section 12E(3)

> (3) Any expenditure (other than expenditure referred to in section 11(*a*)) incurred by a taxpayer during any year of assessment in moving an asset in respect of which a deduction was allowed or is allowable under this section from one location to another must—
>
> (a) where the taxpayer is or was entitled to a deduction in respect of that asset under subsection (1A) in that year and one or more succeeding years, be allowed to be deducted from his or her income in equal instalments in that year and each succeeding year in which that deduction is allowable; or
>
> (b) in any other case, be allowed to be deducted from that taxpayer's income in that year.

In terms of section 12E(3)(*b*), the cost of moving an asset which has been written off in full, must be allowed in the year in which the expenditure is incurred. This will also include an asset which was written off under section 12E(1), that is, an asset used directly in a process of manufacture (or a process of a similar nature).

Example 4 – Deduction of moving costs

Facts:

Company X is an SBC with a year of assessment which ends on the last day of February. Due to unforeseen circumstances, the business operations of Company X had to be moved on one occasion. The following information was submitted:

- Asset A qualifies for an allowance under section 12E(1A)(*b*) and was acquired on 1 May 2005 at a cost of R100 000. The cost to move asset A was R6 000.
- Asset B qualifies for an allowance under section 12E(1) and was acquired on 1 April 2005 at a cost of R50 000. The cost to move asset B was R4 000.

Calculate the section 12E(1) or (1A) deduction in respect of assets A and B for the 2006, 2007, 2008 and 2009 years of assessment (if applicable). Also calculate the section 12E(3) deduction for assets A and B, where the assets were moved on either –

- 1 July 2005;
- 1 July 2006;
- 1 July 2008.

Result:

a) Calculation of section 12E(1A)(*b*) deduction for asset A
2006 year of assessment: 50% of R100 000 = R50 000
2007 year of assessment: 30% of R100 000 = R30 000
2008 year of assessment: 20% of R100 000 = R20 000

b) Calculation of section 12E(3) deduction of moving costs of asset A

- 1 July 2005 (2006 year of assessment) [section 12E(3)(*a*)]
  2006 year of assessment: R6 000/3 = R2 000
  2007 year of assessment: R6 000/3 = R2 000
  2008 year of assessment: R6 000/3 = R2 000
  (Moving costs incurred during the year of assessment in which the asset was brought into use, therefore the write-off period of moving costs is the same as the write-off period for capital cost.)

- 1 July 2006 (2007 year of assessment) [section 12E (3)(*a*)]
  2007 year of assessment: R6 000/2 = R3 000
  2008 year of assessment: R6 000/2 = R3 000
  (Two years [2007 and 2008 years of assessment] remains to claim capital cost, therefore the write-off period of moving costs are also two years [2007 and 2008 years of assessment].)

- 1 July 2008 (2009 year of assessment) [section 12E(3)(*b*)]
  2009 year of assessment: R6 000/1 = R6 000
  (The asset has already been written off in the 2008 year of assessment, therefore the moving cost is claimed in full in the 2009 year of assessment.)

c) Calculation of section 12E(1) deduction for asset B
2006 year of assessment: R50 000 x 100% = R50 000 (once off)

d) Calculation of section 12E(3)(*b*) deduction of moving costs of asset B
(As the asset was written off in full in the 2006 year of assessment, the moving costs is to be written off in full in the year of assessment in which such moving cost was incurred.)
Deduction: R4 000 (once off) [under section 12E(3)(*b*)]

5.5 Assets acquired for no consideration

The value of an asset acquired for no consideration (for example, by means of a donation, inheritance or as a dividend *in specie*) must be increased by the direct cost incurred for the installation or erection of that asset under section 11(*e*)(vii) or cost incurred in moving of that asset from one location to another under section 11(*e*)(v). Expenditure incurred for the installation, erection or moving an asset for no consideration must therefore be written off under section 11(*e*).

5.6 Assets written off in full under section 11(*e*)

The installation, erection or moving costs of an asset will be allowed as a deduction in the year of assessment in which such costs were incurred if that asset which has been written off in full under section 11(*e*) is installed, erected or moved from one location to another.

5.7 Recoupment

Any amount which is recovered or recouped as a result of the disposal of an asset used by an SBC is subject to the recoupment provisions under section 8(4)(*a*). The inclusion in the income of the SBC in respect of the amount which is recovered or recouped can, however, despite the provisions of section 8(4)(*a*), be deferred under section 8(4)(*e*) if the taxpayer has made an election that paragraph 65 or 66 of the Eighth Schedule to the Act should apply. The election to defer the recoupment of allowances previously granted can be made only if the proceeds for the disposal of the asset exceed the base cost of the asset and the taxpayer intends acquiring a replacement asset. The amount to be recovered or recouped as well as any capital gain (if any) is spread over the future years of assessment in proportion to the capital allowances to be claimed on the replacement asset. This method of deferring recouped allowances and capital gains is available in respect of assets which are disposed of on or after 22 December 2003.

Example 5 – Recoupment of deductions allowed in respect of the cost of assets

Facts:

An SBC with a year of assessment ending on the last day of February, acquired a truck costing R400 000 on 1 May 2005 and immediately brought the truck into use for the purposes of conducting business operations. The truck was, however, damaged beyond repair due to an accident, on 2 December 2006. An amount of R400 000 was paid out on 31 March 2007 under a contract of insurance. The taxpayer has elected that paragraph 66 of the Eighth Schedule must apply and any recoupment is therefore deferred under section 8(4)(*e*).

The taxpayer has indicated that –

- a replacement vehicle will be acquired within a period of one year subsequent to the disposal of the original vehicle; and
- the replacement vehicle will be brought into use within a period of three years from the date of disposal of the original vehicle.

The SBC concluded an agreement for the acquisition of the replacement asset on 1 April 2007. The cost of the replacement asset was R450 000.

Calculate the deductions and/or recoupment for the 2006 to 2010 years of assessment.

Result:

		R
2006		
Section 12E(1A)(*b*) deduction	R400 000 x 50% =	(200 000)
2007		
Section 12E(1A)(*b*) deduction	R400 000 x 30% =	(120 000)
2008		
Section 12E(1A)(*b*) deduction in respect of damaged truck: As the truck was damaged beyond repair, the truck was not used during the 2008 year of assessment, therefore, no section 12E(1A)(*b*) deduction.		

Section 12E(1A)(*b*) deduction in respect of replacement truck:	
R450 000 x 50% =	(225 000)
The time of disposal under paragraph 13 of the Eighth Schedule is 31 March 2007, that is, the date on which the compensation for the damaged truck was received.	
Original cost of damaged truck	400 000
Less: Deductions allowed in 2006 and 2007(R200 000 + R120 000)	(320 000)
Tax value as at 1 March 2007	80 000
Less: Insurance proceeds	400 000
Recoupment	320 000
Section 8(4)(*e*) recoupment to be included in income:	
R320 000 x 50% =	160 000
2009	
Section 12E(1A)(*b*) deduction R450 000 x 30% =	(135 000)
Section 8(4)(*e*) recoupment to be included in income:	
R320 000 x 30% =	96 000
2010	
Section 12E(1A)(*b*) deduction R450 000 x 20% =	(90 000)
Section 8(4)(*e*) recoupment to be included in income:	
R320 000 x 20% =	64 000

6. Rate of normal tax

The rate of normal tax applicable to SBCs for the years of assessment ending during the period 1 April 2008 to 31 March 2009 is as follows:

Taxable income	**Rates of tax**
Not exceeding R46 000	0% of taxable income
Exceeding R46 000 but not exceeding R300 000	10% of the amount by which the taxable income exceeds R46 000
Exceeding R300 000	R25 400 plus 28% of the amount by which the taxable income exceeds R300 000

The rate of normal tax applicable to SBCs for the years of assessment ending during the period 1 April 2009 to 31 March 2010 is as follows:

Rates of tax	**Taxable Income**
Not exceeding R54 200	0% of taxable income
Exceeding R54 000 but not exceeding R300 000	10% of the amount by which the taxable income exceeds R54 200
Exceeding R300 000	R24 580 plus 28% of the amount by which the taxable income exceeds R300 000

7. Objection and appeal

Any decision made by the Commissioner under the provisions of section 12E is subject to objection and appeal.

8. Conclusion

A company which has complied with all the requirements of an SBC in one year of assessment does not necessarily indicate compliance for any subsequent year of assessment. The facts of each case will, therefore, have to be considered for every year of assessment in order to determine whether the company complies with all the requirements for the specific year of assessment under review.

Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE

Date of first issue: 13 December 2002
Date of second issue: 29 March 2004
Date of third issue: 13 January 2006
Date of fourth issue: 16 February 2007

Annexure A – Section 12E

(4) For the purposes of this section—

(*a*) **"small business corporation"** means any close corporation, co-operative or company registered as a private company in terms of the Companies Act, 1973 (Act No. 61 of 1973), all the shareholders of which are at all times during the year of assessment natural persons, where—

(i) the gross income for the year of assessment does not exceed R14 million: Provided that where the close corporation or company during the relevant year of assessment carries on any trade, for purposes of which any asset contemplated in this section is used, for a period which is less than 12 months, the amount shall be reduced to an amount which bears to that amount, the same ratio as the number of months (in the determination of which a part of a month shall be reckoned as a full month), during which that company or close corporation carried on that trade bears to 12 months;

(ii) none of the shareholders or members at any time during the year of assessment of the company, close corporation or co-operative holds any shares or has any interest in the equity of any other company as defined in section 1, other than—

(*aa*) a company contemplated in paragraph (*a*) of the definition of "listed company";

(*bb*) any portfolio in a collective investment scheme contemplated in paragraph (*e*) of the definition of "company";

(*cc*) a company contemplated in section 10(1)(*e*)(i), (ii) or (iii);

(*dd*) less than 5 per cent of the interest in a social or a consumer co-operative or a co-operative burial society as defined in section 1 of the Co-operatives Act, 2005 Act No. 14 of 2005), or any other similar co-operative if all of the income derived from the trade of that co-operative during any year of assessment is solely derived from its members;[3]

(*ee*) any friendly society as defined in section 1 of the Friendly Societies Act, 1956 (Act No. 25 of 1956); or

(*ff*) less than 5 per cent of the interest in a primary savings co-operative bank or a primary savings and loans co-operative bank as defined in the Co-operative Banks Act, 2007, that may provide, participate in or undertake only the following–

(A) in the case of a primary savings co-operative bank, banking services contemplated in section 14(1)(*a*) to (*d*) of that Act; and

(B) in the case of a primary savings and loans co-operative bank, banking services contemplated in section 14(2)(*a*) or (*b*) of that Act;

(*gg*) a venture capital company as defined in section 12J;

(*hh*) any company, close corporation or co-operative if the company, close corporation or co-operative—

[3] Five per cent limitation effected by s.25(*b)* of the Revenue Laws Amendment Act, No.35 of 2007 and effective as from the commencement of years of assessment ending on or after 1 January 2008. Initially, there was no limitation for social co-operatives for years of assessment ending on or after 7 February 2007.

(A) has not during the year of assessment carried on any trade; and

(B) has not during any year of assessment owned assets, the total market value of which exceeds R5000[4];

(iii) not more than 20 per cent of the total of all receipts and accruals (other than those of a capital nature) and all the capital gains of the company, close corporation or co-operative consists collectively of investment income and income from the rendering of a personal service; and

(iv) such company is not a personal service provider as defined in the Fourth Schedule;[5]

(*b*) ……

(*c*) **"investment income"** means—

(i) any income in the form of dividends, royalties, rental derived in respect of immovable property, annuities or income of a similar nature;

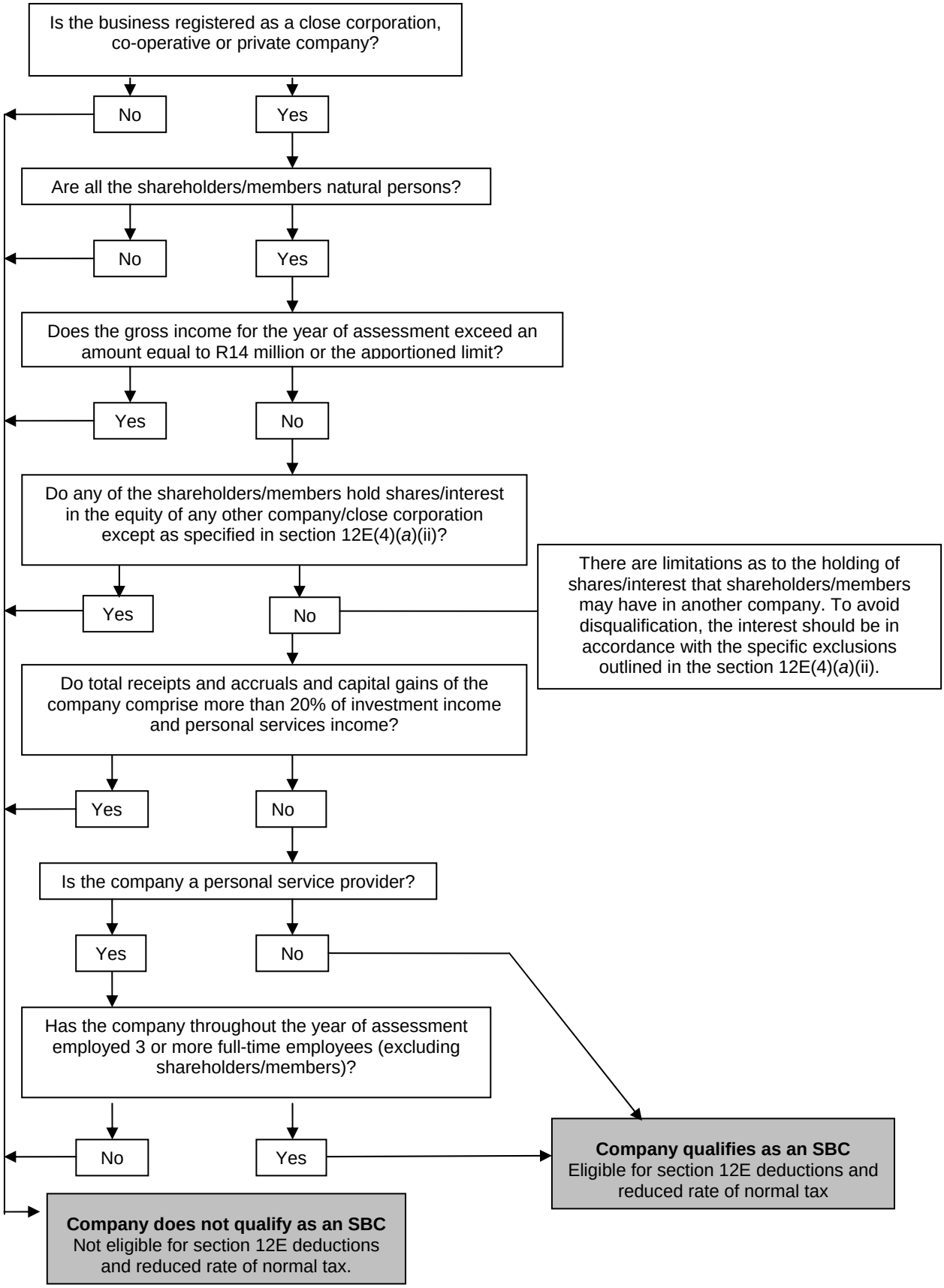
(ii) any interest as contemplated in section 24J (other than any interest received by or accrued to any co-operative bank as contemplated in paragraph (*a*)(ii)(*ff*), any amount contemplated in section 24K and any other income which, by laws of the Republic administered by the Commissioner, is subject to the same treatment as income from money lent; and

(iii) any proceeds derived from investment of trading in financial instruments (including futures, options and other derivatives), marketable securities or immovable property;

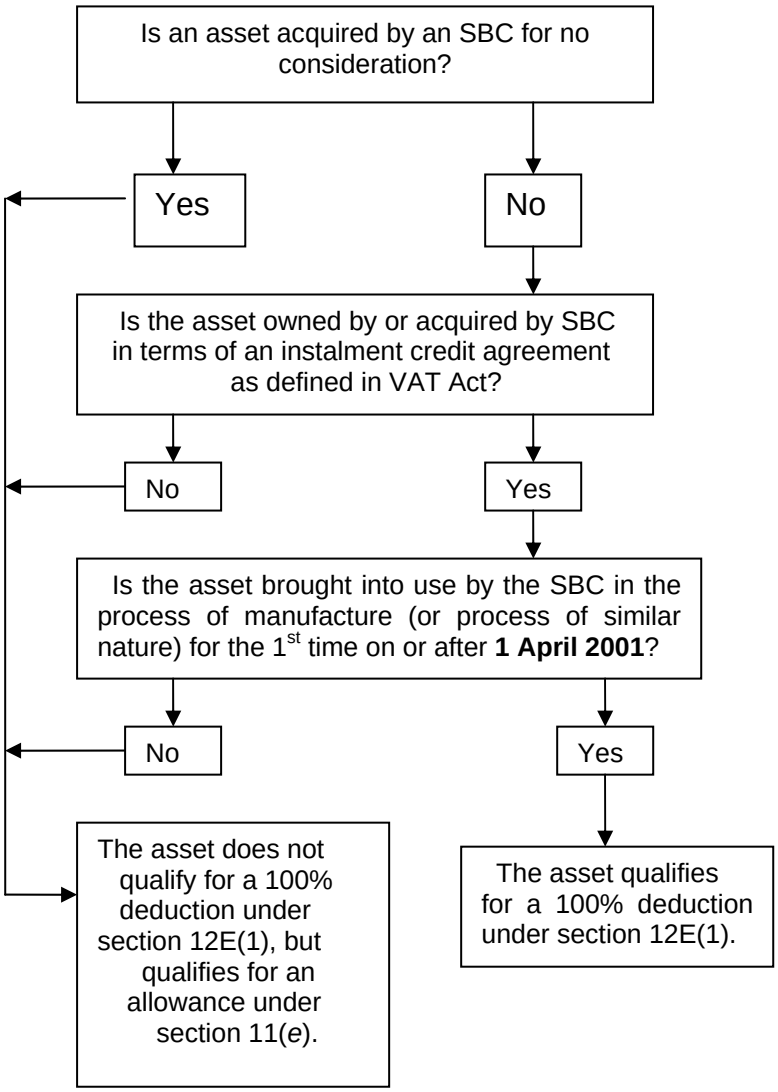
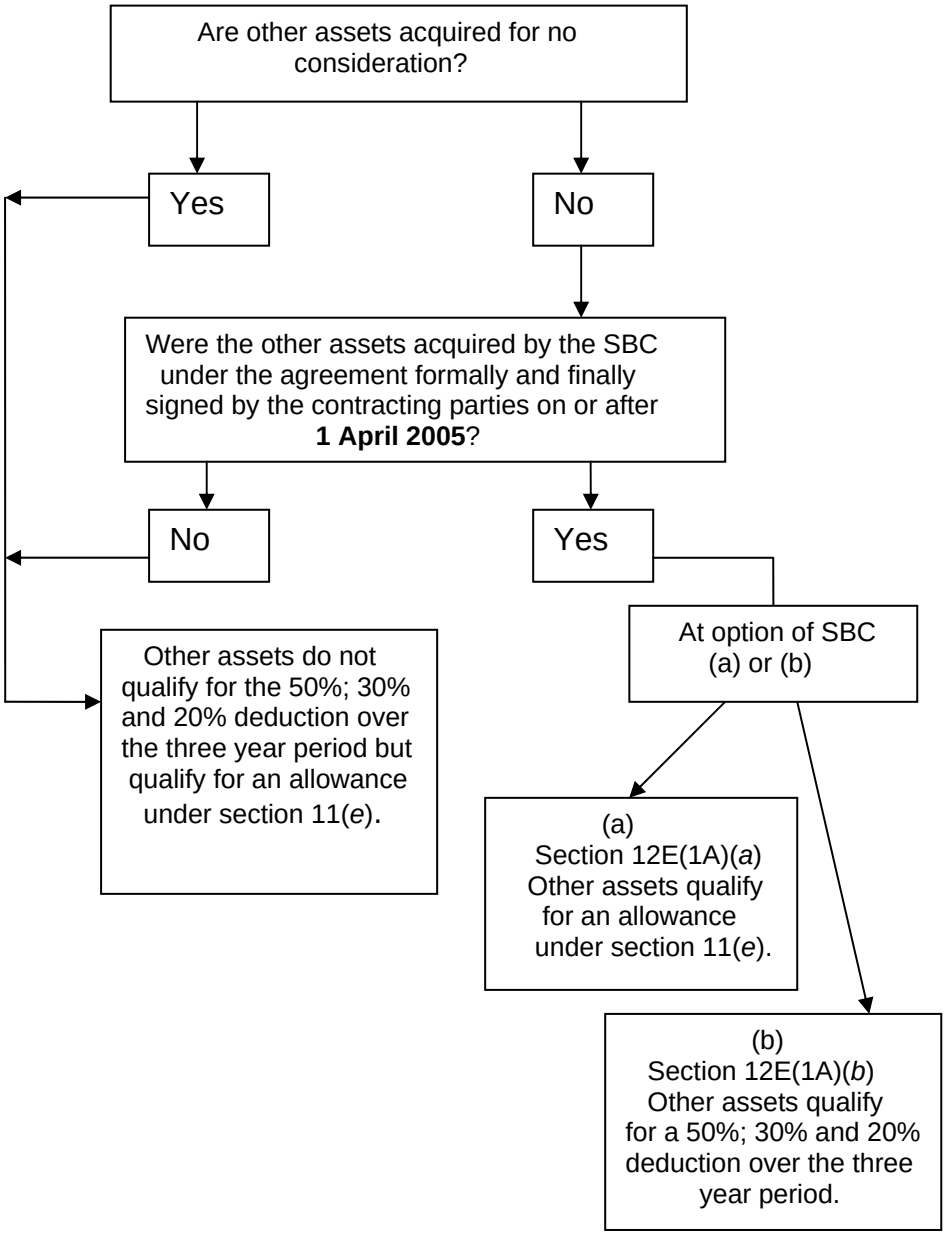
[4] Amendments as per the Taxation Law Amendment Act, No.17 of 2009, and effective from the commencement of years of assessment ending on or after 1 January 2010.

[5] Employment company deleted as a disqualifier and substituted by s 23(1)(*f*) of the Revenue Laws Amendment Act, No.60 of 2008 with effect from 1 March 2009 and applies in respect of a year of assessment commencing on or after that date.

Annexure B – Flowchart –SBC qualification



Annexure C – Plant or machinery ("an asset") used by an SBC directly in a process of manufacture or process of similar nature



Annexure D – Other assets used by an SBC not in a process of manufacture or process of a similar nature