

**INTERPRETATION NOTE: NO. 64 (Issue 2)**

DATE: 6 November 2012

**ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)**  
**SECTION : SECTION 10(1)(e)**  
**SUBJECT : INCOME TAX EXEMPTION: BODIES CORPORATE ESTABLISHED UNDER THE SECTIONAL TITLES ACT NO. 95 OF 1986, SHARE BLOCK COMPANIES ESTABLISHED UNDER THE SHARE BLOCKS CONTROL ACT NO. 59 OF 1980 AND ASSOCIATIONS OF PERSONS MANAGING THE COLLECTIVE INTERESTS COMMON TO ALL MEMBERS**

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### **Preamble**

In this Note unless the context indicates otherwise –

- “basic exemption” means the exemption of income from all other sources other than levy income, up to a maximum of R50 000;
- “body corporate” means a body corporate established under the Sectional Titles Act, 1986;
- “Companies Act, 1973” means the Companies Act No. 61 of 1973;
- “Companies Act, 2008” means the Companies Act No. 71 of 2008;
- “levy” or “levy income” is the amount received or accrued from the members for the purposes of funding expenditure relating to their collective interests;
- “member” means a member of a body corporate, a shareholder of a share block company or a member of an association of persons;
- “section” means a section of the Act;
- “Sectional Titles Act, 1986” means the Sectional Titles Act No. 95 of 1986;
- “share block company” means a share block company as defined in the Share Blocks Control Act, 1980;
- “Share Blocks Control Act, 1980” means Share Blocks Control Act No. 59 of 1980; and
- any word or expression bears the meaning ascribed to it in the Act.

### **1. Purpose**

This Note provides guidance on the application and interpretation of section 10(1)(e).

### **2. Background**

Section 10(1)(e) exempts from income tax the levy income of a body corporate, a share block company and an association of persons. It also provides an exemption for these entities of an amount up to a maximum of R50 000 for all their receipts and accruals other than levy income (the basic exemption).

### **3. The law**

#### **Section 10(1)(e)**

**10. Exemptions.**—(1) There shall be exempt from normal tax—

(e) (i) any levy received by or accrued to—

(aa) any body corporate established in terms of the Sectional Titles Act, 1986 (Act No. 95 of 1986), from its members;

- (bb) a share block company as defined in the Share Blocks Control Act, 1980 (Act No. 59 of 1980), from its shareholders; or
- (cc) any other association of persons (other than a company registered or deemed to be registered under the Companies Act, 1973 (Act No. 61 of 1973), or the Companies Act, 2008 (Act No. 71 of 2008), any co-operative, close corporation and trust, but including a company contemplated in section 21 of the Companies Act, 1973 (Act No. 61 of 1973), and a non-profit company as defined in section 1 of the Companies Act, 2008 (Act No. 71 of 2008)), from its members, where the Commissioner is satisfied that, subject to such conditions as he or she may deem necessary, such association of persons—
  - (A) has been formed solely for purposes of managing the collective interests common to all its members, which includes expenditure applicable to the common immovable property of such members and the collection of levies for which such members are liable; and
  - (B) is not permitted to distribute any of its funds to any person other than a similar association of persons:

Provided that such body, company or association is or was not knowingly a party to, or does not knowingly permit or has not knowingly permitted, itself to be used as part of any transaction, operation or scheme of which the sole or main purpose is or was the reduction, postponement or avoidance of liability for any tax, duty or levy which, but for such transaction, operation or scheme, would have been or would become payable by any person under this Act or any other law administered by the Commissioner; and

- (ii) any receipts and accruals other than levies derived by a body corporate, share block company or association contemplated in subparagraph (i), to the extent that the aggregate of those receipts and accruals does not exceed R50 000;

#### **4. Application of the law**

##### **4.1 Qualifying entities and the way in which they operate**

###### **4.1.1 Body corporate [section 10(1)(e)(i)(aa)]**

The Sectional Titles Act, 1986 provides for separate ownership of a unit in a development scheme. Generally, the buildings and land of the development scheme are divided into sections and common property. A unit refers to a particular section and an undivided share in the common property associated with that section.

Under the Sectional Titles Act, 1986 a body corporate is established to take responsibility for the enforcement of Rules<sup>1</sup> and for the control, administration and management of the common property for the benefit of all owners. A body corporate so established is a qualifying entity under section 10(1)(e)(i)(aa) unless it is a party to the type of transaction, operation or scheme discussed in 6.

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<sup>1</sup> This refers to the rules of a particular development scheme that has been established under the Sectional Titles Act, 1986. These rules provide for the control, management, administration, use and enjoyment of the sections in the development scheme and the common property.

Membership of the body corporate is compulsory and is linked to ownership in the development scheme. The members of the body corporate are required to contribute levies to meet the costs of the common property.

#### 4.1.2 Share block company [section 10(1)(e)(i)(bb)]

A share block company as defined in the Share Blocks Control Act, 1980 is a qualifying entity under section 10(1)(e) unless it is a party to the type of transaction, operation or scheme discussed in 6.

The Share Blocks Control Act, 1980 defines a share block company as follows:

**“[S]hare block company”** means a company the activities of which comprise or include the operation of a share block scheme;

The same Act defines a share block scheme as follows:

**“[S]hare block scheme”** means any scheme in terms of which a share, in any manner whatsoever, confers a right to or an interest in the use of immovable property;

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 company. The shareholder does not become the owner of the specific part of the immovable property which he or she is entitled to occupy, but merely acquires the right of use and occupation of it.

Under the Share Blocks Control Act, 1980 a share block company must establish a levy fund to which the shareholders contribute. The levy fund is used to defray expenditure in respect of repairs, upkeep, control and management and administration of the company and of the immovable property in respect of which it operates the share block scheme as well as payment of rates and other local authority charges for services. It is compulsory for the shareholders to contribute to the levy fund. Upon disposal of a share, the new shareholder automatically becomes a contributor to the fund.

#### 4.1.3 Association of persons [section 10(1)(e)(i)(cc)]

An association of persons includes –

- a company contemplated in section 21 of the Companies Act, 1973;
- a non-profit company as defined in section 1 of the Companies Act, 2008; and
- a voluntary association of members founded on a basis of mutual agreement whose intent and objectives are usually set out in a formal document such as a constitution,

which the Commissioner is satisfied –

- has been formed solely for purposes of managing the collective interests common to members which includes expenditure applicable to the common immovable property of such members and the collection of levies for which such members are liable [section 10(1)(e)(i)(cc)(A)]; and
- is not permitted to distribute any of its funds to any person other than a similar association of persons [section 10(1)(e)(i)(cc)(B)].

The Commissioner may prescribe conditions to ensure that the requirements set out in the preceding two bullet points are met.

An association of persons which satisfies the Commissioner's requirements is a qualifying entity under section 10(1)(e)(i)(cc) unless it is a party to the type of transaction, operation or scheme discussed in 6.

A company registered or deemed to be registered under the Companies Act, 1973 or the Companies Act, 2008, a co-operative, close corporation and trust will not qualify under section 10(1)(e)(i)(cc).

A qualifying association of persons must apply to the SARS Tax Exemption Unit for approval (see 5.2) before it is entitled to the exemptions in section 10(1)(e).

Instead of the members taking individual responsibility for their share of the expenditure pertaining to the common immovable property, these associations accept the responsibility to control and manage the financial and administrative affairs on behalf of their members.

These associations may include home owners' associations or associations formed to control and manage the maintenance, security or appearance of the immovable property common to the members. The association takes responsibility for the collection of levies and for payment of expenditure incurred in respect of the common immovable property. Membership of the association is linked to the ownership or occupation of a particular unit or portion of the property. Members may include residents or owners of a particular residential area (security estates, complexes or gated communities) or tenants of a shopping centre or mall.

#### **Example 1 – Entities qualifying as associations of persons**

It is assumed that the associations of persons in these examples have met the requirements set out in section 10(1)(e)(i)(cc).

##### *Facts (1):*

The Green Estate Home Owners' Association has been formed to control and manage the maintenance and general expenditure on the common immovable property of Birchwood Estate, a security estate consisting of 30 residential stands. Under the constitution of the association, it is compulsory for all the owners to be members of the association and to contribute levies in order to defray expenditure incurred on the common property. These expenses include maintenance of the pavements, perimeter fence or wall, entrance gardens, guard house and security.

##### *Result (1):*

The levy income of the home owners' association qualifies for exemption from income tax under section 10(1)(e)(i)(cc).

##### *Facts (2):*

The City Mall Merchants' Association was formed by the developers of a shopping mall to control and manage the décor and aesthetics of the common property of the centre. It is compulsory for all the tenants to belong to the association and the members contribute levies to meet the relevant expenses.

*Result (2):*

The City Mall Merchants' Association is an association of persons contemplated in section 10(1)(e)(i)(cc). Its levy income is accordingly exempt from income tax.

*Facts (3):*

The ABC Residents' Association is an association of persons formed to control and manage the security of a gated area. The residents that fall within this gated community are collectively responsible for the costs of security patrols, the security gates and perimeter fencing. The residents are required to pay a monthly levy to defray the security costs.

*Result (3):*

The ABC Residents' Association is an association of persons contemplated in section 10(1)(e)(i)(cc). Its levy income is accordingly exempt from income tax.

*Facts (4):*

The Gated Community Residents' Association, membership of which is voluntary, was formed by private home owners in a residential area for purposes of controlling and managing the maintenance of the common road, security fencing, entrance boom gates and the cost of hiring security personnel. The owners of the residential stands contribute to the collective maintenance and upkeep of the common facilities.

*Result (4):*

The Gated Community Residents' Association is an association of persons contemplated in section 10(1)(e)(i)(cc). Its levy income is accordingly exempt from income tax.

**4.1.4. Time-share**

Under a time-sharing arrangement members of the public obtain the exclusive right to use or occupy a property for a specified period each year. The owners of time-share points do not own the common immovable property and are not responsible for expenditure relating to the property, such as maintenance or upkeep, repairs and improvements or bond repayments.

An entity selling time-sharing interests in holiday accommodation to members of the public which is not implemented under the Sectional Titles Act, 1986 or the Share Blocks Control Act, 1980 will not qualify for exemption under section 10(1)(e), since it is not a qualifying entity envisaged in that provision.

**4.2 Levy**

The exemption under section 10(1)(e)(i) is limited to the levy income received by or accrued to the qualifying entities referred to in **4.1**.

The term "levy" is not defined in the Act. In the context of section 10(1)(e) the levies received by or accrued to the entities under **4.1** are the amounts collected by them from their members to pay certain expenditure which arises from the management of the collective interests of the members. Were it not for the qualifying entities that manage the collective interests, the members would be responsible for paying and administering their share of the expenditure.

A “general” levy usually covers the day-to-day running, maintenance or operating costs. A “special” levy may be raised to pay for capital improvements (such as the installation of a satellite dish, the laying of paving or upgrading of security fencing) or to create a reserve for future capital expenditure (such as the future resurfacing of a tennis court or the future upgrading of an entrance and guard house). General and special levies received by or accrued to the qualifying entities referred to in 4.1 are exempt from normal tax.

#### *Building penalty levies*

The management rules of a home owners’ association sometimes provide for a higher levy to be paid by a member for failing to commence or complete building activities within a certain period. Typically such a “building penalty levy” is expressed as a multiple of the normal levy, its primary purpose being to recover additional costs incurred by the home owners’ association as a result of delayed construction. Such costs include, for example, the cost of repairing damage to roads and kerbs caused by heavy construction vehicles and the additional cost of hiring security personnel to ensure that the security of other home owners is not compromised by the presence of vacant stands or by the influx of construction workers. A building penalty levy of this nature will qualify for exemption as a levy and must be distinguished from a penalty or fine

#### *Fines*

A member may be required to pay an additional amount over and above any general or special levy which is not related to expenditure incurred or to be incurred in relation to the common property. Receipts of this nature often arise as a result of a member’s conduct or lack thereof and are instituted to encourage a desired behaviour. In these instances the receipts will not qualify as levy income under section 10(1)(e)(i) as they do not represent an amount collected with the intention of funding expenditure relating to the common property. Examples include amounts charged as a penalty for littering or engaging in activities that disturb other residents.

#### *Late payments*

Late payment penalties or interest charged on outstanding levies or other amounts payable to a qualifying entity do not comprise levy income.

#### *Stabilisation fund levies*

Home owners’ associations sometimes establish a levy stabilisation fund for the purposes of subsidising day-to-day expenditure and to provide a reserve for future capital improvements or unforeseen expenditure on the common immovable property. A fund of this nature is intended to ensure that the monthly and special levies remain affordable by smoothing out the levies thus avoiding undue increases in monthly levies. The levy may be imposed as a once-off payment either when the owner disposes of a unit (a departure or exit levy) or when a person purchases a unit (an entry levy). The payments may be fixed or determined as a percentage of a certain amount such as a percentage of the selling price of the unit.

The contribution to the stabilisation fund of a qualifying association will be regarded as a levy as contemplated in section 10(1)(e)(i) provided the following requirements and conditions are met:

- The founding document of the association must make provision for the establishment of a levy stabilisation fund including rules relating to the governance thereof.
- The founding document must stipulate that the funds of the stabilisation fund may only be used to defray expenditure on the common immovable property governed by the association.
- The levy must be a charge imposed by the association on the member. If the levy is payable by the owner upon alienation of a unit, the founding document must specify that the amount to be paid into the levy stabilisation fund on joining the association is a liability due, although only payable by the member when the member alienates the unit or property.
- The methodology under which the amount that will be payable to the levy stabilisation fund is to be determined, must be specified in the founding document.

#### 4.3 Basic exemption and effective date

The basic exemption of an amount up to a maximum of R50 000 [section 10(1)(e)(ii)] applies to all the receipts and accruals other than levy income of the qualifying entities described in 4.1.

The basic exemption came into operation on 1 January 2009 and applies from the commencement of years of assessment ending on or after 1 January 2009. This means that the basic exemption is applicable to all qualifying entities whose year of assessment ends on or after 1 January 2009.

The basic exemption of R50 000 is applied to the total receipts and accruals, excluding the levy income, which are taxable and not to each separate source of income.

#### Example 2 – Basic exemption

##### *Facts:*

The ABC Estate Home Owners' Association has been formed to manage the maintenance and general expenditure relating to the common immovable property of ABC Estate. The following income is reflected in the financial statements for the year ended 31 October 2012:

	R
Levies received from members	460 240
Rent from cell mast	120 000
Interest on investment	<u>80 000</u>
Total income	<u>660 240</u>

##### *Result:*

#### **Income exempt from income tax**

	R
Levies – exempt from normal tax under section 10(1)(e)(i)	<u>460 240</u>



<b>Receipts and accruals subject to income tax</b>	
Rent from cell mast	120 000
Interest on investment	<u>80 000</u>
Total receipts and accruals subject to income tax	200 000
Less: Basic exemption	<u>(50 000)</u>
Income subject to income tax (before allowable deductions)	<u>150 000</u>

## 5. Application for exemption

### 5.1 Bodies corporate and share block companies

Bodies corporate and share block companies are not registered at the SARS Tax Exemption Unit for income tax purposes but at a SARS branch office. A body corporate or share block company is not required to apply for exemption under section 10(1)(e)(i)(aa) or (bb) respectively. The levy income exemption and the basic exemption are applied on assessment. These entities are required to register for income tax purposes and submit annual income tax returns even if they are unlikely to have an income tax liability.

### 5.2 Association of persons

The Commissioner's satisfaction as to whether the two requirements discussed in 4.1.3 have been met, will be considered when the association lodges its application for approval with the SARS Tax Exemption Unit.

The Commissioner may prescribe conditions which the association of persons must comply with before the Commissioner will be satisfied that the above-mentioned requirements have been met. Additional conditions may be prescribed.

The following should be included in the founding document:

- The sole object of the association of persons must be to manage the collective interests common to all its members, which includes expenditure applicable to the common property and the collection of levies for which such members are liable.
- The association of persons is not permitted to distribute its funds to any person other than to a similar association of persons.
- Any amendments to the memorandum and articles of association or constitution of the association of persons must be submitted to the Commissioner for approval.
- On dissolution of the association of persons, its remaining assets must be distributed to a similar association of persons which is also exempt from income tax under section 10(1)(e).

**Note:** Without the Commissioner's approval an association of persons will be fully taxable on all its receipts and accruals. Contact details of the SARS Tax Exemption Unit are available on the SARS website which also contains the procedure for applying for the Commissioner's approval.

## **6. Prohibited transactions, operations or schemes**

The exemption under section 10(1)(e) does not apply to an entity referred to in **4.1** that is a party to a transaction, operation or scheme the sole or main purpose of which is or was to reduce, postpone or avoid any tax, levy or duty otherwise payable by any person under the Act or any other Act administered by the Commissioner. The denial of the relief will only apply if the entity was knowingly a party to such an arrangement. Either the entity itself or any other person (for example, a shareholder or unit holder) may be the beneficiary of the reduction, postponement or avoidance of any applicable tax, duty or levy. The type of tax, duty or levy that has been so reduced, postponed or avoided may arise under the Act (for example, donations tax, income tax, or dividends tax) or under any other Act administered by the Commissioner (for example, value-added tax or transfer duty). The Acts administered by the Commissioner involving tax, duties or levies are set out in Schedule 1 of the South African Revenue Service Act No. 34 of 1997.

## **7. Determination of taxable income**

### **7.1 Receipts and accruals**

#### **7.1.1 Levy income**

Levy income (see **4.2**) received by or accrued to qualifying entities (see **4.1**) is exempt from income tax.

Expenditure incurred by the qualifying entities referred to in **4.1** in relation to the management of the collective interests of members or shareholders and which is funded by the levies from the members or shareholders is not allowable as a deduction in determining the entities' taxable income. This is because it is incurred in the production of exempt income [section 11(a) and 23(f)]. Consequently, such expenditure in excess of the levy income may not be set off against other income which is subject to income tax and must be disregarded in determining taxable income.

#### **7.1.2 Receipts and accruals from sources other than levy income**

Receipts and accruals from a source other than levy income will be subject to income tax. Examples include –

- fees charged for the use of facilities and equipment such as squash courts, tennis courts, and washing machines;
- rental income from the letting of immovable property such as parking bays, servants' quarters and a demarcated area for a cell phone mast;
- investment income;
- interest received or accrued from members as a result of the late payment of amounts due by them;
- income received for services rendered; and
- amounts receivable as a result of non-compliance (excluding building penalties – see **4.2**).

Receipts and accruals derived from these sources (less the basic exemption), less allowable expenditure attributable to them, will constitute taxable income which is subject to tax.

**Note:** The exemption for interest income under section 10(1)(i) does not apply to the entities referred to in section 10(1)(e) since it only applies to natural persons.

Additional amounts charged on unpaid levies or late payment of levies, and fines paid for not adhering to the management rules (excluding building penalties – see 4.2) are not regarded as levies qualifying for exemption. In determining whether an amount is a levy, regard must be had to the true nature of the transaction. Thus, for example, a charge for the late payment of a levy is likely to be in the nature of interest.

## 7.2 Expenditure

Expenditure relating directly to the receipts and accruals which do not qualify for exemption, will qualify for deduction in determining taxable income provided it meets the requirements for deductibility under the Act.

General expenditure incurred (such as bank charges and audit fees) will be allowable as a deduction to the extent that it meets the requirements for deductibility under the Act, for example, it is not of a capital nature.

The use of a fixed percentage of the general expenditure for the purpose of allocating it to a particular source of income is not acceptable. General expenditure must be allocated to the various sources of income on a logical, fair and reasonable basis. For example, depending on the facts it may be acceptable to allocate the general expenses *pro rata* by applying the ratio that a particular source of receipts and accruals bears to the total receipts and accruals derived by the entity.

As the basic exemption applies to receipts and accruals other than levies, the taxable portion of those receipts and accruals must be determined before calculating allowable deductions.

### Example 3 – Calculation of taxable income

*Facts:*

The XYZ Home Owners' Association, a non-profit company as defined in section 1 of the Companies Act, 2008, has been approved by the Commissioner for the purposes of section 10(1)(e)(i)(cc).

Its financial statements for the year ended 30 June 2012 reflect the following income and expenditure:

<b>1. Receipts and accruals</b>	<b>R</b>
Monthly levies from members	2 000 000
Building penalty levies	40 000
Penalty on late payment of levies and fines for non-compliance	80 000
Interest on investments	<u>20 000</u>
Total receipts and accruals	<u><u>2 140 000</u></u>
<b>2. Expenditure</b>	
Administration and management fees*	1 180 000
Maintenance guard house*	15 000
Maintenance security fence and gates*	102 800
Security services*	234 000
Garden services*	107 200

Insurance*		160 000
Water*		200 000
Electricity*		195 000
Bank charges		2 000
Audit fees		<u>12 000</u>
Total expenses		<u>2 208 000</u>
<b>Note:</b> Levy income of R2 000 000 plus building penalty levies of R40 000 are exempt under section 10(1)(e)(i) and the expenditure relating to such levy income (see * above) is not allowed as a deduction [section 11(a) and 23(f)].		
<i>Result:</i>		
<b>3. Receipts and accruals not qualifying for exemption</b>		
Interest on late payment of levies and fines		80 000
Interest on investments		<u>20 000</u>
Total receipts and accruals subject to income tax		<u>100 000</u>
<b>4. Apply basic exemption</b>		
Gross receipts and accruals subject to income tax		100 000
Less: Basic exemption		<u>(50 000)</u>
Income subject to income tax		<u>50 000</u>
<b>5. Apportion general expenditure to income</b>		
<b>General expenditure:</b>		
Bank charges		3 000
Audit fees		<u>15 000</u>
Total deductions		<u>18 000</u>
<u>Source of receipts and accruals</u> x <u>Allowable expenditure</u>		
Total receipts and accruals		1
<b>Levy income:</b>	<u>2 040 000</u> x <u>18 000</u>	= <u>R17 158</u>
	2 140 000	1
<b>Basic exemption:</b>	<u>50 000</u> x <u>18 000</u>	= <u>R421</u>
	2 140 000	1
<b>Income not qualifying for exemption:</b>		
	<u>50 000</u> x <u>18 000</u>	= <u>R421</u>
	2 140 000	1
<b>6. Calculate taxable income</b>		
Income subject to income tax (4)		50 000
Less: Allowable deductions (5)		<u>(421)</u>
Taxable income		<u>49 579</u>
<b>7. Calculate income tax payable</b>		
Taxable income (6)		49 579
Income tax payable at 28% (2012/13 company tax rate)		<u>13 882.12</u>

## 8. Rate of tax

A body corporate, a share block company and an association of persons fall within the definition of a “company” in section 1(1) and are thus treated as companies for income tax purposes and pay tax at the company rate on their taxable income.

## 9. Provisional tax

As from the commencement of years of assessment ending on or after 1 January 2009, any body corporate, share block company or association of persons contemplated in section 10(1)(e) is exempt from making provisional tax payments. They are excluded from the definition of a “provisional taxpayer” in paragraph 1 of the Fourth Schedule to the Act and are therefore not required to submit provisional tax returns. Should these entities have taxable income, any liability to income tax will become payable on assessment.

## 10. Donations tax

Under section 56(1)(h) donations made by or to an entity referred to in section 10(1)(e) are exempt from donations tax.

## 11. Capital gains tax (CGT)

All capital gains and capital losses made on the disposal of assets must be taken into account in determining a taxable capital gain or assessed capital loss unless excluded by specific provisions. The CGT provisions are contained in the Eighth Schedule to the Act. CGT forms part of the income tax system and a taxable capital gain must be included in taxable income under section 26A. A body corporate, a share block company and an association of persons have an inclusion rate of 66,6%.<sup>2</sup> This means that only 50% of a capital gain will be included in the taxable income of a company.

In practice it would be unusual for a body corporate, a share block company or an association of persons to derive a capital gain during the normal course of its operations as illustrated by the following examples:

- Movable depreciable assets such as washing machines used in a common laundry room are unlikely to yield capital gains on disposal because this would require a consideration in excess of the original cost.
- A share block company only holds the bare *dominium* in the immovable property which is likely to be of little value given the indefinite right of use and occupation held by its shareholders.
- The common property in a development scheme is owned by the sectional title holders jointly in undivided shares and not by the body corporate.<sup>3</sup> Thus the sale of a portion of the common property will not have CGT consequences for the body corporate; rather the unit holders must account for any capital gain or capital loss.

<sup>2</sup> The inclusion rate in paragraph 10 of the Eighth Schedule was increased from 50% to 66,6% by section 9 of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 13 of 2012 and applies to years of assessment commencing on or after 1 March 2012.

<sup>3</sup> Section 16 of the Sectional Titles Act, 1986.

- The transfer of a unit in a share block company to its member as part of the conversion to sectional title will not give rise to a capital gain in the company. In this regard paragraph 67B(1)(a) of the Eighth Schedule provides that the share block company must disregard any capital gain or capital loss on the disposal of a unit under item 8 of Schedule 1 to the Share Blocks Control Act, 1980. Likewise, the transferee must disregard any capital gain or loss on surrender of the share and its stapled right of use and occupation. The transferee is granted roll-over treatment. In other words, details such as the cost and date of acquisition of the shares, cost and date of effecting improvements and usage of the unit are carried over to the sectional title unit.<sup>4</sup>

Capital gains may arise on conversion of a company to a share block company as a result of the disposal of the right of use and occupation to the shareholders. Conversely, in a share block company if a shareholder's right of use and occupation is cancelled and the property or a portion of it is distributed to the shareholders, there will be a disposal by the share block company with attendant CGT consequences (assuming paragraph 67B above does not apply).

**Note:** Clause 129 of the Taxation Laws Amendment Bill B 34—2012 proposes to expand the relief provided by paragraph 67B. The existing paragraph only applies to the transfer of a unit to a shareholder to be held under sectional title but the proposed relief will include the transfer of property to be held under freehold title.

For more information refer to the *Comprehensive Guide to Capital Gains Tax* (Issue 4) which is available on the SARS website.

## 12. Secondary tax on companies (STC)

STC is payable by a "company" that is a "resident" at the rate of 10% on the "net amount" of any dividend declared.<sup>5</sup> The net amount is the amount remaining after deducting from the dividend declared any dividends accrued during the dividend cycle. A dividend cycle begins and ends each time a dividend is declared. A share block company as defined in the Share Blocks Control Act, 1980 and a body corporate established under the Sectional Titles Act, 1986 are included in the definition of a "company" in section 1(1)<sup>6</sup> and are thus subject to STC on any dividends declared. In practice, however, it would be extremely rare for a share block company or body corporate to declare a dividend in the normal course of its operations. STC implications typically arise when a company converts to a share block company, since this involves the transfer of an asset to a shareholder in the form of the right of use and occupation of the company's property. A dividend may also arise when a share block company converts to a normal company and the share block company's property is distributed to the shareholders.

A share block company and a body corporate do not qualify for exemption from STC under section 64B(5)(a). Section 64B(5)(a) applies to a company the entire receipts and accruals of which, or so much of the receipts and accruals of which are derived otherwise than from investments, are exempt from tax under section 10. In addition,

<sup>4</sup> For more on paragraph 67B, see paragraph 13.6 of the *Comprehensive Guide to CGT* (Issue 4).

<sup>5</sup> The terms "company" and "resident" are defined in section 1(1).

<sup>6</sup> An association of persons is also included in the definition of a "company" in section 1(1). However, since it is not permitted to distribute its funds to any person other than a similar association of persons [section 10(1)(e)(i)(cc)(B)] it should not be capable of declaring a dividend.

the company must not be exempt solely because it derives gross income of a particular nature. A share block company or body corporate is not exempt from tax on all its receipts and accruals. Only its levy income is exempt under section 10(1)(e) and all other income (including amounts derived from investments and trade) in excess of the basic exemption of R50 000 is taxable (see **7.1.2**).

For more information on STC refer to the *Comprehensive Guide to Secondary Tax on Companies (Issue 3)* which is available on the SARS website.

**Note:** STC has been replaced by the dividends tax from 1 April 2012.

### 13. Dividends tax

Dividends tax came into operation on 1 April 2012. It is a withholding tax imposed on shareholders comprising individuals, trusts and non-residents. In other words, it does not apply to resident companies. Since an entity qualifying for exemption under section 10(1)(e) is a resident company it will not be liable for the dividends tax on the receipt or accrual of any dividends.

Clause 87 of the Taxation Laws Amendment Bill B 34—2012 proposes to insert section 64FA(1)(d) which will exempt from dividends tax any dividend that comprises a disposal contemplated in paragraph 67B(1) of the Eighth Schedule (see **11**). The proposed amendment comes into operation on 1 January 2013 and applies to dividends paid on or after that date.

### 14. Conclusion

In conclusion –

- only the levy income of share block companies, bodies corporate and qualifying associations of persons referred to in section 10(1)(e)(i) is fully exempt from income tax;
- the sum of other income received by those entities is subject to a basic exemption limit of R50 000;
- share block companies, bodies corporate and qualifying associations of persons referred to in section 10(1)(e)(i) are exempt from the payment of provisional tax and are not required to submit provisional tax returns;
- share block companies and bodies corporate do not have to apply to SARS in order to enjoy exemption from income tax under section 10(1)(e); and
- the qualifying associations of persons referred to in section 10(1)(e)(i)(cc) (for example, home owners' associations) are required to apply for exemption to the SARS Tax Exemption Unit in order to qualify for exemption from income tax under section 10(1)(e).