

INTERPRETATION NOTE 67 (Issue 4)

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ACT : INCOME TAX ACT 58 OF 1962
SECTION : SECTION 1(1), DEFINITION OF “CONNECTED PERSON”
SUBJECT : CONNECTED PERSONS

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Preamble

In this Note unless the context indicates otherwise –

- “**CGT**” means capital gains tax, being the normal tax attributable to the inclusion of a taxable capital gain in taxable income under section 26A;
- “**paragraph**” means a paragraph of the definition of “connected person” in section 1(1);
- “**Schedule**” means a Schedule to the Act;
- “**section**” means a section of the Act;
- “**TA Act**” means the Tax Administration Act 28 of 2011;
- “**the Act**” means the Income Tax Act 58 of 1962; and

- any other word or expression bears the meaning ascribed to it in the Act.

All guides and interpretation notes referred to in this Note are available on the SARS website at www.sars.gov.za. Unless indicated otherwise, the latest issue of these documents should be consulted.

1. Purpose

This Note provides guidance on the interpretation and application of the definition of “connected person” in section 1(1).

Section 1(1) of the Value-Added Tax Act 89 of 1991 contains a definition of “connected persons”. Apart from the fact that the term is defined in the plural, there are a number of other significant differences between the value-added tax definition and the income tax definition. For example, the value-added tax definition includes the estates of deceased and insolvent persons, a partnership, and in specified circumstances, a branch or division of a person, while the income tax definition does not. Although the two definitions share some common features, this Note focuses on the income tax definition only and should not be relied on for purposes of interpreting the value-added tax definition.

Section 1 of the TA Act defines “connected person” as meaning “a connected person as defined in section 1 of the Income Tax Act”.

2. Background

The Income Tax Act 113 of 1993 introduced the definition of “connected person” into section 1.¹ This definition is central to specific anti-avoidance provisions that regulate the tax consequences of transactions entered into between related taxpayers. Such related-party transactions are more likely to be open to manipulation in order to secure a fiscal advantage than transactions entered into between unconnected parties, hence the need for specific rules to deal with connected persons.

3. The law and its application

This Note reflects the law as amended by the Taxation Laws Amendment Act 34 of 2019 which was promulgated on 15 January 2020.

For ease of reference, the current definition of “connected person” in section 1(1) is quoted in full in **Annexure A**.

The definition of “connected person” identifies connected persons in relation to different types of person, namely –

- natural persons [paragraph (a)];
- trusts [paragraph (b)];
- connected persons in relation to a trust [paragraph (bA)];
- members of partnerships or foreign partnerships [paragraph (c)]; and

¹ The definition became effective as from 21 June 1993. It replaced the previous definition of “connected person” in section 12C(6) that was relevant in the context of that section only. The definition in section 1(1) has been amended since it was originally introduced.

- companies and close corporations [paragraph (d)].

The definition also establishes the reverse relationship between the persons that are connected persons in relation to the above persons [paragraph (e)]. In other words, if A is a connected person in relation to B, B is a connected person in relation to A.

In identifying the connected person relationship between persons, more than one paragraph of the definition may need to be considered depending on the facts of each case.

3.1 Connected person in relation to a natural person

3.1.1 Paragraph (a)

“Connected person” means –

- (a) in relation to a natural person—
 - (i) any relative; and
 - (ii) any trust (other than a portfolio of a collective investment scheme)² of which such natural person or such relative is a beneficiary;

3.1.2 Meaning of “natural person” [paragraph (a)]

Paragraph (a) determines who is a connected person in relation to a natural person. The term “natural person” is not defined in the Act and must therefore be given its ordinary legal meaning. *LAWSA* states the following in this regard:³

“Modern law distinguishes between two classes of persons: (a) natural persons; and (b) juristic or artificial persons...All human beings, irrespective of their age, mental condition or intellectual ability, are recognised as legal subjects. Every human being therefore can have rights, duties and capacities although the content of these rights, duties and capacities may vary depending on factors such as the person’s mental condition and age. To distinguish them from other juristic persons humans are referred to as ‘natural persons’.”

LAWSA continues:⁴

“A natural person’s legal personality begins at birth. Before birth the unborn foetus is not a legal subject but merely forms part of the mother.”

(Footnotes suppressed.)

See **3.10** for a discussion of the definition of “connected person” in relation to deceased and insolvent estates.

² The definition was amended with effect from 8 January 2016 (the date of promulgation of the Taxation Laws Amendment Act 25 of 2015) to exclude all portfolios of collective investment schemes from a trust. Previously, only a portfolio of a collective investment scheme in securities and a portfolio of a collective investment scheme in property were excluded.

³ DSP Cronje (updated by M Carnelley) “Different Kinds of Person” 20(1) (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 30 November 2009) in paragraph 439.

⁴ DSP Cronje (updated by M Carnelley) “Moment of Beginning” 20(1) (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 30 November 2009) in paragraph 440.

3.1.3 A relative [paragraph (a)(i)]

A relative of a natural person is a connected person in relation to that person. The term “relative” is defined in section 1(1) as follows:

“**[R]elative**” in relation to any person, means the spouse of that person or anybody related to that person or that person’s spouse within the third degree of consanguinity, or any spouse of anybody so related, and for the purpose of determining the relationship between any child referred to in the definition of “child” in this section and any other person, that child shall be deemed to be related to the adoptive parent of that child within the first degree of consanguinity;

A relative of a natural person includes –

- that person’s spouse;
- anybody related to that person within the third degree of consanguinity;
- anybody related to that person’s spouse within the third degree of consanguinity; and
- the spouse of anybody related within the third degree of consanguinity to that person or to that person’s spouse.

A person falling within the definition of “relative” in section 1(1) will be a relative in relation to another person if both persons are alive at the date of determining the relationship between them. A natural person and that person’s spouse will cease to be relatives in relation to each other on termination of their marriage upon the spouse’s death. *LAWSA* confirms this view as follows:⁵

“The death of one of the spouses terminates the marriage and all its consequences.”

In *Davis & another NNO v CIR* it was held that –⁶

“no one can be the spouse of a deceased person”.

The deceased estate or insolvent estate of a natural person is, however, treated as a natural person under specified circumstances – see **3.10** dealing with deceased and insolvent estates.

The term “spouse” is defined in section 1(1) as follows:

“**[S]pouse**”, in relation to any person, means a person who is the partner of such person—

- (a) in a marriage or customary union recognised in terms of the laws of the Republic;
- (b) in a union recognised as a marriage in accordance with the tenets of any religion; or
- (c) in a same-sex or heterosexual union which is intended to be permanent,

and “**married**”, “**husband**” or “**wife**” shall be construed accordingly: Provided that a marriage or union contemplated in paragraph (b) or (c) shall, in the absence of proof to the contrary, be deemed to be a marriage or union out of community of property;

⁵ J Heaton, J Church & J Church “Marriage/General” 16 (Second Edition) *LAWSA* [online] (My LexisNexis: 31 March 2006) in paragraph 154.

⁶ 1960 (3) SA 360 (T), 23 SATC 443 at 444.

The assessment of whether a relationship is intended to last for an indefinite period, and is thus considered permanent, will be based on a review of all the facts and circumstances applicable to the particular case.

The word “consanguinity” is not defined in the Act. Dictionaries describe its ordinary meaning as follows:

“[R]elationship by blood as opposed to affinity or relationship by marriage.”⁷

“[O]f the same blood.”⁸

“1 Relationship by descent from a common ancestor; blood relationship.”⁹

The degree of relationship between two persons is determined by counting the number of steps up to a common ancestor and then, if necessary, the number of steps down to the person concerned. For example, a cousin is related in the fourth degree (person [up to] parent (1) [up to] grandparent (2) [down to] uncle or aunt (3) [down to] cousin (4)).

For purposes of determining the degree of consanguinity in the definition of “relative”, the first, second and third degrees of consanguinity are relevant (see the diagram in **Annexure B**).

The following persons qualify as “relatives” in relation to any person, based on their respective degrees of consanguinity:

- Children (including adopted children¹⁰) (first degree of consanguinity)
- Grandchildren (second degree of consanguinity)
- Great-grandchildren (third degree of consanguinity)
- Parents (first degree of consanguinity)
- Grandparents (second degree of consanguinity)
- Great-grandparents (third degree of consanguinity)
- Brothers and sisters (second degree of consanguinity)
- Nephews and nieces¹¹ (third degree of consanguinity)
- Uncles and aunts (third degree of consanguinity)

A cousin, being related within the fourth degree of consanguinity, falls outside the definition of “relative”.

⁷ EM Kirkpatrick *Chambers 20th Century Dictionary* new ed (1983) W& R Chambers Ltd.

⁸ C Soanes, A Stevenson & S Hawker *Concise Oxford English Dictionary* 11 ed revised (2006) Oxford University Press.

⁹ A Stevenson *Shorter Oxford English Dictionary on Historical Principles* 6 ed (2007) Oxford University Press in vol 1.

¹⁰ Under the definition of “relative” in section 1(1) an adopted child is deemed to be related to his or her adoptive parent within the first degree of consanguinity.

¹¹ Children of a brother or sister.

The term “child” is defined in section 1(1) as follows:

“**[C]hild**”, in relation to any person, includes any person adopted by him or her—

- (a) under the law of the Republic;¹² or
- (b) under the law of any country other than the Republic, provided the adopted person is under such law accorded the status of a legitimate child of the adoptive parent and the adoption was made at a time when the adoptive parent was ordinarily resident in such country;

Example 1 – Connected person in relation to a natural person

Facts:

E is married to F. B and A are the parents of E, and C and D are the parents of F.

Are B and A connected persons in relation to C and D under paragraph (a)(i)?

Result:

B and A are not connected persons in relation to C and D under paragraph (a)(i), since they are not related to them within the third degree of consanguinity and therefore are not relatives of C and D.

Example 2 – Connected person in relation to a natural person

Facts:

B and A have the same father but different mothers.

Is B a connected person in relation to A under paragraph (a)(i)?

Result:

B is related to A within the second degree of consanguinity, since B and A have the same father. B is therefore a connected person in relation to A under paragraph (a)(i).

Example 3 – Connected person in relation to a natural person

Facts:

A’s father, B, is married to C who is A’s stepmother.

Is C a connected person in relation to A under paragraph (a)(i)?

Result:

The term “relative” as defined in section 1(1) in relation to a person (C) includes anyone related to that person’s spouse (B) within the third degree of consanguinity. C is the spouse of B and, since A and B are related within the first degree of consanguinity, C is a relative and hence a connected person in relation to A under paragraph (a)(i).

¹² The adoption of persons is currently dealt with under the Children’s Act 38 of 2005.

Example 4 – Connected person in relation to a natural person

Facts:

The parents of X are C and D and the parents of Y are E and F. Both sets of parents are divorced. Subsequently D and E marry each other. X and Y are thus stepchildren in relation to their stepparents (Y is D's stepchild and X is E's stepchild). X and Y have not been adopted by their stepparents.

Are X and Y connected persons in relation to each other under paragraph (a)(i)?

Result:

Each stepchild is connected to his or her parent (first degree of consanguinity) and stepparent (being a relative of the stepparent by reason of their parent's spousal relationship – see Example 3). However, since X and Y do not have a common parent with whom they have a blood relationship, they are not relatives in relation to each other. Since they have not been adopted by their respective stepparents, they are also not deemed to be related to their stepparents within the first degree of consanguinity. Had they been so adopted, X and Y would have become related within the second degree of consanguinity and would have been connected persons in relation to each other.

3.1.4 A trust (other than a portfolio of a collective investment scheme) of which the natural person or relative is a beneficiary [paragraph (a)(ii)]

A trust is a connected person in relation to a natural person if the natural person, or a relative of the natural person, is a beneficiary of the trust.

The term “trust” is defined in section 1(1) as follows:

“**[T]rust**” means any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person;

The term “beneficiary” is defined in section 1(1) as follows:

“**[B]eneficiary**” in relation to a trust means a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust;

The authors of *Income Tax in South Africa* comment as follows on this definition:¹³

“The term ‘beneficiary’ is defined as meaning any person who has a vested or contingent interest in all or a portion of the receipts, accruals, or assets of a trust. This definition thus includes both capital and income beneficiaries. It is considered that so-called ‘discretionary beneficiaries’, whose interests are dependent upon the decisions from time to time of the trustees, have contingent interests as contemplated in the definition and are therefore ‘beneficiaries’ as defined, irrespective of whether or not they have ever been in receipt of any distributions or have formally accepted benefits. The same applies to members (named or unnamed) of any class of persons designated in the deed. Whether a particular person, whether or not identified by name, has such rights must always be a question of fact to be determined by examination of the trust deed. A contingent beneficiary whose rights are dependent upon reaching a specific

¹³ D Clegg & R Stretch *Income Tax in South Africa* [online] (My LexisNexis: July 2018) in paragraph 24.1.1.

age, will, it is submitted, also be a 'beneficiary' prior to that date, notwithstanding that the interest is entirely conditional upon survival to a future date;"¹⁴

SARS is in agreement with the authors' comments on the definition of "beneficiary".

Example 5 – Connected person in relation to a natural person

Facts:

B, who is the spouse of A, is a beneficiary of AB Family Trust.

Is AB Family Trust a connected person in relation to A under paragraph (a)(ii)?

Result:

AB Family Trust is a connected person in relation to A under paragraph (a)(ii) because B is a relative of A and a beneficiary of AB Family Trust.

Example 6 – Connected person in relation to a natural person

Facts:

D is the founder of ABC Family Trust. D's three grandchildren, A, B and C, were named as beneficiaries of the trust.

Is ABC Family Trust a connected person in relation to D under paragraph (a)(ii)?

Result:

A, B and C are related to D within the second degree of consanguinity and they are beneficiaries of ABC Family Trust. ABC Family Trust is therefore a connected person in relation to D under paragraph (a)(ii), since D's relatives are beneficiaries of the trust.

3.2 Connected person in relation to a trust (other than a portfolio of a collective investment scheme)

3.2.1 Paragraph (b)

Connected person means –

- (b) in relation to a trust (other than a portfolio of a collective investment scheme)—
- (i) any beneficiary of such trust; and
 - (ii) any connected person in relation to such beneficiary;

3.2.2 A beneficiary of the trust [paragraph (b)(i)]

A beneficiary of a trust is a connected person in relation to the trust (see 3.1.4 on the meaning of "beneficiary").

3.2.3 A connected person in relation to the beneficiary of the trust [paragraph (b)(ii)]

A person, who is a connected person in relation to a beneficiary of a trust, is also a connected person in relation to the trust.

¹⁴ See also *C: SARS v Airworld CC & another* 2008 (3) SA 335 (SCA), 70 SATC 48.

Example 7 – Connected person in relation to a trust*Facts:*

C is the founder of A Family Trust of which B Family Trust is the only beneficiary. The beneficiaries of B Family Trust are C, C's son D and C's stepchild E.

Are C, D and E connected persons in relation to A Family Trust under paragraph (b)(ii)?

Result:

B Family Trust is a connected person in relation to A Family Trust under paragraph (b)(i) because it is a beneficiary of A Family Trust.

C, D and E are connected persons in relation to B Family Trust under paragraph (b)(i) because they are all beneficiaries of B Family Trust. C, D and E are therefore connected persons in relation to A Family Trust under paragraph (b)(ii), since they are connected persons in relation to the beneficiary of A Family Trust, namely B Family Trust.

3.3 Connected person in relation to a connected person in relation to a trust**3.3.1 Paragraph (bA)**

Connected person means –

(bA) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment scheme), any other person who is a connected person in relation to such trust;

3.3.2 A person who is a connected person in relation to the trust [paragraph (bA)]

All connected persons in relation to a trust are connected persons in relation to one another. For purposes of paragraph (bA) a trust excludes a portfolio of a collective investment scheme (see 3.7).

The beneficiary of a trust and a company in which the trust holds at least 20% of the equity shares or voting rights are connected persons in relation to each other, since they are both connected persons in relation to the trust (see Example 9).¹⁵ Beneficiaries of the same trust are likewise connected to one another under paragraph (bA), since they are all connected persons in relation to the trust (see Example 8).

Example 8 – Connected person in relation to a connected person in relation to a trust*Facts:*

B Family Trust and AC CC are beneficiaries of ABC Family Trust.

Are B Family Trust and AC CC connected persons in relation to each other under paragraph (bA)?

¹⁵ Under paragraph (b)(i) the beneficiary would be a connected person in relation to the trust and under paragraphs (d)(iv) and (e) the company would be a connected person in relation to the trust.

Result:

B Family Trust and AC CC are both beneficiaries of, and connected persons in relation to, ABC Family Trust under paragraph (b)(i). B Family Trust and AC CC are therefore connected persons in relation to each other under paragraph (bA), since they are both connected persons in relation to ABC Family Trust.

Example 9 – Connected person in relation to a connected person in relation to a trust*Facts:*

ABC Trust holds all the equity shares and voting rights in XYZ (Pty) Ltd. MNO CC is a discretionary beneficiary of ABC Trust.

Are XYZ (Pty) Ltd and MNO CC connected persons in relation to each other under paragraph (bA)?

Result:

XYZ (Pty) Ltd is a connected person in relation to ABC Trust under paragraph (d)(iv) and paragraph (e) because ABC Trust holds 100% of the equity shares and voting rights in XYZ (Pty) Ltd (see 3.5.3 and 3.6.1).

MNO CC is a connected person in relation to ABC Trust under paragraph (b)(i) because it is a beneficiary of ABC Trust. XYZ (Pty) Ltd and MNO CC are connected persons in relation to each other under paragraph (bA), since they are both connected persons in relation to ABC Trust.

Example 10 – Connected person in relation to a connected person in relation to a trust*Facts:*

J and A, who are not relatives, are both beneficiaries of AJ Trust. K and B are respectively the spouses of J and A.

Are K and B connected persons in relation to each other under paragraph (bA)?

Result:

J and A are connected persons in relation to AJ Trust under paragraph (b)(i), since they are beneficiaries of AJ Trust.

K and B are relatives of J and A respectively and connected persons in relation to them under paragraph (a)(i). K and B are connected persons in relation to AJ Trust under paragraph (b)(ii), since they are connected persons in relation to the beneficiaries of AJ Trust. K and B are connected persons in relation to each other under paragraph (bA), since they are both connected persons in relation to AJ Trust.

3.4 Connected person in relation to a member of any partnership or foreign partnership

3.4.1 Paragraph (c)

Connected person means –

- (c) in relation to a member of any partnership or foreign partnership—
- (i) any other member; and
 - (ii) any connected person in relation to any member of such partnership or foreign partnership;

3.4.2 Any other member of the partnership [paragraph (c)(i)]

All members of a partnership or foreign partnership are connected persons in relation to one another.

Partners include ordinary profit-sharing partners and partners in extraordinary partnerships (in other words, silent partners¹⁶ and partners *en commandite*¹⁷).¹⁸ The existence and identity of silent and *en commandite* partners is typically not disclosed to the public but must, when required, be disclosed to SARS.

In *Bester v Van Niekerk*¹⁹ Holmes AJA confirmed that a joint venture, even one involving a single transaction, will be a partnership if it meets the following essentials:

- Each of the partners brings something into the partnership, or binds that person to bring something into it, whether it be money, or that person's labour or skill.
- The business must be carried on for the joint benefit of both parties.
- The object must be to make profit.
- In addition, the true intention of the parties must be to form a partnership.

The term "foreign partnership" is defined in section 1(1) as follows:

"[F]oreign partnership", in respect of any year of assessment, means any partnership, association, body of persons or entity formed or established under the laws of any country other than the Republic if—

- (a) for the purposes of the laws relating to tax on income of the country in which that partnership, association, body of persons or entity is formed or established—
 - (i) each member of the partnership, association, body of persons or entity is required to take into account the member's interest in any amount received by or accrued to that partnership, association, body of persons or entity when that amount is received by or accrued to the partnership, association, body of persons or entity; and

¹⁶ Anonymous, sleeping or dormant partners.

¹⁷ Commanditarian partners.

¹⁸ On extraordinary partnerships, see JJ Henning under "Partnership / Kinds of Partnership / Extraordinary Partnerships" in *LAWSA 19* (Second Edition Replacement Volume) [online] (My LexisNexis: 29 February 2016) in paragraph 260.

¹⁹ 1960 (2) SA 779 (A) at 783.

- (ii) the partnership, association, body of persons or entity is not liable for or subject to any tax on income, other than a tax levied by a municipality, local authority or a comparable authority, in that country;²⁰ or
- (b) where the country in which that partnership, association, body of persons or entity is formed or established does not have any applicable laws relating to tax on income—
- (i) any amount—
- (aa) that is received by or accrued to; or
- (bb) of expenditure that is incurred by,
- the partnership, association, body of persons or entity is allocated concurrently with the receipt, accrual or incurral to the members of that partnership, association, body of persons or entity in terms of an agreement between those members; and
- (ii) no amount distributed to a member of a partnership, association, body of persons or entity may exceed the allocation contemplated in subparagraph (i) after taking into account any prior distributions made by the partnership, association, body of persons or entity;

3.4.3 A connected person in relation to any member of the partnership or foreign partnership [paragraph (c)(ii)]

A person, who is a connected person in relation to a member of a partnership or foreign partnership, is also a connected person in relation to the other members of the partnership or foreign partnership.

Example 11 – Connected person in relation to a member of a partnership

Facts:

A and B are members of the AB Partnership. C, the spouse of B, is a beneficiary of ABC Trust.

Is ABC Trust a connected person in relation to A under paragraph (c)(ii)?

Result:

Under paragraph (c)(ii) ABC Trust will be a connected person in relation to A if it is a connected person in relation to any member of AB Partnership (that is, in relation to A or B). ABC Trust is a connected person in relation to B (and hence in relation to A) because –

- C is a relative of B, being B's spouse [definition of "relative" in section 1(1)]. C, being a relative of B, is therefore a connected person in relation to B under paragraph (a)(i);
- ABC Trust is a connected person in relation to C, since C is a beneficiary of that trust [paragraph (a)(ii)]; and

²⁰ Paragraph (a)(ii) of the definition was amended with effect from years of assessment ending on or after 31 December 2015 to include the words "other than a tax levied by a municipality, local authority or a comparable authority".

- ABC Trust is a connected person in relation to B because a relative of B, namely C, is a beneficiary of the trust [paragraph (a)(ii)].

3.5 Connected person in relation to a company

In determining whether a person is a connected person in relation to a company, regard must be had to each of the tests in paragraph (d)(i), (iv), (v), (vA) and (vi).

3.5.1 Paragraph (d)

Connected person means –

- (d) in relation to a company—
- (i) any other company that would be part of the same group of companies as that company if the expression “at least 70 per cent of the equity shares in” in paragraphs (a) and (b) of the definition of “group of companies” in this section were replaced by the expression “more than 50 per cent of the equity shares or voting rights in”;
 - (ii)
 - (iii)
 - (iv) any person, other than a company as defined in section 1 of the Companies Act that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of—
 - (aa) the equity shares in the company; or
 - (bb) the voting rights in the company;
 - (v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, and no holder of shares holds the majority voting rights in the company;
 - (vA) any other company if such other company is managed or controlled by—
 - (aa) any person who or which is a connected person in relation to such company; or
 - (bb) any person who or which is a connected person in relation to a person contemplated in item (aa); and
 - (vi) where such company is a close corporation—
 - (aa) any member;
 - (bb) any relative of such member or any trust (other than a portfolio of a collective investment scheme) which is a connected person in relation to such member; and
 - (cc) any other close corporation or company which is a connected person in relation to—
 - (i) any member contemplated in item (aa); or
 - (ii) the relative or trust contemplated in item (bb); and

The term “company” is defined in section 1(1) as follows:

“**[C]ompany**” includes—

- (a) any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law; or
- (b) any association, corporation or company incorporated under the law of any country other than the Republic or any body corporate formed or established under such law; or
- (c) any co-operative; or
- (d) any association (not being an association referred to in paragraph (a) or (f)) formed in the Republic to serve a specified purpose, beneficial to the public or a section of the public; or
- (e) any—
 - (i)
 - (ii) portfolio comprised in any investment scheme carried on outside the Republic that is comparable to a portfolio of a collective investment scheme in participation bonds or a portfolio of a collective investment scheme in securities in pursuance of any arrangement in terms of which members of the public (as defined in section 1 of the Collective Investment Schemes Control Act) are invited or permitted to contribute to and hold participatory interests in that portfolio through shares, units or any other form of participatory interest; or
 - (iii) portfolio of a collective investment scheme in property that qualifies as a REIT as defined in the listing requirements of an exchange approved in consultation with the Minister and published by the Prudential Authority, as defined in section 1 of the Financial Markets Act, in terms of section 11 of that Act; or
- (f) a close corporation,

but does not include a foreign partnership;

A portfolio comprised in any collective investment scheme in securities was deleted from the definition of “company” with effect from years of assessment commencing on or after 1 January 2010. For purposes of the definition of “connected person”, a portfolio of a collective investment scheme is deemed to be a company (see **3.8**).

3.5.2 A company that would form part of the same group of companies [paragraph (d)(i)]

A company that forms part of the same group of companies as another company, is a connected person in relation to the other company.

The terms “group of companies”, “controlling group company” and “controlled group company” are defined in section 1(1) as follows:

“[G]roup of companies” means two or more companies in which one company (hereinafter referred to as the “controlling group company”) directly or indirectly holds shares in at least one other company (hereinafter referred to as the “controlled group company”), to the extent that—

- (a) at least 70 percent of the equity shares in each controlled group company are directly held by the controlling group company, one or more other controlled group companies or any combination thereof; and
- (b) the controlling group company directly holds at least 70 per cent of the equity shares in at least one controlled group company;

“controlling group company” means a controlling group company contemplated in the definition of “group of companies”;

“controlled group company” means a controlled group company contemplated in the definition of “group of companies”;

For the purposes of the definition of “connected person”, paragraph (d)(i) refers to and modifies the definition of “group of companies” in section 1(1).

In applying the definition of “group of companies” in section 1(1), paragraph (d)(i) provides that the expression “at least 70 per cent of the equity shares in” is replaced with “more than 50 percent of the equity shares or voting rights in”. A company will thus form part of the same group of companies if more than 50% of its equity shares or voting rights are directly held by a controlling company, one or more other controlled group companies or any combination of such companies. The controlling group company should directly hold more than 50% of the equity shares or voting rights in at least one controlled group company.

In determining the “more than 50% of the equity shares or voting rights” requirement, a summation of direct holdings of controlling and controlled group company holdings in the company in question must be made. The calculation is not based on the determination of an effective percentage interest.

For example, if A owns 60% of B and B owns 60% of C, A’s 60% interest in B and B’s 60% interest in C will determine whether A and B, B and C, or A and C are part of the same group of companies. Taking into account A and B’s 60% shareholdings, A, B and C are part of the same group of companies for purposes of the definition of “connected person” in section 1(1). A’s effective interest in C of 36% (60% x 60%) is irrelevant for this purpose.

The reference to a controlling group company’s indirect holding of shares in the opening words of the definition of “group of companies” confirms that a group of companies can include multiple tiers.

Holding of equity shares

The term “equity share” is defined in section 1(1) as follows:

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

A distribution could take the form of a distribution of profits (dividends) or capital (return of contributed tax capital). As long as the right to participate in either of these types of distribution is unrestricted, the share will be an equity share. If both these rights are restricted, the share will not be an equity share.

It is considered that a person holds equity shares in a company if that person is the beneficial owner of the shares. The person named in the share register of a company, for example, an agent or intermediary, is not necessarily the beneficial owner of the shares.²¹

More than 50% of either the equity shares or the voting rights

A company will form part of the same group of companies if more than 50% of either its equity shares or voting rights are directly held by a controlling company, one or more other controlled group companies or any combination of such companies. The controlling group company should directly hold more than 50% of either the equity shares or voting rights in at least one controlled group company. It is not a requirement that more than 50% of both the equity shares and voting rights in a company must be held by the companies noted in this paragraph to qualify as a group of companies for purposes of paragraph (d)(i).

Example 12 – Connected person in relation to a company*Facts:*

XYZ (Pty) Ltd holds 51% of the equity shares in ABC (Pty) Ltd and 30% of the equity shares in MNO (Pty) Ltd. ABC (Pty) Ltd holds 51% of the equity shares in MNO (Pty) Ltd.

Are XYZ (Pty) Ltd, ABC (Pty) Ltd and MNO (Pty) Ltd connected persons in relation to one another under paragraph (d)(i)?

Result:

XYZ (Pty) Ltd, ABC (Pty) Ltd and MNO (Pty) Ltd are connected persons in relation to one another under paragraph (d)(i), since they form part of the same group of companies. This requirement is met because –

- XYZ (Pty) Ltd is a controlling group company, since it holds more than 50% of the equity shares in ABC (Pty) Ltd, namely 51%;

²¹ See, for example, cases dealing with beneficial entitlement such as *Geldenhuis v CIR* 1947 (3) SA 256 (C), 14 SATC 419; *SIR v Smant* 1973 (1) SA 754 (A), 35 SATC 1 and *Taxpayer v COT Botswana* (1980) 43 SATC 118. See also paragraph 2.3.1 of the *Comprehensive Guide to Dividends Tax* for a discussion of the meaning of “beneficial owner” for purposes of dividends tax. The term “beneficial owner” is defined in section 64D for purposes of dividends tax only. The discussion in the *Comprehensive Guide to Dividends Tax* also considers the general meaning of “beneficial owner”.

- ABC (Pty) Ltd is a controlling group company, since it holds more than 50% of the equity shares in MNO (Pty) Ltd, namely, 51%;
- ABC (Pty) Ltd and MNO (Pty) Ltd are controlled group companies in the same group of companies;
- more than 50% of the equity shares in ABC (Pty) Ltd are directly held by XYZ (Pty) Ltd, namely 51%; and
- more than 50% of the equity shares in MNO (Pty) Ltd are directly held by ABC (Pty) Ltd (51%) and XYZ (Pty) Ltd (30%).

Example 13 – Connected person in relation to a company

Facts:

XYZ (Pty) Ltd and MNO (Pty) Ltd each hold 50% of the equity shares in ABC (Pty) Ltd. XYZ (Pty) Ltd holds 100 Class A shares that carry a voting right of one vote per share. MNO (Pty) Ltd holds 100 Class B shares that carry a voting right of two votes per share.

Are XYZ (Pty) Ltd and MNO (Pty) Ltd connected persons in relation to ABC (Pty) Ltd?

Result:

Under paragraph (d)(i) XYZ (Pty) Ltd and MNO (Pty) Ltd will be connected persons in relation to ABC (Pty) Ltd if they form part of the same group of companies as ABC (Pty) Ltd. For purposes of paragraph (d)(i) this requirement would be met if both XYZ (Pty) Ltd and MNO (Pty) Ltd hold more than 50% of –

- the equity shares in ABC (Pty) Ltd; or
- the voting rights in ABC (Pty) Ltd.

MNO (Pty) Ltd holds only 50% of the equity shares in ABC (Pty) Ltd and thus does not meet the minimum shareholding requirement to be part of the same group of companies as ABC (Pty) Ltd. However, since MNO (Pty) Ltd holds 66,67% (200 votes / 300 votes × 100%) of the voting rights in ABC (Pty) Ltd, it is part of the same group of companies as ABC (Pty) Ltd and is thus a connected person in relation to ABC (Pty) Ltd under paragraph (d)(i).

XYZ (Pty) Ltd is not a connected person in relation to ABC (Pty) Ltd under paragraph (d)(i) because it holds only 50% of the equity shares in ABC (Pty) Ltd and 33,33% (100 votes / 300 votes × 100%) of the voting rights in ABC (Pty) Ltd. It has thus failed both the “more than 50% of the equity shareholding and voting rights” requirements.

XYZ (Pty) Ltd is also not a connected person in relation to ABC (Pty) Ltd under paragraph (d)(v) (see **3.5.4**). Although XYZ (Pty) Ltd holds at least 20% of the equity shares and voting rights in ABC (Pty) Ltd, another holder of shares (MNO (Pty) Ltd) holds the majority voting rights in ABC (Pty) Ltd thus disqualifying XYZ (Pty) Ltd as a connected person under paragraph (d)(v).

Example 14 – Connected person in relation to a company*Facts:*

XYZ (Pty) Ltd holds 40% of the equity shares and voting rights in MNO (Pty) Ltd and 30% of the equity shares and voting rights in ABC (Pty) Ltd. MNO (Pty) Ltd holds 40% of the equity shares and voting rights in ABC (Pty) Ltd. No other holder of shares holds more than 50% of the voting rights in MNO (Pty) Ltd.

Are XYZ (Pty) Ltd, MNO (Pty) Ltd and ABC (Pty) Ltd connected persons in relation to one another under paragraph (d)(i)?

Result:

Although more than 50% of ABC (Pty) Ltd's equity shares and voting rights are held by MNO (Pty) Ltd (40%) and XYZ (Pty) Ltd (30%), the companies are not part of the same group of companies because there is no controlling group company which directly holds more than 50% of the equity shares or voting rights in at least one controlled group company. XYZ (Pty) Ltd directly holds only 40% of MNO (Pty) Ltd's equity shares and voting rights and 30% of ABC (Pty) Ltd's equity shares and voting rights. MNO (Pty) Ltd directly holds only 40% of ABC (Pty) Ltd's equity shares and voting rights.

XYZ (Pty) Ltd, MNO (Pty) Ltd and ABC (Pty) Ltd therefore do not form part of the same group of companies and are not connected persons in relation to one another under paragraph (d)(i).

These companies are, however, connected persons in relation to one another under paragraph (d)(v) (see **3.5.4**) read with paragraph (e) because –

- XYZ (Pty) Ltd holds at least 20% of the equity shares and voting rights in MNO (Pty) Ltd and ABC (Pty) Ltd and no holder of shares holds the majority voting rights in these companies; and
- MNO (Pty) Ltd holds at least 20% of the equity shares and voting rights in ABC (Pty) Ltd and no holder of shares holds the majority voting rights.

Example 15 – Connected person in relation to a company*Facts:*

XYZ (Pty) Ltd holds 51% of the equity shares in ABC (Pty) Ltd and 10% of the equity shares in MNO (Pty) Ltd. ABC (Pty) Ltd holds 41% of the equity shares in MNO (Pty) Ltd.

Are XYZ (Pty) Ltd, ABC (Pty) Ltd and MNO (Pty) Ltd connected persons in relation to one another under paragraph (d)(i)?

Result:

XYZ (Pty) Ltd is a controlling group company of ABC (Pty) Ltd because it holds 51% of the equity shares in ABC (Pty) Ltd. XYZ (Pty) Ltd's 51% holding satisfies paragraph (b) of the definition of "group of companies" as modified by paragraph (d)(i).

Under paragraph (a) of the definition of “group of companies” –

- ABC (Pty) Ltd is a controlled group company because 51% of its equity shares are held by a controlling group company (XYZ (Pty) Ltd); and
- MNO (Pty) Ltd is also a controlled group company because 51% (10% + 41%) of its equity shares are held directly by a controlling group company (XYZ (Pty) Ltd – 10%) and a controlled group company (ABC (Pty) Ltd – 41%).

All three companies are therefore part of the same group of companies and connected persons in relation to one another under paragraph (d)(i).

3.5.3 A person that holds at least 20% of the equity shares or voting rights in the company [paragraph (d)(iv)]

Any person (*other than* a company as defined in section 1 of the Companies Act), that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20% of the equity shares or voting rights in a company, is a connected person in relation to the company.

“Any person” holding the equity shares or voting rights

The term “person” is defined in section 1(1) as including an insolvent estate, the estate of a deceased person, any trust and any portfolio of a collective investment scheme. A foreign partnership is, however, excluded from the ambit of the definition. The word “includes” is generally used in legislation as a term of extension which means that the definition of “person” is not limited to only the persons specifically mentioned.

It is therefore also necessary to consider the ordinary meaning of the term as well as the definition of the term in the Interpretation Act 33 of 1957.

The *Shorter Oxford English Dictionary on Historical Principles* includes the following meanings of “person” relevant to the present context:²²

“2 An individual human being; spec. a human being as opp. to a thing or an animal.

...

“5 *LAW*. An individual (also natural person) or a group of individuals as a corporation (also artificial person), regarded as having rights and duties recognized by the law.”

The Interpretation Act 33 of 1957 defines “person” to include –

- any divisional council, municipal council, village management board, or like authority;
- any company incorporated or registered as such under any law; and
- any body of persons corporate or unincorporate.

Thus, besides specifically including an insolvent estate, deceased estate, trust and collective investment scheme, the definition of “person” in section 1(1) includes a natural person and a juristic person²³ such as a company or close corporation.

²² A Stevenson 6 ed (2007) Oxford University Press.

²³ DSP Cronje “Persons” 20(1) (Second edition) *LAWSA* [online] (My LexisNexis: 30 November 2009) in paragraph 439.

The term “portfolio of a collective investment scheme” is defined in section 1(1) as follows:

“**[P]ortfolio of a collective investment scheme**” means any—

- (a) portfolio of a collective investment scheme in participation bonds;
- (b) portfolio of a collective investment scheme in property;
- (c) portfolio of a collective investment scheme in securities; or
- (d) portfolio of a declared collective investment scheme;²⁴

“Any person” referred to in paragraph (d)(iv) therefore includes any of the following persons:

- A natural person
- An insolvent estate
- The estate of a deceased person
- A trust
- A portfolio of a collective investment scheme
- A company not falling within the definition of that term in the Companies Act

The term “company” is defined in section 1 of the Companies Act as follows:

“**[C]ompany**” means a juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date—

- (a) was registered in terms of the—
 - (i) Companies Act, 1973 (Act No. 61 of 1973), other than as an external company as defined in that Act; or
 - (ii) Close Corporations Act, 1984 (Act No. 69 of 1984), if it has subsequently been converted in terms of Schedule 2;
- (b) was in existence and recognised as an “existing company” in terms of the Companies Act, 1973 (Act No. 61 of 1973); or
- (c) was deregistered in terms of the Companies Act, 1973 (Act No. 61 of 1973), and has subsequently been re-registered in terms of this Act;

Categories of companies as defined in section 1(1) falling *outside* the definition of “company” in the Companies Act and which consequently constitute “any person” referred to in paragraph (d)(iv), include –

- portfolios of a collective investment scheme in property that qualify as a REIT as defined in the listing requirements of an exchange approved in consultation with the Minister of Finance and published by the Prudential Authority, as defined in section 1 of the Financial Markets Act 19 of 2012, under section 11 of that Act;²⁵
- companies registered outside South Africa;

²⁴ A “portfolio of a declared collective investment scheme” as defined in section 1(1) includes a “portfolio of a hedge fund collective investment scheme” which term is also defined in section 1(1).

²⁵ The JSE, A2X, 4AX, EESE and ZAR X are the only exchanges currently licensed under section 9 of the Financial Markets Act.

- voluntary associations deriving their corporate status under the common law from their constitutions; and
- companies incorporated under other statutes.

Examples of companies incorporated under other statutes referred to in the last bullet above include the following:

- Close corporations established under the Close Corporations Act 69 of 1984 that did not convert to a company under the Companies Act. A close corporation may not be formed on or after 1 May 2011 but a pre-existing close corporation may continue and is not obliged to convert to a company under the Companies Act.
- A body corporate established under section 36 of the Sectional Titles Act 95 of 1986.

Companies falling within the definition of “company” in the Companies Act and which are therefore *excluded* from “any person” referred to in paragraph (d)(iv) include the following:

- A state-owned company, a private company, a personal liability company, a public company and a non-profit company.
- A domesticated company, which is a company whose registration has been transferred to South Africa. Under section 13(5) of the Companies Act a domesticated company is treated as if it had been originally incorporated under the Companies Act.
- A close corporation that converted to a company on or after 1 May 2011.
- A share block company, which is a company as defined in the Companies Act even though it must comply with the Share Blocks Control Act 59 of 1980.

Holding of equity shares

It is considered that a person holds equity shares in a company if that person is the beneficial owner of the shares. The person named in the share register of a company, for example, an agent or intermediary, is not necessarily the beneficial owner of the shares.²⁶

Individual and joint holding of equity shares or voting rights

Having regard to the purpose of paragraph (d)(iv), the word “jointly” is used in paragraph (d)(iv) in the sense of “together” or “in combination” and not in the restricted sense of an undivided share held in co-ownership. In other words, to determine whether a particular person meets the 20% threshold in relation to the company being examined, that person’s holding and the individual holdings of all connected persons in relation to that person must be aggregated. In aggregating that person’s holding and the holdings of all connected persons any double counting that arises must be

²⁶ See, for example, cases dealing with beneficial entitlement such as *Geldenhuis v CIR* 1947 (3) SA 256 (C), 14 SATC 419; *SIR v Smant* 1973 (1) SA 754 (A), 35 SATC 1 and *Taxpayer v COT Botswana* (1980) 43 SATC 118. See also paragraph 2.3.1 of the *Comprehensive Guide to Dividends Tax* for a discussion of the meaning of “beneficial owner” for purposes of dividends tax. The term “beneficial owner” is defined in section 64D for purposes of dividends tax only. The discussion in the *Comprehensive Guide to Dividends Tax* also considers the general meaning of “beneficial owner”.

eliminated – see examples below. A person not holding any equity shares or voting rights cannot have a joint holding of equity shares or voting rights, as appropriate, with someone else.

A South African partnership is not an entity to which the law attributes legal personality.²⁷ The Act also excludes foreign partnerships from the definitions of “person” and “company” in section 1(1). Partners are usually co-owners of shares held by a partnership. In such a case the look-through principle is applied and the shareholding of the individual partners is assessed to determine their individual holdings. Under paragraph (c)(i) partners are connected persons in relation to one another and as a result the other partners’ holdings will need to be taken into account when determining the percentage equity shares or voting rights a partner jointly holds with a connected person.

Direct or indirect holding of shares

The term “directly or indirectly” means that indirect holdings must be taken into account in determining whether the 20% threshold in paragraph (d)(iv) has been attained. An indirect holding is determined by ascertaining the effective interest, namely, by multiplying the respective percentage holdings in a chain of companies together. For example, if Individual X owns 20% of Company A and Company A owns 20% of Company B, Individual X has an indirect interest of $20\% \times 20\% = 4\%$ in Company B.

At least 20% of the equity shares or voting rights

Paragraph (d)(iv) requires that at least 20% of the equity shares or voting rights in a company must be held by a person and connected persons in relation to that person in order for that person to be a connected person in relation to that company. It is not a requirement of paragraph (d)(iv) that at least 20% of both the equity shares and voting rights in a company must be so held. For example, a person holding 20% of the voting rights in a company but only 10% of the equity shares will be a connected person in relation to that company even though the person holds less than 20% of the equity shares.

Example 16 – Connected person in relation to a company

Facts:

ABC CC and A, who holds a 15% membership interest in ABC CC, each hold 10% of the equity shares in XYZ (Pty) Ltd.

Are ABC CC and A connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(iv)(aa)?

Result:

ABC CC and A are connected persons in relation to each other under paragraph (d)(vi)(aa) and paragraph (e), since A is a member of ABC CC (see **3.5.6** and **3.6**).

²⁷ *Michalow, NO v Premier Milling Co Ltd* 1960 (2) SA 59 (W) at 61.

ABC CC directly holds 10% of the equity shares in XYZ (Pty) Ltd. A directly holds 10% and indirectly holds 1,5% (15% × 10%) of the equity shares in XYZ (Pty) Ltd. ABC CC and A are connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(iv)(aa), since they jointly hold 20% (10% + 10% + 1,5%, limited to 20% under these circumstances to eliminate double counting) of the equity shares in XYZ (Pty) Ltd.

Example 17 – Connected person in relation to a company

Facts:

A is a beneficiary of ABC Family Trust. A does not have a vested right in the income or assets of the trust. ABC Family Trust and A each hold 10% of the equity shares and voting rights in XYZ (Pty) Ltd.

Are ABC Family Trust and A connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(iv)?

Result:

ABC Family Trust and A are connected persons in relation to each other under paragraphs (a)(ii), (b)(i) and (e) (see **3.1.4**, **3.2.2** and **3.6**). They jointly hold 20% (10% + 10%) of the equity shares and voting rights in XYZ (Pty) Ltd. ABC Family Trust and A are therefore connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(iv).

Example 18 – Connected person in relation to a company

Facts:

D and E are members of DE Partnership. Under the partnership agreement D is entitled to 1% and E to 99% of the profits of the partnership. DE Partnership holds 100% of the equity shares in DEF (Pty) Ltd on behalf of its partners.

Are D and E connected persons in relation to DEF (Pty) Ltd?

Result:

D and E are the members of DE Partnership and are therefore connected persons in relation to each other under paragraph (c)(i) (see **3.4.2**). D and E jointly hold 100% of the equity shares in DEF (Pty) Ltd and are therefore connected persons in relation to DEF (Pty) Ltd under paragraph (d)(iv)(aa).

Note:

A partnership is not a “person” as defined in section 1(1) and therefore cannot hold any shares in a company in its own right. The shares in DEF (Pty) Ltd are therefore held by the individual partners in accordance with the partnership agreement.

Example 19 – Connected person in relation to a company

Facts:

X, a natural person, holds 100% of the member’s interest in XYZ CC. XYZ CC holds 20% of the equity shares in DEF (Pty) Ltd.

Are X and XYZ CC connected persons in relation to DEF (Pty) Ltd under paragraph (d)(iv)(aa)?

Result:

X and XYZ CC are connected persons in relation to each other under paragraph (d)(vi)(aa) and paragraph (e), since X is a member of XYZ CC (see **3.5.6** and **3.6**).

X indirectly holds 20% ($100\% \times 20\%$) of the equity shares in DEF (Pty) Ltd. XYZ CC directly holds 20% of the equity shares in DEF (Pty) Ltd. X and XYZ CC jointly hold 20% ($100\% \times 20\% + 20\%$, limited to 20% under these circumstances to eliminate double counting) of the equity shares in DEF (Pty) Ltd. X and XYZ CC are, therefore, connected persons in relation to DEF (Pty) Ltd under paragraph (d)(iv)(aa).

Example 20 – Connected person in relation to a company

Facts:

D, a natural person, holds 20% of the equity shares in ABC (Pty) Ltd and ABC (Pty) Ltd holds 20% of the equity shares in DEF (Pty) Ltd. Both ABC (Pty) Ltd and DEF (Pty) Ltd are incorporated under the Companies Act.

Are D and ABC (Pty) Ltd connected persons in relation to DEF (Pty) Ltd?

Result:

D and ABC (Pty) Ltd are connected persons in relation to each other under paragraphs (d)(iv) and (e) because D holds at least 20% of the equity shares in ABC (Pty) Ltd.

D indirectly holds 4% ($20\% \times 20\%$) of the equity shares in DEF (Pty) Ltd. D is a connected person in relation to DEF (Pty) Ltd under paragraph (d)(iv)(aa), since D, together with a connected person (ABC (Pty) Ltd), jointly holds at least 20% of the equity shares in DEF (Pty) Ltd ($4\% + 20\% = 24\%$, limited to 20% under these circumstances to eliminate double counting).

ABC (Pty) Ltd is not a connected person in relation to DEF (Pty) Ltd under paragraph (d)(iv), since a company incorporated under the Companies Act is specifically excluded from a person referred to in paragraph (d)(iv).

However, ABC (Pty) Ltd may be a connected person in relation to DEF (Pty) Ltd under paragraph (d)(v) if no holder of shares holds the majority voting rights in DEF (Pty) Ltd.

Example 21 – Connected person in relation to natural persons

Facts:

C is the father of A and B. A, B and C respectively hold 12%, 11% and 10% of the equity shares in ABC (Pty) Ltd.

Are A, B and C connected persons in relation to ABC (Pty) Ltd under paragraph (d)(iv)?

Result:

C is related to A and B within the first degree of consanguinity. A and B are related to each other within the second degree of consanguinity, since they have the same father. A, B and C are therefore connected persons in relation to each other under paragraph (a)(i), since they are all relatives.

A, B and C jointly hold 33% (12% + 11% + 10%) of the equity shares in ABC (Pty) Ltd. A, B and C are therefore connected persons in relation to ABC (Pty) Ltd under paragraph (d)(iv). ABC (Pty) Ltd is a connected person in relation to A, B and C under paragraph (e).

3.5.4 Any other company that holds at least 20% of the equity shares or voting rights in the company and no holder of shares holds the majority voting rights [paragraph (d)(v)]

A company holding at least 20% of the equity shares or voting rights in another company is a connected person in relation to the other company if no holder of shares holds the majority (more than 50%) voting rights in that other company.

In determining the “at least 20%” requirement, only direct holdings of shares are considered, since the term “directly or indirectly” is not used.

The term “holder of shares” is intended to refer to the person holding beneficial ownership of the shares. A person who is, for example, a registered shareholder and acts in a nominee capacity would thus not be a holder of shares for the purposes of paragraph (d)(v).

Paragraph (d)(v) will not apply to a company holding at least 20% of the equity shares of or voting rights in another company if a holder of shares beneficially owns the majority voting rights in that other company.

Example 22 – Connected person in relation to a company

Facts:

ABC (Pty) Ltd and MNO (Pty) Ltd each hold 50% of the equity shares and voting rights in XYZ (Pty) Ltd.

Are ABC (Pty) Ltd and MNO (Pty) Ltd connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(v)?

Result:

Both ABC (Pty) Ltd and MNO (Pty) Ltd are connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(v) because each company holds at least 20% of the equity shares or voting rights in the company and neither company holds the majority voting rights.

Example 23 – Connected person in relation to a company

Facts:

XYZ (Pty) Ltd holds 51% and MNO (Pty) Ltd holds 49% of the equity shares and voting rights in ABC (Pty) Ltd.

Are XYZ (Pty) Ltd and MNO (Pty) Ltd connected persons in relation to ABC (Pty) Ltd under paragraphs (d)(i) or (d)(v)?

Result:

XYZ (Pty) Ltd is a connected person in relation to ABC (Pty) Ltd, since it holds more than 50% of the equity shares and voting rights in ABC (Pty) Ltd. These companies are treated as being part of the same group of companies under paragraph (d)(i).

MNO (Pty) Ltd and ABC (Pty) Ltd are not treated as being part of the same group of companies, since MNO (Pty) Ltd does not hold more than 50% of the equity shares or voting rights in ABC (Pty) Ltd. These companies are therefore not connected persons in relation to each other under paragraph (d)(i).

Since XYZ (Pty) Ltd holds the majority (51%) voting rights in ABC (Pty) Ltd, MNO (Pty) Ltd is not a connected person in relation to ABC (Pty) Ltd under paragraph (d)(v) even though it holds at least 20% of the equity shares and voting rights in ABC (Pty) Ltd.

Example 24 – Connected person in relation to a company

Facts:

DEF (Pty) Ltd and GHI (Pty) Ltd each hold 50% of the equity shares and voting rights in XYZ (Pty) Ltd. ABC (Pty) Ltd holds 100% of the equity shares and voting rights in DEF (Pty) Ltd.

Are ABC (Pty) Ltd, DEF (Pty) Ltd and GHI (Pty) Ltd connected persons in relation to XYZ (Pty) Ltd?

Result:

Both DEF (Pty) Ltd and GHI (Pty) Ltd are connected persons in relation to XYZ (Pty) Ltd under paragraph (d)(v) because each company holds at least 20% of the equity shares or voting rights in the company and neither company holds the majority voting rights.

ABC (Pty) Ltd is not a connected person in relation to XYZ (Pty) Ltd for the following reasons:

- It does not directly hold at least 20% of the equity shares or voting rights in XYZ (Pty) Ltd. In the latter regard, the word “held” in paragraph (d)(v) refers to a direct holding of shares or voting rights and does not include indirect holdings.
- These companies do not form part of the same group of companies for purposes of paragraph (d)(i), since no company holds more than 50% of XYZ (Pty) Ltd’s equity shares or voting rights.

3.5.5 Any other company that is managed or controlled by a connected person [paragraph (d)(vA)]

Assuming that there are two companies, A and B, this provision makes company B a connected person in relation to company A when company B is managed or controlled by –

- a person who is a connected person in relation to company A [paragraph (d)(vA)(aa)]; or

- a person who is a connected person in relation to a person who is a connected person in relation to company A [paragraph (d)(vA)(bb)].

Paragraph (d)(vA)(bb) can be illustrated as follows:

- X is a connected person in relation to Company A
- Y manages or controls Company B
- Y is a connected person in relation to X
- Company B is therefore a connected person in relation to Company A

The expression “managed or controlled” is integral to applying paragraph (d)(vA). The use of the co-ordinating conjunction “or” between “managed” and “controlled” means that either term can apply. The expression is thus wider than “managed and controlled”.

Managed

The word “management” is defined in BusinessDictionary.com as –²⁸

“1. [t]he organization and coordination of the activities of a business in order to achieve defined objectives...”.

The words “management” and, in context, “manage” are very broad and it is not possible to list activities that do and do not constitute management. Instead, when assessing whether a particular person is managing a company, it is necessary to consider all the facts of the particular case taking into account the activities for which the person is responsible, the person’s level of seniority and the scope of the person’s responsibilities. For example, an employee responsible only for managing a company’s mailroom would not be considered to be managing the company. However, in contrast, the managing director of the company having overall responsibility for running all the company’s business activities would be considered to be managing it.

Controlled

Control refers to *de facto*²⁹ control and not shareholder control. *De facto* control is generally but not necessarily held and exercised by the board of directors. However, the facts and circumstances of each case are critical in determining who is controlling a company because the presence and influence of a controlling person or persons can have a significant impact.

In ITC 1741³⁰ the court considered the meaning of “control”. In that case the appellant purchased certain machinery and plant from another company (J Shopfitters (Pty) Ltd) and claimed a deduction under section 12C(1) on the cost of acquisition of the machinery and plant. The Commissioner reduced the allowances under section 12C(4) and (6)³¹ to an amount based on the cost of the machinery and plant to the seller, contending that the buyer and the seller were connected persons in relation to each

²⁸ www.businessdictionary.com/definition/management.html [Accessed 27 January 2020].

²⁹ In fact, whether by right or not.

³⁰ (2002) 65 SATC 106 (EC).

³¹ As the sections read in 1992.

other. Under the then section 12C(6)(a)(i) a connected person in relation to a company included –

“any other company if both such companies are controlled or owned directly or indirectly by the same persons”.

Based on the facts of the case, the appellant company and J Shopfitters (Pty) Ltd were not commonly owned and the sole issue for decision was whether there was the requisite control by substantially the same persons.

Factually each company had its own board of directors. However, there was a substantial difference in terms of who made the decisions and practically ran the respective companies. The evidence showed that, in the appellant company’s case, control was exercised by the board of directors (excluding Mr C who although a director did not have any “real” say or power in relation to the appellant company). By contrast, the evidence clearly showed that even though the board of directors had the legal ability to control J Shopfitters (Pty) Ltd, the board was not practically in control of the company. Mr C was a domineering presence who effectively made all the decisions and informed everyone afterwards. He controlled the company and the input from fellow directors, if any, was limited to that of a consulting nature.

The court held that “controlled” in the absence of a statutory definition or any other contrary indicators meant *de facto* control. It did not mean the potential for the exercise of legal control by the board of directors or by the shareholders at a general meeting. Thus, if the directors of a company give a particular director *carte blanche* to run a company, the company will be *de facto* controlled by that individual. In the appellant company’s case control was exercised by the board of directors but in J Shopfitter’s case *de facto control* was exercised by Mr. C. Accordingly, the two companies were held not to be connected persons in relation to each other.

The case also highlighted that *de facto* control is not fixed and may change from time to time. It is therefore important to evaluate *de facto* control at the time required by the relevant provision of the Act.

The court further noted that interpreting control to mean *de facto* control was consistent with the purpose of section 12C(4) and (6), namely, to prevent persons from manipulating assets under their control to increase tax allowances while in effect the assets remained under their control.³²

The same principle applies to the definition of “connected person” in section 1(1) that replaced the definition of that term in section 12C(6).

Example 25 – Connected person in relation to a company

Facts:

K, a natural person, holds 100% of the equity shares in XYZ (Pty) Ltd and manages MNO (Pty) Ltd.

³² In the absence of section 12C(4) and (6) this would have been achieved by selling the asset to a connected person at a price that was above the seller’s cost, thus entitling the purchaser to an allowance calculated on an enhanced cost price.

Is MNO (Pty) Ltd a connected person in relation to XYZ (Pty) Ltd under paragraph (d)(vA)(aa)?

Result:

K is a connected person in relation to XYZ (Pty) Ltd under paragraph (d)(iv)(aa), since K holds at least 20% of its equity shares (see 3.5.3). MNO (Pty) Ltd is a connected person in relation to XYZ (Pty) Ltd under paragraph (d)(vA)(aa), since MNO (Pty) Ltd is managed by K who is a connected person in relation to XYZ (Pty) Ltd.

Example 26 – Connected person in relation to a company

Facts:

XYZ (Pty) Ltd and MNO (Pty) Ltd both have five directors on their respective boards of directors. K is the only director who is common to both boards. K effectively makes all the decisions and practically “runs the show” at both companies. K owns 5% of the equity shares and voting rights in XYZ (Pty) Ltd and 15% of the equity shares and voting rights in MNO (Pty) Ltd.

Is MNO (Pty) Ltd a connected person in relation to XYZ (Pty) Ltd under paragraph (d)(vA)(aa)?

Result:

K is not a connected person in relation to either XYZ (Pty) Ltd or MNO (Pty) Ltd, since K holds less than 20% of these companies' equity shares and voting rights. Thus, in spite of XYZ (Pty) Ltd and MNO (Pty) Ltd being controlled by the same person, they are not connected persons under paragraph (d)(vA)(aa).

Example 27 – Connected person in relation to a company

Facts:

XYZ (Pty) Ltd is controlled by X who holds all its equity shares and voting rights. ABC (Pty) Ltd is controlled by B who holds all its equity shares and voting rights. B is X's spouse.

Are XYZ (Pty) Ltd and ABC (Pty) Ltd connected persons in relation to each other under paragraph (d)(vA)(bb)?

Result:

X and B are connected persons in relation to each other under paragraph (a)(i), since they are relatives (see 3.1.3). X and B are respectively connected persons in relation to XYZ (Pty) Ltd and ABC (Pty) Ltd under paragraph (d)(iv)(aa), since they hold at least 20% of the equity shares and voting rights in these companies (see 3.5.3). XYZ (Pty) Ltd and ABC (Pty) Ltd are connected persons in relation to each other under paragraph (d)(vA)(bb), since they are controlled by X and B respectively, who are connected persons in relation to each other and who are respectively connected persons in relation to XYZ (Pty) Ltd and ABC (Pty) Ltd.

3.5.6 Connected person in relation to a company that is a close corporation [paragraph (d)(vi)]

The following persons are connected persons in relation to a close corporation:

- A member of the close corporation [paragraph (d)(vi)(aa)].
- A relative of a member of the close corporation [paragraph (d)(vi)(bb)].
- A trust (other than a portfolio of a collective investment scheme) that is a connected person in relation to a member of the close corporation [paragraph (d)(vi)(bb)].
- A close corporation or company that is a connected person in relation to any of the following persons:
 - A member of the close corporation [paragraph (d)(vi)(cc)(i)].
 - Any relative of a member of the close corporation [paragraph (d)(vi)(cc)(ii)].
 - Any trust (other than a portfolio of a collective investment scheme) that is a connected person in relation to a member of the close corporation [paragraph (d)(vi)(cc)(ii)].

Example 28 – Connected person in relation to a close corporation

Facts:

X holds a 100% member's interest in XYZ CC. B, who is X's spouse, is a beneficiary of AB Trust.

Is AB Trust a connected person in relation to XYZ CC?

Result:

B is a connected person in relation to X under paragraph (a)(i), since they are relatives. AB Trust is a connected person in relation to B under paragraph (a)(ii), since B is a beneficiary of the trust.

AB Trust is a connected person in relation to X under paragraph (a)(ii), since a relative of X, namely B, is a beneficiary of the trust (see 3.1.4). AB Trust is therefore a connected person in relation to XYZ CC under paragraph (d)(vi)(bb), since the trust is a connected person in relation to the member of the CC, namely X.

Example 29 – Connected person in relation to a close corporation

Facts:

X holds a 100% member's interest in ABC CC and a 20% members' interest in DEF CC.

Is DEF CC a connected person in relation to ABC CC?

Result:

X is a connected person in relation to ABC CC and DEF CC under paragraph (d)(vi)(aa), since X is a member of these close corporations. ABC CC and DEF CC are connected persons in relation to X under paragraph (e) (see 3.6). DEF CC is a connected person in relation to ABC CC under paragraph (d)(vi)(cc)(i), since DEF CC is a connected person in relation to X, who is a member of ABC CC.

Example 30 – Connected person in relation to a close corporation*Facts:*

X holds a 100% member's interest in ABC CC. B, who is X's daughter, holds all the equity shares and voting rights in DEF (Pty) Ltd.

Is DEF (Pty) Ltd a connected person in relation to ABC CC under paragraph (d)(vi)(cc)(ii)?

Result:

B is related to X within the first degree of consanguinity. B is therefore X's relative and a connected person in relation to X under paragraph (a)(i) (see 3.1.3). B is a connected person in relation to DEF (Pty) Ltd under paragraph (d)(iv), since B holds 100% of the equity shares and voting rights in DEF (Pty) Ltd.

Paragraph (e) establishes the reverse relationship between B and DEF (Pty) Ltd meaning that DEF (Pty) Ltd is a connected person in relation to B. DEF (Pty) Ltd is a connected person in relation to ABC CC under paragraph (d)(vi)(cc)(ii), since it is a connected person in relation to a relative (B) of ABC CC's member (X). ABC CC is a connected person in relation to DEF (Pty) Ltd under paragraph (e) (see 3.6).

3.6 The reverse “connected person” relationship**3.6.1 Paragraph (e)**

Connected person means –

(e) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:

3.6.2 The other person in the “connected person” relationship [paragraph (e)]

A person is a connected person in relation to another person, if the other person is a connected person in relation to the first-mentioned person. For example, A is a connected person in relation to B, if B is a connected person in relation to A.

Therefore, if a person is identified as a connected person in relation to another person under paragraphs (a) to (d), the other person is a connected person in relation to the person so identified.

Example 31 – Reverse “connected person” relationship*Facts:*

B holds 100% of the equity shares and voting rights in ABC (Pty) Ltd.

Is ABC (Pty) Ltd a connected person in relation to B?

Result:

B is a connected person in relation to ABC (Pty) Ltd under paragraph (d)(iv) because B holds at least 20% of the equity shares and voting rights in ABC (Pty) Ltd. Under paragraph (e) ABC (Pty) Ltd is a connected person in relation to B, since B is a connected person in relation to ABC (Pty) Ltd.

3.7 Exclusion of a portfolio of a collective investment scheme from a trust

For purposes of the definition of “connected person” a portfolio of a collective investment scheme is excluded from a trust. This rule ensures, for example, the following:

- A portfolio of a collective investment scheme is not a connected person in relation to a natural person who is a beneficiary of the portfolio or whose relative is a beneficiary of the portfolio [paragraph (a)(ii)].
- A beneficiary of the portfolio of a collective investment scheme and any connected person in relation to that beneficiary is not a connected person in relation to the portfolio [paragraph (b)].
- Persons that would have been connected persons in relation to a portfolio of a collective investment scheme but for the exclusion of portfolios of collective investment schemes from paragraph (b), are not connected persons in relation to one another. For example, beneficiaries of the portfolio are not connected persons in relation to one another [paragraph (bA)].
- A portfolio of a collective investment scheme that would have been a connected person in relation to a member of a close corporation, but for the exclusion of a portfolio from a trust under paragraph (a)(ii) and paragraph (b) read with paragraph (e), is not a connected person in relation to that close corporation [paragraph (d)(vi)(bb)].

The exclusion of a portfolio of a collective investment scheme from a trust for purposes of the definition of “connected person” does not mean that the portfolio cannot be a connected person under any of the subparagraphs of the definition. For example, a portfolio of a collective investment scheme is a “person” as defined in section 1(1) and therefore qualifies as “any person” for purposes of paragraph (d)(iv) (see **3.5.3**).

3.8 A portfolio of a collective investment scheme deemed to be a company**3.8.1 Proviso to the definition of “connected person”**

The proviso to the definition of “connected person” reads as follows:

Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme;³³

³³ See definition in section 1(1).

3.8.2 A portfolio of a collective investment scheme deemed to be a company [proviso to the definition of “connected person”]

Portfolios of collective investment schemes are generally treated as trusts for income tax purposes (see 3.9 for one of the exceptions). However, for the purposes of the definition of “connected person”, a portfolio of a collective investment scheme is treated as a company.³⁴

In determining whether a particular person is a connected person in relation to such a portfolio, paragraph (d) must therefore be considered.

Example 32 – Portfolio of a collective investment scheme in securities

Facts:

A portfolio of a collective investment scheme in securities holds 20% of the equity shares and voting rights in XYZ (Pty) Ltd. No other holder of shares holds more than 50% of the voting rights in the company.

Is the portfolio a connected person in relation to XYZ (Pty) Ltd under paragraph (d)(v)?

Result:

The portfolio is a connected person in relation to XYZ (Pty) Ltd under paragraph (d)(v) because –

- the portfolio is deemed to be a company for purposes of the definition of “connected person” under the proviso to the definition;
- the portfolio holds at least 20% of the equity shares and voting rights in XYZ (Pty) Ltd; and
- no other holder of shares holds the majority voting rights in the company.

3.9 A portfolio of a collective investment scheme in property that qualifies as a REIT

The term “portfolio of a collective investment scheme in property” is defined in section 1(1) as follows:

“[P]ortfolio of a collective investment scheme in property” means any portfolio comprised in any collective investment scheme in property contemplated in Part V of the Collective Investment Schemes Control Act managed or carried on by any company registered as a manager under section 51 of that Act for the purposes of that Part;

A portfolio of a collective investment scheme in property normally operates in the form of a vesting trust, but is included in the definition of “company” as defined in section 1(1) if it qualifies as a REIT³⁵ as defined in the listing requirements of an

³⁴ With effect from 18 December 2017 all portfolios of a collective investment scheme are treated as a company for purposes of the definition of “connected person”. Previously, only a portfolio of a collective investment scheme in securities was treated as a company. See 3.9 for the treatment of a REIT.

³⁵ See Interpretation Note 97 “Taxation of REITs and Controlled Companies” for a discussion of the meaning of “REIT”.

exchange³⁶ approved in consultation with the Minister of Finance and published by the Prudential Authority, as defined in section 1 of the Financial Markets Act 19 of 2012, under section 11 of that Act.³⁷ Accordingly, in determining whether a particular person is a connected person in relation to a REIT, paragraph (d) must be considered.

Example 33 – Portfolio of a collective investment scheme in property that qualifies as a REIT

Facts:

A portfolio of a collective investment scheme in property, which qualifies as a REIT, holds 30% of the equity shares and voting rights in ABC (Pty) Ltd. No other holder of shares holds more than 50% of the voting rights in the company.

Is the REIT a connected person in relation to ABC (Pty) Ltd under paragraph (d)(v)?

Result:

The REIT is a connected person in relation to ABC (Pty) Ltd under paragraph (d)(v) because –

- the REIT is a “company” as defined in section 1(1);
- it holds at least 20% of the equity shares and voting rights in ABC (Pty) Ltd; and
- no other holder of shares holds the majority voting rights in the company.

3.10 The deceased or insolvent estate of a natural person

The deceased estate

The death of a person results in the termination of a taxpayer (the deceased person) and the creation of another, namely, the deceased estate of that person. A deceased estate is included in the definition of “person” in section 1(1) and is thus a taxpayer in its own right.³⁸ The deceased estate of a person dying on or after 1 March 2016 is treated under section 25(5) as a natural person except for the rebates in sections 6 (normal tax rebates), 6A (medical scheme fees tax credit) and 6B (additional medical expenses tax credit).

Although a deceased estate is treated as a natural person under section 25(5), it is not treated as the same natural person as the deceased person. A deceased estate does not have a blood relationship with natural persons and therefore does not have relatives. Accordingly, paragraph (a)(i) cannot be applied to a deceased estate under the main body of the Act, although it may apply under the Eighth Schedule – see below.

³⁶ The JSE, A2X, 4AX, EESE and ZAR X, are the only exchanges currently licensed under section 9 of the Financial Markets Act.

³⁷ Paragraph (e)(iii) of the definition of “company” in section 1(1).

³⁸ See sections 9HA, 9HB, 25, 66(13)(a), 67(1) and paragraph 40 of the Eighth Schedule dealing with deceased persons and deceased estates.

Under paragraph (a)(ii) a trust will be a connected person in relation to a natural person (deceased estate) if the natural person (deceased estate) is a beneficiary of the trust. The term “beneficiary” is defined in section 1(1) in relation to a trust to mean –

“a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust”.

Thus, if a deceased beneficiary’s vested interest in a trust was acquired by the beneficiary’s deceased estate, the deceased estate would have a vested interest in the assets or income of the trust which would make the deceased estate a “beneficiary” in relation to the trust. The trust would accordingly be a connected person in relation to the deceased estate under paragraph (a)(ii).

Paragraph (b)(i) makes a beneficiary of a trust a connected person in relation to that trust. Thus, the converse connected person relationship between a trust and a deceased estate will similarly be established if the deceased estate acquires a deceased beneficiary’s vested interest in the trust.

Once the deceased estate is connected to the trust in the manner described above, other beneficiaries of the trust and the deceased estate would be connected persons in relation to one another under paragraph (bA).

Paragraph (c) is unlikely to apply because a partnership of which the deceased person was a partner generally terminates upon the person’s death and the deceased estate will not enter into a partnership.

A deceased estate qualifies as “any person” for purposes of paragraph (d)(iv). A deceased estate could therefore be a connected person in relation to a company, making the company a connected person in relation to that deceased estate under paragraph (e).

Under section 29(2)(c) of the Close Corporations Act 69 of 1984, a member of the close corporation may include a natural or juristic person who, in the case of a member who is deceased, is an executor of a deceased estate. Paragraph (d)(vi) may, therefore, depending on the facts, apply in the context of a deceased estate.

By contrast, paragraph 40(3) of the Eighth Schedule provides that for the purposes of the Eighth Schedule, the disposal of an asset by the deceased estate of a natural person shall be treated in the same manner as if that asset had been disposed of by *that* natural person. It is the intention that the deceased estate should be taxed at the same rate and enjoy the same inclusion rate and exclusions (for example, the annual, personal-use asset and primary residence exclusions) that the deceased person would have enjoyed had the deceased person disposed of the assets. In addition, if the deceased person would have been a connected person in relation to the person to whom the asset was disposed of, the deceased estate will also be treated as having disposed of an asset to a connected person. For example, if the deceased estate disposed of an asset to a relative of the deceased person, the deceased estate will be treated as disposing of an asset to a connected person for the purposes of determining the CGT consequences of that disposal under the Eighth Schedule. Such consequences could include, amongst others, the application of paragraph 38 (determination of proceeds at market value when an asset is disposed of at a non-arm’s length price to a connected person) and paragraph 39 (capital losses determined in respect of disposals to certain connected persons).

To the extent that any transactions of the deceased person or the deceased estate are governed by sections 9HA, 9HB and 25, those provisions will take precedence over any core disposal rules involving connected persons in the Eighth Schedule.

Example 34 – Connected person in relation to a deceased estate

Facts:

At the time of X's death, X and Y were married. Are X and Y connected persons in relation to X's deceased estate?

Result:

On X's death, X's deceased estate came into existence.

For the purposes of the Act outside the Eighth Schedule, X and Y would not be connected persons in relation to X's deceased estate under paragraph (a)(i), since they do not enjoy a blood relationship with it and are thus not relatives of it.

However, for the purposes of the disposal of an asset by the deceased estate to Y under the Eighth Schedule, Y would be treated as a connected person in relation to the deceased estate because paragraph 40(3) of the Eighth Schedule requires the disposal to be treated in the same manner as if the asset had been disposed of by X. Y was a connected person in relation to X under paragraph (a)(i).

To the extent that the transactions between X, Y and the deceased estate are governed by sections 9HA, 9HB and 25, those provisions will take precedence over any core disposal rules involving connected persons in the Eighth Schedule.

Example 35 – Connected person in relation to a deceased estate

Facts:

At the date of X's death, X held 20% of the equity shares and voting rights in XYZ (Pty) Ltd.

Are X's deceased estate and XYZ (Pty) Ltd connected persons in relation to each other on X's date of death?

Result:

On X's date of death, X's deceased estate came into existence.

X's deceased estate is treated as a natural person under section 25(5).

Under section 9HA(1) X is treated as having disposed of the equity shares and voting rights held in XYZ (Pty) Ltd on date of death. Under section 25(2) X's deceased estate is treated as having acquired the equity shares and voting rights in XYZ (Pty) Ltd from X on X's date of death. X's deceased estate is therefore treated as having acquired 20% of the equity shares and voting rights in XYZ (Pty) Ltd on X's date of death.

Under paragraph (d)(iv) X's deceased estate is a connected person in relation to XYZ (Pty) Ltd on X's date of death, since it held at least 20% of XYZ (Pty) Ltd's equity shares and voting rights on that date.

XYZ (Pty) Ltd is a connected person in relation to X's deceased estate under paragraph (e).

The insolvent estate of a natural person

Upon the sequestration of a taxpayer's estate, three separate taxpayers exist, namely, the insolvent person for the period before date of sequestration, the insolvent estate from the date of sequestration and the insolvent person from the date of sequestration.³⁹

The definition of "connected person" makes no mention of an insolvent estate. An insolvent estate may, however, fall within some of the paragraphs of the definition of "connected person".

The insolvent estate of a natural person (insolvent estate) is a person as defined in section 1(1) but it is not a natural person and does not have relatives. Accordingly, paragraph (a) cannot be applied to an insolvent estate. For example, an insolvent estate will not be a connected person in relation to the insolvent person's spouse under paragraph (a)(i). This position is effectively overridden by paragraph 83(1) of the Eighth Schedule for CGT purposes.

An insolvent estate would be a connected person in relation to a trust if it was a beneficiary of that trust under paragraph (b)(i). It would, for example, become a beneficiary of a trust if it acquired the insolvent person's vested interest in that trust on the date of sequestration (see discussion above on the definition of "beneficiary" in section 1(1) in the context of deceased estates). Other beneficiaries of the trust and the insolvent estate would be connected persons in relation to one another under paragraph (bA). Depending on the facts, paragraph (b)(ii) could also apply.

Paragraph (c) is unlikely to apply because a partnership of which the insolvent person was a partner generally terminates upon the insolvent person's sequestration and the insolvent estate will not enter into a partnership.

An insolvent estate qualifies as "any person" for purposes of paragraph (d)(iv). An insolvent estate could therefore be a connected person in relation to a company, making the company a connected person in relation to the insolvent estate under paragraph (e).

Under section 29(2)(c) of the Close Corporations Act 69 of 1984, a member of the close corporation may include a natural or juristic person who, in the case of a member who is insolvent, is a trustee of the insolvent estate. Paragraph (d)(vi) may, therefore, depending on the facts, apply in the context of an insolvent estate.

Under paragraph 83(1) of the Eighth Schedule, the disposal of an asset by the insolvent estate is treated in the same manner as if it were disposed of by the insolvent person. Thus, if the insolvent estate disposed of an asset to a person who was a connected person in relation to the insolvent person, such as a relative of the insolvent person, the insolvent estate will be treated as having disposed of the asset to a

³⁹ See sections 25C, 66(13)(a) and 67(1) and Interpretation Note 8 "Insolvent Estates of Natural Persons".

connected person for the purposes of determining the CGT consequences of that disposal under the Eighth Schedule.

3.11 Holders of shares in a company

The definition of “connected person” does not contain a paragraph which establishes a relationship between persons that hold shares in the same company by reason of their holdings in that company. A connected person relationship may, however, be established between holders of shares in the same company because of some other relationship. For example, such a relationship may exist because the holders are relatives, members of the same partnership or beneficiaries of the same trust.

Example 36 – Connected person in relation to the holder of shares in a company

Facts:

Individuals B and A each hold 50% of the equity shares and voting rights in ABC (Pty) Ltd. B and A are not relatives, beneficiaries of a trust or members of a partnership.

Are B and A connected persons in relation to each other?

Result:

Individuals B and A are not connected persons in relation to each other under any of the paragraphs of the definition of “connected person”. They are also not connected persons in relation to each other because of their holding of shares in ABC (Pty) Ltd.

Example 37 – Connected person in relation to the holder of shares in a company

Facts:

Individuals B and A are married to one another. They each hold 50% of the equity shares and voting rights in ABC (Pty) Ltd.

Are B and A connected persons in relation to each other?

Result:

Individuals B and A are not connected persons in relation to each other because of their holding of shares in ABC (Pty) Ltd. They are, however, connected persons in relation to each other under paragraph (a)(i), since they are relatives.

3.12 Timing of the “connected person” test

The majority of the provisions in the Act using the term “connected person” indicate that the criteria to determine whether persons are connected should be considered at the time of a transaction, which in turn generally requires the persons to be connected persons just before the transaction is concluded. In other words, a connected person relationship is generally determined when the acquisition or disposal of an asset takes place or when certain expenditure is incurred.

For example, paragraph 39(1)(a) of the Eighth Schedule provides that a person must, when determining the aggregate capital gain or aggregate capital loss of that person, disregard any capital loss determined on disposal of an asset to any person who was a connected person in relation to that person immediately before the disposal. It will also apply if immediately after the disposal the acquirer is a member of the same group

of companies as the disposer or a trust with a beneficiary which is a member of the same group of companies as the disposer.

Similarly, while paragraph 56(1) of the Eighth Schedule does not contain an explicit timing rule for the determination of the connected person relationship, it is clear from the wording that the parties would have to be related at the time of disposal of the debt, and not after the disposal of the debt. Paragraph 56(1) of the Eighth Schedule applies when a creditor disposes of a debt owed by a connected person and provides that the creditor must disregard any capital loss incurred in consequence of the disposal unless paragraph 56(2) applies.

Some provisions, however, indicate that the relationship between persons should be determined at specified times which differ from the above. For example, under section 24N special timing rules apply⁴⁰ when a person disposes of equity shares to another person during the year of assessment and a quantified or quantifiable amount, which is payable by the purchaser to the seller, is not due and payable in that year. The amount in question will be regarded as not having accrued to the seller and not having been incurred by the purchaser during that year to the extent that it is not due and payable during that year. One of the requirements stipulated in section 24N(2)(c) is that the purchaser and seller are not connected persons in relation to each other after the disposal of the equity shares.

Section 23I is an anti-avoidance provision that stipulates, amongst other things, that under specified circumstances no deduction will be allowed –

- for any amount of expenditure incurred for the use or the right to use or permission to use any “tainted intellectual property”; or
- for expenditure the incurral or amount of which is determined directly or indirectly with reference to expenditure incurred for the use or, right of use of or permission to use tainted intellectual property.

The term “tainted intellectual property” is defined in section 23I(1). In subparagraph (a) of the definition reference is made to intellectual property that was the property of the end-user or of a taxable person that is or was a “connected person” as defined in section 31(4) in relation to the end-user. The relevant time for determining the “connected person” relationship is therefore when the intellectual property was developed and when the expenditure referred to in section 23I(2) is incurred. Subparagraph (d) of the definition refers to intellectual property which, amongst others, was discovered, devised, developed, created or produced by a taxable person as defined that is a connected person, as defined in section 31(4), in relation to the end user at the time it was discovered, devised, developed, created or produced.

Paragraph 38 of the Eighth Schedule applies, amongst other circumstances, when a person disposes of an asset to a connected person in relation to that person for a consideration that does not reflect an arm’s length price. Under these circumstances the proceeds and base cost must be determined using the market value of the asset. Paragraph 38 requires that the connected person relationship be established immediately prior to or immediately after the disposal.

⁴⁰ Provided detailed criteria, as specified in the section, are met.

These examples are not exhaustive and are merely presented for illustrative purposes. The timing of the “connected person” relationship will depend on the wording of the particular provision of the Act.

3.13 Expanded or restricted definition of “connected person”

The table below sets out the provisions of the Act that expand or restrict the definition of “connected person” in section 1(1).

Table 1 – Expanded or restricted definition of “connected person”

Section of the Act or paragraph of the Eighth Schedule	Expanded or restricted definition of “connected person”
Section 9C(1) – definition of “connected person”	As defined in section 1(1), provided that the expression “and no holder of shares holds the majority voting rights in the company” in paragraph (d)(v) of that definition must be disregarded.
Section 23I(1) definition “tainted intellectual property”	“Connected person” as defined in section 31(4).
Section 29A(10) ⁴¹	The individual policyholder fund, company policyholder fund, untaxed policyholder fund, corporate fund and risk policy fund shall be deemed to be separate companies that are connected persons in relation to each other for the purposes of section 29A(6), (7) and (8) and sections 20, 24I, 24J, 24K, 24L, 26A and 29B and the Eighth Schedule.
Section 31(4)	As defined in section 1(1), provided that the expression “and no holder of shares holds the majority voting rights in the company” in paragraph (d)(v) of that definition must be disregarded.
Paragraph 39(3) of the Eighth Schedule	<p>A connected person in relation to a natural person does not include a relative of that person other than a parent, child, stepchild, brother, sister, grandchild or grandparent of that person.</p> <p>A connected person in relation to a fund of an insurer contemplated in section 29A does not include another such fund of that insurer in respect of the disposal of an asset by such fund to another such fund.</p>
Paragraph 42(3) of the Eighth Schedule	A connected person in relation to a natural person does not include a relative of that person other than a parent, child, stepchild, brother, sister, grandchild or grandparent of that person.

⁴¹ Section 29A(10) was amended with effect from years of assessment commencing on or after 1 January 2016 to include a risk policy fund.

Section of the Act or paragraph of the Eighth Schedule	Expanded or restricted definition of “connected person”
	A connected person in relation to a fund of an insurer contemplated in section 29A does not include another such fund of that insurer in respect of the disposal of an asset by such fund to another such fund.

3.14 Application of the definition of “connected person”

The application of the definition of “connected person” is illustrated by the examples below.

Example 38 – Application of the definition of “connected person” – Paragraph 38(1) of the Eighth Schedule

Facts:

Individual C holds 20% of the equity shares and voting rights in XYZ (Pty) Ltd. Individual C sold a fixed property that was acquired after 1 October 2001 for R500 000 to XYZ (Pty) Ltd for R600 000. The market value of the property at the date of disposal was R2 million.

For the purposes of this example, ignore donations tax and the annual exclusion for CGT purposes and assume Individual C has no other capital gains or capital losses for the year of assessment or an assessed capital loss brought forward from the previous year of assessment. Apply a CGT inclusion rate of 40%.⁴²

Result:

Individual C and XYZ (Pty) Ltd are connected persons in relation to each other under paragraphs (d)(iv) and (e).

Paragraph 38(1)(a) of the Eighth Schedule determines that if a person disposes of an asset to a connected person for a consideration that does not reflect an arm's-length price, the person disposing of the asset is treated as having disposed of it for an amount equal to its market value on the date of the disposal. The person acquiring the asset is treated as having acquired it at a cost equal to the same market value under paragraph 38(1)(b).

Individual C is therefore deemed to have disposed of the property at market value of R2 million and must declare a taxable capital gain of R600 000 $[(R2\ 000\ 000 - R500\ 000) \times 40\%]$ instead of a taxable capital gain of R40 000 $[(R600\ 000 - R500\ 000) \times 40\%]$ that would have been determined if Individual C and XYZ (Pty) Ltd had not been connected persons in relation to each other.

XYZ (Pty) Ltd is deemed to have acquired the property at a cost of R2 million.

⁴² The inclusion rate for natural persons was increased from 33,3% to 40% for years of assessment commencing on or after 1 March 2016.

Example 39 – Application of the definition of “connected person” – Section 8(4)(k) and paragraph 38(1) of the Eighth Schedule

Facts:

B and C are connected persons in relation to each other.

At the beginning of year of assessment 1, B acquired office equipment at a cost of R1 million.

For years of assessment 1 and 2 B claimed a wear-and-tear or depreciation allowance under section 11(e) at the rate of 20% a year (R200 000) on the straight-line basis.⁴³

At the beginning of year of assessment 3, B sold the office equipment to C at its written-down tax value of R600 000 (R1 000 000 – R400 000). The arm’s length market value of the office equipment under a cash transaction at the time of disposal was R800 000.

Result:

Recoupment under section 8(4)(a)

Section 8(4)(k) applies because the office equipment was disposed of to a connected person for an amount that was less than its market value. Under that provision B is deemed for purposes of section 8(4)(a) to have disposed of the equipment for an amount equal to its market value of R800 000 at the time of disposal. The amount to be recouped by B under section 8(4)(a) is determined as follows:

	R
Original cost of office equipment	1 000 000
Less: Wear-and-tear allowance (R200 000 × 2) [section 11(e)]	<u>(400 000)</u>
Tax value	600 000
Deemed consideration received by B [section 8(4)(k)]	<u>(800 000)</u>
Amount recouped and included in B’s income under section 8(4)(a)	<u>(200 000)</u>

CGT

	R	R
Amount deemed to be received or accrued (paragraph 38(1)(a) of Eighth Schedule)		800 000
Less: Amount included in income under section 8(4)(a) (paragraph 35(3)(a) of Eighth Schedule)		<u>(200 000)</u>
Proceeds (paragraph 35 of Eighth Schedule)		600 000
Less: Base cost		(600 000)
Original cost	1 000 000	
(paragraph 20(1)(a) of Eighth Schedule)		
Less: Allowances claimed	<u>(400 000)</u>	
(paragraph 20(3)(a) of Eighth Schedule)		
Capital gain or capital loss		<u>Nil</u>

Under paragraph 38(1)(b) of the Eighth Schedule, C is treated as having acquired the office equipment at a cost of R800 000.

⁴³ See Binding General Ruling 7 dated 2 November 2012 “Wear-and-Tear or Depreciation Allowance” and Interpretation Note 47 “Wear-and-Tear or Depreciation Allowance” for the rates at which assets are allowed to be depreciated for normal tax purposes.

Should C use the office equipment to carry on a trade, future wear-and-tear or depreciation allowances will be based on a deemed acquisition cost of R800 000 under paragraph (vii) of the proviso to section 11(e). This paragraph of the proviso deems the cost to be equal to the cost that would have been incurred under a cash transaction concluded at arm's length.

Example 40 – Application of the definition of “connected person” – Section 11(o) and paragraph 39

Facts:

B and C are connected persons in relation to each other.

At the beginning of year of assessment 1, B acquired office equipment at a cost of R1 million. For year of assessment 1, B claimed a wear-and-tear or depreciation allowance under section 11(e) at the rate of 20% a year (R200 000) on the straight-line basis.⁴⁴

At the beginning of year of assessment 2, B sold the office equipment to C at its then market value of R600 000.

Result:

Application of section 11(o)

The tax value of the equipment on date of disposal was R800 000 (R1 000 000 – R200 000). B therefore incurred a loss on disposal of R200 000 (R600 000 – R800 000). B is prohibited from claiming the loss of R200 000 under the further proviso to section 11(o), since the equipment was disposed of to a connected person.

CGT

The loss of R200 000 (proceeds of R600 000 less base cost of R800 000) is also disregarded as a capital loss under paragraph 39(1)(a) of the Eighth Schedule but may under paragraph 39(2) be deducted from future capital gains determined on disposals of assets to C.

4. Conclusion

The definition of “connected person” in section 1(1) identifies those persons that are connected persons in relation to the following persons:

- A natural person
- A trust
- A connected person in relation to a trust
- A member of a partnership or foreign partnership
- A company

⁴⁴ See Binding General Ruling 7 dated 2 November 2012 “Wear-and-Tear or Depreciation Allowance” and Interpretation Note 47 “Wear-and-Tear or Depreciation Allowance” for the rates at which assets are allowed to be depreciated for normal tax purposes.

- A close corporation

The definition of “connected person” also establishes the reverse relationship between the persons that are connected persons in relation to the above persons.

For the purposes of the definition of “connected person”, a portfolio of a collective investment scheme is excluded from a trust and treated as a company.

A deceased estate is deemed to be a natural person under section 25(5) except for the purposes of the rebates under sections 6, 6A and 6B. Under paragraph 40(3) of the Eighth Schedule, the disposal of an asset by the deceased estate of a natural person is treated in the same manner as if that asset had been disposed of by that natural person. Thus, for the purposes of the Eighth Schedule, the disposal of an asset by the deceased estate to a relative of the deceased person would be treated as a disposal to a connected person in relation to the deceased estate.

Under paragraph 83(1) of the Eighth Schedule, the disposal of an asset by the insolvent estate of a person whose estate was sequestrated must be treated in the same manner as if that asset had been disposed of by that person. Thus, for the purposes of the Eighth Schedule, the disposal of an asset by the insolvent estate to a connected person in relation to the natural person whose estate was sequestrated, will be treated as a disposal between connected persons.

A deceased or insolvent estate would be a connected person in relation to a trust under paragraph (b)(i) if it was a beneficiary of that trust, making the trust a connected person in relation to the deceased or insolvent estate under paragraph (e). Other beneficiaries of the trust and the deceased or insolvent estate would be connected persons in relation to one another under paragraph (bA). A deceased or insolvent estate could be a connected person in relation to a company or a close corporation under paragraph (d)(iv) and (vi), making the company or close corporation a connected person in relation to the deceased or insolvent estate under paragraph (e).

The holders of shares in a company are not connected persons in relation to one another by virtue of their holding of shares but may be connected through another relationship which would bring them within one of the paragraphs of the definition of “connected person”.

The wording of a particular provision of the Act will determine the time at which the existence of any “connected person” relationship must be determined. It will also determine whether an expanded or restricted meaning of the term as defined in section 1(1) must be applied.

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Annexure A – The law

Section 1(1) – Definition of “connected person”

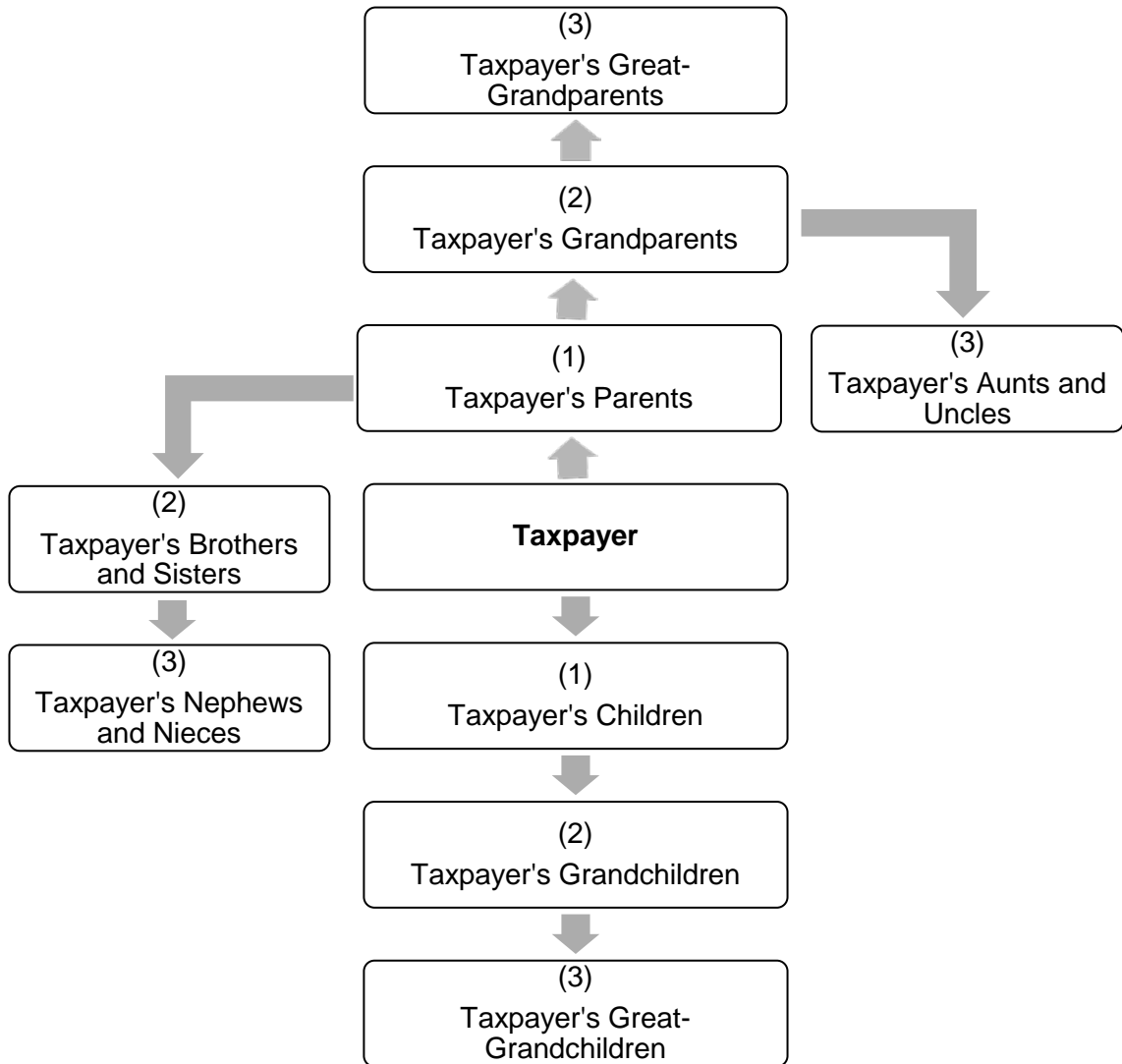
“connected person” means—

- (a) in relation to a natural person—
 - (i) any relative; and
 - (ii) any trust (other than a portfolio of a collective investment scheme) of which such natural person or such relative is a beneficiary;
- (b) in relation to a trust (other than a portfolio of a collective investment scheme)—
 - (i) any beneficiary of such trust; and
 - (ii) any connected person in relation to such beneficiary;
- (bA) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment scheme), any other person who is a connected person in relation to such trust;
- (c) in relation to a member of any partnership or foreign partnership—
 - (i) any other member; and
 - (ii) any connected person in relation to any member of such partnership or foreign partnership;
- (d) in relation to a company—
 - (i) any other company that would be part of the same group of companies as that company if the expression “at least 70 per cent of the equity shares in” in paragraphs (a) and (b) of the definition of “group of companies” in this section were replaced by the expression “more than 50 per cent of the equity shares or voting rights in”;
 - (ii)
 - (iii)
 - (iv) any person, other than a company as defined in section 1 of the Companies Act that individually or jointly with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of—
 - (aa) the equity shares in the company; or
 - (bb) the voting rights in the company;
 - (v) any other company if at least 20 per cent of the equity shares or voting rights in the company are held by that other company, and no holder of shares holds the majority voting rights in the company;
 - (vA) any other company if such other company is managed or controlled by—
 - (aa) any person who or which is a connected person in relation to such company; or
 - (bb) any person who or which is a connected person in relation to a person contemplated in item (aa); and
 - (vi) where such company is a close corporation—
 - (aa) any member;
 - (bb) any relative of such member or any trust (other than a portfolio of a collective investment scheme) which is a connected person in relation to such member; and

- (cc) any other close corporation or company which is a connected person in relation to—
 - (i) any member contemplated in item (aa); or
 - (ii) the relative or trust contemplated in item (bb); and
- (e) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:

Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme;

Annexure B – Diagram illustrating the rule for determining persons who are related within the third degree of consanguinity



Figures in brackets indicate the degree of consanguinity. Persons who are related within the third degree of consanguinity are “relatives”. See 3.1.3 for other persons who are also included in the definition of “relative”.