South African Revenue Service

BINDING CLASS RULING: BCR 063

DATE: 6 July 2018

ACT	**:**	**INCOME TAX ACT 58 OF 1962 (the Act)**
SECTION	**:**	**SECTIONS 1(1) – DEFINITIONS OF "GROSS INCOME", PARAGRAPH (*d*) AND "SEVERANCE BENEFIT", 11(*a*), 23(*g*) AND 25B(2)**
SUBJECT	**:**	**INCOME TAX IMPLICATIONS OF SETTLEMENT AGREEMENT**

1. Summary

This ruling determines the treatment of contributions made by employer companies to a trust in terms of a settlement agreement and how the amounts accruing to or received by the trust and the beneficiaries of the trust will be treated.

2. Relevant tax laws

This is a binding class ruling issued in accordance with section 78(2) and published in accordance with section 87(2) of the Tax Administration Act 28 of 2011.

In this ruling references to sections are to sections of the Act applicable as at 22 May 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of –

- section 1(1) – definitions of "gross income", paragraph (*d*) and "severance benefit";
- section 11(*a*);
- section 23(*g*);
- section 25B(2); and
- Practice Note No. 37 dated 13 January 1995: "Income Tax Deduction of Fees Paid to Accountants, Bookkeepers and Tax Consultants for the Completion of Income Tax Returns (Practice Note 37).

3. Class

The class members to whom this ruling will apply are the companies referred to in **4**.

4. Parties to the proposed transaction

The applicant: A resident company

The co-applicant:	A discretionary charitable trust established for the benefit of the companies' current and former employees and the dependants of deceased former employees
The companies:	The employer companies (including the applicant)

5. Description of the proposed transaction

The companies will enter into an agreement to settle a legal dispute brought against them by their current and former employees and the dependants of deceased former employees (collectively hereafter referred to as the "claimants"). The claimants alleged that they, and in the case of the dependants, the deceased former employees, contracted occupational diseases during the course of their employment with one or more of the companies and accordingly suffered damages for which the companies were claimed to be legally liable to compensate them. These allegations were made in an application for the certification of the claimants as a procedural class.

The contraction of these diseases is an inherent risk in the carrying on of the businesses of the companies.

The proposed transaction will be achieved as follows:

- The companies and the representatives of the claimants will enter into a settlement agreement in terms of which the companies will agree to fully and finally, without admission of liability, settle the intended litigation.
- The settlement agreement will make provision for the establishment of the trust by the companies. The sole object of the trust is to give effect to the settlement agreement and provide benefits to qualifying claimants.
- The companies will fund the trust by making the following contributions –
  - the start-up contribution which will be used to establish the various components of a claims processing system;
  - the trust administration contributions which will be used for the maintenance of the claims processing system, the payment of various professional fees and other administration expenses;
  - the initial contribution which will be used to make awards to beneficiaries in the first two years of the trust's existence; and
  - the benefit contributions which will be contributed annually and which will be used to pay compensation to beneficiaries.
- The trust will use the funds to locate potential claimants, process their claims, determine whether or not they qualify to receive benefits from the trust and vest amounts in qualifying claimants (i.e. the beneficiaries of the trust).

The settlement agreement must be sanctioned by a court of law.

Save for the contributions that the trust will receive from the companies, its only source of income will be interest income earned on its bank account(s).

6. Conditions and assumptions

This binding class ruling is subject to the additional condition and assumption that each of the companies is carrying on a trade for purposes of section 11(*a*).

7. Ruling

The ruling made in connection with the proposed transaction is as follows:

a) The contributions that will be incurred by the companies in favour of the trust will –

- be deductible under section 11(*a*) read with section 23(*g*); and
- constitute accruals of a capital nature in the trust.

b) The contributions that will accrue to the trust and that will then be vested by the trust in beneficiaries in the same year of assessment will be deemed to be derived for the benefit of the beneficiaries in terms of section 25B(2). The contributions that will not be vested by the trust in beneficiaries in the same year of assessment as their accrual will be derived for the benefit of the trust.

c) The amounts that will be distributed by the trust to its beneficiaries will be amounts of a capital nature that will either –

- fall within the ambit of paragraph (*d*) of the definition of "gross income" read with the definition of "severance benefit" in section 1(1); or
- not fall within the definition of "gross income" in section 1(1),

depending on the personal circumstances of the beneficiary, such as a beneficiary who is a dependant of a deceased former employee or a former employee in whom the disease becomes manifest after leaving his or her employment with one or more of the companies, amounts received would not constitute a severance benefit but would be of a capital nature. The trustees of the trust must determine on a case-by-case basis, taking into consideration the individual facts and circumstances of each beneficiary, whether an amount to be vested in a beneficiary constitutes a severance benefit that must be included in paragraph (*d*) of the definition of "gross income" in section 1(1), or whether the amount does not fall within the definition of "gross income" at all.

d) For the purposes of employees' tax, the proviso to the definition of "severance benefit" in section 1(1) will not apply to payments by the trust in respect of deceased former employees as the payments will not be made in consequence of or following upon their death but rather as a consequence of the decisions that the trustees of the trust will make subsequent to the deaths of the former employees. Accordingly the normal accrual rules will apply.

e) Fees paid by the trustees to accountants, bookkeepers, tax consultants and other professional persons or institutions for the completion of the trust's tax returns may be deducted from the interest income of the trust, provided that those fees do not create a tax loss and that they are apportioned between exempt interest and other interest in accordance with paragraphs 4 and 5 of Practice Note 37.

8. Period for which this ruling is valid

This binding class ruling is valid for a period of seven years from 22 May 2018.

Legal Counsel: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE