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Legal & Policy Division
SARS
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BY E-MAIL: policycomments@sars.gov.za

Dear Sir / Madam

CALL FOR COMMENT: DRAFT INTERPRETATION NOTE - DEFINITION OF "CONNECTED PERSON"

We refer to the call for comments on the Draft Interpretation Note issued by SARS which deals with the definition of "connected person" found in section 1 of the Income Tax Act, No 58 of 1962 ("the Act").

General comment
We are of the opinion that the proposed interpretation note will be a very useful guide. However, it needs to be enhanced in order to make it more user friendly and easier to analyse the information given. Proposed enhancements would be to include organograms or diagrammatic details to illustrate connections as opposed to having it only written out in words. In its current state, the user needs to draw organograms or diagrams in order to properly understand or grasp the specific connection being illustrated.

SARS should also consider expanding the application of the interpretation note to include an analysis of the definition of "connected person" as contained in section 1 of the Value-Added Tax Act, No 89 of 1991 ("the VAT Act"). Consideration should be given to, at the very least, highlight the important differences between the meaning of "connected person" for purposes of the Act and that of the VAT Act.

The majority of the examples given reflect situations where something is sold at a price which exceeds the market value. SARS should incorporate examples of transactions where the consideration is less than market value as well.

The commentary should be further expanded to deal with the application of the corporate rules contained in sections 41 to 47 of the Act where the application of those provisions "override" the provisions where "connected persons" are relevant.

On page 13, second paragraph, the interpretation note makes the point that in determining the "more than 50% requirement" in a group, one does not look at the effective interest but one
"looks through" the chain and examines the interest of the company immediately above the company below. We have no problem with such an approach, because it is for the purpose of determining whether, in the example given, company C forms part of the same group as company A.

The situation is different, however, where one is dealing with the "at least 20%" criterion, as in paragraph 3.5.4 on page 18 of the interpretation note. We think it is clear that if A owns 20% in B and B owns 20% in C, one must look at the effective holding so that A owns only an effective 4% in C, and thus A and C are \textit{not} connected. An example should be included for this purpose.

The following sentence in the second paragraph on page 13 needs clarification: “...but this is irrelevant in determining whether A, B and C form part of the same group of companies”. Because the interests in A, B and C is only 60%, the issue is whether it would be a group of companies if the 50% rule is applied.

The statement regarding the shares held indirectly by the controlling company “is merely a linking mechanism” does not give effect to the words used in the definition, it is negated by the use of the word directly in paragraphs (a) and (b) of the definition.

In examples 16 and 17 there is a misinterpretation of the meaning of the word "jointly". The word "jointly" there is used in the sense of "when added together", but this is not what jointly means. The word "jointly" is defined in \textit{Chambers 21st Century Dictionary} to mean "owned or done, etc in common; shared". This is something completely different from simply adding together individual holdings. There are real legal differences between the two. For example, if a husband (H) and a wife (W) each owns 50% in a company (representing 100% of the issued shares), either H or W is free to sell his or her shares without the permission of the other. But if H and W own all 100 shares jointly, then, for example, H has no power to sell 50 shares without W's agreement.

Joint ownership is really the same as co-ownership, so that each individual share is held jointly by H and W. Although H, for example, can sell his 50% joint interest in the shares to another without the approval of W, H cannot, as mentioned, actually sell 50 shares to another without W's approval.

Consequently, in examples 16 and 17 the shares are \textit{not} jointly held. Only in example 18 are they jointly held because partners in a partnership \textit{do} hold their assets in joint and undivided shares.

In paragraph 3.1.3 on page 6 of the document, SARS cites a section from the publication “Clegg and R Stretch Income Tax in South Africa [electronic version – last updated March 2011] Lexis Nexis Butterworths in 11.4.1A.” The authors of the publication basically state that the definition of the term “beneficiary in relation to a trust” is very wide. However, it is not clear whether or not SARS agrees with the author’s statement, thus, there is a certain
degree of uncertainty as to SARS’ view. It is suggested that it should be clarified whether or not SARS supports the view of the authors, and how SARS interprets the term “beneficiary”.

The definition of "shareholder" in paragraph 3.5.4 has now been deleted from the Act. As regards paragraph 3.5.5, we do not think it is correct to read anything significant into the word "or" in the expression "managed or controlled", so that one looks at management on the one hand and control on the other. The fact is that, if one searches the cases dealing with control (being the control exercised by a board of directors) the expressions "managed and controlled" and "managed or controlled" are used interchangeably, and essentially mean the same thing. We can give examples of these cases should it be necessary to do so. Also, prior to 2001, both expressions were found in the Act but they both essentially meant the same thing, and essentially it should mean the person who calls the shots.

**Specific comments**

**Spouse**
SARS lists a number of factors that may indicate an intention of permanence such as whether the individuals concerned share the same postal address, bank accounts, medical schemes, pension funds, insurance schemes. We note that it is not uncommon for even married individuals not to share a postal address, bank account or medical aid. It is dangerous to put that much emphasis on things like postal address, bank accounts and medical aids.

**Controlled**
The detailed discussion of "controlled" on page 20 is appreciated and valuable.

**Paragraph 3.7.2 - A portfolio of a collective investment scheme in securities (proviso to the definition of "connected person")**
The discussion needs to be expanded and include examples of connected persons.

**Application of the definition of "connected person"**
SARS should add an example of a combination of the facts noted in example 28 and 29. The examples given here should also deal with the exceptions which will arise through the application of the corporate rules contained in section 41 to 47 of the Act.

**Annexure A**
The list of sections and paragraphs where reference is made to connected persons is useful. It would be even more useful if SARS could incorporate practical examples of the application of each of the sections and paragraphs listed, i.e. enhance and expand the document with more detailed examples.

Please do not hesitate to contact us, should you have any questions regarding the above.

Yours faithfully
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