1 October 2008

South African Revenue Service
Private Bag X923
PRETORIA
0001

By e-mail: nalberts@sars.gov.za

Dear Sir

INTERPRETATION ISSUE SECTION 12E

1. BACKGROUND

Section 12E of the Income Tax Act deals with the qualifying criteria for Small Business Corporations (“SBCs”). In terms of section 12E(4)(a)(iii), not more than 20% of all the receipts and accruals of such entity can “consist collectively of investment income and income from the rendering of a personal service”. “Personal service” is defined in section 12E(4)(d). Section 12E(4)(d)(ii) excludes from the definition of “personal service” a company or close corporation if that company or close corporation does throughout the year of assessment employ three or more full-time employees (other than any employee who is a shareholder of the company or member of the close corporation, as the case may be, or who is a connected person in relation to a shareholder or member), who are on a full-time basis engaged in the business of that company or close corporation of rendering that service.

2. INTERPRETATION OF THE S 12E(d)(4)(ii) EXCLUSION

From the above exclusion it follows that a qualifying company or close corporation that provides personal services (in excess of 20% of total receipts and accruals) will still be able to qualify as a SBC if such entity employs three or more full-time employees (other than shareholders or members or connected persons to such shareholders or members) and if such employees are engaged on a full-time basis in the business of that company or close corporation rendering that service.

There appears to be uncertainty among taxpayers regarding the interpretation and application of the requirement that such three ‘independent employees’ should be engaged in the business of that company or close corporation rendering that service. For example, some taxpayers argue that the employee must be directly involved in rendering the service, for example must be a doctor in a medical practice (direct in relation to the specific profession involved). Other
taxpayers argue that the involvement of the employee need not be that direct and will include administrative staff such as the receptionist that is also dealing with clients. There is also further uncertainty regarding employees not involved in the core business, but still providing services to clients, such as nurses in a medical practice. This could be further extended to trainee accountants in an accountancy practice. Some taxpayers have even taken the aggressive interpretation of regarding all independent employees, even those employees that provide only administrative services, as part of the count to pass the three full-time employee test. Interpretation Note 9: Small business corporations (issue 4) does not appear to provide any guidance in this regard.

We seek clarity on what the official view is at SARS head office in relation to the interpretation of the section 12E(4)(d)(ii) exclusion as discussed above.

Please do not hesitate to contact me should you require further information.

Yours faithfully

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PROJECT DIRECTOR: TAX
The South African Institute of Chartered Accountants