Ref: #233501

6 November 2008

South African Revenue Service
Private Bag X923
PRETORIA
0001

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

Dear Sir

SECTION 12E OF THE INCOME TAX ACT

Our submission dated 11 March 2008 refers. As requested, we have updated our submission to include a recommended solution to the problem.

Section 12E of the Income Tax Act deals with small business corporations, setting out the criteria for a small entity to qualify as a small business corporation, as well as the tax relief available to entities that do qualify as small business corporations. Section 12E(4)(a)(ii) deals with qualifying criteria pertaining to members’ or shareholders’ other interests, and reads as follows:

“(ii) none of the shareholders or members at any time during the year of assessment of the company or close corporation holds any shares or has any interest in the equity of any other company as defined in section 1, other than—

(aa) a company contemplated in paragraph (a) of the definition of “listed company”;

(bb) any portfolio in a collective investment scheme contemplated in paragraph (e) of the definition of “company”; or

(cc) a company contemplated in section 10 (1) (e) (i), (ii) or (iii); and

(dd) a social or consumer co-operative or a cooperative burial society as defined in section 1 of the Co-operatives Act, 2005 (Act No. 14 of 2005), or any other similar co-operative if all of the income derived from the trade of that co-operative during any year of assessment is solely derived from its members; or

(EE) any friendly society as defined in section 1 of the Friendly Societies Act, 1956 (Act No. 25 of 1956)”

From the above it is clear if any member or shareholder of the entity in question had any of the above disallowable shareholdings or members’ interests at any time during the year of assessment, then the entity will not qualify as a small business corporation.
Taxpayers experience the following problem, with reference to the above criteria. Instead of forming a new close corporation, taxpayers buy a so-called “shelf close corporation”, which in the first instance did not qualify as a small business corporation for various reasons. The new member then does qualify, but as the members’ interest was not held by the qualifying person throughout the year of assessment, it cannot qualify as a small business corporation for tax purposes.

We submit that such a disqualification is unfair towards the taxpayer who ‘purchased’ the so-called “shelf close corporation” as such taxpayer did comply with all the section 12E requirements from the first day that the “shelf close corporation” was purchased. It is therefore proposed that section 12E be amended to make provision for a shelf close corporation that was ‘purchased’ by a taxpayer to qualify for small business corporation relief in terms of section 12E.

We therefore propose to exclude from Section 12E(4)(a)(ii) the other interests of shareholders or members of private companies or close corporations where there was a change in membership or shareholding during the year and the private company or close corporation has not traded before the change in shareholding (therefore only started trading for the first time after the change of membership or shareholding). This will allow for the interests of the shareholders/ members of the shelf entity before it was “sold” to be ignored.

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

Yours faithfully

M Hassan CA(SA)
PROJECT DIRECTOR: TAX
The South African Institute of Chartered Accountants

cc: Keith.Engel@Treasury.gov.za