South African Revenue Service

INTERPRETATION NOTE 97

DATE: 8 December 2017

ACT	**:**	**INCOME TAX ACT 58 OF 1962**
SECTION	**:**	**SECTIONS 1(1) – DEFINITION OF "REIT", 8F(2) AND (3)(*d*), 8FA(2) AND (3)(*d*), 9C(2) AND (5), PARAGRAPH (*aa*) OF THE PROVISO TO SECTION 10(1)(*k*)(i), 11(*a*), 11(*x*), 23N(5), 24J(2), 25BB, 41 TO 47, 64E(1), 64F(1)(*a*) AND (*l*) AND (2), 64FA(1)(*a*); PARAGRAPH 20(3)(*a*) OF THE EIGHTH SCHEDULE; SECTIONS 2(1) AND 8(1)(*t*) OF THE SECURITIES TRANSFER TAX ACT; SECTIONS 1(1) – DEFINITION OF "RESIDENTIAL PROPERTY COMPANY", 2(1) AND 9(1)(*l*) OF THE TRANSFER DUTY ACT; AND SECTIONS 2, 7(1)(*a*), 12(*a*) AND 17(1) OF THE VALUE-ADDED TAX ACT**
SUBJECT	**:**	**TAXATION OF REITs AND CONTROLLED COMPANIES**

CONTENTS

PAGE

Preamble

In this Note unless the context indicates otherwise –

- **“CFC”** means a “controlled foreign company” as defined in section 1(1);
- **“CGT”** means capital gains tax, being the portion of normal tax attributable to the inclusion in taxable income of a taxable capital gain;
- **“CISIP”** means a collective investment scheme in property for purposes of the JSE Limited Listings Requirements;
- **“Collective Investment Schemes Control Act”** means the Collective Investment Schemes Control Act 45 of 2002;
- **“Companies Act”** means the Companies Act 71 of 2008;
- **“Controlled company”** means a “controlled company” as defined in section 25BB(1) (see **4.2**);
- **“JSE”** means the securities exchange operated by JSE Ltd;
- **“JSE Limited Listings Requirements”** is defined in section 1(1) and means the JSE Limited Listings Requirements, 2003, made by the JSE Limited under section 11 of the Financial Markets Act 19 of 2012;

- "**linked unit**" means a "linked unit" as defined in section 1(1) (see **4.4.1**);
- **"paragraph"** means a paragraph of the JSE Limited Listings Requirements as defined in section 1(1);
- **"property company"** means a "property company" as defined in section 25BB(1) (see **4.4.1**);
- **"qualifying distribution"** means a "qualifying distribution" as defined in section 25BB(1) (see **4.4.1**);
- **"REIT"** stands for "Real Estate Investment Trust" but bears its meaning as defined in section 1(1) (see **4.1**);
- **"Schedule"** means a Schedule to the Act;
- **"section"** means a section of the Act;
- **"tax treaty"** means an agreement for the avoidance of double taxation entered into between South Africa and another country;
- **"the Act"** means the Income Tax Act 58 of 1962;
- **"VAT Act"** means the Value-Added Tax Act 89 of 1991; 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 section 25BB, which deals with the taxation of REITs and controlled companies;
- considers other selected provisions of the Act that are particularly relevant to REITs, controlled companies and the holders of shares or linked units in these companies;
- does not discuss all the sections which apply to REITs and controlled companies which, while not specifically referring to REITs and controlled companies, are nevertheless applicable to REITs and controlled companies; and
- reflects the amendments introduced by the Taxation Laws Amendment Act 15 of 2016.

2. Background

Before the introduction of specific REIT legislation in South Africa,[1] two forms of listed property investment entity existed in South Africa, namely, property loan stock companies and property unit trusts (collective investment schemes in property). These entities were subject to different regulatory controls and tax treatment. A collective investment scheme in property operated as a trust both in reality and for

[1] Section 25BB and the JSE Limited Listings Requirements dealing with REITs.

income tax purposes, while a property loan stock company operated as a company. A unified approach was adopted and REITs were introduced in South Africa with effect from 1 April 2013. The REIT is the international standard and more than 25 countries in the world use a similar REIT model.[2]

South African REITs own several kinds of commercial property such as shopping centres, office buildings, factories, warehouses, hotels, hospitals and, to a lesser extent, residential property, in South Africa.[3] Some REITs also invest in property in other countries.[4] The objective of a REIT is to provide investors with steady rental income and capital growth in the underlying properties.

A REIT may be a company as commonly understood or may be deemed to be a company for taxation purposes. A portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x) is deemed to be a "company".[5]

Both corporate and trust (collective investment schemes in property) REITs that comply with the JSE Limited Listings Requirements are listed and publicly trade on the JSE.[6] Once the shares in a company or a trust which is deemed to be a company for tax purposes are listed as shares in a REIT as defined in paragraph 13.1(x) (see **4.1.4**), the company or trust will qualify as a REIT for income tax and CGT purposes.

A REIT, and a "controlled company" as defined,[7] are subject to a specific tax regime under section 25BB. In essence, a REIT and a controlled company are treated as conduits for the income they derive, with the REIT or controlled company being granted a deduction, subject to various limitations, for distributions made by it. A resident investor is subject to normal tax on distributions derived from a REIT or controlled company. By contrast, a non-resident investor is liable for dividends tax (as opposed to normal tax) on such distributions.

A REIT and a controlled company must also consider dividends tax, transfer duty, securities transfer tax and VAT.

3. The law

Section 25BB is quoted in **Annexure A**.

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2 **www.sareit.co.za** [Accessed 7 December 2017].
3 **www.sareit.co.za** [Accessed 7 December 2017].
4 **www.sareit.co.za** [Accessed 7 December 2017].
5 Paragraph (*e*)(iii) of the definition of "company" in section 1(1).
6 Even though ZARX (Pty) Ltd and 4 Africa Exchange (Pty) Ltd are licensed as exchanges, a company or trust listed on these exchanges will not qualify as a REIT under the Act because it would not be listed on the JSE. A listing on the JSE is a requirement of the JSE Limited Listings Requirements.
7 In section 25BB(1).

4. Application of the law

4.1 General requirements of a "REIT" (section 1(1) – definition of "REIT")

A "REIT" is defined in section 1(1) as –

> "…a company—
>
> (*a*) that is a resident; and
>
> (*b*) the shares of which are listed—
>
> (i) on an exchange (as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act); and
>
> (ii) as shares in a REIT as defined in the JSE Limited Listings Requirements;"

The requirements for a REIT are therefore that –

- it must be a company as defined in section 1(1) (see **4.1.1**);
- it must be a resident as defined in section 1(1) (see **4.1.2**);
- its shares must be listed on an exchange as defined in section 1(1) (see **4.1.3**); and
- its shares must be listed as shares in a REIT as defined in the JSE Limited Listings Requirements (see **4.1.4**).

These requirements are considered below.

4.1.1 The REIT must be a company (section 1(1) – preamble to the definition of "REIT")

The term "company" is defined in section 1(1). In order to qualify as a "company" for purposes of the definition of "REIT", an entity must either be –

- a company as defined in section 1 of the Companies Act [paragraph (*a*) of the definition of "company" in section 1(1)] [see **4.1.1 (a)**];
- a company incorporated under the law of any country other than the Republic [paragraph (*b*) of the definition of "company" in section 1(1)] [see **4.1.1 (b)**]; or
- a portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x) [paragraph (*e*)(iii) of the definition of "company" in section 1(1)][8] (see **4.1.1**).

[8] Paragraph (*e*) of the definition of "company" in section 1(1) was amended by the addition of paragraph (*e*)(iii) to include a portfolio of a collective investment scheme in property with effect from years of assessment commencing on or after 1 April 2013. It was further amended with effect from years of assessment commencing on or after 1 January 2015 to refer to a portfolio of a collective investment scheme in property that qualifies as a REIT and with effect from 1 January 2015 to refer to a portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x).

(a) A company as defined in the Companies Act

A "company" is defined in section 1 of the Companies Act and 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;"

A domesticated company referred to in the above definition is a company whose registration has been transferred to South Africa from a foreign jurisdiction. Under section 13(5) of the Companies Act such a company is treated as if it had been originally incorporated and registered under the Companies Act.

In essence only a "public company" that is a "profit company" as defined in section 1 of the Companies Act will potentially qualify as a REIT.

(b) A company incorporated under the law of any country other than the Republic

A company incorporated under the law of any country other than the Republic is a "company" as defined for income tax purposes and can thus also qualify as a REIT provided that it complies with all the other requirements of the definition of "REIT". One such requirement is that it must be a resident (see **4.1.2**).

(c) A portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(x)

A portfolio of a collective investment scheme in property is, with effect from years of assessment commencing on or after 1 January 2015, a company for income tax purposes if it qualifies as a "REIT" as defined in paragraph 13.1(x) [see **4.1.4** for the definition of "REIT" as defined in paragraph 13.1(x)].

A "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;"

The terms "portfolio" and "collective investment scheme" are defined in section 1 of the Collective Investment Schemes Control Act as follows:

> " **'[P]ortfolio'** means a group of assets including any amount of cash in which members of the public are invited or permitted by a manager to acquire, pursuant to a collective investment scheme, a participatory interest or a participatory interest of a

specific class which as a result of its specific characteristics differs from another class of participatory interests;"

" **'collective investment scheme'** means a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which—

(*a*) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and

(*b*) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed,

but not a collective investment scheme authorised by any other Act;"

A "collective investment scheme in property" as defined in section 47(1) of the Collective Investment Schemes Control Act includes a scheme the portfolio of which consists of the following assets:

- Property shares
- Immovable property
- Assets prescribed by the Registrar
- Investments outside the Republic

Property shares

The term "property shares" is defined in section 47(1) of the Collective Investment Schemes Control Act as follows:

" **'[P]roperty shares'** means shares in and of—

(*a*) a fixed property company; or

(*b*) a holding company which has no subsidiaries other than fixed property companies which are wholly owned subsidiaries as referred to in section 3(1)(*b*) of the Companies Act;"

Section 3(1)(*b*) of the Companies Act provides that a company is a wholly owned subsidiary of a juristic person, for example, the holding company referred to in the definition of "property shares", if all the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by that juristic person, one or more subsidiaries of that juristic person or one or more nominees of that juristic person or any of its subsidiaries.

A "fixed property company" is in turn defined in section 47(1) of the Collective Investment Schemes Control Act as follows:

" **'[F]ixed property company'** means a company all the issued shares of which are included in a portfolio, and the principal business of which consists in the acquisition and holding of—

(*a*) urban immovable property[9] or any undivided share or interest therein or leasehold in respect thereof; and

[9] As defined in section 47(1) of the Collective Investment Schemes Control Act.

> (*b*) such other immovable property or any undivided share or interest therein or leasehold in respect thereof as the registrar may have approved;"

While "urban immovable property" is defined in section 47(1) of the Collective Investment Schemes Control Act, the words "other immovable property" are not defined. As to the meaning of "immovable property" see discussion below.

Immovable property

According to *Silberberg and Schoeman's: The Law of Property*[10] *corporeal* immovable things (property) consist of –

> "land and everything that is attached to land by natural or artificial means."

According to LAWSA immovable things –[11]

> "are things which cannot be moved from one place to another without damage or change of form…"

It would seem that the determination of whether an incorporeal thing (property) is movable or immovable –[12]

> "would depend on the nature of the object to which it pertains".

It is considered that usufructs over land constitute immovable property as contemplated in the definition of "fixed property company" in section 47(1) of the Collective Investment Schemes Control Act.

Assets prescribed by the Registrar

The registrar of collective investment schemes may for purposes of Part V (sections 47 to 51) of the Collective Investment Schemes Control Act determine assets, other than property shares, immovable property or any investment permitted under section 49, which may be included in a portfolio of a collective investment scheme in property.

Investments outside the Republic

Under section 49 of the Collective Investment Schemes Control Act a manager may, subject to specific provisions or any other law, invest assets of a portfolio of a collective investment scheme in property in immovable property in a foreign country and property shares or participatory interests in a collective investment scheme in property in a foreign country if specified requirements are met.

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[10] PJ Badenhorst, JM Pienaar & H Mostert *Silberberg and Schoeman's: The Law of Property* [online] (MyLexisNexis: 5 ed August 2006) in paragraph 3.3.2.2(a).

[11] CG Van der Merwe "Movables and Immovables" 27 (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 31 January 2014) in paragraph 51.

[12] PJ Badenhorst, JM Pienaar & H Mostert *Silberberg and Schoeman's: The Law of Property* [online] (MyLexisNexis: 5 ed August 2006) in paragraph 3.3.2.2(b). See also CG Van der Merwe "Examples of Movables and Immovables" 27 (Second Edition Volume) *LAWSA* [online] (My LexisNexis: 31 January 2014) in paragraph 53.

4.1.2 The REIT must be a resident (section 1(1) – paragraph (*a*) of the definition of "REIT")

Only a resident company qualifies as a REIT. In relation to a juristic person, paragraph (*b*) of the definition of "resident" in section 1(1) defines a resident as a person that –

- is incorporated, established or formed in the Republic; or
- has its place of effective management in the Republic.

See Interpretation Note 6 dated 26 March 2002 "Resident: Place of Effective Management (Persons Other Than Natural Persons)" and Interpretation Note 6 (Issue 2) dated 3 November 2015 "Resident – Place of Effective Management (Companies)" for a discussion of the term "place of effective management".

Thus a company incorporated outside South Africa but which is effectively managed in South Africa could qualify as a REIT if all the other requirements to be a REIT are complied with.

A company that is deemed to be exclusively a resident of another country under a tax treaty is excluded from the definition of "resident" in section 1(1). Thus a company incorporated in South Africa but effectively managed outside South Africa would not be a resident if the tax treaty with the country concerned made such a company exclusively a resident of that country because of its place of effective management.

4.1.3 The shares of the REIT must be listed on an exchange (section 1(1) – paragraph (*b*)(i) of the definition of "REIT")

In order to qualify as a REIT, the shares of the company must be listed on an exchange as defined in the Financial Markets Act 19 of 2012 and licensed under section 9 of that Act. An "exchange" is defined in section 1 of the Financial Markets Act as follows:

> " **'[E]xchange'** means a person who constitutes, maintains and provides an infrastructure—
>
> (*a*) for bringing together buyers and sellers of securities;
>
> (*b*) for matching bids and offers for securities of multiple buyers and sellers; and
>
> (*c*) whereby a matched bid and offer for securities constitutes a transaction;"

The JSE, ZARX (Pty) Ltd and 4 Africa Exchange (Pty) Ltd are currently licensed under section 9 of the Financial Markets Act 19 of 2012.[13] However, only a company the shares of which are listed as shares in a REIT, as defined in the JSE Limited Listings Requirements, qualifies as a REIT (see **4.1.4**).[14]

[13] The Financial Services Board Press Release dated 1 September 2016 announced that ZARX (Pty) Ltd and 4 Africa Exchange (Pty) Ltd had been granted exchange licences with conditions.

[14] Even though ZARX (Pty) Ltd and 4 Africa Exchange (Pty) Ltd are licensed as exchanges, a company or trust listed on these exchanges will not qualify as a REIT under the Act because it would not be listed on the JSE. A listing on the JSE as shares in a REIT is a requirement of the JSE Limited Listings Requirements.

The shares of the company must be listed. A "share" is defined in section 1(1) to mean, in relation to any company, any unit into which the proprietary interest in that company is divided. A share, therefore, includes a participatory interest in a portfolio of a collective investment scheme in property.

A listed property entity or a property entity seeking a listing must comply with the requirements in section 13 of the JSE Limited Listings Requirements, in addition to all other applicable Listing Requirements.[15] A "property entity" is defined in paragraph 13.1(t) as a company or CISIP that is primarily engaged, directly or indirectly, in property activities including –

- the holding of properties and development of properties for letting and retention as investments; or
- the purchase of land for development of properties for retention as investments.

4.1.4 The shares of the REIT must be listed as shares in a REIT as defined in the JSE Limited Listings Requirements (section 1(1) – paragraph (*b*)(ii) of the definition of "REIT")

The shares of the REIT must be listed on an exchange licensed under section 9 of the Financial Markets Act as shares in a "REIT" as defined in paragraph 13.1(x).

The term "REIT" is defined in paragraph 13.1(x) as follows:

> " **'REIT'** means Real Estate Investment Trust and is defined as an applicant issuer which receives a REIT status in terms of the Listings Requirements."

The term "applicant or applicant issuer" is defined in the definitions of the JSE Limited Listings Requirements and means an issuer, an issuer of specialist securities[16] or a new applicant.

REIT status listing criteria for property entities other than CISIPs are dealt with in paragraphs 13.46 to 13.54, 13.59 and 13.60 and those for CISIPs in paragraphs 13.55 to 13.59 and 13.61. These listing criteria are summarised in **Annexure B**.

4.2 General requirements of a "controlled company" (section 25BB(1) – definition of "controlled company")

The term "controlled company" is defined in section 25BB(1) and means a company that is a subsidiary, as defined in IFRS, of a REIT.[17]

A "subsidiary" as defined in IFRS 10 means an entity that is controlled by another entity. The meaning of the word "control" is discussed in paragraphs 5 to 18 of IFRS 10. It is stated in paragraph 5 of IFRS 10 that an investor, regardless of the nature of its involvement with an entity (the investee), must determine whether it is a parent by assessing whether it controls the investee. Paragraph 6 of IFRS 10 stipulates that an investor controls an investee when it is exposed or has rights to

[15] Paragraph 13.2(a).
[16] Specialist securities are dealt with in section 19 of the JSE Limited Listings Requirements.
[17] The term "IFRS" is defined in section 1(1) and means the International Financial Reporting Standards issued by the International Accounting Standards Board.

variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Although the IFRS definition of "subsidiary" also includes a controlled trust, only a "company" as defined in section 1(1) can be a controlled company for purposes of section 25BB. A trust cannot therefore be a controlled company.

A company will, therefore, be a "controlled company" if it is controlled by a REIT as contemplated in IFRS 10.

A company will also be a "controlled company" if it is controlled by a REIT which holds shares in the company through a vesting trust.

The shares of a controlled company need not be listed on the JSE. It is furthermore not a requirement that a controlled company be a resident, although section 25BB(2), which provides for the deduction of qualifying distributions, applies to a controlled company only if that company is a resident (see **4.4**).

4.3 Time of determination whether a company qualifies as a REIT or a controlled company

The determination whether a company is a REIT or a controlled company must be made on the following dates:

- For the purposes of section 25BB(2)(*a*), (2A), (4) and (5) that company must be a REIT or a controlled company on the last day of its year of assessment (see **4.4.1**, **4.6** and **4.7**). In addition, the definition of "qualifying distribution" in section 25BB(1) requires the company to be a REIT or a controlled company as at the end of a year of assessment and section 25BB(2)(*a*) requires the qualifying distribution to be made by the REIT or controlled company.
- Section 25BB(6)(*b*) stipulates that a company must be a REIT or a controlled company at the time of receipt or accrual of interest on a debenture forming part of a linked unit in a property company (see **4.8.2**).
- For the purposes of section 25BB(5)(*a*), (6)(*a*), 6(*c*), (7) and (8) a company must be a REIT or a controlled company at the time the relevant amount is received or accrued, or when the relevant transaction or event takes place (see **4.7**, **4.8.1**, **4.8.3, 4.9** and **4.10**).

4.4 Deduction of a qualifying distribution made by a REIT or a resident controlled company [section 25BB(2)]

4.4.1 Qualifying distribution [section 25BB(2)(*a*)]

Under section 25BB(2)(*a)* the amount of a "qualifying distribution" as defined (see below) made by a REIT, or a resident controlled company, for a year of assessment must be deducted from the income of that REIT or controlled company for that year of assessment, but only if that company is a REIT or a resident controlled company *on the last day of that year of assessment*. In addition, the REIT, or resident controlled company must be a REIT or a controlled company *as at the end of the year of assessment* in order to meet the definition of and have a "qualifying distribution". A company that is a REIT or a controlled company *on* the last day of the year of assessment will be one *as at the end* of the year of assessment unless it ceased to be a REIT or a controlled company on the last day of the year of assessment.

In addition, section 25BB(2)(*a*) requires the qualifying distribution to be "made by that REIT or that controlled company" which means the company must be a REIT or a resident controlled company at the time the distribution is made. A distribution can and often is made in a year of assessment subsequent to the year to which it relates. The distribution will be considered as having been made by the REIT or resident controlled company if that company has an unconditional legal obligation to pay the dividend or interest. This unconditional legal obligation will generally arise on the date of declaration of the dividend or incurral of the interest and not, in the case of a dividend, on the "record date" or the date of payment.

A company does not have to be a REIT or a resident controlled company for the whole of a year of assessment to qualify for a deduction under section 25BB(2)(*a*). The requirement to be a REIT or a resident controlled company must be met on and as at the end of the last day of that year of assessment and at the time of making the distribution and not necessarily during the preceding period in the year of assessment.

A company ceasing to be a REIT and not qualifying as a resident controlled company, or ceasing to be a resident controlled company and not qualifying as a REIT, is not entitled to deduct a qualifying distribution in the year of assessment in which it ceases to be a REIT or a resident controlled company because its year of assessment is deemed to end on the date that it so ceases to be a REIT or a resident controlled company under section 25BB(7)(*a*) (see **4.9**).[18] The company will therefore not be a REIT or resident controlled company as at the end of the year of assessment as required.

Meaning of "qualifying distribution"

The term "qualifying distribution" is defined in section 25BB(1) in respect of a year of assessment of a company that is a REIT or controlled company *as at the end* of the year of assessment. A distribution by a REIT or a controlled company must comply with the following requirements to be a "qualifying distribution":

- The distribution must consist of any or both of the following :
    - ➢ A dividend[19] paid or payable, excluding a share buy-back contemplated in paragraph (*b*) of the definition of "dividend" in section 1(1). A dividend constituting a share buy-back is exempt from normal tax in the hands of the holders of the shares or linked units under section 10(1)(*k*)(i) and therefore a REIT or a resident controlled company is not allowed to deduct it as part of a qualifying distribution (see **5.4.1**).
    - ➢ Interest incurred on a debenture forming part of a linked unit (see below) in that company.[20]
- The amount of the dividend and the interest referred to above in respect of a year of assessment must be determined with reference to the financial results as reflected in the financial statements prepared for that year of assessment.

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[18] See proposed changes to section 25BB(7) in clause 44(*b*) of the draft Taxation Laws Amendment Bill, 2017.

[19] See paragraph 2.2.3 of the *Comprehensive Guide to Dividends Tax* for a discussion of the meaning of "dividend" as defined in section 1(1).

[20] Any interest that forms part of "qualifying distribution" is not otherwise deductible under the Act.

For example, when a distribution, the amount of which is determined with reference to the financial results of year 1 as reflected in the financial statements of year 1, is declared and actually paid in year 2, it will be allowed as a deduction in year 1 even though the actual distribution is made in year 2.

- At least 75% of the gross income[21] received by or accrued to a company during the first year of assessment in which the company qualifies as a REIT or controlled company must comprise rental income (see below on the meaning of "rental income").
- In any other case, at least 75% of any gross income received by or accrued to a REIT or a controlled company in the year of assessment preceding the year of assessment in respect of which the distribution is paid or payable, if a dividend, or incurred if interest, must consist of rental income (see below).
- Under section 9D(2) a portion of the net income of a CFC must be included in the income of holders of shares that are residents, other than headquarter companies, if residents directly or indirectly hold more than 50% of the participation rights or voting rights in the CFC. Although section 9D(2) provides that a portion of the net income of a CFC is included in the "income" of holders of shares, it is actually included in gross income under paragraph (*n*) of the definition of "gross income" in section 1(1). In determining a "qualifying distribution", an amount that must be included in the income of the REIT or controlled company under section 9D(2) must not be taken into account for purposes of applying the "75% of gross income test".

A company may lose its REIT status on the JSE if a distribution does not meet the requirements of the definition of "qualifying distribution" in section 25BB(1) (see **4.1.4** and paragraph 13.53(a) in **Annexure B**).

See **4.9** for the tax consequences for a company that loses its REIT status on the JSE.

Example 1 – Determination of the amount of a qualifying distribution

Facts:

REIT A owned a commercial property and 100% of the equity shares in Controlled Company A. REIT A and Controlled Company A's years of assessment end on 31 December.

REIT A and Controlled Company A earned rental income of R1 million and R500 000 respectively during the 2015 year of assessment. No expenditure was incurred by these companies during this year of assessment. Controlled Company A declared and paid a dividend of R500 000 to REIT A on 31 January 2016 which was determined with reference to its financial results as reflected in its financial statements prepared for the 2015 year of assessment. REIT A declared and paid a dividend of R1,5 million on 15 February 2016 with reference to the rental income received of R1 million during the 2015 year of assessment and the dividend of R500 000 received from Controlled Company A on 31 January 2016.

[21] As defined in section 1(1).

REIT A and Controlled Company A received rental income of R2 million and R1,5 million respectively during the 2016 year of assessment. No expenditure was incurred by these companies during this year of assessment. Controlled Company A declared and paid a dividend of R1,5 million to REIT A on 31 January 2017 which was determined with reference to its financial results as reflected in its financial statements for the 2016 year of assessment. REIT A declared and paid a dividend of R3,5 million on 15 February 2017 with reference to the rental income of R2 million received during the 2016 year of assessment and the dividend of R1,5 million received from Controlled Company A on 31 January 2017.

Result:

Calculation of the amounts of the qualifying distributions and taxable income of REIT A and Controlled Company A

Controlled Company A

	2015 R	2016 R
Rental income	500 000	1 500 000
Less: Expenses	(0)	(0)
Taxable income before the qualifying distribution	500 000	1 500 000
Less: Qualifying distribution under section 25BB(2)	(500 000)	(1 500 000)
Taxable income	0	0

REIT A

	2015 R	2016 R
Rental income	1 000 000	2 000 000
Qualifying distribution received from Controlled Company A (Note 1)	0	500 000
Total income	1 000 000	2 500 000
Less: Expenses	(0)	(0)
Taxable income before the qualifying distribution	1 000 000	2 500 000
Less: Qualifying distribution under section 25BB(2) (Notes 2 and 3)	(1 000 000)	(2 500 000)
Taxable income	0	0

Notes:

(1) The dividend of R500 000 declared and paid by Controlled Company A is included in REIT A's gross income in the 2016 year of assessment, since it accrued and was received by REIT A on 31 January 2016. Similarly, the dividend of R1,5 million declared and paid by Controlled Company A on 31 January 2017 is included in REIT A's gross income in the 2017 year of assessment, since it accrued and was received by REIT A on 31 January 2017. These dividends are included in REIT A's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1) and are not exempt from normal tax under paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) (see **5.4.2**).

(2) REIT A declared and paid a dividend of R1,5 million on 15 February 2016. R1 million of this amount was determined with reference to the financial results reflected in the financial statements prepared for the 2015 year of assessment. R1 million of the total dividend paid as a "qualifying distribution" qualifies as a deduction under section 25BB(2) in respect of the 2015 year of assessment. The difference of R500 000 qualifies as a deduction under section 25BB(2) in respect of the 2016 year of assessment.

(3) REIT A declared and paid a dividend of R3,5 million on 15 February 2017. R2 million of this amount was determined with reference to the financial results reflected in the financial statements prepared for the 2016 year of assessment. R2 million of the total dividend of R3,5 million paid as a "qualifying distribution" qualifies as a deduction under section 25BB(2) in respect of the 2016 year of assessment. Therefore, the total qualifying distribution for the 2016 year of assessment is R2,5 million (R500 000 (see point 2) above + R2 million). The portion of the dividend paid on 15 February 2017, that is R1,5 million, relating to the dividend of R1,5 million received from Controlled Company A on 31 January 2017 may form part of a qualifying distribution in respect of the 2017 year of assessment.

(4) REIT A's board resolutions should specify the amount of the dividend paid that was determined with reference to the financial results reflected in the financial statements prepared for each respective year of assessment.

Meaning of "rental income" referred to in the definition of "qualifying distribution"

The term "rental income" is defined in section 25BB(1) and means any of the following amounts received by or accrued to a REIT or a controlled company:

- An amount received or accrued for the use of immovable property, including any penalty or interest charged on the late payment of such amount (paragraph (*a*) of the definition of "rental income").
- Any dividend, other than a share buy-back contemplated in paragraph (*b*) of the definition of "dividend" in section 1(1), from a company that is a REIT at the time of the distribution of that dividend (paragraph (*b*) of the definition of "rental income"). A share buy-back by a REIT is excluded from "rental income" because it is exempt from normal tax in the hands of the holders of the shares under section 10(1)(*k*)(i) (see **5.4.1**). A dividend received or accrued from a REIT includes an amount of interest paid on a debenture forming part of a linked unit held in a REIT (see **4.8.1**).
- A qualifying distribution[22] from a company that is a controlled company at the time of that distribution (paragraph (*c*) of the definition of "rental income").
- A dividend or foreign dividend from a company that is a property company (see below) at the time of that distribution (paragraph (*d*) of the definition of "rental income").[23]
- Any amount recovered or recouped under section 8(4) in respect of an amount of an allowance previously deducted under section 11(*g*), 13, 13*bis*, 13*ter*, 13*quat*, 13*quin* or 13*sex* (paragraph (*e*) of the definition of "rental

[22] As defined in section 25BB(1).
[23] The terms "dividend" and "foreign dividend" are defined in section 1(1).

income”).[24] These allowances could be claimed by a company before it became a REIT or a controlled company.

Meaning of a “property company” referred to in the definition of “rental income”

A “property company” is defined in section 25BB(1) and can be a resident company or a foreign company. It must meet the following requirements:

- A REIT or a controlled company, whether alone or together with any other company forming part of the same group of companies (see below) as that REIT or that controlled company, must hold 20% or more of the equity shares (see below) or linked units (see below) in that company (paragraph (*a*) of the definition of “property company”). A person is considered to hold equity shares or linked units in a company if that person is the beneficial owner of the shares or linked units. The person recognised in the share register of a company, for example, an agent or intermediary, is not necessarily the beneficial owner of the shares or linked units. A direct holding of equity shares or linked units is envisaged, since the word “indirectly” is not used in paragraph (*a*) of the definition of “property company”.

- At the end of the previous year of assessment of that company, 80% or more of the value of its assets, reflected in the annual financial statements prepared in accordance with the Companies Act or IFRS[25] for that previous year of assessment, must directly or indirectly (see below) be attributable to immovable property (paragraph (*b*) of the definition of “property company”). See **4.1.1 (c)** for the meaning of “immovable property”. A company incorporated during the current year of assessment will be unable to meet this requirement even if 80% or more of its assets during the current year comprise immovable property.

The requirements to be a property company must be met at the time of the happening of a specific event, for example, when –

- a distribution in the form of a dividend or foreign dividend is made by the company to a REIT or a controlled company [paragraph (*d*) of the definition of “rental income” in section 25BB(1)];

- a share or a linked unit in that company is disposed of by a REIT or a controlled company [section 25BB(5)(*c*)]; and

- an amount of interest is received by or accrues to a REIT or a controlled company on a debenture forming part of a linked unit in that company [section 25BB(6)(*b*)].

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24 Paragraph (*e*) of the definition of “rental income” was inserted by section 48(1)(*a*) of the Taxation Laws Amendment Act 15 of 2016 with effect from years of assessment ending on or after 1 January 2016.

25 The reference to IFRS was added by section 45(1)(*a*) of the Taxation Laws Amendment Act 43 of 2014 with effect from 1 April 2013 and applicable in respect of years of assessment commencing on or after that date. The financial statements of a foreign company will not be prepared in accordance with the South African Companies Act, but are generally prepared in accordance with IFRS.

Example 2 – Meaning of "property company"

Facts:

REIT A holds 100% of the equity shares in Company B and 10% of the equity shares in Company C. Company B holds 10% of the equity shares in Company C. Company B and Company C are residents.

Result:

REIT A and Company B form part of the same "group of companies" as defined in section 1(1) because REIT A holds at least 70% of the equity shares in Company B.

The "20% equity share requirement" in paragraph (*a*) of the definition of "property company" in section 25BB(1) is met, since REIT A [together with a company forming part of the same group of companies (Company B)] holds at least 20% of the equity shares in Company C.

Company C would therefore be a property company if the requirements of paragraph (*b*) of the definition of "property company" are also met.

Note:

Company B is a controlled company because it is a subsidiary of REIT A. Depending on the facts, Company B can make qualifying distributions which, from REIT A's perspective, fall within paragraph (*c*) of the definition of "rental income" (see **4.4.1**). However, if Company B were a foreign company, notwithstanding that it is a controlled company, it must be determined whether it is also a "property company" as defined in section 25BB(1). A foreign company cannot make a "qualifying distribution" and dividends paid by it would not fall within paragraph (*c*) of the definition of "rental income". For a foreign dividend paid by a foreign company to constitute "rental income" as defined in section 25BB(1), it has to be paid by a property company as defined.

Example 3 – Meaning of "property company"

Facts:

REIT A holds 40% of the equity shares in Company B and 10% of the equity shares in Company C. Company B holds 10% of the equity shares in Company C. Company B and Company C are residents.

90% of the value of Company C's assets, as reflected in the annual financial statements prepared in accordance with IFRS for the previous year of assessment, are directly attributable to immovable property.

Result:

REIT A and Company B do not form part of the same "group of companies" as defined in section 1(1) because REIT A holds less than the required 70% of the equity shares in Company B.

The "20% equity share requirement" in paragraph (*a*) of the definition of "property company" in section 25BB(1) is not met, since REIT A directly holds only 10% of the equity shares in Company C which is less than the required 20%. REIT A's indirect holding of 4% (40% × 10%) of the equity shares in Company C is not considered, since a direct holding of equity shares is envisaged in paragraph (*a*) of the definition of "property company" in section 25BB(1). Therefore, even though 80% or more of the value of Company C's assets, as reflected in the annual financial statements prepared in accordance with IFRS for the previous year of assessment, are directly attributable to immovable property, Company C is not a property company.

Example 4 – Meaning of "property company"

Facts:

REIT A has a vested right in all the assets of Trust A. Trust A holds 20% of the equity shares in Company B. Company B and Company C are residents.

Result:

REIT A beneficially holds 20% of the equity shares in Company B because it has a vested right in the shares held by Trust A in Company B.

The "20% equity share requirement" in paragraph (*a*) of the definition of "property company" in section 25BB(1) is met, since REIT A holds at least 20% of the equity shares in Company B.

Company B would be a property company if the requirements of paragraph (*b*) of the definition of "property company" are also met.

Meaning of "group of companies" in the definition of "property company"

A "group of companies" is defined in section 1(1) and means two or more companies in which one company (the controlling group company) directly or indirectly holds[26] shares in at least one other company (the controlled group company), to the extent that –

- at least 70% 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
- the controlling group company directly holds at least 70% of the equity shares in at least one controlled group company.

Meaning of "equity share" referred to in the definition of "property company"

The term "equity share" is defined in section 1(1) and 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.

[26] See discussion above in "Meaning of a 'property company' referred to in the definition of 'rental income" on the meaning of "hold".

A distribution from a company could take the form of a distribution of profits (dividends) or capital (return of contributed tax capital).[27] As long as the right to participate in either of these types of distribution is unrestricted, the share will be an equity share. The share will be an equity share if only one of these rights is restricted, but not if both are restricted.

Meaning of the words "directly or indirectly attributable to immovable property" as referred to in the definition of "property company"

It is a requirement that 80% or more of the value of the assets of a property company must directly or indirectly be attributable to immovable property.

The words "directly attributable" include, for example, the value of immovable property owned directly by the property company and the value of leasehold rights because the lease derives its value from the immovable property of the lessor.

The words "indirectly attributable" include, for example, the market value of any equity shares held by a property company to the extent that the market value of the equity shares is attributable, directly or indirectly, to immovable property.

In determining the portion of the market value of any equity shares held by a potential property company (Company A) in another company (Company B) which is directly or indirectly attributable to immovable property, any liabilities of Company B must be disregarded. However, in determining the market value of the equity shares held by the potential property company (Company A) in the other company (Company B), which is reflected in Company A's annual financial statements prepared in accordance with the Companies Act or IFRS, Company A will have taken all of Company B's liabilities into account.

For example, a potential property company, Company A, holds 100% of the equity shares in Company B. Company B's assets comprise immovable property valued at R1 million and cash on hand of R50 000. Its only liability is a bond over the fixed property of R900 000. The market value of Company B's net assets is R150 000 (R1 million immovable property + R50 000 cash – R900 000 bond). The market value of the equity shares held by Company A in Company B is therefore R150 000 (R150 000 × 100%). In determining the portion of the market value of the equity shares held by Company A in Company B which is attributable to immovable property, Company B's liabilities of R900 000 must be disregarded. Therefore, 95,24% (R1 000 000 / R1 050 000 ×100%) of the value of Company B's assets is attributable to immovable property, and 95,24% of the market value of the equity shares held by Company A in Company B of R150 000 is likewise attributable to Company B's immovable property.

Example 5 – Meaning of "immovable property" of a property company

Facts:

The years of assessment of REIT A, Company B and Company C end on 31 December. During the 2015 and 2016 years of assessment REIT A held 20% of the equity shares in Company B and Company B held 10% of the equity shares in Company C. Company B and Company C are residents.

[27] The term "contributed tax capital" is defined in section 1(1).

The market values of the assets of Company B and Company C at the end of the 2015 year of assessment were as follows:

	Company B	Company C
	R	R
Land and buildings	10 000 000	5 000 000
Leasehold rights	2 000 000	0
Equity shares in Company C	500 000	
Other assets	300 000	600 000
Market value of assets	12 800 000	5 600 000

Result:

The "20% equity share requirement"

The "20% equity share requirement" in paragraph (*a*) of the definition of "property company" in section 25BB(1) has been met, since REIT A held 20% of the equity shares in Company B.

The "80% market value of assets requirement"

It must be determined whether 80% or more of the market value of the assets of Company B was directly or indirectly attributable to immovable property at the end of its 2015 year of assessment.

Assets of Company B directly attributable to immovable property

	R
Land and buildings	10 000 000
Leasehold rights	2 000 000
Market value of assets directly attributable to immovable property	12 000 000

Assets of Company B indirectly attributable to immovable property

89% (R5 000 000 / R5 600 000 × 100 rounded to the nearest R1) of the market value of the assets of Company C was attributable to immovable property. Therefore, 89% of the market value of the equity shares held by Company B in Company C (R500 000) was attributable to immovable property, namely, R445 000 (R500 000 × 89%).

Assets indirectly attributable to immovable property	445 000
Market value of assets of Company B attributable to immovable property	12 445 000

The requirements of paragraph (*b*) of the definition of "property company" in section 25BB(1) have been met because 97% (R12 445 000 / R12 800 000 × 100) of the market value of Company B's assets at the end of its previous year of assessment (2015) was directly or indirectly attributable to immovable property, which is more than the required 80%.

Company B is a property company because the requirements of paragraphs (*a*) and (*b*) of the definition of "property company" in section 25BB(1) have been met.

Example 6 – Meaning of "immovable property" of a property company

Facts:

The years of assessment of REIT A, Company B, Company C and Company D end on 31 December. During the 2015 and 2016 years of assessment REIT A held 20% of the equity shares in Company B, Company B held 100% of the equity shares in Company C and Company C held 100% of the equity shares in Company D.

Company B and Company C did not own any other assets and did not have any liabilities at the end of the 2015 year of assessment. The market values of the assets and liabilities of Company D at the end of the 2015 year of assessment were as follows:

	Company D R
Assets	
Land and buildings	10 000 000
Other assets	2 000 000
Market value of assets	12 000 000
Liabilities	
Loan from shareholder	500 000
Bond over fixed property	1 500 000
Market value of liabilities	2 000 000

The market value of the equity shares in Company D at the end of the 2015 year of assessment was R10 million (assets of R12 million – liabilities of R2 million).

Result:

The "20% equity share requirement" in relation to Company B

The "20% equity share requirement" in paragraph (*a*) of the definition of "property company" in section 25BB(1) has been met, since REIT A held 20% of the equity shares in Company B.

The "80% market value of assets requirement" in relation to Company B

It must be determined whether 80% or more of the market value of the assets of Company B was directly or indirectly attributable to immovable property at the end of its 2015 year of assessment.

The market value of the equity shares held by Company C in Company D was R10 million. 83,33333% (R10 million / R12 million) of the market value of Company D's assets was attributable to immovable property. Therefore, 83,33333% of the market value of the equity shares held by Company C in Company D (R10 million) was attributable to immovable property, namely, R8 333 333 (R10 million × 83,33333%).

The market value of the equity shares held by Company B in Company C was R10 million which was equal to the market value of the equity shares held by Company C in Company D (R10 million). 83,33333% (R10 million / R12 million) of the market value of Company D's assets was attributable to immovable property. Therefore, 83,33333% of the market value of the equity shares held by Company B in Company C (R10 million) (that is, the market value of the assets of Company B) was also indirectly attributable to immovable property, namely, R8 333 333 (R10 million × 83,33333%).

The requirements of paragraph (*b*) of the definition of "property company" in section 25BB(1) have been met, since 83,33% (R10 million / R12 million × 100) of the market value of Company B's assets at the end of its 2015 year of assessment was directly or indirectly attributable to immovable property, which is more than the required 80%.

Company B qualified as a property company for the 2016 year of assessment because the requirements of paragraphs (*a*) and (*b*) of the definition of "property company" in section 25BB(1) have been met.

Meaning of "linked unit" referred to in the definitions of "qualifying distribution" and "property company"

The term "linked unit" is defined in section 1(1) and means a unit comprising a share and a debenture (see below) in a company where that share and that debenture are linked and are traded together as a single unit. Certain REITs, previously known as property loan stock companies, issue linked units to their holders. Profits distributed by these companies comprise both dividend and interest elements. For example, a distribution of R100 may consist of a dividend of R1 and interest of R99.

Meaning of "debenture" as referred to in the definition of "linked unit"

The word "debenture" is not defined in the Act. It is stated in *Henochsberg on the Companies Act 71 of 2008* that a "debenture" means –[28]

> "any document, however it may be described, and whatever form it may take, which creates or acknowledges indebtedness in the company to another for moneys advanced or to be advanced to the company".

4.4.2 Limitation of the deduction of the "qualifying distribution" [section 25BB(2)(*b*)]

The aggregate amount of qualifying distributions (dividends and interest on a debenture forming part of a linked unit) that may be deducted in any year of assessment may not exceed the taxable income of the REIT or the resident controlled company for that year of assessment, before taking into account the following:

- Any deduction of the qualifying distribution.
- Any assessed loss brought forward under section 20. An assessed loss of a REIT or a controlled company before it became a REIT or a controlled company may be carried forward under section 20.

[28] PM Meskin *et al Henochsberg on the Companies Act 71 of 2008* [online] (My LexisNexis: May 2016) in Commentary on section 43 of the Companies Act.

- The amount of a taxable capital gain included in taxable income under section 26A. A taxable capital gain will constitute an amount that is not disregarded under section 25BB(5) (see **4.7**).

Expenditure or allowances (other than certain specified capital allowances on immovable property, see **4.6**) that are deductible under other provisions of the Act must first be deducted from the REIT or controlled company's income before determining the limitation on the amount of the qualifying distribution deduction under section 25BB(2)(*b*). A REIT or a controlled company may, for example, claim a deduction of –

- salaries under section 11(*a*);
- a wear-and-tear or depreciation allowance under section 11(*e*);
- energy-efficiency savings under section 12L;
- foreign tax under section 25BB(2A)(*a*) and (*b*) (see **4.5.1** and **4.5.2)**; and
- *bona fide* donations made to certain organisations under section 25BB(2A)(*c*) (see **4.5.3)**.

Since the aggregate amount of qualifying distributions deductible in any year of assessment may not exceed the REIT or controlled company's taxable income, the deduction of qualifying distributions under section 25BB(2)(*a*) cannot create an assessed loss or increase an assessed loss carried forward.

The amount of any qualifying distribution that is not deductible because it exceeds the REIT or controlled company's taxable income as determined under section 25BB(2)(*b*) is forfeited and cannot be carried forward to a subsequent year of assessment. Even so, the full amount of the qualifying distribution is taxable in the hands of resident holders of shares under paragraph (*k*) of the definition of "gross income" in section 1(1) (see **5.4.1**) while non-resident holders are subject to dividends tax.

Example 7 – Taxation of a REIT and the normal tax and dividends tax implications of dividends paid to the holders of shares in a REIT

Facts:

REIT A was incorporated on 10 January 2016 and its year of assessment ends on 31 December. REIT A holds 51% of the equity shares in Controlled Company C and 20% of the equity shares in Property Company D. It also holds 10% of the linked units in REIT B. All four companies are residents.

Residents hold 70% of the equity shares in REIT A and non-residents hold 30%. REIT A declared a dividend of R15,4 million on 15 March 2017 that was paid on 31 March 2017. The dividend was determined with reference to the financial results reflected in the 2016 financial statements.

The following gross income was received by or accrued to REIT A during its 2016 year of assessment:

	R
Rental income from letting of fixed property	2 000 000
Dividend received from REIT B	100 000
Interest on a linked unit in REIT B	9 900 000
Qualifying distribution from Controlled Company C	1 000 000
Dividend from Property Company D	300 000
Interest on loans	400 000
Dividends on investments in other companies	300 000
Total gross income	14 000 000

REIT A made the following capital gains on the disposal of assets during the 2016 year of assessment:

	R
Capital gain on disposal of fixed property	5 000 000
Capital gain on disposal of other assets	2 000 000
Sum of capital gains	7 000 000

REIT A incurred expenses of R1,5 million in the production of the rental income. REIT A owns fixed property with a cost price of R20 million and claimed an allowance of R1 million under section 13*quin*(1).

Result:

Calculation of the qualifying distribution

The dividend of R15,4 million will be a "qualifying distribution"[29] as defined in section 25BB(1) if at least 75% of the gross income of REIT A for its 2016 year of assessment consisted of rental income.

The following amounts of income received by or accrued to REIT A for the 2016 year of assessment constituted "rental income" as defined in section 25BB(1):

	R
Rental income from letting of fixed property	2 000 000
Dividend from REIT B (Note 1)	100 000
Interest on a linked unit in REIT B (Note 2)	9 900 000
Qualifying distribution from Controlled Company C (Note 3)	1 000 000
Dividend from Property Company D (Note 4)	300 000
Total amount of "rental income"	13 300 000

The "rental income" received by or accrued to REIT A constituted 95% (R13,3 million / R14 million) of the gross income received or accrued to it for the 2016 year of assessment which is more than the required 75%.

The dividend of R15,4 million therefore constitutes a "qualifying distribution" in the 2016 year of assessment. Although the dividend was declared and paid in the 2017 year of assessment, on the basis that it was determined with reference to the financial results reflected in the financial statements prepared for the 2016 year of assessment, it is deductible in the 2016 year of assessment.

29 Paragraph (*a*) of the definition of "qualifying distribution".

Limitation of the amount of the "qualifying distribution" under section 25BB(2)(b)

	R
Gross income	14 000 000
Less: Dividend exemption – section 10(1)(*k*)(i) (Note 5)	(600 000)
Income	13 400 000
Less: Expenses incurred in the production of rental income	(1 500 000)
Less: Capital allowance under section 13*quin*(1) (Note 6)	0
Taxable income before taking into account the deduction under section 25BB(2)(*a*) and the taxable capital gain	11 900 000

The qualifying distribution of R15,4 million deductible in the 2016 year of assessment is therefore limited to R11 900 000 under section 25BB(2)(*b*). The shortfall of R3 500 000 (R15 400 000 – R11 900 000) is not carried forward to the 2017 year of assessment and is forfeited.

Calculation of taxable income of REIT A

	R
Taxable income before taking into account the deduction under section 25BB(2)(*a*) and the amount of the taxable capital gain	11 900 000
Less: Deduction of the qualifying distribution – section 25BB(2)(*a*)	(11 900 000)
Taxable capital gain (R2 million × 66,6%[30]) (Note 7)	1 332 000
Taxable income of REIT A	1 332 000

Notes:

(1) Any dividend received or accrued from a REIT (other than in relation to a share buy-back) constitutes "rental income" as defined [paragraph (*b*) of the definition of "rental income" in section 25BB(1)].

(2) Interest on a debenture forming part of a linked unit in a REIT is deemed to be a dividend received or accrued under section 25BB(6)(*a*). A dividend received or accrued from a REIT (other than in relation to a share buy-back) in turn constitutes "rental income" as defined [paragraph (*b*) of the definition of "rental income" in section 25BB(1)].

(3) A qualifying distribution from a controlled company constitutes "rental income" as defined [paragraph (*c*) of the definition of "rental income" in section 25BB(1)].

(4) A dividend received or accrued from a property company constitutes "rental income" as defined [paragraph (*d*) of the definition of "rental income" in section 25BB(1)].

(5) The exemption under section 10(1)(*k*)(i) applies to the dividends received from Property Company D (R300 000) and the other companies (R300 000). The dividends and deemed dividends received from REIT B and Controlled Company C do not qualify for the exemption because of the exclusion in paragraph (*aa*) of the proviso to section 10(1)(*k*)(i).

(6) Under section 25BB(4) REIT A may not claim the capital allowance of R1 million under section 13*quin*(1).

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[30] Under section 12 of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 13 of 2016 the inclusion rate for companies was increased from 66,6% to 80% for years of assessment commencing on or after 1 March 2016.

(7) Under section 25BB(5) the capital gain of R5 000 000 on disposal of the fixed property must be disregarded in determining the aggregate capital gain or aggregate capital loss of REIT A.

Normal tax and dividends tax implications for the resident holders of shares in REIT A

The dividends of R10 780 000 (R15,4 million × 70%) received by or accrued to the resident holders of the shares are included in their gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). Under paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) these dividends are not exempt from normal tax. The dividends of R10 780 000 paid to the resident beneficial owners are exempt from dividends tax under section 64F(1)(*l*) because of their inclusion in income for normal tax purposes.

Normal tax and dividends tax implications for the non-resident holders of shares in REIT A

The dividends of R4 620 000 (R15,4 million × 30%) received by or accrued to the non-resident holders of shares are included in their gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). These dividends are, however, exempt from normal tax under section 10(1)(*k*)(i).

The dividends of R4 620 000 paid to the non-resident beneficial owners are subject to dividends tax under section 64E(1). REIT A, or its regulated intermediary, is liable under section 64G(1) or section 64H(1) to withhold dividends tax of R693 000 (R4 620 000 × 15%[31]) from the dividends paid to the non-resident beneficial owners. Dividends tax may be withheld at a reduced rate if the requirements of section 64G(3) or section 64H(3) are met.

4.5 Deduction of foreign taxes and *bona fide* donations [section 25BB(2A)]

Section 25BB(2A) provides for three types of deduction in determining a REIT or resident controlled company's taxable income. These deductions, which are discussed in **4.5.1**, **4.5.2** and **4.5.3**, must be deducted in the determination of a REIT or a resident controlled company's taxable income for years of assessment commencing on or after 1 January 2016.

These deductions are determined before taking into account any qualifying distribution under section 25BB(2). This treatment is necessary because a qualifying distribution would typically result in a substantial reduction in taxable income thus severely curtailing the amount of the deductions that a REIT or controlled company could claim under section 25BB(2A).

[31] The rate of dividends tax was increased from 15% to 20% in the Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill of 2017 for dividends paid on or after 22 February 2017.

4.5.1 Deduction of foreign taxes attributable to a REIT or controlled company's interest in a non-resident vesting trust [section 25BB(2A)(*a*)]

A REIT or a resident controlled company that is a beneficiary of a non-resident *vesting* trust may deduct any amount of tax on income *proved to be payable* by that trust to the government of a country other than South Africa that is attributable to the interest of that REIT or controlled company in that trust – provided the non-resident trust is *liable for or subject to tax on income* in the country in which that trust is established or formed.[32] A deduction will not be allowed if any person has any right of recovery of that tax.

This section will therefore apply only when –

- *income* is derived by a non-resident trust during a year of assessment;
- a REIT or a resident controlled company has a *vested right* in that income during the same year of assessment;
- the trust is "liable for or subject to" tax on that *income* in the country in which that trust is established or formed;
- the relevant tax is "proved to be payable" by the trust to a government other than South Africa; and
- no person has a right of recovery in relation to the taxes proved to be so payable.

Tax on income

It is only tax borne on *income* derived by the trust that will qualify for deduction under section 25BB(2A)(*a*). In determining whether or not a particular foreign tax qualifies as a tax on *income*, the basis of taxation of the foreign tax must be compared with that of the Act. The foreign tax will be accepted as a tax on income only if the basis of taxation is substantially similar to that of the Act.

To a certain extent it is immaterial that the detail of a foreign tax law differs from South Africa's domestic tax law. The important consideration is whether the basis of taxation is substantially similar. For example, a foreign tax law may include certain items of income or may allow certain exclusions or deductions not included or allowed under South African domestic tax law but the relevant foreign tax could still be considered to be a tax on income.

In contrast, the mere fact that a foreign tax is regarded as a tax on income by the country levying the tax or that the same term is used is not sufficient. The precise nature of the foreign tax and the meaning of particular terms must be determined and considered. In other words, the foreign tax liability must be a tax on income within the South African concept of that term.

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[32] Any foreign taxes that are deductible under section 25BB(2A)(*a*) are not otherwise deductible under the Act.

SARS levies the following taxes on income:[33]

- Normal tax on taxable income, which includes a taxable capital gain [section 5]
- Tax on foreign entertainers and sportspersons, a final tax [section 47B(1)]
- Turnover tax on micro businesses [section 48A]
- Withholding tax on royalties, a final tax payable by non-residents on income derived from royalties or similar payments [section 49B(1)]
- Withholding tax on interest, a final tax [section 50(B)(1)]
- Dividends tax [section 64E(1)]

Any foreign tax which is substantively similar in nature to these taxes will be considered a tax on income. A withholding tax constituting an advance payment on an ultimate foreign tax liability does not qualify as a foreign tax on income although the underlying ultimate foreign tax liability may itself qualify as a tax on income. For example, foreign taxes similar to employees' tax, provisional tax and section 35A withholding tax levied on payments made to non-resident sellers of immovable property in South Africa do not qualify as a tax on income.

Interest, additional foreign taxes, fines, penalties and any other similar liabilities imposed under the tax laws of a foreign country are not regarded as taxes on income and do not qualify for a deduction under section 25BB(2A)(*a*).

"Liable for or subject to" tax in the foreign jurisdiction

In order for a REIT or resident controlled company to qualify for the deduction of foreign taxes under section 25BB(2A)(*a*), the non-resident trust must have been "liable for or subject to" tax on that income in the country in which the trust is established or formed.

The words "liable for" and "subject to" are not defined in the Act. While these words have not received judicial consideration in South Africa, it is evident from an analysis of foreign case law[34] that what is required for the trust to be "*liable for*" the tax on the relevant income is that tax must have been imposed on the amount of the income. The fact that an exemption may apply in relation to the specific income and no tax may therefore be payable by the trust does not alter the fact that the trust is "liable for" the tax. By contrast, the non-resident trust will be regarded as "*subject to*" tax on the relevant income only if the trust is actually required to pay the tax. If an exemption applies in respect of the income, the non-resident trust is not "subject to" tax on the income. Practically, given that the foreign tax must also "be proved to be payable" (see below), it is insufficient for the non-resident trust to be only "liable for" the tax. The non-resident trust must in fact be "subject to" tax on the relevant vested income.

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[33] See Binding General Ruling (Income Tax) 9 (Issue 3) "Taxes on Income and Substantially Similar Taxes for purposes of South Africa's Tax Treaties".

[34] See *Paul Weiser v HM Revenue and Customs* [2012] UKFTT 501 (TC) and L Kruger "Interest-free and Low-interest Shareholder Loans" (September 2014) 5 *Business Tax and Company Law Quarterly* 21.

"Proved to be payable"

A tax will be "proved to be payable" if the non-resident trust has an unconditional legal liability to pay the tax and the trust has either paid the tax or will have to pay the tax in the future. An unconditional legal liability to pay the foreign tax arises only once all the events that fix the amount of the foreign tax, and the non-resident trust's liability, have taken place.

Given that the relevant foreign tax will qualify to be dealt with under section 25BB(2A)(*a*) only if it is "proved to be payable" ***and*** no person has "any right of recovery" of the tax, it is apparent that an unconditional legal liability in the context of section 25BB(2A)(*a*) means that the foreign tax must have been levied legitimately under the foreign jurisdiction's tax law and tax treaty (if applicable) before it can qualify for a deduction under section 25BB(2A)(*a*). If the foreign tax has not been levied legitimately under the domestic law of the foreign jurisdiction or has been levied contrary to the clear provisions of a tax treaty (if applicable), it cannot be said that the foreign tax is "proved to be payable" or that the resident does not have a "right of recovery".

See Interpretation Note 18 "Rebates and Deduction for Foreign Taxes on Income" for a discussion of the meaning of "tax on income" and "proved to be payable" as well as documentary proof required by SARS in respect of foreign taxes.[35]

Example 8 – Deduction of foreign taxes attributable to a REIT's interest in a non-resident vesting trust

Facts:

REIT A has a vested right of 100% in the rental income derived by a non-resident trust, Trust A, which was established in Foreign Country A. Trust A invested in immovable property in Foreign Country A. During REIT A's year of assessment ending on 31 December 2016, Trust A derived rental income of R100 000 which vested in REIT A. Trust A is subject to foreign tax in Foreign Country A on rental income received by or accrued to it at a rate of 10% and is therefore liable for tax of R10 000 on its rental income.

Result:

The rental income of R100 000 vesting in REIT A must be included in its gross income under section 25B(1) and the definition of "gross income" in section 1(1).

Under section 25BB(2A)(*a*) the foreign tax of R10 000 proved to be payable by Trust A on the rental income of R100 000 vesting in REIT A must be allowed as a deduction in determining REIT A's taxable income for the 2016 year of assessment. The foreign tax of R10 000 is allowed as a deduction in full, since REIT A has an interest of 100% in the rental income derived by Trust A.

[35] Paragraphs 4.3.1, 4.3.2 and 9 of the Interpretation Note.

4.5.2 Deduction of foreign taxes on income proved to be payable by a REIT or a controlled company to any sphere of government of a foreign country [section 25BB(2A)(*b*)]

A deduction must be allowed for the sum of any taxes on *income* "proved to be payable" (see **4.5.1**) by a REIT or resident controlled company in respect of any amount to any sphere of government of any foreign country.[36] Such a deduction will not be allowed if any person has any right of recovery (see **4.5.1**) of those foreign taxes, other than a right of recovery under any entitlement to carry back losses arising during any year of assessment.

The amount of the deduction is limited to the amount of taxable income that is attributable to the amounts in respect of which the taxes on income were proved to be payable. Taxable income for purposes of this limitation is determined before taking into account the deduction of donations under section 25BB(2A)(*c*) (see **4.5.3**) and the qualifying distribution under section 25BB(2)(*a*) (see **4.4**).

See Interpretation Note 18 "Rebates and Deduction for Foreign Taxes on Income" for a discussion of the meaning of "tax on income" and "proved to be payable" as well as documentary proof required by SARS in respect of foreign taxes.[37]

Example 9 – Deduction of foreign taxes on income proved to be payable by a REIT to any sphere of government of a foreign country

Facts:

REIT A's year of assessment ends on 31 December. During its 2016 year of assessment, foreign dividends of R100 000 accrued to REIT A from Foreign Company A. REIT A holds 5% of the equity shares in Foreign Company A. Foreign Company A withheld tax of R15 000 (15% × R100 000) from the dividend and paid the net amount of R85 000 (R100 000 – R15 000) to REIT A. REIT A's taxable income for the 2016 year of assessment, before taking into account the deductions under section 25BB(2)(*a*) and (2A)(*b*), is R1 million.

Result:

The foreign dividends of R100 000 that accrued to REIT A must be included in its gross income under paragraph (*k*) of the definition of "gross income" in section 1(1). The foreign dividends are not exempt from normal tax under section 10B(2) but are partially exempt under section 10B(3). The amount of the foreign dividend exempt under section 10B(3) is R46 429 (R100 000 × 13 / 28[38]). R53 571 (R100 000 – R46 429) is therefore included in taxable income.

Under section 25BB(2A)(*b*) the foreign withholding tax of R15 000 must be allowed in full as a deduction in determining REIT A's taxable income for the 2016 year of assessment, since it does not exceed the amount of R53 571 included in taxable income.

[36] Any foreign taxes that are deductible under section 25BB(2A)(*b*) are not otherwise deductible under the Act.

[37] Paragraphs 4.3.1, 4.3.2 and 9 of the Interpretation Note.

[38] The Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill of 2017 proposes changing this ratio to 8 / 28 with effect from years of assessment commencing on or after 1 March 2017.

4.5.3 Deduction of *bona fide* donations made by a REIT or a controlled company [section 25BB(2A)(*c*)]

Any *bona fide* donations made by a REIT or a resident controlled company during a year of assessment to any organisation as contemplated in section 18A(1)(*a*) or (*b*) are allowed as a deduction under section 25BB(2A)(*c*).[39] The amount of this deduction may, however, not exceed 10% of the REIT or resident controlled company's taxable income determined before deducting the amount of any qualifying distribution under section 25BB(2),[40] but after taking into account –

- any assessed loss brought forward from the previous year of assessment;[41]
- any taxable capital gain;[42] and
- any deductions for foreign taxes under section 25BB(2A)(*a*) (see **4.5.1**) and (*b*) (see **4.5.2**).[43]

No provision is made for the carry-forward of any amount paid in excess of the 10% limitation to a subsequent year of assessment and any such excess will be forfeited.

The organisations referred to in section 18A above are the following:

- A public benefit organisation actively carrying on in South Africa any public benefit activity listed in Part II of the Ninth Schedule [section 18A(1)(*a*)(i)].
- A public benefit organisation not itself carrying on the public benefit activities listed in Part II but which provides funds or assets to another approved public benefit organisation referred to in the preceding bullet, or to an institution, board or body contemplated in section 10(1)(*c*A)(i) which carries on in South Africa any public benefit activity listed in Part II [section 18A(1)(*b*)].
- An institution, board or body established by or under law approved by SARS under section 10(1)(*c*A)(i) carrying on any public benefit activity listed in Part II in South Africa [section 18A(1)(*a*)(ii)].

The following explanation is provided in the *Tax Exemption Guide for Public Benefit Organisations in South Africa* (Issue 5) in paragraph 21.4 on the meaning of "*bona fide* donation":

> "A donation[44] is a gratuitous disposal by the donor out of liberality or generosity, under which the donee is enriched and the donor impoverished. It is a voluntary gift which is freely given to the donee. There must be no *quid pro quo*, no reciprocal obligations and no personal benefit for the donor. If the donee gives any consideration at all it is not a donation.
>
> A PBO may not accept donations which are subject to conditions that could enable the donor or any connected person in relation to the donor to derive some direct or indirect benefit from the application of the donation. The donation may also, subject to limited exceptions, not be revocable by the donor."

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[39] Any donation that is deductible under section 25BB(2A)(*c*) is not otherwise deductible under the Act.

[40] See the proviso to section 25BB(2A)(*c*).

[41] See section 20(1) and the definition of "taxable income" in section 1(1).

[42] See section 26A and the definition of "taxable income" in section 1(1).

[43] See the proviso to section 25BB(2A)(*c*).

[44] The term "donation" is defined in section 55.

Example 10 – Deduction of *bona fide* donations made by a REIT

Facts:

REIT A's year of assessment ends on 31 December. Its taxable income for the 2016 year of assessment was as follows:

	R
Taxable income before taking into account the amounts below	1 000 000
Amounts not included in or deducted from taxable income of R1 000 000:	
Foreign withholding taxes meeting the requirements of section 25BB(2A)(*b)*	10 000
Bona fide donations	100 000
Balance of assessed loss brought forward from 2015	100 000
Capital gain on disposal of office equipment	30 030

After the end of its 2016 year of assessment REIT A declared a dividend of R900 000 which constituted a "qualifying distribution" as defined in section 25BB(1). The amount of the dividend was determined with reference to the financial results reflected in the 2016 financial statements.

Result:

Calculation of the allowable donation under section 25BB(2A)(c) and taxable income before the deduction of the qualifying distribution:

	R
Taxable income as stated above	1 000 000
Less: Foreign withholding taxes [section 25BB(2A)(*b*)]	(10 000)
Less: Assessed loss brought forward	(100 000)
Taxable capital gain (R30 030 × 66,6% inclusion rate)[45]	20 000
Taxable income before donations and the qualifying distribution	910 000
Less: Deduction of donations [limited to 10% of R910 000 under the proviso to section 25BB(2A)(*c*)]	(91 000)
Taxable income before taking into account the qualifying distribution	819 000

Calculation of the qualifying distribution

	R
Taxable income before deduction of the qualifying distribution (see above)	819 000
Add back the assessed loss brought forward	100 000
Less: Taxable capital gain	(20 000)
Maximum deduction allowed for the qualifying distribution of R 900 000 under section 25BB(2)	899 000

45 The inclusion rate for companies was increased from 66,6% to 80% by the Rates and Monetary Amounts and Amendment of Revenue Laws Act 13 of 2016 for years of assessment commencing on or after 1 March 2016.

Calculation of taxable income after taking into account the qualifying distribution

	R
Taxable income before taking into account the qualifying distribution	819 000
Less: Qualifying distribution under section 25BB(2)	(899 000)
Assessed loss (Note)	(80 000)

Note:

The deduction of the qualifying distribution has not created or increased the assessed loss. The assessed loss of R80 000 relates to the assessed loss brought forward from 2015 of R100 000 reduced by the taxable capital gain of R20 000.

4.6 Prohibition of deduction of capital allowances on immovable property [section 25BB(4)]

Section 25BB(4) prohibits a company that is a REIT or a controlled company *on the last day of a year of assessment* from deducting an allowance on immovable property under the following sections:

- 11(*g*) – An allowance granted to a lessee for expenditure actually incurred in pursuance of an obligation to effect improvements on land or to buildings.
- 13 – Allowance on buildings used in a process of manufacture.
- 13*bis* – Allowance on buildings used by hotel keepers.
- 13*ter* – Allowance on residential buildings.
- 13*quat* – Allowance on erection or improvement of buildings in urban development zones.
- 13*quin* – Allowance on commercial buildings.
- 13*sex* – Allowance on certain residential units.

A depreciation allowance on assets, other than immovable property, may be claimed by a REIT or a controlled company under section 11(*e*) assuming the detailed requirements of that section are met.

While the building allowances described in section 25BB(4) are not deductible, this disadvantage is counterbalanced by the fact that any capital gains or capital losses on disposal of immovable property must be disregarded by a REIT or a controlled company for CGT purposes under section 25BB(5) (see **4.7**).

Even so, there will be a recoupment of capital allowances claimed as a deduction by a REIT or a controlled company before the company became a REIT or a controlled company when immovable property is disposed of (see **4.7**). The recoupment of capital allowances will constitute "rental income" as defined in section 25BB(1) with effect from years of assessment ending on or after 1 January 2016 (see **4.4.1**).

4.7 Disregarding of a capital gain or capital loss on the disposal of certain property by a REIT or a controlled company [section 25BB(5)]

A capital gain or capital loss determined on the disposal of an asset by a company that qualifies as a REIT or a controlled company *on the last day of its year of assessment* must be disregarded in determining its aggregate capital gain or aggregate capital loss,[46] if the disposal comprises –

- immovable property of a company that is a REIT or a controlled company at the time of the disposal [section 25BB(5)(*a*)];
- a share or a linked unit in a company that is a REIT at the time of that disposal [section 25BB(5)(*b*)]; or
- a share or a linked unit in a company that is a property company at the time of that disposal [section 25BB(5)(*c*)].

The capital gain or capital loss on disposal by a REIT of a share or a linked unit in a controlled company will not always be disregarded under section 25BB(5)(*c*). A controlled company may own assets other than immovable property and in order to qualify for the relief provided under section 25BB(5)(*c*) the controlled company must qualify as a property company at the time of the disposal. The disposal by a REIT of a share or a linked unit in a controlled company that does not qualify as a property company at the time of disposal will be subject to CGT if the proceeds are of a capital nature.

While a capital gain or capital loss on disposal of the assets described above must be disregarded, any capital allowances allowed on immovable property before the company became a REIT or a controlled company must be recouped and included in the gross income of the REIT or controlled company under paragraph (*n*) of the definition of "gross income" in section 1(1). The amount of the recoupment will constitute "rental income" as defined in section 25BB(1) with effect from years of assessment ending on or after 1 January 2016 (see **4.4.1**).

A capital gain or capital loss determined on the disposal of an asset of a REIT or a controlled company that is not listed in section 25BB(5) will be subject to CGT. Assets not listed in section 25BB(5) could, for example, include motor vehicles and office equipment although such assets are unlikely to give rise to capital gains and losses. A controlled company that is a foreign company will be subject to CGT on the disposal of assets referred to in paragraph 2(1)(*b*) of the Eighth Schedule. Since a capital gain or capital loss determined on disposal of immovable property is excluded under section 25BB(5), the only assets remaining under paragraph 2(1)(*b*) are assets which are effectively connected with a permanent establishment of the controlled company in South Africa.

Income of a revenue nature derived from the disposal of shares, immovable property and other assets that were, for example, held as trading stock must be included in a REIT or controlled company's gross income. Such income will be included in the gross income of a controlled company that is a foreign company if derived from a source within South Africa.[47]

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[46] The terms "aggregate capital gain" and "aggregate capital loss" are defined in paragraphs 6 and 7 of the Eighth Schedule, respectively.

[47] Paragraph (ii) of the definition of "gross income" in section 1(1).

Section 25BB(5)(*a*) refers to immovable property of a company that is a REIT or a controlled company and as such envisages direct disposals of immovable property. Direct disposals of immovable property envisaged in section 25BB(5)(*a*) include disposals of immovable property by a trust if a REIT or a controlled company has a vested interest in immovable property, since the immovable property is beneficially owned by the REIT or controlled company and not by the trust. Whether a company has a vested interest in a trust asset will depend on the terms of the trust deed. A vested interest in a trust asset must be distinguished from a vested interest in the capital (residue) of a trust. A company having a vested interest in the trust capital (assets less liabilities) will not necessarily have an interest in a trust asset. Consequently, should the trust dispose of an asset, it will have to account for any capital gain unless it is vested in a resident beneficiary under paragraph 80(2) of the Eighth Schedule.

Section 25BB(5)(*a*) does not include –

- a capital gain determined on the vesting of immovable property in a beneficiary that is a REIT or a controlled company under paragraph 80(1)(*b*) of the Eighth Schedule; or
- the distribution of a capital gain arising on the disposal of immovable property by a trust under paragraph 80(2)(*b*) of the Eighth Schedule to a beneficiary that is a REIT or a controlled company.

Capital gains on the disposal of immovable property by a trust which are vested in and attributed to a REIT or a controlled company under paragraph 80(1)(*b*) or 80(2)(*b*) of the Eighth Schedule will be included in the taxable income of the REIT or controlled company.

Section 25BB(5)(*b*) is not limited to direct disposals of shares or linked units by a REIT or controlled company and can, for example, potentially include capital gains on the disposal by a trust of shares and linked units in a REIT attributed under paragraph 80.

Section 25BB(5)(*c*) is limited to direct disposals of shares or linked units in a property company by a REIT or a controlled company because the definition of "property company" is included in section 25BB which deals with the taxation of REITs and controlled companies. The definition of "property company" therefore applies in relation to a holding of shares or linked units in that company by a REIT or a controlled company and not in relation to a holding of shares or linked units in a company by a discretionary trust.

4.8 Interest on a debenture forming part of a linked unit deemed to be a dividend [section 25BB(6)]

4.8.1 Interest received by or accrued to a person on a debenture forming part of a linked unit held in a REIT or a controlled company [section 25BB(6)(*a*)]

Section 25BB(6)(*a*) provides that any interest received by or accrued to a person during a year of assessment in respect of a debenture forming part of a linked unit held by that person in a company that is –

- a REIT or a resident controlled company, must be deemed to be a dividend received by or accrued to that person; or

- a controlled company that is a foreign company, must be deemed to be a foreign dividend received by or accrued to that person,

during that year of assessment.

Section 25BB(6)(*a*) applies to years of assessment of any person commencing on or after 1 April 2013.

Section 25BB(6)(*c*), which deems interest paid in respect of a linked unit in a REIT or controlled company to be a dividend for dividends tax purposes (see **4.8.3**), applies to years of assessment commencing on or after 1 April 2013 *of the REIT or controlled company paying the interest*.

As a result, it was possible that interest paid on a linked unit by a REIT or a controlled company was deemed to be a dividend, for the purposes noted above, from the REIT or controlled company's perspective, but was not deemed to be a dividend from the perspective of the person that received the dividend or to whom it accrued. This would arise if, for example, REIT A with a year of assessment commencing on 1 April 2013, paid interest on a linked unit to Resident B on 30 April 2013 that had a year of assessment commencing on 1 March 2013. Section 25BB(6)(*a*) did not apply to Resident B, since Resident B's year of assessment commenced before 1 April 2013, while section 25BB(6)(*c*) applied to REIT A because REIT A's year of assessment commenced on or after 1 April 2013.

This result could occur only in the first year of assessment of the REIT or controlled company commencing on or after 1 April 2013 when the year of assessment of the holder of a linked unit in the REIT or controlled company commenced before 1 April 2013. It will not occur when both the year of assessment of the holder of the linked unit and the year of assessment of the REIT or controlled company commenced on or after 1 April 2013.

Section 25BB applies to years of assessment of a REIT or a controlled company commencing on or after 1 April 2013. Therefore, interest paid on a linked unit in years of assessment commencing before 1 April 2013 by a company, which qualified as a REIT or a controlled company in a later year of assessment, is not deemed to be a dividend under section 25BB(6)(*a*).

See **5.4.1** for the normal tax implications of dividends received by or accrued to a person from a REIT or a controlled company and **5.8** for the dividends tax implications of such dividends.

4.8.2 Interest received by or accrued to a REIT or a resident controlled company on a debenture forming part of a linked unit held in a property company [section 25BB(6)(*b*)]

Interest received by or accrued to a company that is a REIT or a resident controlled company during a year of assessment on a debenture forming part of a linked unit held by that company in a property company is deemed to be –

- a dividend if the property company is a resident; or
- a foreign dividend if the property company is a foreign company

received by or accrued to that company during that year of assessment if that company is a REIT or a resident controlled company *at the time of that receipt or accrual*.

Any such deemed dividends or deemed foreign dividends received by or accrued to a REIT or a controlled company must be included in the gross income of the REIT or controlled company. Dividends and foreign dividends (which would include such deemed dividends and deemed foreign dividends) may be fully exempt from income tax under section 10(1)(*k*)(i) (domestic dividends) or fully or partially exempt under section 10B (foreign dividends).

See **5.8.2** for the dividends tax implications of dividends and foreign dividends received by or accrued to a REIT or a controlled company.

Dividends and foreign dividends received by or accrued to a REIT or a resident controlled company from a property company qualify as "rental income" as defined in section 25BB(1) and are used to determine a "qualifying distribution" as defined in section 25BB(1) (see **4.8.1**).

4.8.3 Interest paid on a debenture forming part of a linked unit in a REIT or a controlled company [section 25BB(6)(*c*)]

Interest paid on a debenture forming part of a linked unit in a REIT or a resident controlled company is deemed –

- to be a dividend paid by that REIT or that controlled company for the purposes of dividends tax; and
- not to be an amount of interest paid by that REIT or that controlled company for the purposes of withholding tax on interest.[48]

This means interest paid by a REIT or a resident controlled company on a debenture forming part of a linked unit is potentially subject to dividends tax.

Interest on a debenture forming part of a linked unit paid by a controlled company that is not a resident –

- was deemed to be a dividend for purposes of dividends tax if paid before 1 January 2017. This treatment meant it was potentially subject to dividends tax if the controlled company's shares were listed on the JSE and the "dividend" did not constitute the distribution of an asset *in specie*.
- is not deemed to be a dividend for purposes of dividends tax if paid on or after 1 January 2017 and will not, therefore, be subject to dividends tax.

See **5.8.1** for the dividends tax implications of dividends paid by a REIT or a controlled company.

Interest paid on a debenture forming part of a linked unit in a REIT or a controlled company may be a "qualifying distribution" as defined in section 25BB(1) and, if so, may, subject to certain limitations, be deducted from the income of the REIT or resident controlled company under section 25BB(2) (see **4.4**).

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[48] The legislation for withholding tax on interest is contained in sections 50A to 50H and became effective on 1 March 2015.

4.9 Cessation of a REIT or a controlled company [section 25BB(7)]

A REIT or a controlled company's year of assessment is deemed to end before the end of its financial year when –

- the REIT ceases to be a REIT and does not qualify as a controlled company; or
- the controlled company ceases to be a controlled company and does not qualify as a REIT.

These events have the result that –[49]

- the year of assessment of the REIT or controlled company is deemed to end on the day that the company ceases to be a REIT or a controlled company as indicated above; and
- the next year of assessment of the company is deemed to commence on the day immediately after the day that the company ceased to be either a REIT or a controlled company.

A company will cease to be a REIT when –

- the JSE removes the REIT status of an applicant issuer that fails to comply with paragraph 13.49;[50]
- an issuer that received REIT status makes application to the JSE to have its status removed;[51] or
- it does not meet the requirements of a "REIT" as defined in section 1(1).

A company that ceases to be a REIT can still qualify as a controlled company if it is controlled by another company that is a REIT. Under these circumstances, section 25BB(7) will not apply.

A company will cease to be a controlled company when it ceases to be controlled by a company that is a REIT. A company that ceases to be a controlled company can still be a REIT if it satisfies the requirements of a "REIT" as defined in section 1(1). Under these circumstances, section 25BB(7) will not apply.

As noted above, the year of assessment is deemed to end on the day the company ceases to be a REIT or a controlled company, as applicable. This loss of status means it is no longer a REIT or a controlled company as at the end of the year of assessment and therefore there cannot be a qualifying distribution in respect of that year of assessment.[52]

Section 25BB does not apply to a company in years of assessment following the year of assessment in which the company ceases to be a REIT or a controlled company.

After an entity ceases to be a REIT or a controlled company, it will be subject to income tax under the general rules applicable to its legal form. In other words, a

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[49] See the proposed changes to section 25BB(7) in clause 44(*b*) of the draft Taxation Laws Amendment Bill, 2017.
[50] Paragraph 13.53(a).
[51] Paragraph 13.54.
[52] Section 25BB(7) and the definition of "qualifying distribution" in section 25BB(1).

company will be taxed as a company and a trust will be taxed as a trust. The taxation of the holders of shares in a company and beneficiaries of a trust will follow the normal tax rules applicable to such persons.

Manual returns of income (ITR14) should be submitted for the year of assessment during which a company ceases to be a REIT or a controlled company, until SARS' systems have been updated to accommodate this situation.

Example 11 – Cessation of a REIT

Facts:

Company A's financial year ends on 31 December. It ceased to be a REIT on 31 January 2016 and did not qualify as a controlled company on that date.

Result:

Under section 25BB(7)(*a*) Company A's 2016 year of assessment is deemed to have ended on 31 January 2016. An ITR14 return for the 2016 year of assessment must therefore be submitted for the period 1 January 2016 to 31 January 2016, as a REIT.

Under section 25BB(7)(*b*) Company A's next year of assessment is deemed to have commenced on 1 February 2016. A second ITR14 return for the 2016 year of assessment must therefore be submitted for the period 1 February 2016 to 31 December 2016 as a company, not qualifying as a REIT or a controlled company.

4.10 Cancellation of the debenture part of a linked unit [section 25BB(8)]

Specific rules apply when a REIT or a controlled company cancels the debenture part of a linked unit and capitalises the issue price of the debenture to stated capital for the purposes of financial reporting in accordance with IFRS. After cancellation of the debenture part of a linked unit, a person will hold only a share in the REIT or controlled company. The tax consequences of the cancellation of the debenture part of a linked unit are as follows:

- The cancellation of the debenture must be disregarded in determining the taxable income of the holder of the debenture and of the REIT or controlled company. No gain or loss on the cancellation of the debenture will, therefore, be determined for the holder of the linked unit and for the REIT or controlled company [section 25BB(8)(*a*)].
- Expenditure incurred by the holder of shares in the REIT or controlled company on the capitalised shares is deemed to be equal to the amount of the expenditure incurred on the acquisition of the linked unit. This expenditure will be used to determine the base cost of the shares held as a capital asset under paragraph 20(1) of the Eighth Schedule or the amount of expenditure actually incurred on the shares under section 11(*a*) for a share-dealer [section 25BB(8)(*b*)].
- The issue price of the cancelled debenture must be added to the contributed tax capital[53] of the class of shares forming part of the cancelled linked unit. Contributed tax capital is a tax concept and broadly represents the amounts contributed to a company in exchange for the issue of its shares. Contributed

[53] The term "contributed tax capital" is defined in section 1(1).

tax capital of a company is increased by the consideration received by or accrued to that company for the issue of its shares on or after 1 January 2011. Contributed tax capital is determined per class of shares. The issue price of a cancelled debenture can, therefore, be added to the contributed tax capital of the class of shares relating to the cancelled linked unit only [section 25BB(8)(*c*)].

See **5.7.3** for the income tax implications of a "substitutive share-for-share transaction" under section 43 under which linked units in a company are exchanged for equity shares.

5. Other provisions affecting REITs, controlled companies and the holders of shares or linked units in REITs and controlled companies

5.1 The law

The relevant sections and other legislation are quoted in **Annexure A**.

5.2 Interest on hybrid debt instruments deemed to be a dividend *in specie* [section 8F(2) and (3)(*d*)]

Under section 8F(2)(*a*) an amount of interest incurred by a company on a hybrid debt instrument[54] is, on or after the date that the instrument becomes a hybrid debt instrument –

- deemed for the purposes of the Act to be a dividend *in specie* declared and paid by that company on the last day of the year of assessment of that company during which it was incurred; and
- not deductible under the Act.

The interest that is deemed to be a dividend *in specie* declared and paid by the company incurring the interest expense is potentially subject to dividends tax under section 64E(1). The company incurring the interest expense is the party liable under section 64EA(*b*) for any dividends tax payable because the interest expense is deemed to be a dividend *in specie*.[55] The deemed dividend, however, qualifies for an exemption from dividends tax under section 64FA(1)(*a*) read with section 64F(1)(*l*) if it constitutes income for the holder (see below).

While section 8F(2)(*a*) provides that the interest on a hybrid debt instrument which is deemed to be a dividend *in specie* is not deductible under the Act, the deemed dividend may be deductible by a REIT or a resident controlled company as part of a qualifying distribution under section 25BB(2)(*a*) if the requirements of that section are met.

Section 8F(2)(*b*) provides that any amount of interest that is incurred by a company in respect of an instrument on or after the date that the instrument becomes a hybrid debt instrument is deemed for the purposes of this Act to be a dividend *in specie* that is declared and paid in respect of a share on the last day of the year of assessment of the company incurring the interest, to the person to whom that amount accrued.

[54] The term "hybrid debt instrument" is defined in section 8F(1).

[55] Section 64EA(*b*) uses the expression "distribution of an asset *in specie*" while section 8F refers to a "dividend *in specie*". Nothing turns on the difference in wording, since both expressions bear the same meaning for the purpose of determining the liability for, and incidence of, dividends tax.

The interest that accrues to a person and which is deemed to be a dividend *in specie* must be included in the person's "gross income" under paragraph (*k*) of the definition of "gross income" in section 1(1). The amount of the interest paid by a REIT or a controlled company that is deemed to be a dividend *in specie* will not qualify for exemption if the beneficial owner is a resident [paragraph (*aa*) of the proviso to section 10(1)(*k*)(i)].

Section 8F(3)(*d*) provides that section 8F does not apply to an instrument that constitutes a linked unit in a company when the linked unit is *held* by a REIT, amongst other entities (but not a controlled company), if –

- the REIT holds at least 20% of the linked units in that company [section 8F(3)(*d*)(i)];
- the REIT acquired those linked units before 1 January 2013 [section 8F(3)(*d*)(ii)]; and
- at the end of the previous year of assessment 80% or more of the value of the assets of the company incurring the interest expense, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable property [section 8F(3)(*d*)(iii)].

Section 8F(3)(*d*) will be deleted with effect from 1 January 2018.[56] Section 8F will therefore also apply to amounts of interest incurred on or after that date on linked units that constitute hybrid debt instruments that are *held* by a REIT, amongst other entities.

The exclusion in section 8F(3)(*d*) does not apply to hybrid debt instruments which are not linked units held by a REIT.

Currently section 8F applies, amongst others, to hybrid debt instruments *issued* by a REIT,[57] hybrid debt instruments (excluding linked units) held by a REIT and any hybrid debt instrument *issued*[58] *or held* by a controlled company. In addition, as noted above, section 8F(3)(*d*) will not apply and therefore section 8F will apply to any linked unit constituting a hybrid debt instrument *held* by a REIT –

- in respect of interest incurred on the linked unit on or after 1 January 2018;
- if the linked unit was acquired on or after 1 January 2013;
- if the REIT held less than 20% of the linked units in the company that issued the linked units; or
- if the "80% of the value of assets requirement" in section 8F(3)(*d*)(iii) (see above) has not been met.

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[56] Section 8F(3)(*d*) is to be deleted with effect from 1 January 2018 by section 13(1)(*c*) of the Taxation Laws Amendment Act 31 of 2013, read with section 144 of the Taxation Laws Amendment Act 25 of 2015 and section 98 of the Taxation Laws Amendment Act 15 of 2016.

[57] A company can be a REIT or a controlled company only with effect from years of assessment commencing on or after 1 April 2013. Therefore, a REIT or a controlled company could issue a hybrid debt instrument only on or after 1 April 2013, which is after the acquisition date of 1 January 2013 specified in section 8F(3)(*d*)(ii). Section 8F(3)(*d*) can therefore not apply to hybrid debt instruments issued by a REIT or a controlled company, which means that section 8F will apply.

[58] See above.

In summary, the exclusion in section 8F(3)(*d*) applies to hybrid debt instruments which are linked units that are *held* by a REIT, amongst others, and which meet the additional requirements noted above.

If section 8F applies, it means that the interest will be deemed to be a dividend *in specie* declared and paid by the REIT or controlled company and –

- the dividend will be exempt from dividends tax for a resident beneficial owner under section 64FA(1) read with section 64F(1)(*l*) because it will be included in the beneficial owner's income;
- the dividend will potentially be subject to dividends tax for a non-resident beneficial owner;
- that interest will not be deductible but the REIT or resident controlled company may be entitled to a deduction of the deemed dividend as part of a "qualifying distribution" under section 25BB(2)(*a*) if the requirements of that section are met;
- the dividend will be included in the gross income of a resident debenture holder and will not be exempt from normal tax, since it is excluded from the exemption in section 10(1)(*k*)(i) under paragraph (*aa*) of the proviso to section 10(1)(*k*)(i); and
- the dividend will be included in the gross income of a non-resident debenture holder but will be exempt from normal tax under section 10(1)(*k*)(i), since paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) does not apply to non-resident beneficial owners , assuming the other paragraphs of the proviso do not apply.

5.3 Hybrid interest deemed to be a dividend *in specie* [section 8FA(2) and (3)(*d*)]

Under section 8FA(2)(*a*) interest constituting hybrid interest[59] *incurred* by a company is, on or after the date that the interest becomes hybrid interest –

- deemed for the purposes of the Act to be a dividend *in specie* declared and paid by that company on the last day of that year of assessment; and
- not deductible under the Act.

The interest deemed to be a dividend *in specie* declared and paid by the company incurring the interest expense is potentially subject to dividends tax under section 64E(1). The deemed dividend will, however, qualify for an exemption from dividends tax under section 64FA(1)(*a*) read with section 64F(1)(*l*) if it constitutes income for the holder (see below).

Section 8FA(2)(*b*) provides that any amount incurred by a company in respect of interest on or after the date that the interest becomes hybrid interest is deemed for the purposes of this Act to be a dividend *in specie* that is declared and paid in respect of a share on the last day of the year of assessment of the company incurring the interest, to the person to whom that amount accrued.

See **5.2** for the dividends tax and normal tax implications of interest deemed to be a dividend *in specie*.

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[59] The term "hybrid interest" is defined in section 8FA(1).

Section 8FA(3)(*d*) provides that section 8FA does not apply to interest owed on an instrument that constitutes a linked unit in a company that is *held by a REIT*, amongst other entities (but not including a controlled company), if certain requirements are met. These requirements are similar to those in section 8F(3)(*d*) (see **5.2**).

Section 8FA(3)(*d*) will be deleted with effect from 1 January 2018.[60] Section 8FA will therefore also apply to amounts of hybrid interest incurred on or after that date on linked units held by a REIT, amongst other entities.

In summary, the exclusion in section 8FA(3)(*d*) applies to interest owed on an instrument that constitutes a linked unit in a company *held* by a REIT, amongst others, and which meets the other requirements specified in section 8FA(3)(*d*).

Section 8FA(2) will apply to, for example, hybrid interest paid or derived on a debenture forming part of a linked unit *issued* by a REIT or controlled company. If section 8FA(2) applies, the interest is deemed to be a dividend *in specie* declared and paid by the REIT or controlled company and –

- the dividend will be exempt from dividends tax for a resident beneficial owner under section 64FA(1) read with section 64F(1)(*l*) because it will be included in the beneficial owner's income;
- the dividend will potentially be subject to dividends tax for a non-resident beneficial owner;
- that interest will not be deductible, but the REIT or resident controlled company may be entitled to a deduction of the deemed dividend as part of a "qualifying distribution" under section 25BB(2)(*a*) if the requirements of that section are met;
- the dividend will be included in the gross income of a resident debenture holder and will not be exempt from normal tax, since it is excluded from the exemption in section 10(1)(*k*)(i) under paragraph (*aa*) of the proviso to section 10(1)(*k*)(*i*); and
- the dividend will be included in the gross income of a non-resident debenture holder but will be exempt from normal tax under section 10(1)(*k*)(i), since paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) does not apply to beneficial owners who are not residents, assuming the other paragraphs of the proviso do not apply.

5.4 Receipt or accrual of dividends and foreign dividends (section 1(1) – paragraph (*k*) of the definition of "gross income", paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) and section 10B)

5.4.1 Receipt or accrual of dividends and foreign dividends from a REIT or a controlled company

Dividends and foreign dividends received by or accrued to a person are included in that person's gross income under paragraph (*k*) of the definition of "gross income" in section 1(1).

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[60] Section 8FA(3)(*d*) is to be deleted by section 15(1)(*c*) of the Taxation Laws Amendment Act 31 of 2013, section 145 of the Taxation Laws Amendment Act 25 of 2015 and section 99 of the Taxation Laws Amendment Act 15 of 2016.

Dividends[61] received by or accrued to a resident that were distributed by a REIT or a resident controlled company are not exempt from normal tax [paragraph (*aa*) of the proviso to section 10(1)(*k*)(i)]. Dividends distributed by a REIT or a resident controlled company include amounts of interest (see **4.4.1**) paid on a debenture forming part of a linked unit that are deemed to be dividends received or accrued under section 25BB(6)(*a*).

However, interest received or accrued from a non-resident controlled company on a debenture forming part of a linked unit is deemed to be a foreign dividend under section 25BB(6)(*a*)(ii) (see **4.8.1**). Given that the interest is deemed to be a foreign dividend received or accrued, it is treated as a foreign dividend for purposes of the definition of "foreign dividend" in sections 1(1) and 10B(1) and may be fully or partially exempt from normal tax under section 10B. See Interpretation Note 93 "The Taxation of Foreign Dividends" for a discussion of section 10B which deals with the exemptions available for certain foreign dividends.

A dividend received by or accrued to a person from a REIT or a resident controlled company that constitutes a share buy-back as contemplated in paragraph (*b*) of the definition of "dividend" in section 1(1) is, however, exempt from normal tax under section 10(1)(*k*)(i). A share buy-back by a REIT or a resident controlled company is excluded from a "qualifying distribution" as defined in section 25BB(1) made by that REIT or controlled company and is, therefore, not deductible under section 25BB(2).

Dividends received by or accrued to a non-resident that were distributed by a REIT or a resident controlled company are exempt from normal tax under section 10(1)(*k*)(i).

See **5.8.1** for the dividends tax implications of dividends paid by a REIT or a controlled company.

5.4.2 Dividends and foreign dividends received by or accrued to a REIT or a controlled company

Dividends and foreign dividends received by or accrued to a REIT or a controlled company are included in the gross income of that REIT or controlled company under paragraph (*k*) of the definition of "gross income" in section 1(1). These dividends potentially qualify for the exemptions under section 10(1)(*k*)(i), while the foreign dividends potentially qualify for full or partial exemption under section 10B. See Interpretation Note 93 "The Taxation of Foreign Dividends" for a discussion of section 10B.

Dividends received by or accrued to a REIT or a resident controlled company from another REIT or resident controlled company do not qualify for exemption under section 10(1)(*k*)(i) because of the exclusion in paragraph (*aa*) of the proviso to section 10(1)(*k*)(i).

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[61] Excluding a dividend constituting a share buy-back, see below.

5.5 Normal tax and CGT implications for the holder of a share or a linked unit in a REIT or a controlled company on disposal of that share or linked unit

5.5.1 Disposal of a share or a linked unit in a REIT or a controlled company (section 1(1) – definition of "gross income" and paragraphs 2(2), 3 and 4 of the Eighth Schedule)

The proceeds on disposal of shares or linked units in a REIT or a controlled company held on revenue account by a resident holder of the shares or linked units constitute gross income for the holder.

The proceeds on disposal of shares or linked units in these companies held as capital assets by a resident holder of such shares or linked units will be of a capital nature and hence excluded from the gross income of the holder.

Under section 9C(2) the proceeds on disposal of equity shares in a REIT or a controlled company will be of a capital nature if they have been held for a period of at least three years at the time of the receipt or accrual of the proceeds on disposal (see **5.5.2**).

A capital gain or capital loss on disposal of shares or linked units in a REIT or a controlled company must be determined under paragraph 3 or 4 of the Eighth Schedule respectively (see **4.7** for the CGT implications if the holder of the share or linked unit is a REIT).

Non-resident holders of shares or linked units in a REIT or a controlled company holding these assets on revenue account will be liable to tax in South Africa only if the proceeds are from a South African source, for example, if the relevant assets are effectively connected with a permanent establishment in South Africa.

Non-resident holders of such shares or linked units holding them on capital account will be liable to CGT if –

- the shares are deemed to be an interest in immovable property under paragraph 2(2) of the Eighth Schedule, for example, if the holder holds, directly or indirectly, at least 20% of the equity shares in the company and 80% or more of the market value of those shares is directly or indirectly attributable to immovable property in South Africa; or
- the shares or linked units are effectively connected with the holder's permanent establishment in South Africa.

5.5.2 Recoupment of expenditure or losses incurred on equity shares in a REIT or a controlled company held for at least three years [section 9C(2) and (5) and paragraph 20(3)(*a*) of the Eighth Schedule]

Any amount received or accrued (other than a dividend or foreign dividend) or any expenditure incurred in respect of an equity share[62] must be deemed under section 9C(2) to be of a capital nature if the equity share had, at the time of the receipt or accrual of that amount or incurral of that expenditure, been held for a period of at least three years.

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[62] The term "equity share" is defined in sections 1(1) and 9C(1). See paragraph 4.4 of Interpretation Note 43 (Issue 6) dated 16 February 2017 for the meaning of "equity share".

While the proceeds derived on disposal of an equity share held for at least three years are of a capital nature, section 9C(5) provides that there must be included in a taxpayer's income in the year of assessment in which that equity share is disposed of, any expenditure or losses incurred in respect of that share and allowed as a deduction from the income of the taxpayer during that or any previous year of assessment under section 11. The amount of the deemed recoupment is determined with reference to the amounts previously allowed as a deduction against income and bears no relationship to any amount derived on disposal of the share. Therefore, even if a share is disposed of at a capital loss, the amounts previously allowed as a deduction must be included in income.

Under paragraph (*b*) of the proviso[63] to section 9C(5) there will be no recoupment under section 9C(5) of expenditure or losses allowed under section 11 in respect of equity shares in a REIT or a resident controlled company.[64] Section 9C(5) does not apply to the disposal of equity shares in a REIT or a resident controlled company because dividends received or accrued from these companies, other than dividends constituting a share buy-back, are not exempt from normal tax for resident holders of these shares (see **5.4.1**).

Paragraph 20(3)(*a*) of the Eighth Schedule provides that the expenditure in paragraph 20(1)(*a*) to (*g*) incurred by a person in respect of an asset must be reduced by any amount which –

- is or was allowable or is deemed to have been allowed as a deduction in determining the taxable income of that person; and
- is not included in the taxable income of that person under section 9C(5),

before the inclusion of any taxable capital gain.

Example 12 – Disposal of equity shares in a REIT held for at least three years

Facts:

Company A's year of assessment ends on the last day of March.

On 1 April 2013 Company A acquired equity shares in a REIT as trading stock at a cost of R100 000 and claimed this amount as a deduction under section 11(*a*). Company A reflected R100 000 as the value of closing stock under section 22(1)(*a*) on 31 March 2014.

Company A incurred interest of R6 000 during the 2014, 2015 and 2016 years of assessment respectively on a debt that was used to fund the acquisition of the equity shares. The interest incurred was allowed as a deduction under section 24J(2) read with section 11(*x*) for all three years of assessment. Company A received interest on other investments of R20 000 during each of the 2014, 2015 and 2016 years of assessment.

On 1 April 2016 Company A disposed of the equity shares for R80 000.

[63] The proviso to section 9C(5) was substituted by section 19 of the Taxation Laws Amendment Act 15 of 2016. Paragraph (*b*) of the proviso applies with effect from years of assessment ending on or after 1 January 2016.

[64] See the proposed amendment to paragraph (*b*) of the proviso to section 9C(5) in clause 12 of the draft Taxation Laws Amendment Bill, 2017.

Result:

2017 year of assessment

On 31 March 2016 the equity shares had been held by Company A for three continuous years. The proceeds on disposal of the equity shares on 1 April 2016 are treated as being of a capital nature under section 9C(2), since they comprise equity shares held for at least three years.

Section 9C(5), subject to its proviso, stipulates that a taxpayer must include in income in the year of assessment in which any equity share, held for at least three years, is disposed of, any expenditure or losses incurred in respect of that equity share and allowed as a deduction from the income of the taxpayer during that or any previous year of assessment under section 11.

Company A claimed deductions for the expenditure incurred of R100 000 for the acquisition of the equity shares in the 2014 year of assessment under section 11(*a*) and the interest incurred of R6 000 during each of the 2014, 2015 and 2016 years of assessment under section 24J(2) read with section 11(*x*).

No amount relating to the deductions claimed under section 11(*a*) and (*x*) must be included in Company A's income under section 9C(5) by virtue of paragraph (*b*) of the proviso to section 9C(5).

Notes:

(1) The base cost of Company A's equity shares in the REIT has for CGT purposes been reduced to RNil under paragraph 20(3)(*a*) of the Eighth Schedule, because the expenditure of R100 000 was allowed as a deduction under section 11(*a*) and no amount was included in Company A's income on disposal of the shares under section 9C(5).

(2) Company A will realise a capital gain on disposal of the equity shares of R80 000 (proceeds of R80 000 *less* base cost of RNil).

5.5.3 Return of capital and foreign return of capital (paragraph 76B of the Eighth Schedule)

A return of contributed tax capital to the holder of a share or linked unit in a REIT or a resident controlled company constitutes a return of capital which must be accounted for under paragraph 76B of the Eighth Schedule.[65] A distribution of a foreign return of capital by a controlled company that is not a resident must similarly be dealt with under paragraph 76B. See Chapter 18 of the *Comprehensive Guide to Capital Gains Tax* for a discussion of paragraph 76B.

[65] The terms "contributed tax capital" and "return of capital" are defined in section 1(1).

5.6 Limitation of interest deductions on reorganisation and acquisition transactions [section 23N(5)]

Section 23N(2)[66] stipulates that the deduction of an amount of interest incurred by an acquiring company[67] on a debt is limited in specified circumstances to an amount determined under section 23N(3). Depending on the facts, a REIT or a controlled company may be an acquiring company.

Section 23N(5)[68] provides that section 23N does not apply to interest incurred by an acquiring company on a debt contemplated in section 23N(2) when the interest is incurred on a linked unit in the acquiring company and that interest accrues to a REIT, amongst other entities, and –

- the REIT holds at least 20% of the linked units in that acquiring company;
- the REIT acquired those linked units before 1 January 2013; and
- at the end of the previous year of assessment 80% or more of the value of the assets of that acquiring company, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable property.

5.7 The corporate restructuring rules (sections 41 to 47)

5.7.1 Application to REITs and controlled companies

Section 41(2) provides that, subject to section 41(3), with regard to the transactions to which they apply, the corporate restructuring rules in sections 42 to 47 override other provisions in the Act, except sections 24BA (Transactions where assets are acquired as consideration for shares issued) and 103 (Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income), Part IIA of Chapter III (Impermissible tax avoidance arrangements) and paragraph 11(1)(*g*) of the Eighth Schedule (value-shifting arrangements). The corporate restructuring rules offer relief in the form of a deferral of the tax consequences, which would otherwise arise, until a later date.

A detailed analysis of the corporate restructuring rules as they apply to REITS and controlled companies is outside the scope of this Note. This Note does not therefore consider the application and impact of all the corporate restructuring rules in sections 41 to 47 that taxpayers must consider based on the facts of a particular case. In **5.7.1** to **5.7.7** some of the aspects relevant in the context of REITs and controlled companies are discussed.[69]

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[66] Section 23N was inserted by section 63(1) of the Taxation Laws Amendment Act 31 of 2013 and came into operation on 1 April 2014.

[67] The term “acquiring company” is defined in section 23N(1).

[68] Section 23N(5) in its current form was inserted by section 42(1) of the Taxation Laws Amendment Act 15 of 2016 and deemed to have come into operation on 31 December 2015 and applicable in respect of amounts of interest incurred on or after that date.

[69] In addition, see Binding Private Ruling 204 “Definition of ‘Disposal’ for purposes of Asset-for-Share and Amalgamation Transactions; ‘Qualifying distribution’ upon Conversion to a Corporate Real Estate Investment Trust” dated 24 August 2015 and Binding Class Ruling 050 dated 9 February 2016 “Tax Consequences for Unitholders in a REIT of an Amalgamation Transaction, Followed by an Asset-for-Share Transaction”.

The corporate restructuring rules potentially apply, amongst others, to a "company" which is defined in section 1(1) but restricted in section 41(1) as follows:

> " **'[C]ompany'** does not include a headquarter company and, for the purposes of sections 42 and 44, includes any portfolio of a collective investment scheme in securities or any portfolio of a hedge fund collective investment scheme;"

A REIT (see **4.1.1**) and a controlled company (see **4.2**) must by definition be a "company" as defined in section 1(1) and are not excluded from the definition of "company" in section 41(1). Accordingly, the corporate restructuring rules apply to a REIT and a controlled company if the detailed requirements of the particular section are met. A REIT may be a company incorporated under the Companies Act, a company incorporated under the law of any country other than the Republic or a portfolio of a collective investment scheme in property that qualifies as a REIT as defined in paragraph 13.1(*x*), all of which are companies as defined under section 1(1) (see **4.1.1**).

The term "equity share" is used in a number of the corporate restructuring rules. The definition of "equity share" in section 1(1) 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 "share" as defined in section 1(1) means, in relation to a company, any unit into which the proprietary interest in that company is divided. The definition of "equity share" in section 1(1) therefore include shares in a company incorporated under the Companies Act or foreign law, and a participatory interest in a portfolio of a collective investment scheme in property that qualifies as a REIT as noted above, if the requirements of the equity share definition are met.

In assessing whether a transaction qualifies under the corporate restructuring rules, some important considerations to bear in mind are –

- the facts of the particular case;
- the definitions in section 1(1) and 41(1); and
- the entire provision to ensure that exceptions and exclusions are not overlooked (for example, a person may satisfy the definition of "asset-for-share transaction" yet be excluded under section 42(8A)).

5.7.2 Asset-for-share transactions (section 42)

The term "asset-for-share transaction" is defined in section 42(1) and caters for various situations in which certain assets are disposed of to a company in exchange for equity shares in that company. Under paragraph (*a*) of the definition the transferee company must be a resident. Paragraph (*b*) of the definition deals with the situation when a company disposes of equity shares in a foreign company to another foreign company in exchange for equity shares in that other foreign company. That other foreign company must be part of the same group of companies as the company and also a CFC in relation to any resident company that forms part of the same group of companies as that company and that other foreign company.

Broadly, if section 42 applies, a qualifying transferor will not suffer any immediate tax consequences as a result of the disposal of the transferred assets while the transferee company takes over the history of the asset from the transferor such as the date of acquisition and allowable expenditure. The transferee company's contributed tax capital will also be increased as set out in the section. The base cost and the date of acquisition of the equity shares issued to the transferor is derived from the transferred assets. Only assets that would have produced a capital gain or revenue profit had they been disposed of otherwise than under section 42 will qualify for roll-over relief. If the transferor becomes entitled to any consideration in addition to the equity shares, part of the transaction will not be an asset-for-share transaction and the deferral of the tax consequences available under section 42 will not apply.

A REIT or a controlled company could potentially qualify as a transferor under paragraph (*a*) of the definition of "asset-for-share transaction", since it qualifies as a person. Under paragraph (*a*) of the definition a resident controlled company or a REIT, which is a resident by definition, could potentially be a transferee company. However, a non-resident controlled company could not be a transferee company.

In contrast, a REIT or a resident controlled company could not be a transferee company under paragraph (*b*) of the definition of "asset-for-share transaction" but a non-resident controlled company could potentially be a transferee company. A REIT or a controlled company could potentially qualify as a transferor under paragraph (*b*) of the definition of "asset for share transaction" if all the requirements of paragraph (*b*) are met.

5.7.3 Substitutive share-for-share transactions (section 43)

Under section 43(2) roll-over treatment will apply when a person disposes of an equity share in the form of a linked unit in, amongst other companies, a REIT, a controlled company or a property company, and acquires an equity share other than a linked unit in that same company. Such a transaction is a "substitutive share-for-share transaction" as defined in section 43(1). Thus, before the transaction a person holds an equity share and a debenture in the company, but after the transaction holds only an equity share in the company.

A person disposing of a share under a substitutive share-for-share transaction is deemed to have –

- disposed of the equity share for an amount equal to the expenditure allowable in respect of that share under paragraph 20 of the Eighth Schedule or taken into account under section 11(*a*), 22(1) or (2) [section 43(2)(*a*)];
- acquired the other equity share for the same expenditure referred to above on the latest date on which any of the equity shares disposed of were acquired [section 43(2)(*b*)]; and
- incurred the cost referred to in section 43(2)(*b*) on the same date on which the latest of the previous shares were acquired [section 43(2)(*c*)].

The cost attributable to the new equity shares acquired as –

- capital assets, is treated for purposes of paragraph 20 of the Eighth Schedule as expenditure actually incurred in respect of those equity shares; or
- trading stock, is treated for purposes of section 11(*a*) or 22(1) or (2) as the amount to be taken into account in respect of those equity shares.

Section 43(1A) provides that when a person disposes of an equity share in a company that comprises a pre-valuation date asset and acquires another equity share in that company under a substitutive share-for-share transaction, that person must, for the purposes of determining the date of acquisition of that equity share and the expenditure in respect of the cost of acquisition of that equity share, be treated as having –

- disposed of that equity share at a time immediately before the substitutive share-for-share transaction, for an amount equal to the market value of that equity share at that time; and
- immediately reacquired that equity share at that time at an expenditure equal to that market value.

The market value reacquisition cost must be reduced by any capital gain and increased by any capital loss arising from the deemed disposal. The resulting expenditure is treated as having been incurred for the purposes of paragraph 20(1)(*a*) of the Eighth Schedule. A pre-valuation date share is, therefore, converted to a post-valuation date share in order that section 43(2) can be applied.

Section 43(4) provides that when a person disposes of an equity share in a company under a substitutive share-for-share transaction and that person becomes entitled, in exchange for that equity share, to any consideration other than a dividend, foreign dividend or another equity share in that company, the roll-over treatment afforded under section 43(2) will not apply to the extent of the other consideration received.

The portion of the expenditure relating to the equity shares disposed of that must be attributed to the other consideration received is determined by multiplying the expenditure relating to those shares by the amount of the other consideration received divided by the sum of the market value of the equity shares acquired and the market value of the other consideration.

Section 43(4A) provides that when an equity share is issued under a substitutive share-for-share transaction, the issue price of the linked unit disposed of under that transaction is deemed to be contributed tax capital in respect of the class to which the equity share so acquired relates. Contributed tax capital of a company is increased by the consideration received by or accrued to that company for the issue of its shares on or after 1 January 2011 and is determined per class of shares.[70]

Example 13 – Substitutive share-for-share transaction

Facts:

Individual A acquired 2 000 linked units in REIT B on 1 March 2013 for R20 000 (R2 000 for the share and R18 000 for the debenture components of the linked units) and a further 1 000 linked units on 1 April 2013 for R10 100 (R1 000 for the share and R9 100 for the debenture components of the linked units). The linked units were held as capital assets.

On 1 August 2016 REIT B issued 3 000 equity shares with a market value of R50 000 to Individual A in exchange for the surrender of the 3 000 linked units held by Individual A.

70 The term "contributed tax capital" is defined in section 1(1).

Result:

The exchange of the linked units held by Individual A for equity shares qualifies as a "substitutive share-for-share transaction" as defined in section 43(1). Under section 43(2)(*a*) Individual A is deemed to have disposed of the linked units in REIT B for R30 100, being the base cost of the linked units under paragraph 20 of the Eighth Schedule. The capital gain on disposal of the linked units is nil (proceeds of R30 100 – base cost of R30 100).

Under section 43(2)(*b*) Individual A is deemed to have acquired the new equity shares in REIT B for R30 100 on 1 April 2013, being the latest date that the linked units were acquired by Individual A. Under section 43(2)(*c*) this cost of acquisition is treated for purposes of paragraph 20 of the Eighth Schedule as being the base cost of the new equity shares acquired by Individual A.

The contributed tax capital for REIT B of the newly issued shares is R30 100 under section 43(4A), being the price of the linked units previously issued by REIT B.

5.7.4 Amalgamation transactions (section 44)

The term "amalgamation transaction" is defined in section 44(1) and means any of the transactions described below and as a result of which the existence of the amalgamated company will be terminated.

Paragraph (a) of the definition of "amalgamation transaction"

A transaction under which any company (the amalgamated company) which is a resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up) to another company (the resultant company) which is a resident, by means of an amalgamation, conversion or merger.

Paragraph (b) of the definition of "amalgamation transaction"

Any transaction under which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up) to a resultant company which is a resident, by means of an amalgamation, conversion or merger if, immediately before that transaction, any shares in that amalgamated company are held as capital assets.

Paragraph (c) of the definition of "amalgamation transaction"

Any transaction under which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to its liquidation or winding-up) to a resultant company which is a foreign company, by means of an amalgamation, conversion or merger if –

- immediately before that transaction the amalgamated company and the resultant company form part of the same "group of companies" as defined in section 1(1), the resultant company is a CFC in relation to any resident that is part of that group of companies and any shares in the amalgamated company that are directly or indirectly held by that resultant company are held as capital assets; and
- immediately after that transaction, more than 50% of the equity shares in that resultant company are directly or indirectly held by a resident (whether alone or together with any other person that is a resident and that forms part of the same "group of companies" as defined in section 41(1) as that resident).

A REIT or a controlled company that is a party to an "amalgamation transaction" could meet the requirements of one of the transactions identified in paragraphs (*a*), (*b*) or (*c*) above and therefore qualify for the relief[71] under section 44 if the requirements of that section are met. For example, under paragraph (*a*) of the definition of "amalgamation transaction" a portfolio of a collective investment scheme in property that is a REIT could dispose of all its assets to a resident company by means of an amalgamation, conversion or merger as a result of which the existence of the portfolio will be terminated. A portfolio will cease to be a REIT when the existence of the portfolio is terminated. See **4.9** for the implications of a company losing its REIT or controlled company status during a year of assessment.

Section 44(4) provides that the deferral rules in section 43(2) and (3) do not apply to the disposal of an asset by an amalgamated company to the extent the asset is disposed of in exchange for consideration other than equity shares in the resultant company or the assumption of debt as specified in section 44(4)(*b*). The portion of the expenditure relating to the equity shares disposed of that must be attributed to the other consideration received is determined by multiplying the expenditure relating to those shares by the amount of the other consideration received divided by the sum of the market value of the equity shares acquired and the market value of the other consideration.

If a resultant company issues shares in exchange for the disposal of an asset under an amalgamation transaction, the amount received or accrued as consideration for purposes of determining the resultant company's contributed tax capital is deemed to be equal to an amount bearing to the contributed tax capital of the amalgamated company at the time of its termination, the same ratio as the value of the shares in the amalgamated company held by holders of shares other than the resultant company at that time to the value of all shares held in the amalgamated company at

[71] See section 44 for detail of the relief provided.

that time. The proviso to section 44(4A)[72] specifically applies to a portfolio of a collective investment scheme in property and stipulates that when the amalgamated company is a portfolio of a collective investment scheme in property, the price at which the participatory interests in that collective investment scheme was issued must be added to the contributed tax capital[73] of the class of shares issued by the resultant company.

5.7.5 Intra-group transactions (section 45)

A transaction will be an intra-group transaction if any of the transactions described below occurs.

Paragraph (a) of the definition of "intra-group transaction"

An asset is disposed of by a transferor company to a resident transferee company, both companies form part of the same "group of companies" as defined in section 41(1) as at the end of the day of that transaction and the transferee company acquires a capital asset as a capital asset or trading stock as trading stock, as the case may be.

Paragraph (b) of the definition of "intra-group transaction"

An asset constituting an equity share held by a transferor company as a capital asset in a foreign company, is disposed of by the transferor company to a transferee company and acquired by the transferee company as a capital asset, in exchange for the issue of debt or shares other than equity shares by that transferee company. Immediately before and as at the end of the day of that transaction the transferor company and the transferee company must form part of the same "group of companies" as defined in section 1(1) and both companies must be residents or CFCs in relation to one or more residents forming part of the group of companies.

A REIT or a controlled company that is a party to an "intra-group" transaction could meet the requirements of one of the transactions identified in paragraph (*a*) or (*b*) above and therefore qualify for the relief[74] provided for under section 45 if the requirements of that section are met.

It may happen that a REIT or a controlled company disposes of assets to its shareholders under an intra-group transaction to which the relief in section 45 is applied for a consideration that is less than the market value of the assets. While the facts of the specific case must always be considered, the difference between the market value of the assets and the consideration given by the shareholders will generally not comprise a "dividend" as defined in section 1(1).

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72 The proviso to section 44(4A) was added by section 93(1)(*c*) of the Taxation Laws Amendment Act 31 of 2013 with effect from 24 October 2013.

73 The term "contributed tax capital" is defined in section 1(1).

74 See section 45 for details of the relief provided.

5.7.6 Unbundling transactions (section 46)

The term "unbundling transaction" is defined in section 46(1) and means any of the transactions described below.

Paragraph (a) of the definition of "unbundling transaction"

Any transaction –

- under which the equity shares in a resident company (the unbundled company), that are held by a resident company (the unbundling company), are all distributed by that unbundling company to any of its shareholders in accordance with the effective interest of the shareholders in the shares of that unbundling company, and –
  - ➢ all of the equity shares of the unbundled company are listed shares or will become listed shares within 12 months after that distribution;
  - ➢ the shareholder to which that distribution is made forms part of the same "group of companies" as defined in section 41(1) as that unbundling company; or
  - ➢ that distribution is made pursuant to an order under the Competition Act 89 of 1998, made by the Competition Tribunal or the Competition Appeal Court; and
- the equity shares distributed constitute –
  - ➢ when that unbundled company is a listed company immediately before that distribution and no shareholder of the unbundled company other than the unbundling company holds the same number of equity shares as or more equity shares than the unbundling company of that unbundled company, more than 25% of the equity shares of the unbundled company; or
  - ➢ when that unbundled company is a listed company immediately before that distribution and any shareholder of the unbundled company other than the unbundling company holds the same number of equity shares as or more equity shares than the unbundling company of that unbundled company, at least 35% of the equity shares of that unbundled company; or
  - ➢ when that unbundled company is an unlisted company immediately before that distribution, more than 50% of the equity shares of that unbundled company.

Paragraph (b) of the definition of "unbundling transaction"

Any transaction –

- under which all the equity shares in an unbundled company which is a foreign company that are held by a resident unbundling company or a CFC are all distributed by that unbundling company to any of its shareholders in accordance with the effective interest of that shareholder in the shares of the unbundling company if the shareholder is a resident forming part of the same "group of companies" as defined in section 1(1) or a CFC in relation to any resident forming part of the same "group of companies" as defined in section 1(1) as the unbundling company; and

- immediately before the distribution of the equity shares the unbundling company holds more than 50% of the equity shares of the unbundled company and each of those equity shares are held by the unbundling company as a capital asset.

Section 46(2) provides that an unbundling company must disregard the distribution of shares under an "unbundling transaction" for purposes of calculating its taxable income or assessed loss, or its net income for purposes of section 9D. Section 46 contains a number of other rules, including section 46(3)(*a*)(i) dealing with the allocation of expenditure between the shares in the unbundled company and the shares in the unbundling company for the new holder of the unbundled shares and section 46(3A) dealing with the impact on the contributed tax capital of the unbundling company and the unbundled company.

Section 46(6A) provides that section 46 does not apply to an unbundling transaction on or after 20 January 2015 when the unbundling company is a REIT or a controlled company. It follows that a REIT or a controlled company that distributes shares can no longer avail itself of the roll-over relief in section 46.

Before 20 January 2015 section 46(2) had the effect that a REIT or a controlled company that distributed shares under an "unbundling transaction" to its shareholders was not entitled to deduct the distribution from its income, even though it may have constituted a "qualifying distribution" as defined in section 25BB(1).

The distribution of shares as a dividend *in specie* by a REIT or a controlled company under an "unbundling transaction" before 20 January 2015 was included in the "gross income" of the holders of the shares under paragraph (*k*) of the definition of "gross income" in section 1(1). These dividends were not exempt from normal tax under section 10(1)(*k*)(*i*) if they were received by or accrued to holders of shares that are residents [paragraph (*aa*) of the proviso to section 10(1)(*k*)(i)].

The combined effect of section 46(2) and paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) was that shares distributed by a REIT or a controlled company to resident holders of shares under an "unbundling transaction" were disregarded in determining the taxable income or assessed loss of the REIT or controlled company and the holders of the shares did not qualify for the dividend exemption.

Section 46(5) stipulates that shares distributed by an unbundling company under an "unbundling transaction" must be disregarded for dividends tax purposes. It follows that shares distributed by a REIT or a controlled company under an "unbundling transaction" before 20 January 2015 must be disregarded for dividends tax purposes.

5.7.7 Transactions relating to liquidation, winding-up and deregistration (section 47)

The term "liquidation distribution" is defined in section 47(1) and means any of the transactions described below.

Paragraph (a) of the definition of "liquidation distribution"

A resident liquidating company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding up, but only to the extent to which those assets are so disposed of to a resident holding company that on the date of that disposal forms part of the same "group of companies", as defined in section 41(1), as the liquidating company.

Paragraph (b) of the definition of "liquidation distribution"

A liquidating CFC in relation to any resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company –

- to the extent that those assets are disposed of to a resident holding company forming part of the same "group of companies" as defined in section 1(1) as the liquidating company immediately before that distribution, or to a holding company that is a CFC in relation to any resident;
- if, immediately before the transaction, all of the shares held by the holding company in the liquidating company, were held as capital assets; and
- if, immediately after that transaction, in the case of a holding company that is a CFC, more than 50% of its equity shares are directly or indirectly held by a resident whether alone or together with any other resident forming part of the same "group of companies", as defined in section 41(1), as that resident.

A REIT or a controlled company that is a party to a "liquidation transaction" could meet the requirements of one of the transactions identified in paragraph (*a*) or (*b*) above and therefore qualify for the relief[75] under section 47 if the requirements of that section are met. For example, a transaction under which a liquidating controlled company disposes of all its assets to a REIT would qualify as a "liquidation transaction" under paragraph (*a*) of the definition of "liquidation transaction" to the extent that both companies form part of the same "group of companies" as defined in section 41(1). See **4.9** for the implications of a company losing its REIT or controlled company status during a year of assessment.

Section 47(3A) provides that the deferral rules in section 47 apply only to the extent that the equity shares held by the holding company in the liquidating company are disposed of as a result of the liquidation, winding-up or deregistration of the liquidating company and the holding company has not assumed any debt not permitted under section 47(3A)(*b*)(ii).

5.8 Dividends Tax [sections 64E(1), 64F(1)(*a*), (*l*) and (2) and 64FA(1)(*a*)]

Dividends tax is levied under section 64E(1) –

- on a dividend paid by a resident company, other than a headquarter company; or
- on a foreign dividend paid by a company that is not a resident, if the share in respect of which that foreign dividend is paid is a listed share and to the extent that that foreign dividend does not consist of a distribution of an asset *in specie*.

A dividend or interest deemed to be a dividend under section 25BB(6) (see **4.8**) paid by a REIT or, in certain circumstances, a controlled company, is therefore liable to

[75] See section 47 for details of the relief provided.

dividends tax. The dividend may be exempt from dividends tax if it qualifies for an exemption from dividends tax. Some of the exemptions are discussed below.

See the *Comprehensive Guide to Dividends Tax* for a comprehensive discussion of dividends tax, including other exemptions which could apply to particular circumstances not discussed in this Note.

5.8.1 Dividends paid by a REIT or a controlled company [section 64F(1)(*l*) and (2)]

More than one exemption from dividends tax could apply to a particular dividend depending on the facts. For example, the exemptions in section 64F(1)(*a*) and (*l*),[76] discussed below, could apply to the same dividend. A dividend could also have been exempt under section 64F(2) and under one of the paragraphs in section 64F(1). An amount can, however, be exempt only once, meaning that once a specific exemption has been applied, no further exemptions will apply.

A dividend or deemed dividend paid by a REIT or controlled company is exempt from dividends tax under section 64F(1)(*a*) if the beneficial owner of the dividend is a resident company.

A dividend is exempt from dividends tax under section 64F(1)(*l*) to the extent that it does not consist of a dividend *in specie* and it constitutes "income" of the beneficial owner. Therefore, a dividend, excluding a dividend that constitutes a share buy-back and excluding a dividend to the extent the dividend is a dividend *in specie,* paid by a REIT or resident controlled company to a resident beneficial owner is exempt from dividends tax under section 64F(1)(*l*). This dividend is exempt from dividends tax because it is included in the income of a beneficial owner under paragraph (*k*) of the definition of "gross income" in section 1(1) and is not exempt under paragraph (*aa*) of the proviso to section 10(1)(*k*)(i) (see **5.4.1**). A dividend that constitutes a share buy-back does not qualify for the exemption under section 64F(1)(*l*) because it does not constitute income and it is therefore subject to dividends tax. It is, however, exempt from normal tax (see **5.4.1**).

Dividends paid by a REIT or a resident controlled company which are received by or accrue to a non-resident beneficial owner constitute exempt income under section 10(1)(*k*)(i) and are not subject to normal tax (see **5.4.1**). These dividends are subject to dividends tax because they do not qualify for the exemption under section 64F(1)(*l*) as they do not constitute "income".

In addition, a dividend paid by a REIT or a controlled company received by or accrued to a resident beneficial owner or a non-resident before 1 January 2014 was exempt from dividends tax under section 64F(2), but only to the extent that the dividend did not consist of the distribution of an asset *in specie*.

5.8.2 Dividends paid to a beneficial owner that is a REIT or a controlled company [sections 64F(1)(*a*) and 64FA(1)(*a*)]

A REIT and a controlled company qualify as a "company" as defined in section 1(1). Any dividend received by or accrued to a REIT or a resident controlled company will be exempt from dividends tax under sections 64F(1)(*a*) or 64FA(1)(*a*) if the REIT or a controlled company is the beneficial owner of the dividend.

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[76] Section 64F(1)(*l*) applies to dividends received or accrued on or after 1 April 2013.

5.9 Securities transfer tax (sections 2(1) and 8(1)(*t*) of the Securities Transfer Tax Act 25 of 2007)

Section 2(1) of the Securities Transfer Tax Act stipulates that securities transfer tax is levied at the rate of 0,25% of the taxable amount of a security on –

- every transfer of a security issued by –
  - a close corporation or company incorporated, established or formed inside the Republic; or
  - a company incorporated, established or formed outside the Republic and listed on an exchange as defined in section 1 of the Financial Markets Act and licensed under section 9 of that Act; and
- any reallocation of securities from a member's bank restricted stock account or a member's unrestricted and security restricted stock account to a member's general restricted stock account.

Section 8(1)(*t*) of the Securities Transfer Tax Act provides that securities transfer tax is not payable on the transfer of a security that constitutes a share in a "REIT" as defined in section 1(1). Controlled companies are not included in this exemption and the transfer of a share in a controlled company may therefore be subject to securities transfer tax. The term "transfer" is defined in section 1 of the Securities Transfer Tax Act as including –

> **" …** the transfer, sale, assignment or cession, or disposal in any other manner, of a security or the cancellation or redemption of that security, but does not include—
>
> (*a*) any event that does not result in a change in beneficial ownership;
>
> (*b*) any issue of a security; or
>
> (*c*) a cancellation or redemption of a security if the company which issued the security is being wound up, liquidated or deregistered or its corporate existence is being finally terminated;"

5.10 Transfer duty (sections 1(1), 2(1) and 9(1)(*l*) of the Transfer Duty Act 40 of 1949)

Section 2(1) of the Transfer Duty Act stipulates that transfer duty is levied on the value of property acquired by a person, at a rate determined on a sliding scale, based on the value of the property acquired.

The term "property" is defined in section 1(1) of the Transfer Duty Act as land and any fixtures thereon, and includes in paragraph (*d*) of that definition a share (other than a share in a share block company) or member's interest in a residential property company.

The term "residential property company" is defined in section 1(1) of the Transfer Duty Act and specifically excludes a REIT as defined in section 1(1). The acquisition of a share in a REIT is, therefore, not subject to transfer duty. A controlled company, which is not a REIT, is not excluded from the definition of "residential property company" and the transfer of a share in a controlled company may therefore be subject to transfer duty.

The acquisition of property by a company (including a REIT and a controlled company) under any of the following transactions is exempt from transfer duty under section 9(1)(*l*) of the Transfer Duty Act:

- An asset for-share transaction as defined in section 42.
- A substitutive share-for-share transaction as defined in section 43.
- An amalgamation transaction as defined in section 44.
- An intra-group transaction as defined in section 45.
- A liquidation distribution as defined in section 47.
- A transaction which would have constituted a transaction or distribution in the bullets above regardless of whether that person acquired that property as a capital asset or as trading stock.

5.11 VAT treatment of REITs, controlled companies and holders of shares or linked units (sections 2, 7(1)(*a*), 12(*a*) and 17(1) of the VAT Act)

Every supply of goods or services by a vendor in the course or furtherance of that vendor's enterprise is subject to VAT at the standard rate under section 7(1)(*a*) of the VAT Act, unless the supply is exempt or zero rated or falls outside the scope of the VAT Act.

Under section 12(*a*) of the VAT Act, the supply of "financial services" is exempt from VAT. The term "financial services" is defined in section 1(1) of the VAT Act as being the activities which are deemed by section 2 to be financial services.

It is assumed for purposes of the analysis that follows that the REIT, controlled company and holder of shares or linked units are vendors for VAT purposes.

The issue and disposal of shares

Under section 2(1)(*d*) of the VAT Act, the issue, allotment or transfer of ownership of an "equity security" or a "participatory security" is deemed to be financial services and therefore exempt from VAT under section 12(*a*) of the VAT Act. In essence an "equity security" would include a share in a REIT that is a juristic person or a controlled company, while a "participatory security" would include a participatory interest in a portfolio of a collective investment scheme in property that qualifies as a REIT.

The terms "equity security" and "participatory security" are respectively defined in section 2(2)(iv) and (vi) of the VAT Act as follows:

> " **'[E]quity security'** means any interest in or right to a share in the capital of a juristic person or the interest in a close corporation of a member thereof;
>
> **'participatory security'** means a participatory interest as defined in section 1 of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), but does not include an equity security, a debt security, money or a cheque;"

The issue or allotment of a share or participatory security in a REIT or a controlled company is therefore exempt from VAT under section 12(*a*) of the VAT Act. The subsequent disposal of such a share or participatory security by its holder similarly constitutes the supply of an exempt financial service.

The issue and disposal of linked units

A linked unit issued by a REIT or a controlled company contains both a share element (an “equity security”) and a debenture element.

The issue, allotment or transfer of ownership of a “debt security” is exempt from VAT under section 12(*a*) read with section 2(1)(*c*) of the VAT Act. The term “debt security” is defined in section 2(2)(iii) of the VAT Act as follows:

> “ **‘[D]ebt security”** means—
>
> (*aa*) an interest in or right to be paid money; or
>
> (*bb*) an obligation or liability to pay money
>
> that is, or is to be, owing by any person, but does not include a cheque;”

Thus, the issue of a debenture by a REIT or a controlled company is deemed to be a financial service and is therefore exempt from VAT.

With regard to the “share element”, as mentioned above, the issue or allotment of a share is exempt from VAT under section 12(*a*) read with section 2(1)(*d*) of the VAT Act.

The disposal of a linked unit by a REIT or a controlled company, which acquired the linked unit in another REIT or controlled company, similarly constitutes the supply of exempt financial services under section 12(*a*) read with section 2(1)(*c*) and (*d*) of the VAT Act.

Dividends

A dividend paid in respect of a share by a REIT or a controlled company is not consideration for a supply of goods or services and accordingly falls outside the scope of the VAT Act. While a dividend received or accrued from a REIT and a dividend from a controlled company which constitutes a qualifying distribution constitute “rental income” for purposes of the definition of “qualifying distribution” in section 25BB(1), such receipt or accrual remains a dividend for VAT purposes.

While any amount received by or accrued to a REIT or a controlled company on disposal of a financial instrument must be included in gross income if held on revenue account or treated as proceeds for purposes of calculating a capital gain or capital loss for CGT purposes[77], such amount may constitute consideration for the supply of an exempt financial service. If so, such amount will be exempt from VAT under section 12(*a*) read with section 2 of the VAT Act, or, as in the case of the receipt of dividends, fall outside the scope of the VAT Act.

Interest

The provision of credit (the linked loan provided by the holder of the linked unit) constitutes an exempt financial service under section 2(1)(*f*) of the VAT Act. Any consideration (interest) derived under a credit arrangement is accordingly exempt from VAT under section 12(*a*) read with section 2(1)(*f*) of the VAT Act. It follows that any interest received in respect of the “debenture element” constitutes consideration

[77] Excluding a share or a linked unit in a REIT or a property company referred to in section 25BB(5)(*b*) and (*c*).

for the exempt supply of credit and no output tax need be accounted for on any interest received by the holder of the linked unit.

While interest payable by a REIT or a resident controlled company on a debenture that forms part of a linked unit constitutes a "qualifying distribution," and therefore "rental income" for purposes of section 25BB, the interest remains exempt interest for VAT purposes.

Rental income

The supply of commercial property by a REIT or a controlled company in the course or furtherance of its enterprise constitutes a taxable supply under section 7(1)(*a*) of the VAT Act. Rental income received in respect of such a supply is subject to VAT at the standard rate.

However, the supply by a REIT respectively of a dwelling under an agreement for its letting and hiring, and any "right of occupation" as defined in section 1 of the Housing Development Schemes for Retired Persons Act 65 of 1988, are exempt under section 12(*c*) of the VAT Act.

The fact that certain income of a REIT is defined as "rental income" in section 25BB(1) for income tax purposes does not result in such income constituting rental income for VAT purposes.

Thus, for example, while a dividend derived from a REIT or a controlled company falls within the ambit of the definition of "rental income" in section 25BB(1), it will constitute an out-of-scope receipt for VAT purposes.

Sale of fixed property

The supply of "fixed property" by a REIT or a controlled company under an agreement of sale in the course or furtherance of its enterprise is subject to VAT at the standard rate under section 7(1)(*a*) of the VAT Act. The term "fixed property" is defined in section 1(1) of the VAT Act as follows:

> " **'[F]ixed property'** means land (together with improvements affixed thereto), any unit as defined in section 1 of the Sectional Titles Act, 1986 (Act No. 95 of 1986), any share in a share block company which confers a right to or an interest in the use of immovable property, and, in relation to a property time-sharing scheme, any time-sharing interest as defined in section 1 of the Property Time-sharing Control Act, 1983 (Act No. 75 of 1983); and any real right in any such land, unit, share or time-sharing interest;"

However, the sale of property used by a REIT *wholly* in the course and furtherance of making exempt supplies is not subject to VAT. The supply of fixed property that was used by a REIT or a controlled company partly for the purpose of making taxable supplies and partly for some other, for example, exempt purpose is deemed to have been made *wholly* in the course or furtherance of the REIT or controlled company's enterprise, and is a taxable supply under section 8(16) of the VAT Act. Thus, for example, if a REIT or a controlled company supplies fixed property that was used for both commercial (taxable) and residential (exempt) purposes, the REIT or controlled company will be required to account for output tax on the full consideration received for the supply, even though part of the fixed property was used for an exempt purpose. The REIT or controlled company may, however, be entitled to VAT relief under section 16(3)(*h*) of the VAT Act.

The supply of fixed property as a going concern may be subject to VAT at the zero rate if all the requirements of section 11(1)(*e*) of the VAT Act are met.

Input tax

Dividends and interest received by a REIT or a controlled company have an impact on apportionment of input tax claimed under section 17 of the VAT Act. It may happen, for example, that a REIT receives a dividend from a controlled company and immediately after the receipt pays a dividend to its holder of shares. Whether this “flow-through” of a dividend will impact on the apportionment of input tax depends on the facts of each case.

Section 17(1) of the VAT Act provides that the extent to which a vendor may deduct tax payable on goods or services acquired partly for the purpose of making taxable supplies and partly for some other purpose, for example, exempt supplies or non-supplies, is determined by means of a ratio determined by the Commissioner in terms of a ruling contemplated in Chapter 7 of the Tax Administration Act 28 of 2011 (that is, a binding general ruling) or section 41B of the VAT Act (that is, a VAT class ruling or a VAT ruling).

A REIT or a controlled company should therefore apply Binding General Ruling 16 (Issue 2) dated 30 March 2015 “Standard Apportionment Method” or apply for a VAT class ruling or a VAT ruling under section 41B of the VAT Act.

General

The supply of any other goods or services by a REIT or a controlled company in the course or furtherance of its enterprise is subject to VAT at the standard rate under section 7(1)(*a*) unless an exemption or zero-rating applies.

6. Conclusion

Section 25BB introduced a uniform set of rules for the taxation of REITs and their controlled companies as well as the holders of shares or linked units in such REITs and controlled companies with effect from years of assessment commencing on or after 1 April 2013. In order to qualify as a REIT, a company or a portfolio of a collective investment scheme in property must be a resident, be listed on an exchange as a REIT and meet the JSE’s listings requirements. A REIT can be a trust if it takes the form of a portfolio of a collective investment scheme in property, but for income tax purposes it is deemed to be a company.

The effect of section 25BB is to treat a REIT or a controlled company as a flow-through entity for income tax purposes. This treatment is achieved by allowing a deduction of a “qualifying distribution” for a REIT or a resident controlled company. The deductible amount of the qualifying distribution is limited to the taxable income of the REIT or controlled company before taking into account –

- the qualifying distribution;
- any assessed loss brought forward from the previous year of assessment; and
- any taxable capital gain.

A distribution by a REIT or a controlled company that was in existence at the end of the preceding year of assessment will constitute a deductible qualifying distribution only if at least 75% of any gross income derived by the REIT or controlled company for the preceding year of assessment consists of “rental income”. A similar rule applies during the first year of assessment in which a company qualifies as a REIT or controlled company, but in such event the gross income derived by the REIT or controlled company for that year of assessment is used. Rental income includes income from the use of immovable property, dividends from another REIT, a qualifying distribution from a controlled company, dividends or foreign dividends from a property company, and the recoupment of capital allowances claimed under specified sections.

A REIT and a controlled company must disregard any capital gain or capital loss on disposal of shares or linked units in another REIT or a property company as well as any capital gain or capital loss on disposal of immovable property. However, a REIT or a controlled company must account for other capital gains and capital losses while amounts received or accrued of a revenue nature on the disposal of assets are included in gross income.

Interest received by or accrued to a person during a year of assessment on a debenture forming part of a linked unit in a REIT or a resident controlled company is deemed to be a dividend. Dividends from a REIT or resident controlled company that are received by or accrued to resident holders of shares are taxable for normal tax purposes but are exempt from dividends tax. Non-residents are exempt from normal tax on such dividends but are instead subject to dividends tax.

Interest received by or accrued to a person during a year of assessment on a debenture forming part of a linked unit in a controlled company that is not a resident is deemed to be a foreign dividend.

The other provisions of the Act and other legislation dealing with REITs, controlled companies and the holders of shares or linked units, as discussed in this Note, should also be considered.

Legal Counsel
SOUTH AFRICAN REVENUE SERVICE

Annexure A – The law

Income Tax Act

Section 8F(2)[78]

(2) Any amount of interest that—

(*a*) is incurred by a company in respect of an instrument on or after the date that the instrument becomes a hybrid debt instrument is—

(i) deemed for the purposes of this Act to be a dividend *in specie* declared and paid by that company on the last day of the year of assessment of that company during which it was incurred; and

(ii) not deductible in terms of this Act; and

(*b*) is deemed for the purposes of this Act to be a dividend *in specie* that is declared and paid in respect of a share on the last day of the year of assessment of the company contemplated in paragraph (*a*) to the person to whom that amount accrued.

Section 8F(3)(*d*)[79]

(3) This section does not apply to any instrument—

(*d*) that constitutes a linked unit in a company where the linked unit is held by a long-term insurer as defined in the Long-term Insurance Act, a pension fund, a provident fund, a REIT or a short-term insurer as defined in the Short-term Insurance Act, if—

(i) the long-term insurer, pension fund, provident fund, REIT or short-term insurer holds at least 20 per cent of the linked units in that company;

(ii) the long-term insurer, pension fund, provident fund, REIT or short-term insurer acquired those linked units before 1 January 2013; and

(iii) at the end of the previous year of assessment 80 per cent or more of the value of the assets of that company, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable property.

Section 8FA(2)[80]

(2) Any amount—

(*a*) that is incurred by a company in respect of interest on or after the date that the interest becomes hybrid interest is—

(i) deemed for the purposes of this Act to be a dividend *in specie* declared and paid by that company on the last day of the year of assessment of that company during which it was incurred; and

(ii) not be deductible in terms of this Act; and

78 Section 8F(2) was substituted by section 16(1)(*e*) of the Taxation Laws Amendment Act 15 of 2016.

79 Section 8F(3)(*d*) will be deleted with effect from 1 January 2018 and will not apply to amounts of interest incurred on or after that date.

80 Section 8FA(2) was substituted by section 17(1)(*b*) of the Taxation Laws Amendment Act 15 of 2016.

(*b*) is deemed for the purposes of this Act to be a dividend *in specie* that is declared and paid in respect of a share on the last day of the year of assessment of the company contemplated in paragraph (*a*) to the person to whom that amount accrued.

Section 8FA(3)(*d*)[81]

(3) This section does not apply to any interest owed in respect of—

(*d*) an instrument that constitutes a linked unit in a company where the linked unit is held by a long-term insurer as defined in the Long-term Insurance Act, a pension fund, a provident fund, a REIT or a short-term insurer as defined in the Short-term Insurance Act, if—

(i) the long-term insurer, pension fund, provident fund, REIT or short-term insurer holds at least 20 per cent of the linked units in that company;

(ii) the long-term insurer, pension fund, provident fund, REIT or short-term insurer acquired those linked units before 1 January 2013; and

(iii) at the end of the previous year of assessment 80 per cent or more of the value of the assets of that company, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable property.

Section 9C(1), (2) and (5)

9C. Circumstances in which certain amounts received or accrued from disposal of shares are deemed to be of a capital nature.—(1) For the purposes of this section—

"connected person" means a connected person as defined in section 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 shall be disregarded;

"disposal" means a disposal as defined in paragraph 1 of the Eighth Schedule or any event treated as a disposal in terms of section 9H;

"equity share", includes a participatory interest in a portfolio of a collective investment scheme in securities and a portfolio of a hedge fund collective investment scheme excluding a share which at any time during that period was—

(*a*) share in a share block company as defined in section 1 of the Share Blocks Control Act;

(*b*) a share in a company which was not a resident, other than a company contemplated in paragraph (*a*) of the definition of "listed company"; or

(*c*) a hybrid equity instrument as defined in section 8E;

"qualifying share" . . . . . .

(2) Any amount received or accrued (other than a dividend or foreign dividend) or any expenditure incurred in respect of an equity share must be deemed to be of a capital nature if that equity share had, at the time of the receipt or accrual of that amount or incurral of that expenditure, been held for a period of at least three years.

(3), (4)………..

[81] Section 8FA(3)(*d*) will be deleted with effect from 1 January 2018 and will not apply to amounts of interest incurred on or after that date.

(5) There shall in the year of assessment in which any equity share held for a period of at least three years is disposed of by the taxpayer be included in the taxpayer's income any expenditure or losses incurred in respect of such equity share and allowed as a deduction from the income of the taxpayer during that or any previous year of assessment in terms of section 11: Provided that this subsection must not apply—

(*a*) in respect of any expenditure or loss to the extent that the amount of that expenditure or loss is taken into account in terms of section 8(4)(*a*) or section 19; or

(*b*) to equity shares in a REIT or a controlled company, as defined in section 25BB(1), that is a resident.

Paragraph (*aa*) of the proviso to section 10(1)(*k*)(i)

10. Exemptions.—(1) There shall be exempt from normal tax—

(*k*) (i) dividends (other than dividends paid or declared by a headquarter company) received by or accrued to any person: Provided that this exemption shall not apply

(*aa*) to dividends (other than those received by or accrued to or in favour of a person that is not a resident or a dividend contemplated in paragraph (*b*) of the definition of "dividend") distributed by a company that is a REIT, or a controlled company as defined in section 25BB;

Section 11(*a*) and (*x*)

11. General deductions allowed in determination of taxable income.—For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived—

(*a*) expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature;

(*b*) to (*w*) …………………

(*x*) any amounts which in terms of any other provision in this Part, are allowed to be deducted from the income of the taxpayer.

Section 23N(5)

(5) This section does not apply to any interest incurred by an acquiring company in respect of any debt contemplated in subsection (2) where that interest is incurred in respect of a linked unit in the acquiring company and that interest accrues to a long-term insurer as defined in the Long-term Insurance Act, a pension fund, a provident fund, a REIT or a short-term insurer as defined in the Short-term Insurance Act, if—

(*a*) the long-term insurer, pension fund, provident fund, REIT or short-term insurer holds at least 20 per cent of the linked units in that acquiring company;

(*b*) the long-term insurer, pension fund, provident fund, REIT or short-term insurer acquired those linked units before 1 January 2013; and (*c*) at the end of the previous year of assessment 80 per cent or more of the value of the assets of that acquiring company, reflected in the annual financial statements prepared in accordance with the Companies Act for the previous year of assessment, is directly or indirectly attributable to immovable.[82]

Section 24J(2)

(2) Where any person is the issuer in relation to an instrument during any year of assessment, such person shall for the purposes of this Act be deemed to have incurred an amount of interest during such year of assessment, which is equal to—

(*a*) the sum of all accrual amounts in relation to all accrual periods falling, whether in whole or in part, within such year of assessment in respect of such instrument; or

(*b*) an amount determined in accordance with an alternative method in relation to such year of assessment in respect of such instrument,

which must be deducted from the income of that person derived from carrying on any trade, if that amount is incurred in the production of the income.

Section 25BB

25BB. Taxation of REITs.—(1) For the purposes of this section—

"controlled company" means a company that is a subsidiary, as defined in IFRS, of a REIT;

"property company" means a company—

(*a*) in which 20 per cent or more of the equity shares or linked units are held by a REIT or a controlled company (whether alone or together with any other company forming part of the same group of companies as that REIT or that controlled company); and

(*b*) of which at the end of the previous year of assessment 80 per cent or more of the value of the assets, reflected in the annual financial statements prepared in accordance with the Companies Act or IFRS for the previous year of assessment, is directly or indirectly attributable to immovable property;

"qualifying distribution", in respect of a year of assessment of a company that is a REIT or a controlled company as at the end of a year of assessment, means any dividend (other than a dividend contemplated in paragraph (*b*) of the definition of "dividend") paid or payable, or interest incurred in respect of a debenture forming part of a linked unit in that company if the amount thereof is determined with reference to the financial results of that company as reflected in the financial statements prepared for that year of assessment if—

(*a*) at least 75 per cent of the gross income received by or accrued to a company during the first year of assessment that the company qualifies as a REIT or controlled company, consists of rental income; or

(*b*) in any other case, at least 75 per cent of the gross income received by or accrued to a REIT or a controlled company in the preceding year of assessment consists of rental income:

Provided that any amount that must be included in the income of the REIT or controlled company in terms of section 9D(2) must not be included in the gross income of the REIT or controlled company in respect of that year of assessment for the purposes of this definition;

"rental income" means any amount received or accrued—

(*a*) in respect of the use of immovable property, including a penalty or interest in respect of late payment of any such amount;

[82] The word "property" should be inserted after the word "immovable".

(*b*) as a dividend (other than a dividend contemplated in paragraph (*b*) of the definition of "dividend") from a company that is a REIT at the time of the distribution of that dividend;

(*c*) as a qualifying distribution from a company that is a controlled company at the time of that distribution;

(*d*) as a dividend or foreign dividend from a company that is a property company at the time of that distribution; or

(*e*) any amount recovered or recouped in terms of section 8(4) in respect of an amount of an allowance previously deducted in terms of section 11(*g*), 13, 13*bis*, 13*ter*, 13*quat*, 13*quin* or 13*sex*.

(2)(*a*) There must be deducted from the income for a year of assessment of—

(i) a REIT; or

(ii) a controlled company that is a resident,

the amount of any qualifying distribution made by that REIT or that controlled company in respect of that year of assessment if that company is a REIT or a controlled company on the last day of that year of assessment.

(*b*) The aggregate amount of the deductions contemplated in paragraph (*a*) may not exceed the taxable income for that year of assessment of that REIT or that controlled company, before taking into account—

(i) any deduction in terms of this subsection;

(ii) any assessed loss brought forward in terms of section 20; and

(iii) the amount of taxable capital gain included in taxable income in terms of section 26A.

(2A) For the purposes of calculating the taxable income in respect of a year of assessment of a REIT or a controlled company as contemplated in subsection (2)(*b*)—

(*a*) where—

(i) a REIT or a controlled company is a beneficiary of a vesting trust that is not a resident; and

(ii) the trust contemplated in subparagraph (i) is liable for or subject to tax on income in the country in which that trust is established or formed,

so much of any amount of tax on income proved to be payable by that trust to the government of a country other than the Republic as is attributable to the interest of that REIT or controlled company in that trust, without any right of recovery of that tax by any person, must be allowed to be deducted by that REIT or controlled company before taking into account any deduction in terms of subsection (2)(*a*);

(*b*) there must be allowed as a deduction from the income of that REIT or that controlled company the sum of any taxes on income proved to be payable by that REIT or that controlled company in respect of any amount to any sphere of government of any country other than the Republic, without any right of recovery by any person other than a right of recovery in terms of any entitlement to carry back losses arising during any year of assessment, limited to the amount of taxable income that is attributable to those amounts, before taking into account any deduction in terms of paragraph (*c*) and subsection (2)(*a*); and

(*c*) where during any year of assessment a REIT or controlled company has made a bona fide donation to any organisation as contemplated in section 18A(1)(*a*) or (*b*) there must be allowed to be deducted an amount equal to the amount of that donation: Provided that the deduction so allowed may not exceed 10 per cent of the taxable income of that REIT or controlled company after taking into account any deduction in terms of paragraph (*a*) and (*b*) but before taking into account any deduction in terms of subsection (2)(*a*).

(3) …………….

(4) A company that is a REIT or a controlled company on the last day of a year of assessment may not deduct by way of an allowance any amount in respect of immovable property in terms of section 11(*g*), 13, 13*bis*, 13*ter*, 13*quat*, 13*quin* or 13*sex*.

(5) In determining the aggregate capital gain or aggregate capital loss of a company that is a REIT or a controlled company on the last day of a year of assessment for purposes of the Eighth Schedule, any capital gain or capital loss determined in respect of the disposal of—

(*a*) immovable property of a company that is a REIT or controlled company at the time of the disposal;

(*b*) a share or a linked unit in a company that is a REIT at the time of that disposal; or

(*c*) a share or a linked unit in a company that is a property company at the time of that disposal,

must be disregarded.

(6)(*a*) Any amount of interest received by or accrued to a person during a year of assessment in respect of a debenture forming part of a linked unit held by that person in a company that is—

(i) a REIT or a controlled company that is a resident must be deemed to be a dividend received by or accrued to that person; or

(ii) a controlled company that is a foreign company must be deemed to be a foreign dividend received by or accrued to that person,

during that year of assessment.

(*b*) Any amount of interest received by or accrued to a company that is a REIT or a controlled company that is a resident during a year of assessment in respect of a debenture forming part of a linked unit held by that company in a property company must if the property company is a resident be deemed to be a dividend, or if the property company is a foreign company be deemed to be a foreign dividend, received by or accrued to that company during that year of assessment if that company is a REIT or a controlled company that is a resident at the time of that receipt or accrual.

(*c*) Any amount of interest paid in respect of a linked unit in a REIT or a controlled company must be deemed—

(i) to be a dividend paid by that REIT or that controlled company that is a resident for the purposes of the dividends tax contemplated in Part VIII of this Chapter; and

(ii) not to be an amount of interest paid by that REIT or that controlled company for the purposes of the withholding tax on interest contemplated in Part IVB of this Chapter.

(7) If during any year of assessment a company that is a REIT ceases to be a REIT and that company does not qualify as a controlled company or a company that is a controlled company ceases to be a controlled company and that company does not qualify as a REIT—

(*a*) that year of assessment of that REIT or controlled company is deemed to end on the day that the company ceases to be either a REIT or a controlled company; and

(*b*) the following year of assessment of that company is deemed to commence on the day immediately after that company ceased to be either a REIT or a controlled company.

(8) If a REIT or a controlled company cancels the debenture part of a linked unit and capitalises the issue price of the debenture to stated capital for the purposes of financial reporting in accordance with IFRS—

(*a*) the cancellation of the debenture must be disregarded in determining the taxable income of the holder of the debenture and of the REIT or controlled company;

(*b*) expenditure incurred by the holder of a share in the REIT or controlled company in respect of the shares is deemed to be equal to the amount of the expenditure incurred in respect of the acquisition of that linked unit; and (*c*) the issue price of the cancelled debenture must be added to the contributed tax capital of the class of shares that forms part of the linked unit.

Section 41(4)(*a*)(iii)

(4) A company must for the purposes of this Part, be deemed to have taken steps to liquidate, wind up or deregister, where—

(*a*) in the case of a liquidation or winding-up—

(iii) the manager, trustee or custodian of the portfolio of the collective investment scheme in property has in terms of section 102(1) or (2) of the Collective Investment Schemes Control Act applied for the winding up of that portfolio;

Section 42(1) – Definition of "asset-for-share transaction"

"asset-for-share transaction" means any transaction—

(*a*) (i) in terms of which a person disposes of an asset (other than an asset which constitutes a restraint of trade or personal goodwill), the market value of which is equal to or exceeds—

(*aa*) in the case of an asset held as a capital asset, the base cost of that asset on the date of that disposal; or

(*bb*) in the case of an asset held as trading stock, the amount taken into account in respect of that asset in terms of section 11(*a*) or 22(1) or (2),

to a company which is a resident, in exchange for the issue of an equity share in that company and that person—

(A) at the close of the day on which that asset is disposed of, holds a qualifying interest in that company; or

(B) is a natural person who will be engaged on a full-time basis in the business of that company, or a controlled group company in relation to that company, of rendering a service; and

(ii) as a result of which that company acquires that asset from that person—

(*aa*) as trading stock, where that person holds it as trading stock;

(*bb*) as a capital asset, where that person holds it as a capital asset; or

(*cc*) as trading stock, where that person holds it as a capital asset and that company and that person do not form part of the same group of companies:

Provided that this subparagraph does not apply in respect of any transaction which meets the requirements of subparagraph (i) in terms of which a person disposes of—

(i) an equity share in a listed company or in a portfolio of a collective investment scheme in securities or in a portfolio of a hedge fund collective investment scheme to any other company and after that disposal, together with any other transaction that is concluded—

(*aa*) on the same terms as that transaction; and

(*bb*) within a period of 90 days after that disposal,

that other company holds—

(A) at least 35 per cent of the equity shares of that listed company or portfolio; or

(B) at least 25 per cent of the equity shares of that listed company or portfolio if no person other than that other company holds an equal or greater amount of equity shares in the listed company or portfolio; or

(ii) an asset to a portfolio of a hedge fund collective investment scheme; or

(*b*) in terms of which a person that is a company disposes of an asset that constitutes an equity share held by that person in a foreign company as a capital asset, the market value of which is equal to or exceeds the base cost of that equity share on the date of that disposal, to another foreign company in exchange for the issue of an equity share in that other foreign company and—

(i) immediately before the asset is disposed of in terms of that transaction—

(*aa*) that person and the other foreign company form part of the same group of companies (as defined in section 1); and

(*bb*) the other foreign company is a controlled foreign company in relation to any company that is a resident and that forms part of that group of companies; and

(ii) at the close of the day on which the asset is disposed of in terms of that transaction—

(*aa*) more than 50 per cent of the equity shares in the foreign company are directly or indirectly held by a resident (whether alone or together with any company forming part of the same group of companies as that resident); or

(*bb*) at least 70 per cent of the equity shares in that other foreign company are directly or indirectly held by a resident (whether alone or together with any other company forming part of the same group of companies as that resident);

Section 43

43. Substitutive share-for-share transactions.—(1) For the purposes of this section—

"equity share" includes a linked unit;

"equity share interest" . . . . . .

"non-equity share" . . . . . .

"non-equity share interest" . . . . . .

"property linked unit" . . . . . .

"share interest" . . . . . .

"substitutive share-for-share transaction" means a transaction between a person and a company in terms of which that person disposes of an equity share in the form of a linked unit in that company and acquires an equity share other than a linked unit in that company.

(1A) Where a person disposes of an equity share in a company that constitutes a pre-valuation date asset and acquires another equity share in that company in terms of a substitutive share-for-share transaction, for the purposes of determining the date of acquisition of that equity share and the expenditure in respect of the cost of acquisition of that equity share, that person must be treated as having—

(*a*) disposed of that equity share at the time immediately before that substitutive share-for-share transaction, for an amount equal to the market value of that equity share at that time; and

(*b*) immediately reacquired that equity share at that time at an expenditure equal to that market value—

(i) less any capital gain, and

(ii) increased by any capital loss,

that would have been determined had that equity share been disposed of at market value at that time, which expenditure must be treated as an amount of expenditure actually incurred at that time for the purposes of paragraph 20(1)(*a*) of the Eighth Schedule.

(2) Subject to subsection (4), where a person disposes of an equity share in a company and acquires another equity share in that company in terms of a substitutive share-for-share transaction, that person must be deemed to have—

(*a*) disposed of that equity share so disposed of for an amount equal to the expenditure incurred by that person in respect of that equity share so disposed of which is or was allowable in terms of paragraph 20 of the Eighth Schedule or taken into account in terms of section 11(*a*) or 22(1) or (2), as the case may be;

(*b*) acquired that other equity share so acquired on the latest date on which that person acquired any share comprising the equity share so disposed of for a cost equal to the expenditure incurred by that person as contemplated in paragraph (*a*); and

(*c*) incurred the cost contemplated in paragraph (*b*) on the date contemplated in that paragraph, which cost must —

(i) if the equity share so acquired is acquired as a capital asset, be treated for the purposes of paragraph 20 of the Eighth Schedule as an expenditure actually incurred by that person in respect of the equity share so acquired; or

(ii) if the equity share so acquired is acquired as trading stock, be treated for the purposes of section 11(*a*) or 22(1) or (2) as the amount to be taken into account by that person in respect of the equity share so acquired.

(3) …..

(4) (*a*) This subsection applies where—

(i) a person disposes of an equity share in a company in terms of a substitutive share-for-share transaction; and

(ii) that person becomes entitled, in exchange for that equity share, to any consideration other than a dividend, foreign dividend or another equity share that is acquired by that person in terms of that substitutive share-for-share transaction.

(*b*) Where a person disposes of an equity share in terms of a substitutive share-for-share transaction and becomes entitled to consideration other than another equity share as contemplated in paragraph (*a*)(ii)—

(i) subsection (2) must not apply to the part of the equity share so disposed of that relates to that consideration; and

(ii) either—

(*aa*) where that equity share is so disposed of as a capital asset, the base cost at the time of that disposal of the part of the equity share contemplated in subparagraph (i) must be deemed to be equal to an amount which bears to the base cost of the equity share so disposed of the same ratio as the market value of that consideration bears to the sum of the market value of that consideration and the market value of the equity share acquired by that person in terms of that substitutive share-for-share transaction; or

(*bb*) where that interest is so disposed of as trading stock, the amount to be taken into account in terms of section 11(*a*) or 22(1) or (2) in respect of the part of the equity share contemplated in subparagraph (i) must be deemed to be equal to an amount which bears to the total amount taken into account in terms of section 11(*a*) or 22(1) or (2) in respect of the equity share so disposed of the same ratio as the market value of that consideration bears to the sum of the market value of that consideration and the market value of the equity share acquired by that person in terms of that substitutive share-for-share transaction.

(4A) If an equity share is issued in terms of a substitutive share-for-share transaction, the issue price of the linked unit disposed of in terms of that transaction is deemed to be contributed tax capital in respect of the class to which the equity share so acquired relates.

Section 44(1) – Definition of "amalgamation transaction"

"amalgamation transaction" means any transaction—

(*a*) (i) in terms of which any company (hereinafter referred to as the "amalgamated company") which is a resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up) to another company (hereinafter referred to as the "resultant company") which is a resident, by means of an amalgamation, conversion or merger; and

(ii) as a result of which the existence of that amalgamated company will be terminated;

(*b*) (i) in terms of which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding-up) to a resultant company which is a resident, by means of an amalgamation, conversion or merger;

(ii) if, immediately before that transaction, any shares in that amalgamated company are held as capital assets; and

(iii) as a result of which the existence of that amalgamated company will be terminated; or

(*c*) (i) in terms of which an amalgamated company which is a foreign company disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to its liquidation or winding-up) to a resultant company which is a foreign company, by means of an amalgamation, conversion or merger;

(ii) if—

(*aa*) immediately before that transaction—

(A) that amalgamated company and that resultant company form part of the same group of companies (as defined in section 1);

(B) that resultant company is a controlled foreign company in relation to any resident that is part of the group of companies contemplated in subitem (A); and

(C) any shares in that amalgamated company that are directly or indirectly held by that resultant company are held as capital assets; and

(*bb*) immediately after that transaction, more than 50 per cent of the equity shares in that resultant company are directly or indirectly held by a resident (whether alone or together with any other person that is a resident and that forms part of the same group of companies as that resident); and

(iii) as a result of which the existence of that amalgamated company will be terminated.

Proviso to section 44(4A)

Provided that where the amalgamated company is a portfolio of a collective investment scheme in property, the price at which the participatory interests were issued shall be added to the contributed tax capital in respect of the class of shares issued by the resultant company.

Section 45(1) – Definition of "intra-group transaction"

"intra-group transaction" means any transaction—

(*a*) (i) in terms of which any asset is disposed of by one company (hereinafter referred to as the "transferor company") to another company that is a resident (hereinafter referred to as the "transferee company") and both companies form part of the same group of companies as at the end of the day of that transaction; and

(ii) as a result of which that transferee company acquires that asset from that transferor company—

(*aa*) as a capital asset, where that transferor company holds it as a capital asset; or

(*bb*) as trading stock, where that transferor company holds it as trading stock; or

(*b*) (i) in terms of which any asset that constitutes an equity share held by a transferor company as a capital asset in a foreign company is disposed of by that transferor company to a transferee company in exchange for the issue of debt or shares other than equity shares by that transferee company;

(ii) as a result of which that transferee company acquires that asset from that transferor company as a capital asset; and

(iii) if, immediately before and as at the end of the day of that transaction—

(*aa*) that transferor company and that transferee company form part of the same group of companies (as defined in section 1);

(*bb*) that transferor company is a resident or is a controlled foreign company in relation to one or more residents that form part of that group of companies; and

(*cc*) that transferee company is a resident or is a controlled foreign company in relation to one or more residents that form part of that group of companies.

Section 46(1) – Definition of "unbundling transaction"

46. Unbundling transactions.—(1) For the purposes of this section, **"unbundling transaction"** means any transaction—

(*a*) (i) in terms of which the equity shares in a company (hereinafter referred to as the "unbundled company"), which is a resident that are held by a company (hereinafter referred to as the "unbundling company"), which is a resident, are all distributed by that unbundling company to any shareholder of that unbundling company in accordance with the effective interest of the shareholders in the shares of that unbundling company, and if—

(*aa*) all of the equity shares of the unbundled company are listed shares or will become listed shares within 12 months after that distribution;

(*bb*) that shareholder to which that distribution is made by that unbundling company forms part of the same group of companies as that unbundling company; or

(*cc*) that distribution is made pursuant to an order in terms of the Competition Act, 1998 (Act No. 89 of 1998), made by the Competition Tribunal or the Competition Appeal Court; and

(ii) if the equity shares distributed as contemplated in subparagraph (i) constitute—

(*aa*) where that unbundled company is a listed company immediately before that distribution—

(A) and no shareholder of the unbundled company other than the unbundling company holds the same number of equity shares as or more equity shares than the unbundling company of that unbundled company, more than 25 per cent of the equity shares of the unbundled company; or

(B) and any shareholder of the unbundled company other than the unbundling company holds the same number of equity shares as or more equity shares than the unbundling company of that unbundled company, at least 35 per cent of the equity shares of that unbundled company; or

(*bb*) where that unbundled company is an unlisted company immediately before that distribution, more than 50 per cent of the equity shares of that unbundled company; or

(*b*) (i) in terms of which all the equity shares in an unbundled company which is a foreign company that are held by an unbundling company which is a resident or a controlled foreign company are all distributed by that unbundling company to any shareholder of that unbundling company in accordance with the effective interest of that shareholder in the shares of that unbundling company—

(*aa*) if that shareholder is a resident and that shareholder forms part of the same group of companies (as defined in section 1); or

(*bb*) if that shareholder is not a resident and that shareholder is a controlled foreign company in relation to any resident that forms part of the same group of companies (as defined in section 1),

as that unbundling company;

(ii) if, immediately before the distribution of the equity shares of an unbundled company by an unbundling company to any shareholder of that unbundling company as contemplated in subparagraph (i)—

(*aa*) the unbundling company holds more than 50 per cent of the equity shares of the unbundled company; and

(*bb*) each of those equity shares of that unbundled company are held by the unbundling company as a capital asset.

(*cc*) . . . . . .

(iii) . . . . . .

Section 46(2), (5) and (6A)

(2) Where an unbundling company distributes shares in terms of an unbundling transaction, that unbundling company must disregard that distribution for purposes of determining its taxable income or assessed loss, or its net income as contemplated in section 9D.

(5) Where shares are distributed by an unbundling company to a shareholder in terms of an unbundling transaction, the distribution by that unbundling company of the shares must be disregarded in determining any liability for dividends tax.

(6A) This section does not apply in respect of an unbundling transaction where the unbundling company is a REIT or a controlled company as defined in section 25BB(1).

Section 47(1) – Definition of "liquidation distribution"

(1) For the purposes of this section **"liquidation distribution"** means any transaction—

(*a*) in terms of which any company (hereinafter referred to as the “liquidating company”) which is a resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company and other than assets required to satisfy any reasonably anticipated liabilities to any sphere of government of any country and costs of administration relating to the liquidation or winding up, but only to the extent to which those assets are so disposed of to another company (hereinafter referred to as the “holding company”) which is a resident and which on the date of that disposal forms part of the same group of companies as the liquidating company; or

(*b*) in terms of which a liquidating company which is a controlled foreign company in relation to any resident disposes of all of its assets (other than assets it elects to use to settle any debts incurred by it in the ordinary course of its trade) to its shareholders in anticipation of or in the course of the liquidation, winding up or deregistration of that company—

(i) to the extent that those assets are so disposed of to a holding company which—

(*aa*) is a resident and which forms part of the same group of companies (as defined in section 1) as the liquidating company immediately before that distribution; or

(*bb*) is a controlled foreign company in relation to any resident;

(ii) if, immediately before that transaction, each of the shares held by the holding company in the liquidating company is held as a capital asset; and

(iii) if, immediately after that transaction, where that holding company is a controlled foreign company as contemplated in subparagraph (i)(*bb*), more than 50 per cent of the equity shares in the holding company are directly or indirectly held by a resident (whether alone or together with any other resident that forms part of the same group of companies as that resident).

Section 64F(1)(*a*) and (l) and (2)

64F. Exemption from tax in respect of dividends other than dividends *in specie*.—(1) Any dividend is exempt from the dividends tax to the extent that it does not consist of a dividend *in specie* if the beneficial owner is—

(*a*) a company which is a resident;

(*b*) to (*k*)…..

(*l*) any person to the extent that the dividend constitutes income of that person; or

(2) Any dividend paid by a REIT or a controlled company, as defined in section 25BB, and received or accrued before 1 January 2014 is exempt from the dividends tax to the extent that the dividend does not consist of a dividend *in specie*.

Section 64FA(1)(*a*)

64FA. Exemption from and reduction of tax in respect of dividends *in specie*.—(1) Where a company declares and pays a dividend that consists of a distribution of an asset *in specie*, that dividend is exempt from the dividends tax to the extent that it constitutes a distribution of an asset *in specie* if—

(*a*) the person to whom the payment is made has, by the date of payment of the dividend, submitted to the company—

(i) a declaration by the beneficial owner in such form as may be prescribed by the Commissioner that the portion of the dividend that constitutes a distribution of an asset *in specie* would, if that portion had not constituted a distribution of an asset *in specie*, have been exempt from the dividends tax in terms of section 64F; and

(ii) a written undertaking in such form as may be prescribed by the Commissioner to forthwith inform the company in writing should the circumstances affecting the exemption applicable to the beneficial owner referred to in subparagraph (i) change or the beneficial owner cease to be a beneficial owner;

Paragraph 20(3)(*a*) of the Eighth Schedule

(3) The expenditure contemplated in subparagraph (1)(*a*) to (*g*), incurred by a person in respect of an asset must be reduced by any amount which—

(*a*) (i) is or was allowable or is deemed to have been allowed as a deduction in determining the taxable income of that person; and

(ii) is not included in the taxable income of that person in terms of section 9C(5),

before the inclusion of any taxable capital gain; or

Securities Transfer Tax Act 25 of 2007

Section 2(1)

2. Imposition of tax.—(1) There must be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the securities transfer tax, in respect of—

(*a*) every transfer of any security issued by—

(i) a close corporation or company incorporated, established or formed inside the Republic; or

(ii) a company incorporated, established or formed outside the Republic and listed on an exchange; and

(*b*) any reallocation of securities from a member's bank restricted stock account or a member's unrestricted and security restricted stock account to a member's general restricted stock account,

at the rate of 0,25 per cent of the taxable amount of that security determined in terms of this Act.

Section 8(1)(*t*)

8. Exemptions.—(1) The tax is not payable in respect of a transfer of a security—

(*t*) if that security constitutes a share in a REIT as defined in section 1 of the Income Tax Act;

Transfer Duty Act 40 of 1949

Section 2(1)

2. Imposition of transfer duty.—(1) Subject to the provisions of section 9, there shall be levied for the benefit of the National Revenue Fund a transfer duty (hereinafter referred to as the duty) on the value of any property (which value shall be determined in accordance with the provisions of sections 5, 6, 7 and 8) acquired by any person on or after the date of commencement of this Act by way of a transaction or in any other manner, or on the amount by which the value of any property is enhanced by the renunciation, on or after the said date, of an interest in or restriction upon the use or disposal of that property, at the rate of—

(*a*) . . . . . .

(*b*) subject to subsection (5)—

(i) 0 per cent of so much of the said value or the said amount, as the case may be, as does not exceed R750 000;

(ii) 3 per cent of so much of the said value or the said amount, as the case may be, as exceeds R750 000 but does not exceed R1,25 million;

(iii) 6 per cent of so much of the said value or the said amount, as the case may be, as exceeds R1, 25 million but does not exceed R1,75 million;

(iv) 8 per cent of so much of the said value or the said amount, as the case may be, as exceeds R1, 75 million but does not exceed R2,25 million;

(v) 11 per cent of so much of the said value or the said amount, as the case may be, as exceeds R2,25 million; and

(vi) 13 per cent of so much of the said value or the said amount, as the case may be, as exceeds R10 million.

Section 9(1)(*l*)

9. Exemptions from duty.—(1) No duty shall be payable in respect of the acquisition of property by—

(*l*) any company in terms of—

(i) an asset for- share transaction as defined in section 42 of the Income Tax Act, 1962 (Act No. 58 of 1962);

(iA) a substitutive share-for-share transaction as defined in section 43 of the Income Tax Act, 1962 (Act No. 58 of 1962);

(iB) an amalgamation transaction as defined in section 44 of the Income Tax Act, 1962 (Act No. 58 of 1962);

(ii) an intra-group transaction as defined in section 45 of the Income Tax Act, 1962 (Act No. 58 of 1962);

(iii) a liquidation distribution as defined in section 47 of the Income Tax Act, 1962 (Act No. 58 of 1962); or

(iv) a transaction which would have constituted a transaction or distribution contemplated in subparagraphs (i) to (iii) regardless of whether that person acquired that property as a capital asset or as trading stock,

where the public officer of that company has made a sworn affidavit or solemn declaration that such acquisition of property complies with the provisions of this paragraph;

VAT Act

Section 7(1)(*a*)

7. Imposition of value-added tax.—(1) Subject to the exemptions, exceptions, deductions and adjustments provided for in this Act, there shall be levied and paid for the benefit of the National Revenue Fund a tax, to be known as the value-added tax—

(*a*) on the supply by any vendor of goods or services supplied by him on or after the commencement date in the course or furtherance of any enterprise carried on by him;

Section 12(*a*)

12. Exempt supplies.—The supply of any of the following goods or services shall be exempt from the tax imposed under section 7(1)(*a*):

(*a*) The supply of any financial services, but excluding the supply of financial services which, but for this paragraph, would be charged with tax at the rate of zero per cent under section 11;

Section 17(1)

17. Permissible deductions in respect of input tax.—(1) Where goods or services are acquired or imported by a vendor partly for consumption, use or supply (hereinafter referred to as the intended use) in the course of making taxable supplies and partly for another intended use, the extent to which any tax which has become payable in respect of the supply to the vendor or the importation by the vendor, as the case may be, of such goods or services or in respect of such goods under section 7(3) or any amount determined in accordance with paragraph (*b*) or (*c*) of the definition of "input tax" in section 1, is input tax, shall be an amount which bears to the full amount of such tax or amount, as the case may be, the same ratio (as determined by the Commissioner in accordance with a ruling as contemplated in Chapter 7 of the Tax Administration Act or section 41B) as the intended use of such goods or services in the course of making taxable supplies bears to the total intended use of such goods or services: Provided that—

(i) where the intended use of goods or services in the course of making taxable supplies is equal to not less than 95 per cent of the total intended use of such goods or services, the goods or services concerned may for the purposes of this Act be regarded as having been acquired wholly for the purpose of making taxable supplies;

(ii) where goods or services are deemed by section 9(3)(*b*) to be successively supplied, the extent to which the tax relating to any payment referred to in that section is input tax may be estimated where the calculation cannot be made accurately until the completion of the supply of the goods or services, and in such case such estimate shall be adjusted on completion of the supply, any amount of input tax which has been overestimated being accounted for as output tax in the tax period during which the completion occurs and any amount of input tax which has been underestimated being accounted for as input tax in that period; and

(iii) where a method for determining the ratio referred to in this subsection has been approved by the Commissioner, that method may only be changed with effect from a future tax period, or from such other date as the Commissioner may consider equitable and such other date must fall—

(*aa*) in the case of a vendor who is a taxpayer as defined in section 1 of the Income Tax Act, within the year of assessment as defined in that Act, or

(*bb*) in the case of a vendor who is not a taxpayer as defined in section 1 of the Income Tax Act, within the period of twelve months ending on the last day of February, or if such vendor draws up annual financial statements in respect of a year ending other than on the last day of February, within that year,

during which the application for the aforementioned method was made by the vendor.

Annexure B – Summary of the JSE Limited Listings Requirements as last updated on 23 May 2017

REIT status listing criteria for property entities other than CISIPs [paragraphs 13.46 to 13.54, 13.59 and 13.60]

An applicant issuer (that is, a new issuer) seeking to obtain REIT status from the JSE must satisfy the following criteria listed in paragraph 13.46:

- Under paragraph 13.46(a) the directors of the applicant must provide an undertaking and must ensure that the applicant issuer complies with the following distribution provisions set out in paragraph 13.47:
    - ➢ The company must distribute at least 75% of its total distributable profits as a distribution to the holders of its listed securities (which includes shares and linked units) by no later than four[83] months after its financial year end, subject to the solvency and liquidity test.[84]
    - ➢ Interim distributions may occur before the end of a financial year end.
    - ➢ The company will procure that, subject to the solvency and liquidity test and section 46 of the Companies Act, those of its subsidiaries that are property entities incorporated in South Africa will distribute at least 75% of their total distributable profits as a distribution by no later than four[85] months after their financial year ends.
    - ➢ Distributable profits for a financial year is defined as gross income[86] less deductions and allowances that are permitted to be deducted by a REIT under the Act, other than a qualifying distribution.[87]
- It must have gross assets of at least R300 million as reflected in either its audited or reviewed consolidated financial statements or a *pro forma* consolidated statement of financial position compiled under paragraph 13.16, whichever reflects the more recent financial position [paragraph 13.46(b)].
- It must be a property entity [paragraph 13.46(c)].[88]
- At least 75% of the revenue as reflected in the statement of comprehensive income of the applicant issuer's group must be derived from rental revenue. The term "rental revenue"[89] means group revenue that is derived from the owning or leasing of immovable property which is let or sub-let to tenants plus dividends received from another REIT when the investment in that REIT is not consolidated in the group accounts [paragraph 13.46(d)].
- It must qualify for a listing on the Main Board under paragraph 4.2.8 [excluding paragraph 4.28(d)(ii)] or on ALT[X] under paragraph 21.3 [excluding paragraph 21.3(j)(ii)], read together with paragraph 13.3 [paragraph 13.46(e)].
- The directors must each confirm that the applicant issuer will to the best of their knowledge and after making all reasonable enquiries to ascertain such facts, qualify

83 Changed from six to four months with effect from 24 October 2016.
84 As defined and applied in section 46 of the Companies Act.
85 Changed from six to four months with effect from 24 October 2016.
86 As defined in section 1(1).
87 As defined in section 25BB(1).
88 As defined in paragraph 13.1(t).
89 As defined in paragraph 13.1(z).

for a tax deduction of distributions under section 25BB(2) for the current or future financial year end [paragraph 13.46(f)].

- The directors of the applicant must provide an undertaking to the JSE that its consolidated liabilities will not exceed 60% of its gross asset value or consolidated assets, as the case may be, at a specific date [paragraph 13.46(g)].
- It must ensure that the audit committee or a separate risk committee of the board is responsible for adopting and implementing an appropriate risk management policy in accordance with industry practice and meet stipulated reporting requirements [paragraph 13.46(h)].

An *existing issuer*, other than a CISIP, wishing to make application to obtain REIT status must –

- comply with the provisions of paragraph 13.46 (see above);
- not have failed the REIT tax test[90] for the last two consecutive financial years; and
- not have been in breach of the distribution provisions, set out in paragraph 13.47, in the last 24 months provided that it was classified as a REIT during that period.[91]

An applicant issuer, other than a CISIP, must on an on-going basis meet the following criteria listed in paragraph 13.49 in order to retain REIT status:

- It must comply with the distribution requirements in paragraph 13.47.
- It must qualify for a tax deduction of an amount equal to its distributions under section 25BB(2) for the immediately preceding financial year end *or* must not have failed the REIT tax test[92] for the last two consecutive financial year ends.
- The directors of the REIT must ensure that the total consolidated liabilities of the issuer will not be more than 60% of the total consolidated assets, or that they complied with their undertaking mandated in paragraph 13.46(g)(i).
- The directors of the REIT must submit the compliance declaration contemplated in paragraph 13.49(d) to the JSE within four[93] months of the issuer's financial year end.

Paragraph 13.51 stipulates that in every announcement issued by a REIT it must make reference to the fact that it has a REIT status with the JSE. Announcements that deal with distributions must specify –

- that the distribution is regarded as –
    - ➢ a taxable dividend for income tax purposes for residents (see **5.4.1** for the income tax implications of dividends paid by a REIT); and
    - ➢ a taxable dividend for dividends tax purposes from 1 January 2014 for persons who are not residents (distributions made before that date to

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90 The term "failed the REIT tax test" is defined in paragraph 13.1(i) and means that the applicant issuer was granted REIT status by the JSE, but on assessment by SARS, did not qualify for a deduction under section 25BB(2).

91 Paragraph 13.48.

92 The term "failed the REIT tax test" is defined in paragraph 13.1(i) and means that the applicant issuer was granted REIT status by the JSE, but on assessment by SARS, did not qualify for a deduction under section 25BB(2).

93 Changed from six to four months with effect from 24 October 2016.

persons who are not residents are exempt from dividends tax) (see **5.8** for the dividends tax implications of dividends paid by a REIT); and

- the financial period to which the distribution relates.

Under paragraph 13.52 an issuer with REIT status must keep the market informed regarding its tax status. In this regard the issuer must release an announcement containing full details of the implications for the issuer and its security holders, if it –

- fails the REIT tax test or believes that it will not qualify for a tax deduction of distributions under section 25BB(2);
- has breached the distribution provisions in paragraph 13.47; or
- has breached the gearing provisions of paragraph 13.49(c).

Paragraph 13.53(a) stipulates that the JSE will withdraw the REIT status of an applicant issuer if the applicant issuer fails to comply with the requirements of paragraph 13.49 (after taking paragraph 13.50 into account) at any time.

Paragraph 13.54 provides that an issuer who has received REIT status may at any time make application to the JSE to have this status removed.

Any applicant issuer that applies to receive REIT status must make application for a primary listing on the JSE.[94]

Certain transitional provisions under paragraph 13.60 applied to property entities, other than CISIPs. Provided the relevant property entity met the following requirements, it would have received REIT status from the commencement of its first financial year commencing on or after 1 April 2013, even though it did not necessarily meet all the criteria set out in paragraph 13.46.[95] The requirements may be summarised as follows:

- The property entity must have been listed on the Main Board of the JSE in the financials-real estate sector before 30 November 2012.
- The listed securities of the property entity must have comprised of an ordinary share linked to a debenture and traded as a linked or combined unit at that time.
- The property entity must have applied on or before 1 July 2013 to receive a REIT status under these transitional provisions.
- The application letter must have complied with the requirements set out in paragraph 13.60(c).

REIT status listing criteria for CISIPs [paragraphs 13.55 to 13.59 and 13.61]

A CISIP is regulated by the Collective Investment Schemes Control Act, notices issued under that Act, a deed and supplemental deeds approved by the Registrar of Collective Investment Schemes and must comply with the Listings Requirements.[96]

94 Paragraph 13.59.
95 Paragraph 13.60(d) and (e).
96 Paragraph 13.32.

Paragraph 13.55 stipulates that to receive REIT status a CISIP must apply to the JSE and comply with the following requirements:

- The CISIP must provide evidence that it complies with the following requirements in paragraphs 13.46(b) to (*e*) and (h):
    - It must have gross assets of at least R300 million as reflected in either its audited or reviewed consolidated financial statements or a *pro forma* consolidated statement of financial position compiled under paragraph 13.16, whichever reflects the more recent financial position [paragraph 13.46(b)].
    - It must be a property entity [paragraph 13.46(c)].[97]
    - At least 75% of the revenue as reflected in the statement of comprehensive income of the applicant issuer's group must be derived from rental revenue. The term "rental revenue"[98] means group revenue that is derived from the owning or leasing of immovable property which is let or sub-let to tenants plus dividends received from another REIT when the investment in that REIT is not consolidated in the group accounts [paragraph 13.46(d)].
    - It must qualify for a listing on the Main Board under paragraph 4.2.8 [excluding paragraph 4.28(d)(iii)] or on ALT^{X} under paragraph 21.3 [excluding paragraph 21.3(j)(ii)], read together with paragraph 13.3 [paragraph 13.46(e)].
    - It must ensure the responsibilities of an audit committee or a separate risk committee of the board met the requirements stipulated in paragraph 13.46(h).
- The CISIP must provide evidence of registration as a CISIP from the registrar of collective investment schemes.[99]
- The CISIP must confirm that the CISIP deed has been approved by the registrar of collective investment schemes.[100]

A CISIP with REIT status must on an on-going basis comply with the following requirements set out in paragraphs 13.56 to 13.58:

- A CISIP must submit a compliance declaration referred to in paragraph 13.56 to the JSE within four[101] months of the issuer's financial year end.
- In every announcement issued by a CISIP with a REIT status, it must make reference to the fact that it has a REIT status with the JSE. Announcements that deal with distributions must specify –
    - that the distribution is regarded as –
        - a taxable dividend for income tax purposes for residents (see **5.4.1** for the income tax implications of dividends paid by a REIT); and
        - a taxable dividend for dividends tax purposes from 1 January 2014 for persons who are not residents (distributions made before that date to

[97] As defined in paragraph 13.1(t).

[98] As defined in paragraph 13.1(z).

[99] Paragraph 13.55(b).

[100] Paragraph 13.55(c).

[101] Changed from six to four months with effect from 24 October 2016.

persons who are not residents are exempt from dividends tax) (see **5.8** for the dividends tax implications of dividends paid by a REIT); and

- ➢ the financial period to which the distribution relates.[102]

- An issuer that is a CISIP with a REIT status must keep the market informed regarding its REIT status. In this regard the issuer must release an announcement containing full details of the implications for the issuer and its holders of securities, if it –
  - ➢ fails the REIT tax test[103] or believes that it will not qualify for a tax deduction of distributions under section 25BB(2);
  - ➢ has breached the provisions of its deed; or
  - ➢ has breached the provisions of the Collective Investment Schemes Control Act (see **4.9** for the income tax implications if a company ceases to be a REIT).[104]

An applicant issuer that applies to receive REIT status must make application for a primary listing on the JSE.[105]

Transitional provisions applied under paragraph 13.61 to CISIPs seeking to obtain REIT status. In short, the relevant CISIPs were required to –

- be listed on the JSE before 30 November 2012;
- have applied on or before 1 July 2013 to receive a REIT status under these transitional provisions; and
- ensure that the application letter complied with the requirements set out in paragraph 13.61(c).

An applicant issuer that made application to the JSE and met the transitional Listings Requirements received REIT status from the commencement of its first financial year commencing on or after 1 April 2013, even though it did not necessarily meet all the criteria set out in paragraph 13.55.[106]

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102 Paragraph 13.57.

103 The term “failed the REIT tax test” is defined in paragraph 13.1(i) and means that the applicant issuer was granted REIT status by the JSE, but on assessment by SARS did not qualify for a deduction under section 25BB(2).

104 Paragraph 13.58.

105 Paragraph 13.59.

106 Paragraph 13.61(d) and (e).