UNIVERSITY OF KWAZULU-NATAL

THE TAX EFFECTS ON SOUTH AFRICAN TAXPAYERS INVOLVED IN FOREIGN EXCHANGE TRANSACTIONS

By
Jeanine Montocchio
901331650

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School of Accounting
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Supervisor: Professor L Mitchell

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SUPERVISOR'S PERMISSION TO SUBMIT FOR EXAMINATION

Date: 6 October 2010

Student Name: Jeanine Montocchio

Student Number: 901331650

Dissertation Title: The Tax Effects on South African Taxpayers involved in Foreign Exchange Transactions

As the candidate's supervisor I agree to the submission of this dissertation for examination.

The above student has satisfied the requirements of English language competency.

Name of Supervisor: Professor L Mitchell

Signature: ……………………………….

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ABSTRACT

A South African taxpayer's taxable income must be determined in rands. Several provisions of the Income Tax Act (the Act) relate to foreign currency transactions and the interaction of these provisions is complicated. A taxpayer needs to determine the provision that applies to his foreign transaction. It will then provide the rule or method that needs to be applied to his foreign transaction. If an amount is in a foreign currency, it must be translated into rands. If there is an exchange item, a foreign exchange gain or foreign exchange loss must be taken into account. If an asset is disposed of or acquired in a foreign currency then a capital gain or capital loss must be calculated when it is disposed of. Examples of typical foreign exchange transactions have been provided, discussed and analysed in this dissertation. The provisions in the Act that are relevant to the foreign exchange transactions have been identified and the interaction between them has been considered. Potential difficulties because provisions in the legislation contradict each other or do not cater for a particular situation were identified. Also possible tax-saving opportunities have been identified.

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CHAPTER 1
INTRODUCTION

Background

In South Africa an income tax, referred to as normal tax, is paid annually for the benefit of the National Revenue Fund.[1] This tax is determined by subjecting the taxable income received by or accrued to or in favour of a person or company to prescribed rates of tax. Taxable income is calculated in terms of a model that is commonly referred to as the 'normal tax model'.

This model requires the determination of the gross income received by or accrued to or in favour of a taxpayer. Certain amounts are then exempt from normal tax. The amount remaining of the gross income after deducting exempt amounts is defined as 'income'.[2]

'Taxable income' is then determined by deducting general and specific deductions and allowances from 'income' and adding all amounts included or deemed to be included in taxable income in terms of the Income Tax Act (the Act).[3]

Examples of amounts that must be added to taxable income include

- the taxable portion of s 8(1) allowances, in other words, the remainder of the allowance after permitted deductions for expenses incurred or deemed to be incurred have been set off against it, and
- a taxable capital gain.[4]

If

- the gross income received by or accrued to or in favour of a taxpayer,
- the general or specific deductions and allowances, or
- amounts to be included or deemed to be included in taxable income,

are in a foreign currency or arose as the result of a foreign exchange transaction, then the calculation of taxable income is further complicated.

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[1] Section 5(1) of the Income Tax Act.
[2] In terms of the definition of 'income' in s 1.
[3] In terms of the definition of 'taxable income' in s 1.
[4] Section 26A.

When discussing foreign currency in his judgment in *Caltex Oil Ltd v SIR* Botha JA stated that because [5]

> 'sterling [was] not . . . legal tender in South Africa, that amount had to be reflected in [the] appellant's income tax return not in sterling but in the equivalent thereof, converted as at the end of the fiscal year, in the currency of South Africa'.

All foreign currency amounts must therefore be translated into the currency of the Republic, in other words, into rands, to determine a taxpayer's taxable income.

Overall objective

The overall objective of this dissertation is a review of the tax legislation and relevant case law on the effect of a foreign exchange transaction on a South African taxpayer in the determination of his gross income, exempt income, allowances and deductions and capital gains or losses.

Specific aims and objectives

The aims of this dissertation are to

- provide examples of typical foreign exchange transactions,
- identify the provisions in the Act that are appropriate to each type of transaction,
- provide a review of the different provisions in the Act dealing with foreign exchange transactions,
- identify the interaction between the applicable provisions and highlight inconsistencies,
- discuss the practicality of the application of the legislation as it currently stands,
- summarise the discussion, and
- make recommendations, conclusions or predictions based on the discussion.

Brief overview of major changes to the legislation in recent years

In 2001 South Africa changed its basis of taxation from a source basis to a residence (or world-wide) basis. This resulted in the introduction, amongst other provisions, of s 25D into the Act. It also resulted in major changes being made to s 24I, the provision used for

[5] 1975 (1) SA 655 (A), 37 SATC 1 at 13.

determination taxable gains or losses on certain foreign exchange transactions.

Several other provisions of the Act relating to foreign currency transactions have also been introduced. These provisions give the rules for converting a foreign currency amount into rands for the purpose of calculating the taxable income of a resident. For example,

- s 6*quat* (rebate or deduction for foreign taxes on income),
- s 9D (the net income of a CFC),
- s 9G (taxable income of a foreign equity instrument),
- s 35A (withholding of an amount from the payment to a non-resident seller of 'local' immovable property),
- s 47J (tax on a foreign entertainer and sportsperson),
- para 43 of the Eighth Schedule (an asset disposed of or acquired in a foreign currency), and
- paras 84 to 96 of the Eighth Schedule (a foreign currency capital gain or loss).

Another provision that deals with foreign funds is s 9A. It deals with foreign funds that may not be remitted to the Republic from a foreign country as a result of currency or other restrictions or limitations imposed in terms of the laws of that country.

The interaction of these provisions is complicated. A taxpayer needs to determine the provision that applies to his foreign transaction. It will then provide the rule or method that needs to be applied to his foreign currency transaction.

CHAPTER 2
BRIEF OVERVIEW OF THE RELEVANT PROVISIONS OF THE INCOME TAX ACT

Section 24I

Section 24I deals with gains or losses on foreign exchange transactions. In determining the taxable income of a person this provision requires

- an inclusion in, or
- deduction from,

his income of the gain or loss on a foreign exchange transaction. The taxable gain or deductible loss is included in, or deducted from his income irrespective of whether it is realised or capital in nature.

This provision is, however, limited to a foreign currency gain or loss arising from an 'exchange item' as defined. An 'exchange item' is defined in s 24I(1). It is an amount in a foreign currency that is

- a unit of currency,
- an amount owing by or to a taxpayer for a loan, advance or debt,
- a forward exchange contract, or
- a foreign currency option contract.

For a natural person the provisions of s 24I apply only if

- a unit of currency,
- or a loan, advance or debt,

is held as trading stock (s 24I(2)(*c*)). This provision requires that a natural person must hold *any* unit of currency or a loan, advance or debt as trading stock. Should the taxpayer hold an exchange item as trading stock, the provisions of s 24I will then apply to *all* his exchange items.

Section 24I applies to a forward exchange contract or a foreign currency option contract irrespective of whether it is held as trading stock (s 24I(2)(*d*)). In other words, there is no

distinction made between a forward exchange contract or a foreign currency option contract that is held as trading stock and that which is not.

Section 25D

Section 25D is another important provision that applies to a foreign currency transaction. From s 25D the following currency conversion rules apply:

- The general rule is that the foreign currency receipt or accrual or expenditure or loss must be translated to rands by applying the *spot rate* on the date the amount was received or accrued or the expenditure or loss was so incurred (s 25D(1)).
- For a permanent establishment outside the Republic, income and expenditure must be translated to rands by applying the *average exchange rate* for the relevant year of assessment (s 25D(2)).
- A natural person and a non-trading trust may elect to translate a foreign currency receipt or accrual or expenditure or loss by applying the *average exchange rate* for the relevant year of assessment (s 25D(3)) or use the so-called general rule by applying the *spot rate* (see above).

It should be noted that the terms 'spot rate' and 'average exchange rate' are both defined in s 1.

'Spot rate' means the appropriate quoted exchange rate at a specific time by an authorised dealer in foreign exchange for the delivery of currency.

'Average exchange rate' in relation to a year of assessment means the average determined by the use of the closing spot rates at the end of daily or monthly intervals during a year of assessment. This rate must be consistently applied within that year of assessment.

An exchange rate is the price of one currency (for example, rands) in another currency (for example, the Australian dollar).

Section 1 defines a 'permanent establishment' as a permanent establishment as defined in article 5 of the Model Tax Convention on Income and on Capital of the Organisation for Economic Co-operation and Development (the OECD Model Treaty).

A 'permanent establishment' is defined in the OECD Model Treaty in art 5(1) as

> 'a fixed place of business through which the business of an enterprise is wholly or partly carried on'.

A permanent establishment includes a number of specific entities. These specific entities are listed in art 5(2). They are as follows:

- A place of management.
- A branch.
- An office.
- A factory.
- A workshop.
- A mine, an oil or gas well, and a quarry or place of extraction of natural resources.

In terms of art 5(3), a building site or construction or installation project will also be a permanent establishment, but only if it lasts for more than twelve months.

Certain 'exclusions' from the definition of a 'permanent establishment' are set out in art 5(4). Excluded from the definition of a 'permanent establishment' are the following:

- The use of facilities solely for storage, display or delivery of goods belonging to the enterprise.
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery.
- The maintenance of a stock of goods of the enterprise solely for the purposes of processing by another person.
- The maintenance of a fixed place of business solely for the purpose of making purchases or gathering information for the enterprise.
- The maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary nature.
- The maintenance of a fixed place of business solely for the purpose of carrying on any combination of the activities referred to above, provided that these activities are of a preparatory or auxiliary nature.

It is possible to conduct business in a state without establishing either a branch or an office in that state. This situation is covered in art 5(5). It provides that, notwithstanding the definition of a 'permanent establishment' and its so-called specific inclusions, when an enterprise of one state carries on business in the other state through an agent, other than an agent of an

independent status acting in the ordinary course of his business, who has, and habitually exercises, in that other state a power to contract on behalf of his principal, it is deemed to have a permanent establishment in that other state.

Article 5(6) provides that an enterprise is not deemed to have a permanent establishment in a contracting state merely because it carries on business in that state through a broker, general commission agent or another agent of an independent status, provided that he is acting in the ordinary course of his 'own' business.

Article 5(7) provides that if an enterprise of one state is a company that controls, or is controlled by, another company that is a resident of, or carries on business in, the other state, neither company will constitute a permanent establishment of the other.

Section 25D contains the general currency conversions provisions that apply to all situations unless a specific provision contains its own currency conversion rules.

Examples of specific provisions that contain their own currency conversion rules are as follows:

- Section 6*quat* (rebate or deduction for foreign taxes on income).
- Section 9D (net income of a CFC).
- Section 9G (taxable income of a foreign equity instrument).
- Section 24I (gains or losses on a foreign exchange transaction) (see above).
- Section 35A (withholding of an amount from the payment to a non-resident seller of 'local' immovable property).
- Section 47J (tax on a foreign entertainer and sportsperson).
- Paragraph 43 of the Eighth Schedule (an asset disposed of or acquired in a foreign currency).
- Paragraphs 84 to 96 of the Eighth Schedule (a foreign currency capital gain or loss).

Section 9A deals with foreign funds that may not be remitted to the Republic from a foreign country as a result of currency or other restrictions or limitations imposed in terms of the laws of that country.

Section 6*quat*

It is the before-tax amounts of foreign receipts and accruals that are included in the Republic gross income of a resident. With the exception of a foreign withholding tax paid on certain South African sourced amounts (for example, management or accounting fees), taxes paid to foreign countries, including various withholding taxes, are not deductible in the determination of taxable income. Although their deduction is not prohibited in terms of s 23(*d*), it would seem that they will fail to pass the general deduction formula, being the only provision in terms of which their deduction could be considered.

To give relief to the resident who has been taxed twice on the same receipt or accrual, a deduction or credit is given against his Republic normal tax liability in the form of a rebate. It is s 6*quat* that provides both the deduction and the credit relief.

Section 6*quat*(4) provides that the amount of foreign tax proved to be payable as contemplated in s 6*quat*(1A) or (1C) for an amount that is included in the taxable income of a resident during a year of assessment, must be converted to the currency of the Republic on the last day of that year of assessment by applying the average exchange rate for that year of assessment.

Section 6*quat*(4A) provides that if the amount translated in accordance with the s 6*quat*(4) includes cents that are less than a rand, the amount must be rounded off to the nearest rand.

Section 9A

Section 9A deals with blocked foreign funds. Blocked foreign funds arise when an amount or a portion of an amount, received by or accrued to a person is required to be included in income during a year of assessment but may not be remitted to the Republic during that year as a result of currency or other restrictions or limitations imposed in terms of the laws of the country where the amount arose.[6]

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[6] Section 9A(1).

This amount or portion of the amount is included in the person's gross income but it is then deducted from the taxpayer's income. The deducted amount is then deemed to be an amount received by or accrued to the taxpayer in the following year of assessment.[7]

In the absence of a special provision regarding the rate the blocked foreign funds must be translated to rands, it follows that the general currency conversions provisions in s 25D will apply (see above).

Section 9D

Section 9D deals with the net income of a CFC. A CFC means a foreign company when more than 50% of its

- total participation rights are held, or
- voting rights are directly or indirectly exercisable,

by one or more residents.[8]

A proportional amount of the net income of a CFC must be included in a resident's income for the relevant year of assessment. The resident must hold a participation right in a CFC

- on the last day of its foreign tax year, or
- immediately before it ceased to be a CFC if during that year of assessment it ceased to be a CFC before the last day of its foreign tax year.

'Net income' is also a defined term.[9] It is determined in the currency used by the CFC for purposes of financial reporting. It is then translated into rands by applying the average exchange rate for that year of assessment.[10]

But, there are four provisos:

- For the disposal of an asset contemplated in para 43(4) of the Eighth Schedule that is not attributable to a permanent establishment of the CFC outside the Republic, its capital gain or capital loss must, in the application of para 43(4) of the Eighth Schedule, be determined in the currency of the Republic and then translated to the currency used by it for purposes of financial reporting by using the average exchange rate (proviso (*a*)).

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[7] Sections 9A(1) and (2).
[8] In terms of the definition of a 'controlled foreign company' in s 9D(1).
[9] Section 9D(2A).
[10] Section 9D(6).

- For the disposal of a foreign equity instrument constituting trading stock that is not attributable to a permanent establishment of the CFC outside the Republic, the amount to be taken into account in the determination of its net income must be determined in the currency of the Republic and translated to the currency so used by it by using the average exchange rate (proviso (*b*)).
- For the purposes of s 24I, 'local currency' in relation to an exchange item of a CFC that is not attributable to a permanent establishment outside the Republic means the currency of the Republic and an exchange difference determined must be translated to the currency so used by it by using the average exchange rate (proviso (*c*)).
- An asset or foreign equity instrument that is disposed of and an exchange item denominated in a currency other than the currency used by that CFC for purposes of financial reporting is deemed not to be attributable to a permanent establishment of the CFC if the currency used for financial reporting purposes is the currency of a country that has an official rate of inflation of 100% or more throughout that foreign tax year, for example, Zimbabwe (proviso (*d*)).

Section 9G

Section 9G deals with the taxable income resulting from a foreign equity instrument. A foreign equity instrument includes[11]

- a share or depository receipt for a share listed on a foreign stock exchange,
- a participatory interest in a foreign collective investment scheme in securities (a so-called foreign equity unit trust),
- another contractual right or obligation that derives its value from a specified index outside the Republic,
- a coin made mainly from gold or platinum (for example, a krugerrand), or
- an option, future or contract relating to the above.

Section 9G applies only to a foreign equity instrument that is held as trading stock. It also applies only to the disposal of a foreign equity instrument acquired during a year of assessment ending before 8 November 2005.

[11] In terms of the definition of 'foreign equity instrument' in s 1.

When the provisions of s 9G apply then the amount to be included in the gross income of the taxpayer on the disposal of the instrument is the foreign currency amount translated into rands at the average exchange rate for the year of assessment when it is disposed of (s 9G(2)).

The expenditure incurred that is deductible, or an amount that is taken into account, for the foreign equity instrument acquired during a year of assessment ending before 8 November 2005, is translated into rands at

- the ruling exchange rate on 1 October 2001, if the foreign equity instrument was acquired before this date (s 9G(3)(*a*)), or
- in any other situation, at the average exchange rate for the year of assessment when the expenditure was actually incurred by the taxpayer (s 9G(3)(*b*)).

The relevance of s 9G is limited since it applies only to a foreign equity instrument that was acquired as trading stock during a year of assessment ending before 8 November 2005.

The definition of 'trading stock' includes anything that is purchased by a taxpayer for the purpose of sale.[12] Trading stock by its very nature is likely to be an item that is held for a relatively short term. It follows that trading stock acquired during a year of assessment ending before 8 November 2005, is likely to have been sold by 2010. But the period that an asset is held is only one of many factors that need to be considered when determining if it was acquired as a capital investment or as trading stock.[13]

The absence of a special provision that would apply to a foreign equity instrument acquired as trading stock during a year of assessment ending *on or after* 8 November 2005, means that the general currency conversions provisions in s 25D would apply to it (see above).

Section 35A

Section 35A applies when a person (the purchaser) being a resident or non-resident purchases from a non-resident immovable property situated in the Republic.

The purchaser is required to withhold an amount from the amount that must be paid to the seller (the non-resident). This withheld amount is an advance of the non-resident seller's liability for normal tax.

[12] In terms of the definition of 'trading stock' in s 1.

[13] *Durban North Traders Ltd v CIR* 1956 (4) SA 594 (A), 21 SATC 85.

If the amount withheld is in a foreign currency, it must be translated into rands at the spot rate on the date that it is paid to the Commissioner.[14]

Section 47J

Section 47B provides for a final tax on an amount received by accrued to a foreign entertainer or sportsperson for a personal activity exercised in the Republic.

Section 47D requires a resident to deduct or withhold the tax from the amount that he is liable to pay a foreign entertainer or sportsperson for a specified activity.

If the amount deducted or withheld is in a foreign currency, it must be translated into rands at the spot rate on the date the amount was deducted or withheld in terms of s 47J.

Paragraph 43(4) of the Eighth Schedule

Paragraph 43(4) of the Eighth Schedule deals with a foreign equity instrument or an asset if a capital gain or capital loss on its disposal is derived or deemed to have been derived from a source in the Republic, as contemplated in s 9(2).[15]

The foreign equity instrument or asset must be acquired or disposed of in a foreign currency.

The provisions of para 43(4) do not apply to an 'exchange item' as defined. If it is an exchange item, then s 24I will apply to it (see above).

A foreign equity instrument does not meet the requirements of the definition of an 'exchange item'. This means that the provisions of s 24I do not apply to it.

If a foreign equity instrument is not held as trading stock, the provisions of para 43(4) are used to determine the capital gain or capital loss on its disposal.

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[14] Section 35A(5).

[15] Other than an amount owing to a person for a loan, advance or debt payable to him (para (*b*) of the definition of a 'foreign currency asset' in para 84 of the Eighth Schedule).

If it is held as trading stock, then para 43(4) applies but is likely to result in a 'nil' capital gain or capital loss as its proceeds are reduced by amounts included in gross income[16] and the base cost is reduced by amounts deductible in the determination of the taxpayer's taxable income.[17] These gross income inclusions and deductions will be determined by the provisions of s 9G or s 25 (see above).

Paragraphs 43(1) and (2) of the Eighth Schedule

Paragraph 43(1) applies, subject to para 43(4) (see above), when a person disposes of an asset for proceeds in a foreign currency and the expenditure incurred was in the same foreign currency. For example, he buys and sells the assets in pounds.

Paragraph 43(2) applies, subject to para 43(4) (see above), when a person disposes of an asset for proceeds in one currency and the expenditure incurred was in another currency. For example, when he buys the asset in pounds but sells it in dollars.

Paragraphs 84 to 96 of the Eighth Schedule

Paragraphs 84 to 96 in Part XIII of the Eighth Schedule deal with the disposal of a foreign currency asset and the settlement of a foreign currency liability. Part XIII applies to residents only if the provisions of s 24I do not apply (para 85).

A 'foreign currency' is a currency other than the currency of the Republic.[18]

A 'foreign currency asset' is a

- unit of foreign currency, or
- loan, advance or debt in a foreign currency owing to a person.[19]

A 'foreign currency liability' is a loan, advance or debt in a foreign currency.[20]

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[16] Paragraph 35(3)(*a*) of the Eighth Schedule.
[17] Paragraph 20(3)(*a*) of the Eighth Schedule.
[18] In terms of the definition of a 'foreign currency' as set out in para 84 of the Eighth Schedule.
[19] In terms of the definition of a 'foreign currency asset' as set out in para 84 of the Eighth Schedule.
[20] In terms of the definition of a 'foreign currency liability' as set out in para 84 of the Eighth Schedule.

CHAPTER 3
TYPICAL FOREIGN EXCHANGE TRANSACTIONS

Residents and non-residents and typical foreign exchange transactions

A taxpayer is effectively classified as a resident or a non-resident for gross income purposes:

- A resident includes his world-wide receipts and accruals in his gross income.
- A non-resident includes only his receipts and accruals from a source within or deemed to be within the Republic in his gross income.[21]

A resident means a natural person who is

- ordinarily resident in the Republic, or
- is not ordinarily resident in the Republic but is deemed to be a resident with effect from the first day of a year of assessment due to his physical presence in the Republic in the current and five preceding years of assessment (the so-called physical presence test).

The term 'ordinarily resident' is not defined in the Act. It is therefore necessary to look at case law to obtain the meaning of this term. As explained in Interpretation Note 3,[22] the courts have interpreted the concept of 'ordinarily resident' to mean the country to which a person would naturally and as a matter of course return from his wanderings. It might therefore be called a person's usual or principal residence and it would be described, in comparison to other countries, as his real home. This approach was followed in *Cohen v CIR*[23] and confirmed in *CIR v Kuttel*.[24]

The so-called physical presence test requires the natural person to be physically present in the Republic for a period or periods exceeding

- ninety-one days in aggregate during the year of assessment, and
- ninety-one days in aggregate during each of the five years of assessment preceding the current year of assessment, and
- 915 days in aggregate during those five preceding years of assessment.

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[21] From the definition of 'gross income' in s 1.
[22] Issued on 4 February 2002.
[23] 1946 AD 174, 13 SATC 362.
[24] 1992 (3) SA 242 (A), 54 SATC 298.

There are two provisos to this definition:

The first proviso states that a day includes a part of a day, but does not include the day that a person is in transit through the Republic between two places outside the Republic and he does not formally enter the Republic through a 'port of entry' or another place as may be permitted by the Director General of the Department of Home Affairs or the Minister of Home Affairs. Therefore, a person arriving or leaving the Republic must include his day of arrival or departure in the calculation of days, even if he was, for example, present for only an hour. But a person traveling from the United Kingdom to Zimbabwe whose aircraft stops in Johannesburg, will not include that day in his calculation of days present in the Republic provided he does not enter the Republic through a port of entry.

The second proviso states that when a resident is physically outside the Republic for a continuous period of at least 330 full days immediately after the day he ceases to be physically present in the Republic, he is then deemed not to have been a resident from the day he ceased to be physically present. For example, if a person departs from the Republic on 30 November 2008 and is physically outside the Republic from 1 December 2008 to 31 October 2009, in other words, a continuous period of 335 full days. This is more than the required minimum period of at least 330 full days. He is then deemed not to be a resident as from the commencement of the 330-day period, in other words, as from 1 December 2008.[25]

A resident also includes a person, other than a natural person, that

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

The term 'place of effective management' is not defined in the Act. Interpretation Note 6,[26] however, points out that the ordinary meaning of the words, taking into account international precedent and interpretation, will assist in ascribing a meaning to it.

A non-resident is a taxpayer who is not classified as a resident.

[25] Adapted from Interpretation Note 4 (issue 3) issued on 8 February 2006.
[26] Issued on 26 March 2002.

Typical foreign exchange transactions that a resident may be involved in include the

- purchase of trading stock,
- sale of trading stock,
- purchase and sale of a foreign equity instruments held as trading stock,
- investment in, and sale of, an offshore investment,
- receipt or accrual of income from an offshore investment,
- receipt or accrual of a royalty from outside the Republic,
- borrowing and repayment of money from offshore,
- payment or incurral of interest on money borrowed from offshore,
- earning amounts from abroad,
- purchasing of a capital asset in a foreign currency,
- selling of a capital asset in a foreign currency,
- operating of a branch offshore,
- distribution of amounts to a beneficiary of an offshore trust, and
- inheritance or donation of assets from outside the Republic.

Typical foreign exchange transactions that a non-resident may be involved include the

- purchase of trading stock from the Republic,
- sale of trading stock in the Republic,
- investment in, and sale of, a Republic investment,
- amounts earned from working in the Republic (excluding foreign entertainers and sportspersons),
- amounts earned for personal activities exercised by a foreign entertainer or sportsperson,
- acquisition of a capital asset in a foreign currency from the Republic,
- sale of a capital asset in the Republic,
- operating of a branch or agency in the Republic,
- distributions to a beneficiary of a resident trust,
- receipts or accrual of interest from a resident,
- receipts or accrual of a royalty from a resident.

Typical foreign exchange transactions of a resident

Typical foreign exchange transactions that a resident may be involved in and the relevant provisions in the Act that apply to these transactions follow below:

Purchase of trading stock

When trading stock, other than a foreign equity instrument held as trading stock acquired before 8 November 2005 (see further below), is purchased from abroad the relevant provisions are

- s 11(*a*) read with s 25D for its deduction,
- if it is purchased from a connected person then s 31(2) (transfer pricing) could apply to limit the amount of the s 11(*a*) deduction,
- s 22 read with s 25D for its closing and opening stock values, and
- s 24I for the calculation of the foreign exchange gain or loss on the recording, translation and settlement of its supplier (the creditor) and related forward exchange contracts.

Sale of trading stock

When trading stock, other than foreign equity instruments held as trading stock acquired before 8 November 2005 (see further below), is sold abroad the relevant provisions are

- the definition of 'gross income' read with s 25D for its gross income inclusion,
- if it is sold to a connected person, then s 31(2) (transfer pricing) could apply to increase its gross income inclusion,
- s 22 read with s 25D for its closing or opening stock values,
- s 24I for the calculation of the foreign exchange gain or loss on the recording, translation and settlement of its purchaser (the debtor) and related forward exchange contracts, and
- s 6*quat* if foreign taxes were paid on the resulting taxable income.

Purchase and sale of a foreign equity instrument held as trading stock

When the trading stock sold is a foreign equity instruments acquired during a year of assessment ending before 8 November 2005, the listed provisions above apply. Yet s 9G, and not s 25D, is used in the determination of the rand equivalent of the foreign currency amounts.

Investment in and sale of an off shore investment

When investing in a cash investment the relevant provisions are

- s 24I when the taxpayer holds *any* unit of currency or *any* loan, advance or debt owing by or to him as trading stock, or
- paras 84 to 96 of the Eighth Schedule when s 24I does not apply.

When investing in a foreign equity instrument the relevant provision is para 43(4) of the Eighth Schedule.

When investing in a foreign rent-producing property the relevant provisions are

- para 43(1) of the Eighth Schedule if the proceeds and the expenditure incurred were in the same currency and it was not rands, or
- para 43(2) of the Eighth Schedule if it was acquired in one foreign currency and disposed of in another foreign currency.

When investing in an asset that generates lease rentals the relevant provision is para 43(4) of the Eighth Schedule because the capital gain or capital loss on the disposal of this asset is deemed to be from a source in the Republic in terms of s 9(2)(*b*)(i).

Section 9(2)(*b*)(i) does, however, exclude an asset attributable to a permanent establishment of the resident that is situated outside of the Republic. So if the asset that generates lease rentals is attributable to a permanent establishment of the resident that is situated outside of the Republic, then

- s 9(2)(*b*)(i) does not deem the source of the capital gain or capital loss that arises on its disposal to be from the Republic,
- para 43(4) of the Eighth Schedule cannot apply, and

- para 43(1) or para 43(2) of the Eighth Schedule is used to determine the capital gain or capital loss that arises on its disposal to be taken into account in the determination of its aggregate capital gain or loss.

Receipt or accrual of income from an offshore investment

If the receipt or accrual is foreign interest, the relevant provisions are

- the definition of 'gross income' or s 24J (incurral and accrual of interest) read with s 25D for its gross income or income inclusion,
- if the investment is in a connected person, then s 31(2) (transfer pricing) could apply too,
- s 10(1)(*i*)(xv)(*aa*) for the basic exemption amount, and
- s 6*quat* if foreign taxes were paid on the resulting taxable income.

If the receipt or accrual is a 'foreign dividend', the relevant provisions are

- para (*k*) of the definition of 'gross income' read with s 25D for the gross income inclusion,
- s 10(1)(*k*)(ii) for a possible exemption,
- s 10(1)(*i*)(xv)(*aa*) for the basic exemption for 'foreign dividends',
- s 11C for the deduction of interest actually incurred in the production of income in the form of 'foreign dividends', and
- s 6*quat* if foreign taxes were paid on it.

If the receipt or accrual is a foreign rental from a rent-producing property, the relevant provisions are

- the definition of 'gross income' read with s 25D for the gross income inclusion,
- if it is let to a connected person, then s 31(2) (transfer pricing) could apply to increase the gross income inclusion,
- s 11(*a*) read with s 25D for the deduction of expenses incurred in the production of it, and
- s 6*quat* if foreign taxes were paid on it.

If the receipt or accrual is a foreign lease rental, the relevant provisions are

- the definition of 'gross income' read with s 25D for the gross income inclusion,

- if it is let to a connected person, then s 31(2) (transfer pricing) could apply to increase the gross income inclusion,
- s 11(*a*) read with s 25D for the deduction of expenses incurred in the production of it, and
- s 6*quat* if foreign taxes were paid on it.

Receipt or accrual of a royalty from outside the Republic

If the receipt or accrual is a foreign royalty the relevant provisions are

- the definition of 'gross income' read with s 25D for the gross income inclusion,
- if the right of use of an incorporeal asset is given to a connected person, then s 31(2) (transfer pricing) could apply to increase the gross income inclusion,
- s 10(1)(*m*) for an exemption if it accrues to an author for a copyright, if it is subject to a non-refundable income tax in a country other than the Republic and provided he is the first owner of it, and
- s 6*quat* if foreign taxes were paid on it.

Borrow and repay money from offshore

If money is borrowed from offshore and subsequently repaid to the lender the relevant provision is s 24I for the calculation of the foreign exchange gain or loss on the recording, translation and settlement of the loan and related forward exchange contracts.

Interest incurred on moneys borrowed from offshore

If interest is incurred on moneys borrowed from offshore, the relevant provisions are

- s 11(*a*)[27] read with s 25D for the deduction, and
- if a non-resident connected person has granted the financial assistance then s 31(3) (thin capitalisation) and s 31(2) (transfer pricing) could apply to disallow a portion of the interest incurred.

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[27] It could be seen that interest incurred should now be considered for deduction under the provisions of s 24J. Other references in this dissertation to interest being deductible under s 11(*a*) could also refer to interest being deductible under the provisions of s 24J.

Earning amounts from abroad

When an amount is earned for services rendered outside the Republic by a resident, the relevant provisions are

- the definition of 'gross income' read with s 25D for the gross income inclusion,
- if the service is supplied to a connected person, then s 31(2) (transfer pricing) could apply to increase the gross income inclusion,
- the s 10(1)(*o*) exemption if it constitutes 'remuneration' earned by an employee for his services rendered outside the Republic for or on behalf of an employer, if he was outside the Republic for a period or periods exceeding 183 full days in aggregate during a period of twelve-months, and for a continuous period exceeding 60 full days during that twelve-month period,[28] and
- s 6*quat* if foreign taxes were paid on it.

Capital asset purchased in a foreign currency

When a resident purchases a capital asset from abroad, the relevant provisions are

- the s 11(*e*) (wear-and-tear or depreciation allowance), s 11(*o*) (scrapping or termination allowance), s 12B (plant and machinery used in farming allowance), s 12C (plant and machinery used in a process of manufacture allowance), or s 12E (capital assets used by a small business corporation) for the determination of the capital allowance that is available on it, and
- s 24I for the calculation of the foreign exchange gain or loss on the recording, translation and settlement of its supplier and related forward exchange contracts.

Capital asset sold in a foreign currency

When a resident sells a capital asset in a foreign currency, the relevant provisions are

- s 8(4)(*a*) read with s 25D for a possible recoupment to be included in income,
- s 11(*o*) read with s 25D for a possible scrapping or termination allowance to be deducted from income,

[28] Section 10(1)(*o*)(ii).

- para 43(4) of the Eighth Schedule for a possible capital gain or capital loss. This is because the capital gain or capital loss is deemed to be made from a source in the Republic in terms of s 9(2)(*b*)(i) provided the asset is not attributable to a permanent establishment of the resident that is situated outside the Republic,
- para 43(1) or para 43(2) of the Eighth Schedule for a possible capital gain or capital loss if the asset is attributable to a permanent establishment of the resident that is situated outside the Republic, and
- s 24I for the calculation of the foreign exchange gain or loss on the recording, translation and settlement of the debtor and related forward exchange contracts.

Branch offshore

As the foreign branch is likely to be a permanent establishment s 25D(2) would apply. It requires that amounts received by or accrued to, or expenditure incurred by a permanent establishment outside the Republic be translated to rands by applying the average exchange rate for the relevant year of assessment.

If the foreign branch is a permanent establishment and it disposes of an asset, the capital gain or capital loss is determined in terms of para 43(1) or para 43(2) of the Eighth Schedule. Paragraph 43(4) of the Eighth Schedule does not apply because s 9(2)(*b*)(i) does not deem the capital gain or capital loss of an asset that is attributable to a permanent establishment of the resident that is situated outside the Republic to be from a source within the Republic.

Beneficiary of an offshore trust

If a beneficiary of an offshore trust is a resident, and if the receipts and accruals of the trust accrue or are deemed to accrue to him in terms of section 25B(1) or (2), then despite these receipts and accruals being from a non-South African source, they will be included in his gross income because it is determined on a world-wide basis. The receipt or accrual will retain its identity.[29] The relevant provisions that apply are

- the definition of 'gross income' read with s 25D for the gross income inclusion,

[29] *Armstrong v CIR* 1937 AD 343, 10 SATC 1 and *SIR v Rosen* 1971 (1) SA 173 (A), 32 SATC 249.

- s 10(1)(*k*)(ii) for a possible exemption or s 10(1)(*i*)(xv)(*aa*) for the basic exemption for foreign interest and dividends,
- s 11(*a*) read with s 25B(3) and s 25D for a possible deduction, and
- s 6*quat* if foreign taxes were paid on the receipt or accrual.

If a beneficiary of an offshore trust is a resident and he acquires a vested right to an amount representing capital then s 25B(2A) applies. The resident beneficiary must then include the amount in his income.

The provisions of section 25B(2A) apply when a resident acquires a vested right to an amount representing capital of a non-resident trust if

- this capital arose from the receipts and accruals of the trust that would have constituted income had it been a resident during a previous year of assessment when he (the resident) had only a contingent right to it, and
- those receipts and accruals were not previously subjected to tax in the Republic.

The above situations arise only if the receipts and accruals of the offshore trust are not caused by a 'donation, settlement or other [similar] disposition' made by a 'donor'. If the 'disposition' caused the receipt or accrual then s 7 may apply and require the 'donor' to include it in his gross income.

Inheritance or donation from offshore

When a resident obtains an inheritance from outside the Republic it is a capital receipt or accrual and is therefore excluded from his gross income.

A base cost must be determined for this capital asset. Paragraph 20(1)(*h*)(v) of the Eighth Schedule provides that when a resident acquires an asset by way of an inheritance from the deceased estate of a non-resident, its base cost is

- its market value immediately before the death of the deceased person, and
- expenditure contemplated in para 20 incurred by the executor of that deceased estate for it in the process of liquidation or distribution of that deceased estate.

This provision does not apply to an asset of the non-resident, and now the deceased estate, that was already liable for capital gains tax. In other words, para 20(1)(*h*)(v) would not apply

to immovable property situated in the Republic or an asset attributable to a permanent establishment of the non-resident located in the Republic. These assets would be subject to the provisions of para 40 dealing with disposals to and from a deceased estate. It states that when an asset is disposed of by a deceased estate to an heir or legatee, other than the surviving spouse of the deceased person as contemplated in para 67(2)(*a*),

- the deceased estate must be treated as having disposed of it for proceeds equal to its base cost to the deceased estate, and
- the heir, legatee or trustee must be treated as having acquired it at a cost equal to its base cost to the deceased estate.

The base cost to the deceased estate is the market value of the asset on the date of the deceased person's death.[30] The difference between this value and the one determined in terms of para 20(1)(*h*)(v), is only the ability to add expenditure incurred by the executor in the process of liquidation or distribution of that deceased estate.

When a resident receives a donation from outside the Republic it is a capital receipt or accrual and excluded from his gross income.

The base cost of this asset is determined by para 38. It states that when a person disposed of an asset by means of

- a donation, or
- for a consideration not measurable in money, or
- to a person who is his connected person for a consideration that does not reflect an arm's length price,

then

- he is treated as having disposed of it at its market value on the date of disposal, and
- the person who acquired it must be treated as having acquired it a cost equal to its same market value.

Paragraph 38 is subject to both para 12(5) (debt reduced or discharged by a creditor) and para 67 (transfer of an asset between spouses). Paragraph 38 does not apply to the following assets:

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[30] Paragraph 40(1) of the Eighth Schedule.

- A right contemplated in s 8A (share option).
- An asset contemplated in s 10(1)(*n*E) ('stop-loss' provision of employee share-incentive schemes).
- A qualifying equity share contemplated in s 8B (a broad-based employee share plan).
- An equity instrument contemplated in s 8C that has not yet vested (equity instruments vesting in a director or employee).
- An asset that s 24B applies to (an asset exchanged for shares issued).

None of the above provisions states the method to be used to translate the foreign currency amount to rands. In the absence of a provision to the contrary, the provisions of s 25D must apply (see above).

Foreign exchange transactions of a non-resident

Typical foreign exchange transactions that a non-resident may be involved in, and the relevant provisions of the Act that could apply to them, are set out below:

Purchase of trading stock from the Republic

A non-resident includes only his receipts and accruals from a source within or deemed to be within the Republic in his Republic gross income. Therefore, if a non-resident sells his trading stock outside the Republic, he will not have a Republic gross income. It follows that no deduction is available for the purchase of this trading stock since it was not incurred in the production of his Republic income.

This statement applies since when buying and selling goods, the place of sale is generally regarded as the source of the trading profit. According to *CIR v Epstein* it is necessary to look at the activities of the taxpayer to ascertain whether the business activities took place in the Republic.[31] If so, the resulting profit from the business will be included in the taxpayer's taxable income and taxed in the Republic.

[31] 1954 (3) SA 689 (A), 19 SATC 221.

There is, however, an exception to this source rule. This exception was described by Schreiner JA in his judgment in *Transvaal Associated Hide and Skin Merchants v COT*. He remarked as follows:[32]

> 'When all the activities giving rise to the income consist of buying and selling, the country where the sales were made is generally held to be the source of the trading profit. But one can imagine cases where there is an unlimited market for the goods at a fixed price and the only business problem is to find [suppliers] of the goods. In such cases the country where the goods were bought, if it was different from that in which they were sold, might properly be held to have been the source of the profit.'

If, for example, the trading stock acquired from the Republic was a scarce good (for example, a krugerrand or rare antique), and this item was acquired in a foreign currency, then the relevant provisions for this transaction would be

- s 11(*a*) read with s 25D for the deduction,
- if it is purchased from a connected person, then s 31(2) (transfer pricing) could apply to limit the s 11(*a*) deduction,
- s 22 read with s 25D for its closing and opening stock values, and
- s 24I for the calculation of a foreign exchange gain or loss on the recording, translation and settlement by the purchaser and related forward exchange contracts (but see the note below).

It should be noted that s 24I does not apply to an exchange item of a non-resident, other than a CFC, unless the exchange item is attributable to a permanent establishment of the non-resident in the Republic.

If the non-resident is a company and trading or carrying on business in the Republic it may do so through a branch or an agency (see further below).

Sale of trading stock in the Republic

As described above, a non-resident carrying on a business in the Republic will be trading in the Republic. The receipts and accruals of this business will have their true source in the

[32] Court of Appeal, Botswana (May 1967) 29 SATC 97 at SATC 107.

Republic. It is then likely that its trading stock will be sold in rands. But if its trading stock is sold in a foreign currency the relevant provisions are

- the definition of 'gross income' read with s 25D for the amount to be included in gross income,
- if it is sold to a connected person then s 31(2) (transfer pricing) could apply to increase the amount to be included in gross income,
- s 22 read with s 25D for its closing and opening stock values,
- s 24I for the calculation of the foreign exchange gain or loss on the recording, translation or settlement by the purchaser and related forward exchange contracts (but see the note above).

The s 6*quat* rebate is unavailable since it applies only to foreign-sourced income.

Investment in and sale of a Republic investment

Gross income excludes receipts and accruals of a capital nature, therefore, when a non-resident sells his Republic investment (a capital asset), he will not have a Republic gross income. It follows that no deduction is available for the purchase of this investment since it was not incurred in the production of his Republic income and is of a capital nature.

Capital gains tax applies to a disposal made by a non-resident on or after 1 October 2001 only of an asset that is[33]

- immovable property situated in the Republic held by him or his interest or right of whatever nature to or in immovable property situated in the Republic, or
- attributable to his permanent establishment in the Republic.

Therefore, when a non-resident disposes of an investment (other than the two classes of assets described above), no capital gain or capital loss could result.

If a rent-producing property situated in the Republic, that is not attributable to his permanent establishment in the Republic, is sold by a non-resident and it was disposed of, or acquired, in a foreign currency the relevant provision is para 43(4) of the Eighth Schedule for a possible

[33] Paragraph 2(1)(*b*) of the Eighth Schedule.

capital gain or capital loss. This is because the capital gain or capital loss is deemed to be made from a source in the Republic in terms of s 9(2)(*a*).

Section 35A is also relevant because the seller of the rent-producing property situated in the Republic, is a non-resident. The purchaser is required to withhold an amount from the amount that must be paid to the non-resident. This withheld amount is an advance of the non-resident seller's liability for normal tax.

If an asset that is attributable to a permanent establishment of the non-resident in the Republic is sold by him, and it was disposed of or acquired in a foreign currency, the relevant provision is para 43(4) of the Eighth Schedule because the capital gain or loss from this asset is deemed to be made from a source in the Republic in terms of s 9(2)(*b*)(ii).

Work in the Republic (excluding foreign entertainers and sportspersons)

The true source of income from employment and other services rendered is the rendering of the services, irrespective of the place where the contract is made or the earnings are paid. The true source of the earnings would be at the place where the services are rendered. Therefore a non-resident earning an amount for rendering services in the Republic will include this amount in his gross income. If this amount is paid in a foreign currency the relevant provisions are

- the definition of 'gross income' read with s 25D for the amount to be included in his gross income, and
- if the service is supplied to a connected person then s 31(2) (transfer pricing) may apply to increase the amount to be included in his gross income.

Personal activity exercised by a foreign entertainer or sportsperson

If the amount paid to a foreign entertainer or sportsperson is in a foreign currency then the relevant provisions are

- the definition of 'gross income' read with s 25D for the amount to be included in gross income,

- s 10(1)(*l*A) for the exemption of the same amount included in gross income and subject to the tax on a foreign entertainer or sportsperson, and
- s 47B(2) being a 15% final tax that is levied on an amount earned by a foreign entertainer and sportsperson.

Acquire a capital asset in a foreign currency from the Republic

Being a non-resident means that his gross income is determined on a source basis (and not on the so-called residence or world-wide basis). When a non-resident, who does not have Republic-source income, acquires a capital asset in the Republic, even if in a foreign currency, it will not be subject to South African normal tax.

If the non-resident acquires a capital asset to be used in the carrying of a business in the Republic, the normal provisions applicable to a resident will apply to him. These are

- s 11(*e*) (the wear-and-tear or depreciation allowance), s 11(*o*) (the scrapping or termination allowance), s 12B (the allowance for plant and machinery used in farming), s 12C (the allowance for plant and machinery used in a process of manufacture), or s 12E (the allowance for capital assets used by a small business corporation), and
- s 24I for the calculation of the foreign exchange gain or loss on the recording, translation and settlement of the creditor and related forward exchange contracts (if the asset was purchased in foreign currency – see note above).

Sell a capital asset in the Republic

Capital gains tax applies to a disposal made by a non-resident on or after 1 October 2001 only if the asset is[34]

- immovable property situated in the Republic held by him or his interest or right of whatever nature to or in immovable property situated in the Republic, or
- attributable to his permanent establishment in the Republic.

Therefore, when disposing of a capital asset other than the two classes described above, there is no effect on the Republic taxable income of the non-resident.

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[34] Paragraph 2(1)(*b*) of the Eighth Schedule.

If the asset sold by him is immovable property situated in the Republic or is attributable to a permanent establishment of the non-resident in the Republic, and it was disposed of or acquired in a foreign currency, the relevant provision is para 43(4) of the Eighth Schedule because the capital gain or loss arising on the disposal of this asset is from a source in the Republic or deemed to be from a source in the Republic in terms of s 9(2)(*b*)(ii).

Section 35A is also if the non-resident sells immovable property situated in the Republic.

Operate a branch or agency in the Republic

If the non-resident is a company and trading, or carrying on business, in the Republic it may do so through a branch or an agency. Its foreign currency receipt or accrual or expenditure or loss must then be translated to rands by applying the spot rate on the date the amount was received or accrued or the expenditure or loss was so incurred (s 25D(1)).

The branch or agency's taxable income is subject to a rate of corporate tax of 33%. But a dividend declared by the branch of a non-resident company out of these profits is not liable for the secondary tax on companies.

Beneficiary of a resident trust

A non-resident who is a beneficiary of a resident trust will have a foreign currency receipt or accrual only if the resident trust

- has off-shore investments, or
- is trading in the Republic but transacts in foreign currencies, for example, sells goods abroad in a foreign currency.

As described above, the income will retain its identity and therefore in both the situations described above the non-resident will have a receipt or an accrual of an amount from a source outside the Republic. It is not then included in the non-resident's gross income. But, in terms of s 7(8), if this income

- arose as a result of a 'donation, settlement, or other [similar] disposition' made by a resident, and

- the amount that is received by or accrued to the non-resident would have constituted income had he been a resident,

the amount is included in the income of the resident 'donor'.

If a resident trust disposes of an asset, other than immovable property in the Republic, and the capital gain is attributed to the non-resident beneficiary it will not be included in the non-resident's taxable income.[35] But, in terms of para 72 of the Eighth Schedule, if a capital gain (including an amount that would have constituted a capital gain had that person been a resident)

- is attributable to a 'donation, settlement, or other [similar] disposition' made by a resident, and
- has during that year vested in, or is treated as having had vested in, a non-resident,

it is disregarded when determining the aggregate capital gain or aggregate capital loss of the person in whom it vests (the non-resident) and is taken into account when determining the aggregate capital gain or aggregate capital loss of the resident 'donor'.

If a rent-producing property in the Republic, that is not attributable to a permanent establishment of the non-resident in the Republic, is disposed of by a resident trust, was disposed of or acquired in a foreign currency and the capital gain or loss is attributed to the non-resident beneficiary the relevant provision is para 43(4) of the Eighth Schedule for a possible capital gain or capital loss. This is because the capital gain or capital loss is deemed to be made from a source in the Republic in terms of s 9(2)(*a*).

But once again para 72 of the Eighth Schedule applies (see above) and s 35A may also be relevant (see further above).

Earns interest from a resident

A non-resident may earn interest from a resident in a foreign currency. In *CIR v Lever Bros & Unilever Ltd* [36] it was held that the source, or originating cause, of interest earned from a loan was not the debt but the services that the lender performs to the borrower, in other words, the supply of credit.

[35] Paragraph 2(1)(*b*) of the Eighth Schedule.

[36] 1946 AD 441, 14 SATC 1.

- If the non-resident made the funds available in the Republic, then the true source of the interest is the Republic.
- If the non-resident made the funds available outside the Republic then the true source of the interest is outside the Republic.

But if the interest is derived from the use or application of funds in the Republic by the borrower, then s 9(6) deems the source of the interest to be in the Republic.

Section 9(7) provides that the place of use or application by the borrower is, until the contrary is proved, deemed to be

- the place where a natural person ordinarily residents, or
- the place of effective management for a person other than a natural person.

The relevant provisions for interest earned are

- the definition of 'gross income' or s 24J (incurral and accrual of interest) read with s 25D for the amount to be included in gross income,
- s 31(2) (transfer pricing) may apply if the parties are connected persons and the interest inclusion may be increased,
- s 10(1)(*h*) for an exemption provided the non-resident does not carry on business through a permanent establishment in the Republic and for a non-resident who is a natural person provided that he is not physically present in the Republic for a period exceeding 183 days in aggregate during that year, and
- s 10(1)(*i*) for the so-called basic dividend and interest exemption (if s 10(1)(*h*) does not apply).

Earns a royalty from a resident

In *Millen v CIR*[37] it was held that the source of royalties accruing from a book was the place where the author employed her wits, labour and intellect.

In terms of s 9(1)(*b*) and s 9(1)(*b*A), royalties received by or accrued for the use, or right of use, in the Republic of a royalty-producing asset, for example, a patent, design, trade mark, motion picture film or for the imparting of scientific, technical, industrial or commercial knowledge (intellectual property), is deemed to be from a Republic source.

[37] 1928 AD 207, 3 SATC 170.

Section 35 provides that a payment of a royalty to a non-resident is subject to a withholding tax on royalties levied at a rate of 12%. An exemption from this tax applies if the amount is paid to a permanent establishment of that non-resident.

If a royalty, in a foreign currency, is paid to a non-resident (for example, the royalty is payable in English pounds), and has its true or deemed source in the Republic, the relevant provisions are

- the definition of 'gross income' read with s 25D for the amount to be included in his gross income,
- s 10(1)(*l*) for the exemption of the same amount included in his gross income and subject to the s 35 withholding tax on royalties, and
- s 35, subjecting the royalty to a 12% withholding tax.

CHAPTER 4
DETAILED REVIEW OF RELEVANT PROVISIONS OF THE INCOME TAX ACT

Section 24I

Affected taxpayers

Section 24I applies to a

- company, and
- trust carrying on a trade.

The provision has a limited application to a natural person in that it applies only if he holds

- a unit of currency or a loan, advance or debt *as trading stock* (see above for further discussion) , and
- a forward exchange contract or foreign currency option contract.

Section 24I also has limited application to a non-resident since it applies only to an exchange item of a non-resident, other than a CFC, if the exchange item is attributable to his permanent establishment in the Republic.[38]

Application

Section 24I(3) requires that in the determination of the taxable income of anyone of the above mentioned persons, there be an inclusion in, or deduction from, income of

- an exchange difference of his exchange item,
- a premium or like consideration received by, or paid by, him in terms of a foreign currency option contract entered into by him, and
- consideration paid by him for a foreign currency option contract acquired by him.

Section 24I(8) does, however, prohibit the deduction of a foreign exchange loss, or a premium or consideration paid by a person in terms of a foreign currency option contract entered into

[38] Proviso to s 24I(2).

or acquired by him, if the transaction or contract was entered into or acquired solely or mainly to enjoy a reduction in tax by way of a deduction from income.

The definition of an ‘exchange item’, as discussed above, includes[39]

- a unit of currency,
- an amount owing by or to a taxpayer for a loan, advance or debt,
- a forward exchange contract, or
- a foreign currency option contract.

A ‘forward exchange contract’ means an agreement when a person agrees with another person to exchange an amount of currency for another currency at some future date at a specified exchange rate.[40]

A ‘foreign currency option contract’ means an agreement when a person acquires, or grants, the right to buy from or to sell to another person a certain amount of a nominated foreign exchange currency on or before a future expiry date at a specified exchange rate.[41]

‘Foreign currency’ in relation to an exchange item of a person, means a currency that is not a local currency.[42]

‘Local currency’ means in relation to[43]

- an exchange item that is attributable to a permanent establishment of a person outside the Republic, the currency used by that permanent establishment for financial reporting purposes (provided that if this currency has an official rate of inflation of 100% or more throughout the year then the exchange item is deemed not to be attributable to the permanent establishment),
- a resident for an exchange item that is not attributable to a permanent establishment outside the Republic, rands, and
- a non-resident for an exchange item that is attributable to a permanent establishment in the Republic, rands.

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[39] Definition of an ‘exchange item’ in s 24I(1).
[40] Definition of a ‘forward exchange contract’ in s 24I(1).
[41] Definition of a ‘foreign currency option contract’ in s 24I(1).
[42] Definition of ‘foreign currency’ in s 24I(1).
[43] Definition of ‘local currency’ in s 24I(1).

Calculation of the exchange difference

An 'exchange difference' is defined as the foreign exchange gain or loss of an exchange item (see above) during a year of assessment.[44] It is determined by multiplying the exchange item by the difference in ruling exchange rates on two different dates. These dates being either the

- transaction date and the realisation date, or
- transaction date and the translation date, or
- translation date and the realisation date, or
- 'first' translation date and the 'second' translation date.

When the second date is the realisation date then the exchange difference is a 'realised' exchange difference. Otherwise the exchange difference is an 'unrealised' exchange difference.

'Transaction date' means, in relation to

- a loan or advance owing by a person, the date when the amount payable for the loan or advance was received by him,
- a debt owing by him, the date when the debt was actually incurred,
- a loan or advance owing to him, the date when the amount payable for the loan or advance was paid to another person or the date when the loan or advance was acquired by him in another manner,
- a debt owing to him, the date when the amount payable for the debt accrued to him or the date when the debt was acquired by him in another manner,
- a forward exchange contract, the date when that the contract was entered into,
- a foreign currency option contract, the date when that the contract was entered into or acquired, and
- an amount that constitutes a unit of currency, the date when it was acquired.[45]

'Realisation date' means the date when an exchange item is 'realised'.

'Realised' means, in relation to an exchange item, when the exchange item is

[44] Definition of an 'exchange difference' in s 24I(1).
[45] Definition of 'transaction date' in s 24I(1).

- a loan or advance or debt in a foreign currency, when and to the extent that payment is received or made for the loan, advance or debt, or when and to the extent that the loan, advance or debt is settled or disposed of an another manner,
- a forward exchange contract, when payment is received or made for that forward exchange contract,
- a foreign currency option contract, when payment is received or made for the right in terms of the foreign currency contract having been exercised, or the contract expires without the right having been exercised, or when the contract is disposed of, or
- an amount that constitutes a unit of currency, when it is disposed of.[46]

'Translation date' means the date an exchange items is 'translated'.

'Translate' means the restatement of an exchange item in the local currency at the end of a year of assessment, by applying the ruling exchange rate to the exchange item.[47] If more than one end of the year of assessment arises before an exchange item is realised, then the first year of assessment is referred to as the 'first' translation date and the second as the 'second' translation, and so on.

'Ruling exchange rate' is defined in s 24I(1). It is nicely summarised in the table found in Annexure B of Practice Note 4.[48] See Table 4−1 on p 94 of this dissertation.

The following definitions are relevant for the use of the abovementioned table:

Since the term 'spot rate' is no longer defined in s 24I, it is necessary to refer to its definition in s 1. This definition defines the 'spot rate' as the appropriate quoted exchange rate at a specified time by an authorised dealer in foreign exchange for delivery of currency.

The term 'acquisition rate' is defined in s 24I(1) as meaning the exchange rate for an exchange item obtained by dividing the amount of the expenditure incurred for its acquisition by its foreign currency amount.[49]

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[46] Definition of 'realised' in s 24I(1).
[47] Definition of 'translate' in s 24I(1).
[48] Issued on 8 March 1999.
[49] Definition of 'acquisition rate' in s 24I(1).

The term 'forward rate' is also defined in s 24I(1). It means the specified exchange rate as referred to in the definition of 'forward exchange contract'.[50] In other words it is the rate agreed to in the forward exchange contract.

The term 'market value' is also defined in s 24I(1). In relation to a foreign currency option contract it means

- for a person who for accounting purposes uses a market-related valuation method in terms of a practice consistently applied by him to determine the value of all his foreign currency option contracts, the market-related value so determined, or
- in any other situation, the intrinsic value of the foreign currency option contract.[51]

The term 'intrinsic value' is also defined in s 24I(1). In relation to a foreign currency option contract it means the value for the holder or writer determined by applying the difference between the

- spot rate on translation date or the date when the foreign currency option contract is realised, and
- option strike rate

to the amount of the foreign currency.

There is a proviso to the definition of 'intrinsic value'. It states that the intrinsic value will be nil if the holder would have sustained a loss had he exercised his right in terms of the contract on the translation date or date realised due to the unfavourable difference between the option strike rate and the spot rate on the translation date or date realised.[52]

The term 'option strike rate' is also defined in s 24I(1). It means the specified exchange rate as referred to in the definition of a 'foreign currency option contract' (see above).[53] In other words it is the rate agreed to in the foreign currency option contract.

The term 'disposal rate' is also defined in s24I(1). It means the exchange rate for an exchange item obtained by dividing the amount received or accrued for the disposal of the exchange item by the foreign currency amount of the exchange item.[54]

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[50] Definition of 'forward rate' in s 24I(1).
[51] Definition of 'market value' in s 24I(1).
[52] Definition of 'intrinsic value' in s 24I(1).
[53] Definition of 'option strike rate' in s 24I(1).

Examples

Typical foreign exchange transactions that a resident and a non-resident may be involved in were discussed above. For example, if a creditor or debtor arises as a result of the purchase or sale of trading stock, then s 24I applies. An exchange difference must then be calculated. It is calculated as follows:

Example

Data

A resident company purchases bead necklaces made by local tribes in Kwa-Zulu Natal. It then sells them in London.

On 1 December 2008 it sold bead necklaces to the value of £50 000 to a customer in London. The customer was required to settle the amount due on 31 January 2009. It paid the full amount on this date.

- The spot rate on 1 December 2008 was £1 = R14,57.
- The spot rate on 31 January 2009 was £1 = R14,30.

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2008 is £1 = R15,12.)

Suggested solution

Debtor

Exchange item: £50 000	
Ruling exchange rates at the following dates:	
Transaction date (1 December 2008) – £50 000 × R14,57	728 500
Realisation date (31 January 2009) – £50 000 × R14,30	715 000
Exchange difference (£50 000 × R0,27) – a loss	13 500

This loss is tax deductible in terms of s 24I(3)(*a*).

Gross income inclusion (£50 000 × R14,57 (definition of 'gross income' read with s 25D))	728 500

In the same manner if a foreign currency loan is received from or made to another party, then s 24I applies. An exchange difference must again be calculated. It is calculated as follows:

Example

Data

On 1 March 2008 a resident company borrowed $100 000 from a bank in America. The loan was repayable on 31 December 2008 with interest of $7 500. (The spot rate on 1 March 2008 was $1 = R8.) The resident company used the proceeds of this loan to finance its working capital. It settled the loan and interest payable on 31 December 2008. (The spot rate on 31 December 2008 was $1 = R9,90.)

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[54] Definition of 'disposal rate' in s 24I(1).

The resident company's financial year ends on the last day of December. (The 'average exchange rate' for a year of assessment that ends on 31 December 2008 is $1 = R8,25.)

Suggested solution

Loan

Exchange item: $100 000	
Ruling exchange rates at the following dates:	
Transaction date (1 March 2008) – $100 000 × R8	800 000
Realisation date (31 December 2008) – $100 000 × R9,90	990 000
Exchange difference ($100 000 × R1,90) – a loss	190 000
This loss is deductible in terms of s 24I(3)(*a*)	
Deduction of interest ($7 500× R9,90 (s 11(*a*) read with s 25D))	74 250

Forward exchange contracts

A taxpayer may take out a forward exchange contract as a hedge against a foreign currency fluctuation. If this is so, then a second exchange item arises and a further exchange difference needs to be calculated (s 24I(3)(*a*)). It is calculated as follows:

Example

Data

On 1 September 2008 a resident company purchased trading stock from abroad for $100 000. (The spot rate was $1 = R10,35 and the three-month forward cover rate was $1 = R10,40 on 1 September 2008.) The purchase consideration was to be settled on 30 November 2008.

On 1 September 2008 it entered into a three-month forward exchange contract with a local bank for $100 000.

On 30 November 2008, and in terms of the forward exchange contract, the resident company purchased $100 000 from a local bank for R1 040 000. (The spot rate was $1 = R10,39 on 30 November 2008.)

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 year of assessment is $1 = R10,01.)

Suggested solution

Within the forward exchange contract there are two 'exchange items' as defined,

- the debt owing in a foreign currency, and
- the amount owed for a forward exchange contract.

Debt owing

Exchange item: $100 000	
Ruling exchange rates at the following dates:	
Transaction date (1 September 2008) – $100 000 × R10,35	1 035 000
Realisation date (30 November 2008) – $100 000 × R10,39	1 039 000
Exchange difference – a loss	4 000

This is a tax deductible loss in terms of s 24I(3)(*a*).

Forward exchange contract

Exchange item: $100 000
Ruling exchange rates on the following dates:

Transaction date (1 September 2008) – $100 000 × R10,40	1 040 000
Realisation date (30 November 2008) – $100 000 × R10,39	1 039 000
Exchange difference – a loss	1 000

This is a tax deductible loss in terms of s 24I(3)(*a*).

Purchase of trading stock – the section 11(*a*) deduction is the amount actually incurred. In accordance with the provisions of s 25D, the 'spot rate' must be used to translate this amount into rands. The deduction for the purchase of trading stock is therefore R1 035 000 ($100 000 × R10,35).

Summary

Deduction for trading stock purchased (see above)	1 035 000
Exchange differences – deductible losses: R4 000 and R1 000 (s 24I(3)(*a*))	5 000
Cost of trading stock (s 22(3)(*a*))	1 035 000

Foreign currency option contract

A foreign currency option contract may be taken out as a hedge against foreign currency fluctuations. Once again a second exchange item arises and a further exchange difference needs to be calculated (s 24I(3)(*a*)).

The premium received by or paid by the taxpayer for this foreign currency option contract is also included in or deducted from income (s 24I(3)(*b*)). It is calculated as follows:

Example

Data

On 1 August 2008 a resident company purchased trading stock from abroad for $200 000. The trading stock was paid for on 31 January 2009. (The spot rate on 1 August 2008 was $1 = R7,65.)

The resident company purchased a foreign currency option from a local bank for $200 000 for a six-month period at a strike price of R9,35. For this option it paid a premium of R65 450 (3,5% of R1 870 000 ($200 000 × R9,35)) on 1 August 2008.

(On 31 January 2009 the spot rate was $1 = R10.) The resident company therefore exercised its option and purchased the $200 000 at the strike price of $1 = R9,35. With the proceeds it then settled its creditor.

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is $1 = R8,69.

Suggested Solution

Debt owing

Exchange item: $200 000
Ruling exchange rates at the following dates:

Transaction date (1 August 2008) – \$200 000 × R7,65	1 530 000
Realisation date (31 January 2009) – \$200 000 × R10	2 000 000
Exchange difference (\$200 000 × R2,35) – a loss	470 000

This is a tax deductible loss in terms of section 24I(3)(*a*).

Foreign currency option

Exchange item: \$200 000

Ruling exchange rates at the following dates:	
Transaction date (1 August 2008)	'nil'
Realisation date (31 January 2009) – see below	0,65
	0,65
Intrinsic value is the market value of the option contract	
\$200 000 × R0,65 (R10 – R9,35)	130 000
Ruling exchange rate (R130 000 divided by \$200 000)	0,65
Exchange difference: \$200 000 × R0,65 – gain	130 000

This gain is an inclusion in income in terms of s 24I(3)(*a*).

Summary

Deduction for trading stock purchased (\$200 000 × R7,65)	1 530 000
Cost of trading stock (s 22(3)(*a*))	1 530 000
Premium paid – deductible (s 241(3)(*b*)(i))	65 450
Exchange difference – taxable gain (s 24I(3)(*a*))	130 000
Exchange difference – deductible loss (s 24I(3)(*a*))	470 000

Affected contracts

A foreign currency option contract or a forward exchange contract may be entered into

- as a hedge for a loan, advance or debt to be used to acquire an asset,
- to finance an expense,
- to sell an asset, or
- supply a service.

If this is the position and at the end of the year of assessment the loan or advance has not been obtained, or the debt not yet incurred or accrued, then the forward exchange contract or foreign currency option contract is defined in s 24I as an 'affected contract'.[55]

An affected contract requires different ruling exchange rates to be used on the date of translation (see Table 4–1 on p 96 of this dissertation). The effect of these rates is that no exchange difference arises at the end of the year of assessment (translation date) and the exchange difference is deferred to the year of assessment when the loan, advance or debt is recorded. It is calculated as follows:

[55] Definition of an 'affected contract' in s 24I(1).

Example

Data

On 1 November 2008 a resident company purchased trading stock from abroad for $200 000. To settle the purchase consideration it entered into a six-month forward exchange contract with a local bank for $200 000. (The spot rate was $1 = R10,10 and the six-month forward cover rate was $1 = R9,90 on 1 November 2008.)

The order was delayed due to a technical problem. The contract for the purchase of the trading stock was altered to 3 March 2009. The trading stock arrived in the Republic on 28 April 2009. (The spot rate on 3 March 2009 was $1 = R9,99 and on 28 April 2009 was $1 = R9,02.)

On 30 April 2009, and in terms of the forward exchange contract, the resident company purchased $200 000 from a local bank for R1 980 000. The creditor was then settled on 30 April 2009. (The spot rate was $1 = R9,70 on 30 April 2009.)

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is $1 = R10,01.)

Suggested solution

28 February 2009

No trading stock had been contracted for at year end (28 February 2009). It follows that there are no purchases (s 11(*a*) deduction) and no closing stock (s 22). There is, however, a forward exchange contract but this is an 'affected contract'.

Forward exchange contract

Exchange item: $200 000
Ruling exchange rates on the following dates:

Transaction date (1 November 2008) – $200 000 × R9,90	1 980 000
Translation date (28 February 2009) – $200 000 × R9,90	1 980 000
Exchange difference	nil

28 February 2010

Debt owing

Exchange item: $200 000
Ruling exchange rates at the following dates:

Transaction date (3 March 2009) – $200 000 × R9,99	1 998 000
Realisation date (30 April 2009) – $200 000 × R9,70	1 940 000
Exchange difference – a gain	58 000

This gain is an inclusion in income in terms of s 24I(3)(*a*).

Forward exchange contract

Exchange item: $100 000
Ruling exchange rates on the following dates:

Translation date (28 February 2009) – $200 000 × R9,90	1 980 000
Realisation date (30 April 2009) – $200 000 × R9,70	1 940 000
Exchange difference – a loss	40 000

This is a tax deductible loss in terms of s 24I(3)(*a*).

Purchase of trading stock – the section 11(*a*) deduction is the amount actually incurred. In accordance with the provisions of s 25D, the 'spot rate' must be used to translate this amount into rands. The deduction for the purchase of trading stock is therefore R1 998 000 ($200 000 × R9,99).

Summary

Deduction for trading stock purchased ($200 000 × R9,99)	1 998 000
Exchange difference – taxable gain (s 24I(3)(*a*))	58 000
Exchange difference – deductible loss (s 24I(3)(*a*))	40 000

Capital assets

When a loan, advance or debt is used by a person to

- acquire, install, erect or construct a machine, plant, implement, utensil, building or improvement to a building, or
- devise, develop, create, produce, acquire or restore an invention, patent, design, trade mark, copyright or other similar property or knowledge (intellectual property)

then the exchange difference on the

- loan, advance or debt,
- hedging forward exchange contract,
- hedging foreign currency option contract, and
- premium or other consideration paid for the foreign currency option contact

is carried forward and taken into account only in the determination of his taxable income in the year of assessment that the asset, property or knowledge is brought into use for the purposes of his trade.[56]

This is illustrated in the example that follows:

Example

Data

On 1 December 2008 a resident company purchased a machine from an offshore manufacturer for €50 000. The machine was to be shipped to the Republic to be used in a process of manufacture. (The spot rate on 1 December 2008 was €1 = R12,88.)

The machine arrived in the Republic on 14 February 2009. It was then installed and brought into use on 25 March 2009. (The spot rate on 14 February 2009 was €1 = R13 and on 25 March 2009 was €1 = R13,03.)

The creditor was settled on 31 March 2009. (The spot rate on 31 March 2009 was €1 = R13,05.)

The resident company's financial year ends on the last day of February. (The spot rate on 28 February 2009 was €1 = R12,82 and the 'average exchange rate' for a year of assessment that ends on 28 February 2009 is €1 = R12,42.)

[56] Section 24I(7).

Suggested solution

2009 Year of assessment

Creditor

Exchange item: €50 000	
Ruling exchange rates at the following dates:	
Transaction date (1 December 2008) – €50 000 × R12,88	644 000
Translation date (28 February 2009) – €50 000 × R12,82	641 000
Exchange difference (€50 000 × R0,06) – a gain	3 000

In terms of s 24I(7), this gain is not included in income for its 2009 year of assessment but deferred until its 2010 year of assessment when the asset is brought into use (see below).

2010 Year of assessment

Creditor

Exchange item: €50 000	
Ruling exchange rates at the following dates:	
Translation date (28 February 2009) – €50 000 × R12,82	641 000
Realisation date (31 March 2009) – €50 000 × R13,05	652 500
Exchange difference (€50 000 × R0,23) – a loss	11 500

This is a tax deductible loss in terms of s 24I(3)(*a*).

A s 12C allowance of 40% may be claimed on the cost of the machine.

The cost in terms of s 12C(2) is deemed to be the lesser of the actual cost (R652 500) or the cost if the taxpayer had acquired the asset under a cash transaction concluded at arm's length on the date when the transaction for the acquisition of the asset was concluded (R644 000).

Section 24I(6) prohibits a further inclusion in or deduction from income, a deduction or inclusion allowed or included in terms of s 24I. In other words, the actual cost mentioned in s 12C must exclude an exchange gain or exchange loss that is permitted in terms of s 24I. Therefore the cost is the lesser of

- R644 00 (R652 500 + R3 000 – R11 500), or
- R644 000.

Summary

Section 12C allowance R644 000 (€50 000 × R12,88) × 40%	257 600
Exchange difference – taxable gain brought forward from 2009 (s 24I(7))	3 000
Exchange difference – deductible loss (s 24I(3)(*a*))	11 500

This provision is subject to s 36 (mining operations). It is also subject to the proviso that if the exchange difference arose, or the premium was paid or became payable, and the

- loan, advance or debt will no longer be obtained,
- loan advance or debt has not been used as described above, or
- asset, property or knowledge will no longer be brought into use for the purpose of the person's trade,

the exchange difference or premium is no longer carried forward but brought into account in his taxable income in the current year of assessment.

Connected parties and controlled foreign companies

If a loan or advance was obtained or granted by a company to a connected-person company during a year of assessment ending before 8 November 2005 and the loan or advance was of a capital nature then s 24I(7A) applies. This provision disallows the inclusion in, or deduction from, the income of a company of a foreign exchange difference.

Instead it permits an inclusion in, or deduction from, the income of a company of 10% of the deferred amount of the unrealised exchange difference. (This provision is not discussed further due to its lack of relevance to current foreign exchange transactions).

Section 24I(10) came into operation on 1 January 2007. It applies to years of assessment ending on or after that date. It prohibits the inclusion in, or deduction from, the income of an unrealised exchange difference. In other words, an exchange difference determined on the translation (therefore an unrealised exchange difference) of an exchange item, for a

- resident if the exchange item relates to a company that is a connected party,
- resident if the exchange item relates to its CFC or a CFC of a resident company in the same group of companies,
- CFC if the exchange item relates to its resident shareholder or resident company in the same group of companies, or
- CFC if the exchange item relates to another CFC of the same resident or another resident company in the same group of companies.

Section 24I(10) also applies to a forward exchange contract or foreign currency option contract entered into as a hedge for an exchange as item listed above.

The exchange difference, being the difference between rates on the transaction and realisation dates, on these exchange items and a related forward exchange contract or foreign currency option contract, is taken into account when the exchange item is realised. In other words, translation values are ignored.

Section 24I(11A) provides that a resident must disregard

- an exchange difference arising from a forward exchange contract, or
- an exchange difference arising from a foreign currency option contract, or
- a premium from a foreign currency option contract

if the contract was entered into to hedge the acquisition of the equity shares of a company by him or another resident forming part of the same group of companies.

But the exchange difference is disregarded only to the extent that

- he, or the other resident, acquires not less than 20% of its equity shares,
- it will, after the acquisition, be a CFC, and
- for an acquisition by him, that amount is not included in his statement of comprehensive income, or for an acquisition by another resident forming part of the same group of companies, that amount is not included in the consolidated statement of comprehensive income forming part of the group financial statements, pursuant to International Financial Reporting Standards.

Capital gains tax

The reason for the introduction of s 24(11) was to create parity in the tax treatment of the

- exchange differences of an asset, and
- financing of the asset through a loan, advance or debt.[57]

It was argued that the exchange gain or loss element attributable to the ownership of certain foreign assets was not subject to tax on their disposal in terms of the Eighth Schedule and therefore the exchange differences on a loan, advance or debt should not be taken into account for tax purposes.

Section 24(11) was then amended to exclude, rather than include, certain assets.[58]

As it currently reads, s 24I(11) requires an exchange difference arising from a

- loan, advance or debt incurred, or
- forward exchange contract or foreign currency option contract entered into to hedge the loan, advance or debt,

[57] Explanatory Memorandum of the Second Revenue Laws Amendment Bill 2001.
[58] Revenue Laws Amendment Act 74 of 2002, promulgated on 13 December 2002.

to be disregarded when the loan, advance or debt was to acquire certain assets. But it is subject to the following conditions:

- First, its provisions apply only to an exchange difference arising from a loan, advance or debt *incurred* and not to those *payable to* the taxpayer.
- Secondly, the loan, advance or debt must have been incurred to acquire an asset.
- Finally, the asset must *not*
  - be an exchange item (that is a unit of currency, a loan, advance or debt, a forward exchange contract or a foreign currency option contract),
  - have been acquired in rands, or
  - have s 9G (foreign equity instruments) or para 43(4) of the Eighth Schedule (assets disposed of or acquired in a foreign currency – see below) apply to it if it had been disposed of regardless of whether it constitutes trading stock.

Paragraph 43(4) includes the disposal of

- a foreign equity instrument,
- an asset if the capital gain or loss on its disposal is from a source within the Republic, and
- an asset if the capital gain or loss on its disposal is from a source deemed to be within the Republic as contemplated in s 9(2) (see below).

It excludes an asset in the form of a loan, advance or debt payable to a person in a foreign currency.[59]

The provisions of para 43(4) do not apply to an exchange item subject to the provisions of s 24I.

Section 9(2) deems a capital gain or loss from the disposal of an asset of a person to be from a source in the Republic when it is

- immovable property situated in the Republic,
- a movable asset of a resident that is not attributable to a permanent establishment situated outside the Republic and the proceeds are not subject to tax in another country,

[59] Paragraph (*b*) of the definition of a 'foreign currency asset' in para 84 of the Eighth Schedule.

- a movable asset of a non-resident attributable to a permanent establishment situated inside the Republic.

Therefore, by a process of elimination, it means that s 24I(11) will apply only when an asset acquired in a foreign currency is

- immovable property situated outside the Republic,
- a movable asset of a resident attributable to a permanent establishment situated outside the Republic, or
- a movable asset of a non-resident not attributable to a permanent establishment situated inside the Republic,

and the true source from its disposal is not the Republic. The true source is unlikely to be in the Republic except for the situation described in the third alternative above. This means that section 24(11) will probably apply only to the situations described in the first two alternatives.

The following example illustrates section 24(11):

Example

Data

On 1 March 2008 a resident company borrowed €500 000 from an offshore bank. On the same day it used the €500 000 to purchase a foreign rent-producing property. (The spot rate on 1 March 2008 was €1 = R12,20.)

On 30 September 2008 it was forced to sell this property for €520 000. On the same day it settled its loan of €500 000 and invested the balance of €20 000. (The spot rate on 30 September 2008 was €1 = R12,14.)

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is €1 = R12.)

In this example, the interest incurred on the loan has been ignored.

Suggested solution

Loan

Exchange item: €500 000	
Ruling exchange rates at the following dates:	
Transaction date (1 March 2008) – €500 000 × R12,20	6 100 000
Realisation date (30 September 2008) – €500 000 × R12,14	6 070 000
Exchange difference (€500 000 × R0,06) – a gain	30 000

This gain is *not* included in income. The provisions of s 24I(11) apply to it because the asset is immovable property situated outside the Republic and the provisions of s 9(2) do not apply.

Paragraph 43(1) is used to determine the capital gain or loss on its disposal. It is calculated as follows:

Capital gain or loss on disposal of asset

Proceeds	€520 000
Less base cost	€500 000
Capital gain in the foreign currency in terms of para 43(1)	€20 000
Translated to rands by applying the average exchange rate for the year of assessment (para 43(1))	× R12
Capital gain	R240 000

It should be noted that para 43(1) gives the option to translate the capital gain or loss (see the €20 000 capital gain in the above example) into rands using the average exchange rate for the year (as carried out above) or the spot rate on the date of disposal.

In the above example, a translation using the 'spot' rate on the date of disposal would have resulted in a capital gain of R242 800. Therefore by using the average rate instead of the spot rate the capital gain was R2 800 less (converting to a potential tax saving of R392 to a resident company).

This example should be compared with the following example when the asset is not an immovable property situated outside the Republic, but a movable asset, for example, a machine that is not part of its offshore permanent establishment and the proceeds are not subject to tax in another country.

The profit on the sale of the movable asset (a machine) is deemed to be from a source in the Republic (s 9(2)). Paragraph 43(4) then applies for the calculation of the capital gain or loss on its disposal.

Example

Data

On 1 March 2008 a resident company borrowed €500 000 from an offshore bank. On the same day it used the €500 000 to purchase a machine offshore. The machine was to be shipped to the Republic to be used in a process of manufacture. (The spot rate on 1 March 2008 was €1 = R12,20.)

On 30 September 2008, and before the machine was shipped to the Republic it was found to be unsuitable. It was sold for €520 000. On the same day the resident company settled its loan of €500 000 and invested the balance of €20 000. (The spot rate on 30 September 2008 was €1 = R12,14.)

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for 28 February 2009 is €1 = R12.)

In this example, the interest incurred on the loan has been ignored.

Suggested solution

Loan

Exchange item: €500 000	
Ruling exchange rates at the following dates:	
Transaction date (1 March 2008) – €500 000 × R12,20	6 100 000
Realisation date (30 September 2008) – €500 000 × R12,14	6 070 000
Exchange difference (€500 000 × R0,06) – a gain	30 000

This gain is included in income. The provisions of s 24I(11) do not apply to it because although the asset is a movable asset, it is not attributable to a permanent establishment of a resident outside the Republic.

Paragraph 43(4) is then used to determine the capital gain or loss. It is calculated as follows:

Capital gain or loss on disposal of asset

Proceeds (€520 000 × R12,14 (translate proceeds at the spot rate (para 43(4))))	6 312 800
Less base cost (€500 000 × R12,20 (translate proceeds at the spot rate (para 43(4))))	6 100 000
Capital gain	212 800

It should be noted that para 43(4) gives the option to translate the proceeds into rands

- at the average exchange rate for the year of assessment when it was disposed of, or
- at the spot rate on the date of disposal.

The same option is available for the expenditure incurred. It is therefore possible for a taxpayer to choose the rate that is most beneficial, for example, using

- the higher rate for the translation of the expenditure incurred as this increases the base cost and reduces the capital gain or increases a capital loss, and
- the lower rate for the translation of the proceeds as this also reduces the capital gain or increases a capital loss.

This option is illustrated as follows when the most tax efficient rate is chosen for both proceeds and base cost being the two amounts used in the calculation of the capital gain. The following capital gain results when these rates are applied to the above example:

Capital gain or loss on disposal of asset

Proceeds (€520 000 × R12 (translate proceeds at lower of the spot and average rates))	6 240 000
Less base cost (€500 000 × R12,20 (translate expenditure at higher of the spot and average rates))	6 100 000
Capital gain	140 000

By translating the

- proceeds at the lower of the spot and average rates, and
- expenditure at the higher of the spot and average rates,

the capital gain was reduced from R212 800 (when both amounts were translated at their spot rates) to R140 000.

After it was first legislated there was much debate as to whether s 24I(11) applied to trading stock. This then resulted in the inclusion of the term

> 'would apply had that asset been disposed of, regardless of whether or not that asset constitutes trading stock'

being added to s 24I(11).[60]

The following example illustrates the provisions if a resident purchases trading stock from abroad:

Example

Data

A resident company purchases trading stock offshore and sells it locally (in the Republic). On 1 January 2009 it purchased trading stock from an offshore supplier for €50 000. This trading stock was immediately flown to the Republic. (The spot rate on 1 January 2009 was €1 = R13,37.)

On 28 February 2009 the creditor was settled. All the trading stock purchased was sold by 28 February 2009. Total sales were R1 430 000. (The spot rate on 28 February 2009 was €1 = R12,80.)

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is €1 = R12,42.)

Suggested solution

Creditor

Exchange item: €50 000
Ruling exchange rates at the following dates:

Transaction date (1 January 2009) – €50 000 × R13,37	668 500
Realisation date (28 February 2009) – €50 000 ×R12,80	640 000
Exchange difference – a gain	28 500

This gain is included in income. The provisions of s 24I(11) do not apply because the true source of the profit on sale of the trading stock is the Republic.

Gross income inclusion	1 430 000
Deduction for trading stock purchased (€50 000 × R13,37 (s 11(*a*) read with s 25D))	668 500

Paragraph 43(4) is used to determine the capital gain or loss. It is calculated as follows:

Capital gain or loss on disposal of asset

Proceeds (R1 430 000 – R1 430 000 (amount included in income))	nil
Less base cost ((€50 000 × R13,37 (translate expenditure at the spot rate) (para 43(4)) – R668 500)	nil
Capital gain or loss	nil

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[60] Revenue Laws Amendment Act 45 of 2003 promulgated on 22 December 2003.

Once again it should be noted that para 43(4) gives the option to translate the expenditure into rands

- at the average exchange rate for the year of assessment when the expenditure was incurred, or
- at the spot rate on the date the expenditure was incurred.

This allows the taxpayer to choose the rate that is to his advantage for his capital gains tax calculations.

This option is illustrated as follows when a different rate is chosen for the calculation of the capital gain in the above example. In this instance, the other rate (the average rate) is to the disadvantage to the taxpayer:

Capital gain or loss on disposal of asset

Proceeds (R1 430 000 – R1 430 000 (amount included in income))	nil
Less base cost ((€50 000 × R12,42 (translate expenditure at the average exchange rate)) – R668 500)	47 500
Capital gain	47 500

Section 6*quat*

Overview

To give relief to the resident who has been taxed twice on the same receipt or accrual, in other words, both in the Republic and a foreign country, a deduction or credit is given against his Republic normal tax liability in the form of a rebate. It is section 6*quat* that provides both the deduction and the credit relief.

This rebate and deduction is available only to a resident. It is not granted in addition to relief that the resident is entitled to under a double tax agreement with another country, but is in substitution for the relief that he would be entitled to (s 6*quat*(2)). Presumably the resident can choose the relief that is more beneficial to himself.

Rebate

Section 6*quat*(1) provides that a rebate is deductible from the normal tax payable by a resident whose taxable income includes the following:

- Income received by or accrued to the resident from a source outside the country that is not deemed to be from a source within the Republic (s 6*quat*(1)(*a*)).
- The proportional amount of the net income of a CFC (s 6*quat*(1)(*b*)).
- A foreign dividend (s 6*quat*(1)(*d*)).
- A taxable capital gain from a source outside the Republic which is not deemed to be from a source within the Republic (s 6*quat*(1)(*e*).
- An amount contemplated in (*a*), (*b*) or (*d*) that is deemed to have accrued to the resident in terms of s 7 (s 6*quat*(1)(*f*)(i)).
- A capital gain from a source outside the Republic that is not deemed to be from a source in the Republic and is attributable to the resident in terms of para 68, 69, 70, 71, 72 or 80 of the Eighth Schedule, (s 6*quat*(1)(*f*)(ii)).
- An amount contemplated in (*a*), (*b*), (*d*) or (*e*) that represents capital of a trust and is included in the income of the resident in terms of s 25B(2A) or taken into account in the determination the aggregate capital gain or aggregate capital loss of the resident in terms of para 80(3) of the Eighth Schedule (s 6*quat*(1)(*f*)(iii)).

The rebate is an amount equal to the sum of taxes on income proved to be payable to a sphere of government of a country other than the Republic, without a right of recovery by a person (other than a right of recovery in terms of an entitlement to carry back losses arising during a year of assessment to a year of assessment prior to the year of assessment) (s 6*quat*(1A)).

These taxes must be paid by the following persons:

- The resident, for an inclusion in terms of s 6*quat*(1)(*a*),(*d*) and (*e*).
- A CFC, for an inclusion in terms of s 6*quat*(1)(*b*).
- A portfolio of a collective investment scheme in securities (a so-called equity unit trust) for a 'foreign dividend' that is deemed to have been declared to the resident in terms of para (*k*) of the definition of 'gross income' and is included in his taxable income.
- Another person contemplated in s 6*quat*(1)(*f*)(i) or (ii), or a trust contemplated in s 6*quat*(*f*)(iii), for the amount included in his or its taxable income as contemplated in s 6*quat*(1)(*f*).

If a partnership or trust is liable for tax as a separate entity in another country, a proportional amount of tax payable by this entity that is attributable to the resident in the partnership or the trust is deemed to be paid by the resident (proviso to s 6*quat*(1A)).

Section 6*quat*(1B)(*a*) provides that this rebate must not in aggregate exceed an amount that bears to the total normal tax payable the same ratio as the total taxable income attributable to the income, proportional amount, 'foreign dividend', taxable capital gain or amount, that is included as contemplated in s 6*quat*(1), bears to the total taxable income.

In determination of the amount of the taxable income that is attributable to that income, proportional amount, 'foreign dividend', taxable capital gain or amount, deductions contemplated in

- section 11(*n*) (retirement annuity fund contributions),
- section 18 (medical and dental deduction), and
- section 18A (qualifying donations to certain public benefit organisations (PBOs))

are deemed to have been incurred proportionately for income derived from sources within and outside the Republic (proviso (i) to s 6*quat*(1B)).

When the sum of the 'qualifying' taxes proved to be payable exceeds the rebate, the excess amount may be carried forward to the immediately succeeding year of assessment and is deemed to be a tax on income paid to the government of another country in that year. It may be set off against the amount of normal tax payable by the resident during that year of assessment for an amount derived from another country that is included in his taxable income during that year, as contemplated in s 6*quat*(1), after tax payable to the government of another country for an amount so included during the year of assessment that may be deducted in terms of s 6*quat*(1) and (1A) has been deducted from the normal tax payable for the amount so included (proviso (ii) to s 6*quat*(1B)).

The excess amount may not, however, be carried forward for more than seven years reckoned from the year of assessment when it was for the first time carried forward (proviso (iii) to s 6*quat*(1B)).

Deduction

The rebate available under s 6*quat*(1A) is available only against income from a source outside the Republic. It is, however, possible that Republic-source income could also be taxed in another country.

Section 6*quat*(1C) permits a deduction from income of the foreign taxes paid on income derived by the resident from carrying on a trade (other than those contemplated in s 6*quat*(1A)) proved to be payable to a sphere of government of a country other than the Republic, without a right of recovery by a person (other than a right of recovery in terms of an entitlement to carry back losses arising during a year of assessment to a year of assessment prior to the year of assessment).

This deduction must not in aggregate exceed the total taxable income (before taking into account this deduction) attributable to income that is subject to the taxes (s 6*quat*(1D)).

When determining the amount of the taxable income that is attributable to that income, the deductions contemplated in

- section 11(*n*) (retirement annuity fund contributions),
- section 18 (the medical and dental deduction), and
- section 18A (certain deductible donations)

are deemed to have been incurred proportionately in the ratio that that income bears to total income.

Foreign currency

Section 6*quat*(4) provides that the amount of foreign tax proved to be payable as contemplated in section 6*quat*(1A) or (1C) for an amount that is included in the taxable income of a resident during a year of assessment, must be converted to the currency of the Republic on the last day of that year of assessment by applying the average exchange rate for that year of assessment.

Section 6*quat*(4A) provides that if the amount translated in accordance with the s 6*quat*(4) includes cents that are less than a rand, the amount must be rounded off to the nearest rand.

The application of s 6*quat* is illustrated in the following example:

Example

Data

The taxpayer is a resident of the Republic. His taxable income for the 2009 year of assessment (all from a source within the Republic) before the following foreign receipts and accruals and his medical deduction is R750 000.

During the 2009 year of assessment he received:

- foreign dividends of £30 000 and paid £3 000 foreign withholding taxes on this amount,
- foreign net rentals of £15 000 and paid £9 000 foreign taxes on this amount, and
- trade income from a source in the Republic paid by a non-resident of £12 000 and £1 200 foreign taxes on this amount.

His qualifying medical expenses paid were R133 148 (he is not a member of a medical scheme).

(The 'average exchange rate' for 28 February 2009 is £1 = R15,12.)

Suggested solution

Calculation of taxable income

In terms of s 25D(3), a natural person may elect to translate all amounts received by or accrued to, or expenditure or losses incurred by him in a foreign currency into rands by applying the average exchange rate for the relevant year of assessment. Otherwise the spot rate on the date that the amount was received or accrued or expenditure or loss was incurred must be used (s 25D(1)). (The average exchange rate has been used in this solution.)

		South African source	***Foreign sources***	***Total***
Taxable income		750 000	-	750 000
Foreign dividends (£30 000 × R15,12)		-	453 600	453 600
Foreign net rentals (£15 000 × R15,12)		-	226 800	226 800
Trade income from non-resident (£12 000 × R15,12)		181 440	-	181 440
		931 440	680 400	1 611 840
Less exempt income				
Basic investment income exemption (section 10(1)(*i*)(xv)(*aa*))		-	3 200	3 200
Taxable income before the deduction of medical expenses		931 440	677 200	1 608 640
Less medical expenses (section 18)				
Actual 'qualifying' expenses	133 148			
Reduced by R120 648 (7,5% of R1 608 640)	120 648			
	12 500			
Apportionment of the R12 500:				
(R931 440/ R 1 608 640 × R12 500) = R7 238		7 238		
(R677 200/ R 1 608 640 × R12 500) = R5 262			5 262	12 500
Taxable income before s 6*quat* deduction		924 202	671 938	1 596 140
Less s 6*quat* deduction of R18 144 (£1 200 × R15,12)				
Limited to R180 030 (R181 440/ R931 440 × R924 202)		18 144	nil	18 144
Taxable income		906 058	671 938	1 577 996

Calculation of normal tax payable before rebates

Normal tax payable:	
On R490 000	143 010,00
On R1 087 996 at 40%	435 198,40
Total	578 208,40

Calculation of foreign taxes paid

On foreign dividends: £3 000 × R15,12 = R45 360

On foreign net rentals: £9 000 × R15,12 = R136 080

Calculation of foreign taxes relating to the exempt foreign income

R3 200 / R453 600 × R45 360 = R320

This R320 is forfeited and cannot be carried forward to the 2010 year of assessment to be used as a foreign tax credit because it relates to exempt income.

Calculation of foreign taxes payable for taxable foreign income

Foreign taxes payable on gross 'foreign dividends'	45 360,00
Less foreign taxes payable on exempt 'foreign dividends'	320,00
	45 040,00
Add foreign taxes payable on net foreign rentals	136 080,00
	181 120,00

Calculation of the section 6quat rebate

Amount of foreign taxes that qualifies for the rebate	181 120,00
Limited to	246 211,14

The R14 227,92 limit has been calculated as follows:

$$\frac{\text{Taxable income derived from all foreign sources}}{\text{Total taxable income derived from all sources}} \times \text{Normal tax payable}$$

R671 938 / R1 577 996× R578 208,40 = R246 211,14

Note

The qualifying foreign taxes of R181 120 is less than the limit of R246 211,14. It is therefore deductible in full against normal tax payable.

Calculation of the normal tax payable after taking into account rebates

Normal tax payable before rebates	578 208,40
Less rebates	
– Primary	8 280,00
	569 928,40
Less section 6*quat* rebate for this year (see above)	181 120,00
Normal tax liability	388 808,40

Section 9D

Application

Section 9D deals with the net income of a CFC. As was previously discussed a proportional amount of the net income of a CFC must be included in a resident's income for the relevant year of assessment.

In terms of s 9D(6), the net income of a CFC is determined in the currency used by it for financial reporting purposes and then translated into rands by applying the average exchange rate for that year of assessment. This is illustrated in the following example:

Example

Data

A resident company's financial year ends on the last day of February. It holds 80% of the equity shares of in an unlisted foreign company.

The unlisted foreign company is not a business establishment. Its net income for its 2008 'foreign tax year' (that ended on 31 December 2008) as determined under the provisions of s 9D(2A) is £30 000.

(The 'average exchange rate' for a year of assessment ends on 28 February 2009 is £1 = R15,12.)

Suggested solution

The resident company must include R362 880 (80% × £30 000 × R15,12) in its income on 31 December 2008, that is in its 2009 year of assessment (that ended on 28 February 2009).

First proviso

There are four provisos to s 9D(6).

The first proviso to s 9D(6) states that for the disposal of an asset contemplated in para 43(4) of the Eighth Schedule that is not attributable to a permanent establishment of the CFC outside the Republic, its capital gain or capital loss must, in the application of para 43(4) of the Eighth Schedule, be determined in the currency of the Republic and then translated to the currency used by it for purposes of financial reporting by using the average exchange rate (proviso (*a*)).

Paragraph 43(4) of the Eighth Schedule applies when the following assets are acquired or disposed of in a foreign currency

- a foreign equity instrument,
- an asset and the capital gain or capital loss is from a source within the Republic, and
- the following assets contemplated in s 9(2):
  - Immovable property is situated in the Republic.
  - A movable asset of a resident not attributable to a permanent establishment situated outside the Republic and the proceeds are not subject to tax in another country.
  - A movable asset of a non-resident attributable to a permanent establishment situated inside the Republic.

Since

- a CFC is not a resident of the Republic,

- the first proviso does not apply to the disposal of an asset attributable to a permanent establishment of the CFC outside the Republic,
- the second proviso applies to foreign equity instrument constituting trading stock (see below), and
- net income does not include an amount attributable to a foreign business establishment including the disposal or deemed disposal of an assets forming part of the foreign business establishment (s 9D(9)(*b*))

the first proviso will apply only to the following assets if they are acquired or disposed of by the CFC in a foreign currency:

- A foreign equity instrument (provided it is not trading stock and is not attributable to a foreign permanent establishment).
- An asset and the capital gain or capital loss is from a source within the Republic (provided it is not attributable to a foreign permanent establishment).
- Immovable property situated in the Republic (provided it is not attributable to a foreign permanent establishment).
- A movable asset of the CFC attributable to a permanent establishment situated inside the Republic.

A 'foreign business establishment' is defined in s 9D(1) and means a fixed place of business located in a country other than the Republic that is used or will continue to be used for the carrying on of the business of that CFC for a period of not less than one year, when

- that business is conducted through one or more offices, shops, factories, warehouses or other structures (para (*a*)(i)),
- that fixed place of business is suitably staffed with on-site managerial and operational employees of that CFC who conduct the primary operations of that business (para (*a*)(ii)),
- it is suitably equipped for conducting the primary operations of that business (para (*a*)(iii)),
- it has suitable facilities for conducting the primary operations of that business (para (*a*)(iv)), and
- it is located outside the Republic solely or mainly for a purpose other than the postponement or reduction of a tax imposed by a sphere of government in the Republic (para (*a*)(v)).

There is a proviso to paragraph (*a*) of the definition of a 'foreign business establishment'. It states that for the purposes of determining whether there is a fixed place of business as contemplated in this definition, a CFC may take into account the use of structures as contemplated in para (*a*)(i), employees as contemplated in para (*a*)(ii), equipment as contemplated in para (*a*)(iii), and facilities as contemplated in para (*a*)(iv) of another company

- if that other company is subject to tax in the country in which the CFC's fixed place of business is located by virtue of residence, place of effective management or other criteria of a similar nature,
- if that other company forms part of the same group of companies as it, and
- to the extent that the structures, employees, equipment and facilities are located in the same country as its fixed place of business.

In terms of paragraph (*b*) of the definition of a 'foreign business establishment' in relation to a CFC, a foreign business establishment means a place outside the Republic where prospecting or exploration operations for natural resources or mining or production operations of natural resources are carried on by the CFC.

In terms of paragraph (*c*) of the definition of a 'foreign business establishment' in relation to a CFC, a foreign business establishment means a site outside the Republic where the CFC carries on the activities of the construction or installation of

- buildings,
- bridges,
- roads,
- pipelines,
- heavy machinery, or
- other projects of a comparable magnitude,

which lasts for a period of no less than six months.

In terms of paragraph (*d*) of the definition of a 'foreign business establishment' in relation to a CFC, a foreign business establishment means agricultural land in a country other than the Republic used for *bona fide* farming activities directly carried on by the CFC.

In terms of paragraph (*e*) of the definition of a 'foreign business establishment' in relation to a CFC, a foreign business establishment means a

- vessel,
- vehicle,
- rolling stock, or
- aircraft

used for the purposes of transportation or fishing, or prospecting or exploration for natural resources, or mining or production of natural resources, when that vessel, vehicle, rolling stock or aircraft is used solely outside the Republic for these purposes and is operated directly by the CFC or by another company that has the same country of residence as the CFC and forms part of the same group of companies as the CFC.

The application of the first proviso to s 9D(6) is illustrated in the following example:

Example

Data

A resident company's financial year ends on the last day of February. It holds 80% of the equity shares of an unlisted foreign company.

The unlisted foreign company is not a business establishment. Its net income for its 2008 'foreign tax year' (that ended on 31 December 2008) as determined under the provisions of s 9D(2A) is £30 000 before the inclusion of a capital gain.

The unlisted foreign company sold an immovable property in the Republic on 14 November 2008 for £21 000. (The spot rate on 14 November 2008 was £1 = R15,04.) It had purchased this property on 2 July 2007 for R280 000. This is the only asset disposed of by it. It does not have an assessed capital loss brought forward.

(The 'average exchange rate' for a year of assessment that ended on 29 February 2008 is £1 = R14,17 and for a year of assessment that ended on 28 February 2009 is £1 = R15,12.)

Suggested solution

Paragraph 43(4) is used to determine the capital gain or loss.

Capital gain or loss on disposal of asset

Proceeds (£21 000 × R15,04 (translate proceeds at lower of the spot and average rates))	315 840
Less base cost	280 000
Capital gain (in rands)	35 840
Translated to the currency of financial reporting by applying the average exchange rate for the year of assessment (para 43(1))	R15,12
Capital gain (in the currency of financial reporting)	£2 370

Net income

Net income before capital gain	£30 000
Add taxable capital gain (50% × £2 370)	£1 185
Net income	£31 185

The resident company must include R377 214 (80% × £31 185 × R15,12) in its income on 31 December 2008, that is in its 2009 year of assessment (that ended on 28 February 2009).

Second proviso

The second proviso to s 9D(6) states that for the disposal of a foreign equity instrument constituting trading stock that is not attributable to a permanent establishment of the CFC outside the Republic, the amount to be taken into account in the determination of its net income must be determined in the currency of the Republic and translated to the currency so used by it by using the average exchange rate (proviso (*b*)).

As discussed above, s 9G applies to a foreign equity instrument held as trading stock that was acquired during a year of assessment ending before 8 November 2005. The absence of a special provision that would apply to a foreign equity instrument acquired as trading stock during a year of assessment on or after 8 November 2005, means that the currency conversion provisions of s 25D would apply to it.

Per s 25D:

- The general rule is that the foreign currency receipt or accrual or expenditure or loss must be translated to rands by applying the *spot rate* on the date the amount was received or accrued or the expenditure or loss was so incurred (s 25D(1)).
- For a permanent establishment outside the Republic, income and expenditure must be translated to rands by applying the *average exchange rate* for the relevant year of assessment (s 25D(2)).
- A natural person and a non-trading trust may elect to translate a foreign currency receipt or accrual or expenditure or loss by applying the *average exchange rate* for the relevant year of assessment (s 25D(3)) or use the so-called general rule by applying the *spot rate*.

Since the second proviso specifically excludes a trading stock that is attributable to a permanent establishment of the CFC outside the Republic and a CFC is a company by definition, only the first (general) rule applies.

The following example illustrates the interaction of s 25D with proviso (*b*) of s 9D(6):

Example

Data

A resident company's financial year ends on the last day of February. It holds 100% of the equity shares of an unlisted foreign company. It is not a business establishment. Its net income for its 2008 'foreign tax year' (which

ended on 31 December 2008) as determined under the provisions of s 9D(2A) is £40 000 before taking into account the following purchase and disposal of a foreign equity instrument.

The unlisted foreign company bought a foreign equity instrument as trading stock on 19 June 2008 for £2 000. (The spot rate on 19 June 2008 was £1 = R14,61.) The foreign equity instrument was sold on 7 October 2008 for £2 200. (The spot rate on 7 October 2008 was £1 = R16,38.)

(The 'average exchange rate' for the year of assessment that ends on 28 February 2009 is £1 = R15,12.)

Suggested solution

In terms of s 9D(6) proviso (*b*) the amount to be taken into account in the determination of the net income must be determined in rands and then translated into pounds by applying the average exchange rate.
The foreign equity instrument was bought and sold in pounds and to determine these amounts in rands the general rules found in s 25D(1) must be used:

Gross income (£2 200× R16,38 (translate at the spot rate on date amount received or accrued))	36 036
Less deduction (£2 000× R14,61 (translate at the spot rate on date expenditure incurred))	29 280
Amount to be included in net income (in rands)	6 756
Translated to currency of financial reporting by applying the average exchange rate for the year of assessment (s 9D(6) proviso (*d*))	R15,12
Inclusion in net income (in the currency of financial reporting)	£447

Net income

Net income before purchase and disposal of foreign equity instrument	£40 000
Add the profit made on the purchase and sale of the foreign equity instrument in net income	£447
Net income	£40 447

The resident company must include R611 557 (100% × £40 447 × R15,12) in its income on 31 December 2008, that is in its 2009 year of assessment (that ended on 28 February 2009).

Third proviso

In terms of the third proviso to s 9D for the purposes of s 24I, 'local currency' in relation to an exchange item of a CFC that is not attributable to a permanent establishment outside the Republic means the currency of the Republic (rands). An exchange difference determined must then be translated to the currency so used by it by using the average exchange rate (proviso (*c*)). This is illustrated in the following example:

Example

Data

A resident company's financial year ends on the last day of February. It holds 75% of the equity shares of an unlisted foreign company. It has a branch in South Africa. The branch is a business establishment.

The unlisted foreign company's net income for its 2008 'foreign tax year' (that ended on 31 December 2008) as determined under the provisions of s 9D(2A) is £50 000 before taking into account the following purchase of trading stock and settlement of a creditor:

The unlisted foreign company's branch in South Africa purchased consumable stores (trading stock) from a foreign supplier on 15 August 2008 for £13 000. (The spot rate on 15 August 2008 was £1 = R14,47.) The creditor was settled on 30 September 2008 when the spot rate was £1 = R14,98. No consumable stores were on hand at year end.

(The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is £1 = R15,12.)

Suggested solution

Creditor

Exchange item: £13 000	
Ruling exchange rates at the following dates:	
Transaction date (15 August 2008) – £13 000 × R14,47	188 110
Realisation date (30 September 2008) – £13 000 × R14,98	194 740
Exchange difference (£13 000 × R0,51) – a loss	6 630

This loss is deductible in terms of s 24I(3)(*a*).

Net income

Net income before purchase of trading stock and settlement of creditor	£50 000
Less deduction for purchase of trading stock	£13 000
Less exchange loss (R6 630 / R15,12)	£438
Net income	£36 562

The resident company must include R414 613 (75% × £36 562 × R15,12) in its income for the year ended 28 February 2009.

Fourth proviso

In terms of the fourth proviso to s 9D(6) an asset or foreign equity instrument that is disposed of and an exchange item denominated in a currency other than the currency used by that CFC for purposes of financial reporting is deemed not to be attributable to a permanent establishment of the CFC if the currency used for financial reporting purposes is the currency of a country that has an official rate of inflation of 100% or more throughout that foreign tax year, for example, Zimbabwe (proviso (*d*)).

Therefore in the above example if the unlisted foreign company reported its financials in Zimbabwe dollars, since the exchange item (the creditor) is reported in a currency (pounds) other than the currency used by that CFC for purposes of financial reporting (Zimbabwe dollars), the exchange item is deemed not to be attributable to the permanent establishment of the CFC therefore the exchange loss will not be taken into account in the determination of the net income of the unlisted foreign company.

Section 35A

Section 35A applies when a person (the purchaser) being a resident or non-resident purchases from a non-resident immovable property situated in the Republic. It requires that an amount to be withheld from the amount that must be paid to the non-resident.[61]

The amount that must be withheld is

- 5% of the amount payable, when the seller is a natural person,
- 7,5% of the amount payable, when the seller is a company, and
- 10% of the amount payable, when the seller is a trust.

This withheld amount is not a final or additional tax but rather an advance of the non-resident seller's liability for normal tax (caused by a possible taxable capital gain being included in his taxable income) for the year of assessment during when that property is disposed of by him.[62]

The amount withheld by the purchaser must be paid to the Commissioner within

- fourteen days after the date it was withheld if the purchaser is a resident, or
- twenty eight days after the date it was withheld if the purchaser is a non-resident.[63]

If the amount withheld is in a foreign currency it must be translated into rands at the spot rate on the date that the amount is paid to the Commissioner.[64]

In terms of section 35A(14)(*a*), the provisions of section 35A do not apply if the amounts payable by the purchaser to the seller and to another person for or on behalf of the seller, for the acquisition by him of the immovable property, in aggregate do not exceed R2 million.

Example

Data

A foreign company's financial year ends on the last day of February. It is not a resident of the Republic.

It sold an immovable property in the Republic to a resident on 14 November 2008 for £210 000. The resident purchaser paid the amount due to the foreign company on 14 November 2008. (The spot rate on 14 November 2008 was £1 = R15,04.) The resident purchaser paid the s 35A withholding tax to the Commissioner on 28 November 2008. (The spot rate on 28 November 2008 was £1 = R15,20.)

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[61] Section 35A(1).
[62] Section 35A(3).
[63] Section 35A(4).
[64] Section 35A(5).

The foreign company had purchased this property on 2 July 2007 for R2 800 000. This is the only asset disposed of by it in its 2009 year of assessment. It does not have an assessed capital loss brought forward from its 2008 year of assessment. Its only other receipt or accrual for its 2009 year of assessment from a source within or deemed within the Republic is net rentals of R225 000.

(The 'average exchange rate' for a year of assessment that ended on 29 February 2008 is £1 = R14,17 and for a year of assessment that ended on 28 February 2009 is £1 = R15,12.)

Suggested solution

The resident purchaser is required to withhold tax in terms of S 35A at 7,5% of the amount payable (£210 000). The tax withheld of £15 750 (7,5% × £210 000) must be paid to the Commissioner within fourteen days of withholding the amount (by 28 November 2008).

Capital gain or loss on disposal of asset

Paragraph 43(4) is used to determine the capital gain or loss:

Proceeds (£210 000 × R15,04 (translate proceeds at the lower of the spot and average rates))	3 158 400
Less base cost (the property was purchased in rands)	2 800 000
Capital gain (in rands)	358 400

Taxable income of foreign company

Net rentals	225 000
Taxable capital gain (R358 400 × 50%)	179 200
Taxable income	404 200
Normal tax at 28%	113 176
Less tax withheld by purchaser and paid to the Commissioner (£15 750 × R15,20)	239 400
Refund due	126 224

Section 47J

Section 47B(2) provides for a final tax on a foreign entertainer or sportsperson equal to 15% of amounts received by or accrued to him for a specified activity.

An entertainer or sportsperson includes a person who for reward,

- performs an activity as a theatre, motion picture, radio or television artiste or a musician,
- takes part in a type of sport, or
- takes part in another activity that is usually regarded as of an entertainment character.[65]

A specified activity means a personal activity exercised or to be exercised in the Republic by a person as an entertainer or sportsperson, whether alone or with another person or persons.[66]

[65] Definition of an 'entertainer or sportsperson' in s 47A(*a*).
[66] Definition of a 'specified activity' in s 47A(*b*).

This tax is not levied if the non-resident

- is an employee of a resident employer, and
- is physically present in the Republic for a period or periods exceeding 183 full days in aggregate during a twelve-month period commencing or ending during the year of assessment when the specified activity is exercised.[67]

A resident who is liable to pay a foreign entertainer or sportsperson an amount for a specified activity must deduct the tax from it.[68] The amount withheld must be paid to the Commissioner before the end of the month following the month when it was withheld.[69]

If the amount withheld is in a foreign currency it must be translated into rands at the spot rate on the date when it withheld.[70]

Section 10(1)(*l*A) exempts from normal tax an amount received by or accrued to a non-resident that is subject to the tax on foreign entertainers and sportspersons.

Example

Data

An American singer performed in South Africa in March 2008. She was paid $350 000 by a South African promoter on 20 March 2008 for the five performances performed between 6 March and 18 March 2008. (The spot rate on 20 March 2008 was $1 = R9,95.)

The singer was in the Republic for a total of twenty two days during March 2008. She did not return to the Republic during the 2009 year of assessment. She does not have any other receipts or accruals from a source within or deemed within the Republic.

(The ‘average exchange rate’ for a year of assessment that ended on 28 February 2009 is $1 = R8,69.)

Suggested solution

The resident promoter must in terms of S47D withhold tax from the amount payable ($350 000). The tax withheld of $52 500 (15% × $350 000) must then be paid to the Commissioner by the end of the month following the month during when it was deducted (by 30 April 2008). The foreign currency amount must be translated into rands using the spot rate on the date the amount was withheld. Therefore R522 375 ($52 500 × R9,95) must be paid to the Commissioner by 30 April 2008.

Taxable income of American singer

Gross income inclusion ($350 000× R8,69 (definition of ‘gross income’ read with s 25D))	3 041 500
Less s 10(1)(*l*) exemption	3 041 500
Taxable income	nil

[67] Section 47B(3)
[68] Section 47D.
[69] Section 47E.
[70] Section 47J.

Normal tax liability	nil
Tax on foreign entertainers and sportspersons ($52 500 × R9,95)	522 375
Total tax liability	522 375
Less amount deducted from the amount payable ($52 500 × R9,95)	522 375
Amount due	nil

Paragraph 43 of the Eighth Schedule

Paragraph 43(1)

Paragraph 43(1) applies, subject to para 43(4), when a person disposes of an asset for proceeds in a foreign currency (for example, American dollars) and the expenditure incurred was in the same foreign currency (for example, American dollars).

The capital gain or capital loss is determined in the foreign currency and then translated into rands by applying the

- average exchange rate for the year of assessment that the asset was disposed of, or
- spot rate on the date of disposal of the asset.

An example above illustrated the application of para 43(1) and its interaction with s 24I(11) when a resident disposed of an immovable property situated outside the Republic. The property was acquired and disposed of in euros. The capital gain was determined in euros and translated into rands by applying the average exchange rate for the year of assessment.

The average exchange rate for the year was €1 = R12. An option exists to use the spot rate on the date of disposal of the asset as an alternative. But this rate was €1 = R12,14. Had it been used, it would result in a larger capital gain.

A taxpayer should therefore use this option to his advantage by choosing the rate that would decrease his capital gain or increase his capital loss.

The asset disposed of in the above mentioned example was immovable property and the situation is very different if the asset is a movable asset and qualifies for the s 11(*e*) so-called wear-and-tear or depreciation allowance:

Assume a resident has an offshore permanent establishment. Further assume that an asset is purchased offshore for, and used in, this permanent establishment and then a few years later is sold offshore.

The legislature has provided for the translation of this transaction in s 25D(2). It provides that for a permanent establishment outside the Republic, its income and expenditure must be translated to rands by applying the *average exchange rate* for the relevant year of assessment.

But assume that the asset purchased and sold offshore and used in the offshore permanent establishment qualifies for the s 11(*e*) so-called wear-and-tear or depreciation allowance.

Section 11(*e*) has its own 'cost' provision. It is s 11(*e*) proviso (vii). It provides that the 'cost' of the asset is

> 'deemed to be the cost which, in the opinion of the Commissioner, a person, would, if he had acquired the machinery, implements, utensils and articles under a cash transaction concluded at arm's length on the date when the transaction for the acquisition of such machinery, implements, utensils and articles was in fact concluded.'

It does not specifically cater for an asset purchased in a foreign currency.

Paragraph 43(1) must be used to determine the capital gain or capital loss on the disposal of that offshore (foreign) asset. A capital gain could result in a taxable capital gain being included in the resident taxpayer's taxable income. But to determine this capital gain both its proceeds and its base cost need to be determined.

- Proceeds is its selling price less a recoupment (of its s 11(*e*) allowances) included in the resident's gross income.

- Base cost is the amount paid for it less the capital allowances on it (its s 11(*e*) allowances) that have been deducted for normal tax purposes in the determination of the resident's taxable income.

The problem is then the determination of the s 11(*e*) allowances on it, and the recoupment of them. This is illustrated as follows:

Example

Data

A resident company is in the business of letting portable generators. It trades through four branches. Three branches are situated in the major cities in the Republic and the fourth branch is situated offshore. The offshore branch is a permanent establishment.

On 1 October 2008 the offshore branch purchased a movable asset for €60 000. (The spot rate on 1 October 2008 was €1 = R12,92.) The movable asset was let for three months. A total of €4 800 was earned from its letting. Related expenses incurred during this period were €750.

Since it was unsuitable for customer needs it was sold on 7 January 2009 for €55 000. (The spot rate on 7 January 2009 was €1 = R13,13.)

The resident company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is €1 = R12,42.)

Suggested solution

Gross income inclusion (€4 800 × R12,42 (definition of 'gross income' read with s 25D(2)))	59 616
Deduction of expenses (€750 × R12,42 (s 11(*a*) read with s 25D(2)))	9 315

If a wear-and-tear or depreciation allowance was determined in the foreign currency the deductible expense would be €3 000 (€60 000 × 3 / 12 × 1 / 5) and translated at R12,42 this would amount to R37 260.

But as indicated above s 11(*e*), has its own definition of 'cost'. Proviso (vii) to s 11(*e*) states that the cost of the asset must be determined by reference to the rate of exchange ruling

> 'on the date on which the transaction for the acquisition … was …concluded'.

This would be the 'transaction date' under the provisions of s 24I. The wear-and-tear or depreciation allowance would then be as follows:

Wear-and-tear or depreciation allowance (€60 000 × R12,92 × 3 / 12 × 1 / 5 (s 11(*e*)))	38 760

In the same manner, if the s 11(*o*) scrapping or termination allowance was determined in the foreign currency, the deductible amount would be €2 000 (€55000 – (€60 000 – €3 000)). Translated at R12,42 this would amount to R24 840.

But proviso (*bb*) of s 11(*o*) refers to the cost determined in s 11(*e*) and so the scrapping or termination allowance will be determined as follows:

Section 11(o) scrapping allowance on disposal of asset

Cost of the asset (€60 000 × R12,92 (s 11(*e*))	775 200
Less	
Selling price (€55 000 × R12,42 (s 25D(2)))	683 100
Wear-and-tear or depreciation allowance (€60 000 × R12,92 × 3 / 12 × 1 / 5 (s 11(*e*)) – see above)	38 760
Section 11(*o*) scrapping allowance	53 340

The capital gain or capital loss on disposal of asset if determined in the foreign currency would be as follows:

Proceeds	€55 000
Less base cost (€60 000 - €3 000 (wear-and-tear or depreciation allowance) – €2 000 (scrapping or termination allowance))	€55 000
Capital gain or loss in the foreign currency	nil

Since there is no capital gain or loss it matters not whether it is translated at the average exchange rate or the spot rate on the date of disposal.

But the actual rand amounts for the wear-and-tear or depreciation allowance and scrapping or termination allowance were translated at different rates. To convert these rand amounts back into the foreign currency to calculate the capital gain or capital loss as required by para 43(1), the rules of translation prescribed in the provision must be used. They result in the following:

Proceeds	€55 000
Less base cost (€60 000 – (R38 760 / R12,42)(wear-and-tear or depreciation allowance) – (R53 340 / R12,42) (scrapping allowance or termination allowance))	€52 584
Capital gain in the foreign currency in terms of para 43(1)	€2 416
Translated to rands by applying the average exchange rate for the year of assessment (para 43(1))	× R12,42
Capital gain	30 007

If the translation was carried out using the spot rate on the date of disposal the capital gain would have been R31 722 (€2 416 × R13,13). It should be noted that this is an option available to the taxpayer under the provisions of para 43(1) (see above). It would be better for the taxpayer to use the average exchange rate since it gives rise to a capital gain of R30 007 (instead of a capital gain of R31 722 under the spot rate option).

In this example, in the determination of the taxable income of the permanent establishment a total deduction of R62 100 expenses ((€3 000 wear-and-tear or depreciation allowance + €2 000 scrapping or termination allowance) × R12,42) should be claimed. But R92 100 in allowances were actually claimed (R38 760 wear-and-tear or depreciation allowance + R53 340 scrapping or termination allowance). This amounts to an additional deduction of R30 000.

A capital gain of R30 007 arises but only 50% of the gain is included in a company's taxable income (amounting to R15 004), a net reduction of taxable income by R14 996 (R30 000 – R15 004) results.

In this particular illustration the taxpayer has benefited by the different translation rates in s 25D and the proviso to s 11(*e*). But in another illustration with different exchange rates the taxpayer could be worse off.

Since both methods of translation, the s 11(*e*) and para 43(1) methods, are provided for in the legislation, it would seem that the resident taxpayer is entitled to use the method that is more beneficial to him. He would need to weigh-up the tax saving with the inconvenience of having to maintain two sets of records for the assets in his offshore permanent establishment.

Although para 43(1) offers a translation method of simply working out the proceeds, base cost and capital gain or loss in the foreign currency and then having only one translation, as illustrated in the example, it may not result in the best tax consequences to the residential taxpayer.

Paragraph 43(2)

Paragraph 43(2) applies, subject to para 43(1) (see above) and para 43(4) (see below), when a person disposes of an asset for proceeds in one currency (for example, in pounds) and the expenditure incurred was in another currency (for example, in dollars).

Paragraph 43(2) refers to the proceeds received or accrued or denominated for purposes of financial reporting of a permanent establishment as the 'currency of disposal'. The expenditure actually incurred or denominated in another currency is referred to as the 'currency of expenditure'.

'Local currency' is defined in para 43(7) as

- the currency used by a permanent establishment for financial reporting, or
- rands.

If the permanent establishment uses a currency of a country in the common monetary area then the local currency is defined as rands.

Three alternatives are given to determine the capital gain or capital loss:

First, if the currency of expenditure is incurred or denominated in a local currency (rands or the financial reporting currency of a permanent establishment, for example, euros), then the proceeds are translated into the local currency (rands or euros if it is a permanent establishment) using the average exchange rate for the year of assessment when the asset was disposed of. The capital gain or capital loss is determined in the local currency (rands or euros if a permanent establishment) and then translated into rands using the average exchange rate for that year (this step is inapplicable if the local currency is rands). This alternative is illustrated as follows:

Example

Data

On 1 August 2005 a resident of the Republic purchased an offshore holiday home for R2 500 000. On 31 January 2009 he sold it to a non-resident for €217 000.

(The ‘average exchange rates’ for the year of assessment that ended on 28 February 2006 is €1 = R7,83 and for the year of assessment that ended on 28 February 2009 is €1 = R12,42.)

Suggested solution

Capital gain or loss on disposal of asset

Proceeds (translated into the local currency (rands)) €217 000 × R12,42	2 695 140
Less base cost	2 500 000
Capital gain in the local currency (rands)	195 140

Secondly, if the currency of disposal is received or accrued or denominated in a local currency (rands or the financial reporting currency of a permanent establishment, for example, euros), then the expenditure is translated into this local currency (rands or euros if it is a permanent establishment) using the average exchange rate for the year of assessment that the expenditure was incurred in. The capital gain or capital loss is determined in the local currency (rands or euros if it is a permanent establishment) and then translated into rands using the average exchange rate for that year (this step is inapplicable if the local currency is rands).

Example

Data

A resident company has an offshore permanent establishment. On 1 November 2003 it purchased the property and premises that the permanent establishment trades from for £500 000. On 31 January 2009 it sold the property to a non-resident for €450 000.

The permanent establishment uses euros for financial reporting purposes.

The ‘average exchange rates’ for the year of assessment that ended on 29 February 2004 are

£1 = R12,16,
€1 = R8,46, and
£1 = €0,70,

and for the year of assessment that ended on 28 February 2009 are

£1 = R15,12,
€1 = R12,42, and
£1 = €0,82.

Suggested solution

Capital gain or loss on disposal of asset

Proceeds	€450 000
Less base cost (translated into euros) £500 000 × €0,70	€350 000
Capital gain in the local currency (euros)	€100 000
Translated into rands	× R12,42
Capital gain in rands	R1 242 000

Thirdly, if neither the currency of disposal (for example, dollars) nor the currency of expenditure (for example, pounds) constitutes local currency (for example, euros), then the expenditure is translated into the currency of disposal (dollars) using the average exchange rate for the year of assessment when the expenditure was incurred. The capital gain or capital loss is determined in the currency of disposal (dollars) and translated into the local currency (euros) at the average exchange rate for the year of assessment when the asset was disposed of.

This capital gain or capital loss (now in euros), is then translated into rands by applying the average rate of exchange for the year of assessment.

Example

Data

A resident company operates an offshore branch. This branch is a permanent establishment. The branch uses Euros for the purposes of financial reporting.

On 1 March 2008 the branch bought a machine that was to be used in a process of manufacture for £300 000. (The spot rate on 1 March 2008 was £1 = R15,50.)

The machine was not brought into use due to a technical problem. The branch was forced to sell it. On 31 January 2009 the machine was sold for $540 000. (The spot rate on 31 January 2009 was $1 = R10.)

The resident company's financial year ends on the last day of February. The 'average exchange rates' for a year of assessment that ends on 28 February 2009 are as follows:

£1 = R15,12
$1 = R8,70
€1 = R12,42
£1 = $1,74
€1 = $1,43

Suggested solution

Capital gain or loss on disposal of asset

Proceeds	$540 000
Less base cost translated into the currency of disposal (dollars) (para 43(2)(*c*)(i)) (£300 000 × $1,74)	$522 000
Capital gain in the foreign currency (dollars)	$18 000
Translated into the local currency (euros) (para 43(2)(*c*)(ii))	1,43
Capital gain in the local currency (euros)	€12 587

Translated into rands (para 43(2)(*c*)(ii))	× 12,42
Capital gain in rands	R156 331

Paragraph 43(4)

Paragraph 43(4) of the Eighth Schedule applies when the following assets are acquired or disposed of in a foreign currency:

- A foreign equity instrument,
- an asset and the capital gain or capital loss is from a source within the Republic, and
- the following assets contemplated in s 9(2):
  - Immovable property is situated in the Republic.
  - A movable asset of a resident not attributable to a permanent establishment situated outside the Republic and the proceeds are not subject to tax in another country.
  - A movable asset of a non-resident attributable to a permanent establishment situated inside the Republic.

Examples of the disposal of a foreign equity instrument were given above. It was concluded that if a foreign equity instrument is held as trading stock then the para 43(4) calculation is likely to result in a 'nil' capital gain or capital loss as the proceeds are reduced by amounts included in gross income and the base cost is reduced by amounts deductible in the determination of taxable income. These gross income inclusions and deductions will be determined by the provisions of s 9G or s 25D.

Examples of movable assets of a resident not attributable to a permanent establishment situated outside the Republic were given above. It was also noted that para 43(4) gives the option to translate the proceeds into rands at the

- average exchange rate for the year of assessment that the asset was disposed of, or
- spot rate on the date of disposal.

The same option is available for the expenditure incurred. It is therefore possible for a taxpayer to choose the rate that is to his benefit, for example, using a rate that is higher for the translation of the expenditure incurred as this

- increases the base cost, and
- reduces the capital gain.

All that is needed to save tax using the para 43(4) option is to

- have the appropriate rates available, and
- find time to complete the calculations.

An example of the disposal of a movable asset of a non-resident attributable to a permanent establishment situated inside the Republic follows:

Example

Data

A foreign company is not a resident of the Republic. But it does trade in the Republic through a branch that is a permanent establishment.

On 1 March 2008 it purchased a non-depreciating asset for €50 000. (The spot rate on 1 March 2008 was €1 = R12,20.) The asset was shipped to the Republic and then immediately brought into use.

On 30 September 2008 the machine was sold in the Republic for R575 000.

The foreign company's financial year ends on the last day of February. (The 'average exchange rate' for a year of assessment that ends on 28 February 2009 is €1 = R12,42.)

Suggested solution

Capital gain or loss on disposal of asset

Proceeds	575 000
Less base cost (translate proceeds at average or spot rate (para 43(4)) €50 000 × R12,42	621 000
Capital loss in rands	46 000

The average exchange rate was used in the calculation of the base cost because it resulted in a greater base cost and therefore a greater capital loss.

Paragraphs 84 to 96 of the Eighth Schedule

Application

Paragraphs 84 to 96, in Part XIII of the Eighth Schedule, deal with the disposal of a foreign currency asset and the settlement of a foreign currency liability. Part XIII applies to residents only. It applies only if the provisions of s 24I do not apply (para 85).

Section 24I applies to a

- company,
- trust carrying on a trade,

- natural person if he holds a unit of currency or a loan, advance or debt as trading stock, and
- natural person or trust holding a forward exchange contract or foreign currency option contract.

In summary paras 84 to 96 apply only to a

- resident non-trading trust holding a foreign currency asset or foreign currency liability, provided it does not hold a forward exchange contract or foreign currency option contract, and
- resident natural person holding a foreign currency asset or foreign currency liability provided the asset or liability is not held as trading stock and provided he does not hold a forward exchange contract or foreign currency option contract.

Definitions

A ‘foreign currency’ is a currency other than the currency of the Republic.[71]

A ‘foreign currency asset’ is

- a unit of foreign currency, or
- a loan, advance or debt in a foreign currency owing to a person.[72]

A ‘foreign currency liability’ is a loan, advance or debt in a foreign currency.[73]

A ‘personal foreign currency asset’ is excluded from the provisions of Part XIII. A ‘personal foreign currency asset’ is[74]

- a unit of foreign currency held primarily for the regular payment of personal expenses, or
- an account held in the foreign currency with a banking institution from which funds can be immediately withdrawn. This account must be used primarily for the regular payment of personal expenses.

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[71] In terms of the definition of a ‘foreign currency’ as set out in para 84 of the Eighth Schedule.
[72] In terms of the definition of a ‘foreign currency asset’ as set out in para 84 of the Eighth Schedule.
[73] In terms of the definition of a ‘foreign currency liability’ as set out in para 84 of the Eighth Schedule.
[74] In terms of the definition of a ‘personal foreign currency asset’ as set out in para 84 of the Eighth Schedule.

'Personal expenses' of a person means[75]

- domestic or private expenses incurred outside the Republic for foreign accommodation (excluding the acquisition of immovable property),
- domestic or private expenses incurred outside the Republic for foreign personal-use assets, or
- travelling or maintenance expenses.

A foreign personal-use asset is not defined in this part of the Eighth Schedule, however, a 'personal-use asset' is defined in para 53(2) as an asset of a natural person or a special trust that is used mainly for purposes other than the carrying on of a trade. A foreign personal-use asset would be a personal-use asset acquired outside of the Republic.

A foreign currency capital gain arises when a resident[76]

- disposes of a foreign currency asset and its foreign currency proceeds exceeds its foreign currency base cost, and has not otherwise been taken into account in the determination of his taxable income, or
- settles or part settles a foreign currency liability and the amount translated into rands at the average rate for the year of assessment when the liability was incurred exceeds that amount translated into rands at the average exchange rate for the year of assessment when that liability was settled (read with para 93(1)).

A foreign currency capital loss arises when a resident[77]

- disposes of a foreign currency asset and its foreign currency base cost exceeds its foreign currency proceeds, and has not otherwise been taken into account in the determination of his taxable income, or
- settles or part settles a foreign currency liability and the amount translated into rands at the average rate for the year of assessment when the liability was settled exceeds that amount translated into rands at the average exchange rate for the year of assessment when that liability was incurred (read with para 93(2)).

[75] In terms of the definition of 'personal expenses' as set out in para 84 of the Eighth Schedule.
[76] Paragraph 86(1) of the Eighth Schedule.
[77] Paragraph 86(2) of the Eighth Schedule.

Deemed acquisitions and disposals

A disposal of a foreign currency asset includes[78]

- the conversion, sale, donation, expropriation, cession, exchange or alienation or transfer of that foreign currency asset,
- the forfeiture, termination, redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry, abandonment or loss of that foreign currency asset, or
- the vesting of a foreign currency asset of a trust in a beneficiary of that trust.

The following events are treated as an acquisition of a foreign currency asset:

- A person is treated as having acquired on valuation date all foreign currency assets that he held and has not disposed of on that date (para 88(1)). Valuation date is defined as 1 March 2003 or the date when the person becomes a resident. This means that foreign currency capital gains and foreign currency capital losses on or after 1 March 2003 are taken into account and not those from 1 October 2001 as is usually the situation.
- When Part XIII of the Eighth Schedule applies to a person he is then treated as having acquired all his foreign currency assets, other than personal foreign currency assets) immediately before it applied (para 88(4)). For example, s 24I may have applied to a resident in a prior year of assessment, but in the current year s 24I does not apply. The result is that Part XIII of the Eighth Schedule applies.
- When a person ceases to hold a foreign currency asset as a personal foreign currency asset, he is treated as having acquired it on the date that he ceases to hold it as a personal foreign currency asset (para 88(6)).

The following events are treated as a disposal of a foreign currency asset:

- When a person ceases to be a resident he must be treated as having disposed of all foreign currency assets, other than personal foreign currency assets, acquired and not disposed of by him immediately before ceasing to be a resident (para 88(2)).
- When the provisions of s 24I apply to a foreign currency asset of a person, he must be treated as having disposed of all foreign currency assets, other than personal foreign currency assets, that were not disposed of immediately before s 24I applies (para 88(3)).

[78] Paragraph 87 of the Eighth Schedule.

- When a person commences to hold a foreign currency asset that is included in a foreign currency pool, as a personal foreign currency asset, he must be treated as having disposed of the foreign currency asset on the date that he commences to hold it as a personal foreign currency asset (para 88(5)).

If a resident exchanges one foreign currency asset for another foreign currency asset that is denominated in the same currency, then no disposal or acquisition arises provided that the value of the foreign currency surrendered equals the value of the foreign currency asset obtained (para 89(1)). For example, a resident may withdraw $2 000 from one bank investment account and deposit it in another bank investment account. No disposal or acquisition arises.

But this provision does not apply to the extent that the foreign currency asset obtained or surrendered constitutes a personal foreign currency asset (para 89(2)). For example, a resident withdraws $2 000 from one bank investment account and deposits

- $1 500 in another bank investment account, and
- $500 into a credit card to cover traveling costs for a planned holiday,

then a disposal of $500 arises.

Foreign currency asset pools

Residents are required to maintain a foreign currency asset pool for each foreign currency that a foreign currency asset is denominated in (para 90(1)).

The pool includes

- the total amount in foreign currency of all foreign currency assets, other than personal foreign currency assets, acquired on or after valuation date, and
- interest that is deemed to have accrued from these assets,

reduced by the amount in foreign currency of a foreign currency asset disposed of on or after valuation date.

The base cost of the total pool is determined as the sum of the values in foreign currency of each foreign currency asset translated at the average exchange rate for the year of assessment when the asset was acquired (para 90(2)). An example follows:

Example

Data

On February 2008 a resident of the Republic deposited £10 000 in a foreign bank investment account. He earned £40 interest for the month of February 2008.

He deposited a further £5 000 in this investment account on 1 March 2008. He earned £600 interest for the twelve months ending 28 February 2009.

All interest earned is deposited into the investment account. This account is not a personal foreign currency asset.

(The 'average exchange rate' for a year of assessment that ends on 29 February 2008 is £1 = R14,17 and for a year of assessment that ends on 28 February 2009 is £1 = R15,12.)

Suggested solution

Foreign currency asset pool

Date	***Transaction***	***£***	***Average exchange rate***	***R***
1 February 2008	Deposit	10 000	R14,17	141 700
28 February 2008	Interest earned	40	R14,17	567
29 February 2008	Balance	10 040		142 267
1 March 2008	Deposit	5 000	R15,12	75 600
28 February 2009	Interest earned	600	R15,12	9 072
28 February 2009	Balance	15 640		226 939

The resident will include the foreign interest received in his gross income. Using the average exchange rate for the year as permitted for natural persons in s 25D(3)) the inclusions are as follows:

2008 year of assessment (£40 × R14,17)	567
2009 year of assessment (£600 × R14,17)	9 072

When a foreign currency asset is disposed of from this foreign currency asset pool then the base cost is determined as follows (para 91):

> foreign currency value of asset disposed of / total value of foreign currency asset pool (before disposal)
> × rand value of foreign currency asset pool (before disposal)

The proceeds from the disposal of a foreign currency asset is determined by taking the foreign amount and translating it into rands using the average exchange rate for the year of assessment when the asset is disposed (para 92). This amount is

- reduced by a capital gain, and
- increased by a capital loss

that has already been taken into account in the Eighth Schedule. The position is illustrated as follows:

Example

Data

The resident withdraws £3 000 from his foreign bank investment account on 28 February 2009 (see the above example).

Suggested solution

Capital gain or loss on disposal of asset

Proceeds (£3 000 × R15,12)	45 360
Less base cost (£3 000 / £15 640 × R226 939)	43 530
Capital gain	1 830

Settlement of a foreign currency liability

The settlement and part settlement of a foreign currency liability may give rise to

- a foreign currency capital gain (para 86(1)(*b*) read with para 93(1)), or
- a foreign currency capital loss (para 86(2)(*b*) read with para 93(2)).

An example follows:

Example

Data

On 1 January 2008 a resident of the Republic borrowed €12 000 from a non-resident. (The spot rate on 1 January 2008 was €1 = R10,10.)

He repaid the €12 000 loan and €1 000 interest on 1 January 2009. (The spot rate on 1 January 2009 was €1 = R13,10.)

The resident does not hold a unit of currency or a loan, advance or debt as trading stock nor does he hold a forward exchange contract or foreign currency option contract.

(The 'average exchange rate' for the year of assessment that ended 29 February 2008 is €1 = R9,89 and for the year of assessment that ended 28 February 2009 is €1 = R12,42.)

Suggested solution

Section 24I does not apply to the resident because he does not hold a unit of currency or a loan, advance or debt as trading stock nor does he hold a forward exchange contract or foreign currency option contract. This means that Part XIII of the Eighth Schedule applies to him (para 85).

Capital gain or loss on the settlement of the liability

Proceeds (€12 000 × R12,42)	149 040
Less base cost (€12 000 × R9,89)	118 680
Capital loss	30 360

The interest of R12 420 (€1 000 × R12,42) (using the average exchange rate for the year as permitted for natural persons in s 25D(3)) may not be deducted in the determination of his taxable income because it is a domestic expense.

In terms of para 93(3), a person must disregard a foreign currency capital gain or a foreign currency capital loss when a foreign currency liability is settled, except if the liability was used to

- acquire a right in terms of a forward exchange contract or a foreign currency option contract,
- acquire a foreign currency asset other than a personal foreign currency asset,
- acquire a foreign equity instrument or asset in local currency as contemplated in para 43(4), or
- refinance a foreign currency liability that was used to acquire an asset as listed above.

An example when a foreign currency capital gain or foreign currency capital loss is disregarded follows:

Example

Data

On 1 January 2008 a resident borrowed €20 000 from a non-resident to purchase an offshore plot of land for €20 000. (The spot rate on 1 January 2008 was €1 = R10,10.)

He sold the plot of land on 1 January 2009 for €23 000. He repaid the €20 000 loan and €2 000 interest on it on 1 January 2009. (The spot rate on 1 January 2009 was €1 = R13,10.)

The resident does not hold a unit of currency or a loan, advance or debt as trading stock nor does he hold a forward exchange contract or foreign currency option contract.

(The 'average exchange rate' for the year of assessment that ended on 29 February 2008 is €1 = R9,89 and for the year of assessment that ended on 28 February 2009 is €1 = R12,42.)

Suggested solution

The asset disposed of is immovable property outside the Republic. The capital gain or capital loss on the disposal of the immovable property is not from a source within the Republic nor is it deemed to be from a source within the Republic in terms of s 9(2). It follows that para 43(4) of the Eighth Schedule does not apply. Paragraph 43(1) must then be used to determine the capital gain or capital loss on the disposal of the property:

Capital gain or loss on disposal of asset (plot of land) (para 43(1))

Proceeds	€23 000
Less base cost	€20 000
Capital gain	€ 3 000
Translated into rands at the average rate of exchange in the year when the asset is disposed of (R12,42) or at the spot rate on the date of disposal (R13,10).	× 12,42
Capital gain in rands	R37 260

Section 24I does not apply to the resident because he does not hold a unit of currency or a loan, advance or debt as trading stock nor does he hold a forward exchange contract or foreign currency option contract. This means that Part XIII of the Eighth Schedule applies to him (para 85).

Capital gain or loss on settlement of liability

Proceeds (€20 000 × R12,42)	248 400
Less base cost (€20 000 × R9,89)	197 800
Capital loss (para 86(1)(b) read with para 93(1))	50 600

This capital loss is disregarded in terms of para 93(3).

The interest of R12 420 (€1 000 × R12,42) (using the average exchange rate for the year as permitted for natural persons in s 25D(3)) may not be deducted in the determination of taxable income since it is a domestic expense.

In the following example the foreign currency capital gain or foreign currency capital loss is not disregarded:

Example

Data

On 1 January 2008 a resident of the Republic borrowed €20 000 from a non-resident to purchase a foreign equity instrument for €20 000. (The spot rate on 1 January 2008 was €1 = R10,10.)

He sold the foreign equity instrument on 1 January 2009 for €23 000. He repaid the €20 000 loan and €2 000 interest on 1 January 2009. (The spot rate on 1 January 2009 was €1 = R13,10.)

The resident does not hold a unit of currency or a loan, advance or debt as trading stock nor does he hold a forward exchange contract or foreign currency option contract.

(The 'average exchange rate' for the year ended 29 February 2008 is €1 = R9,89 and for 28 February 2009 is €1 = R12,42.)

Suggested solution

The asset disposed of is a foreign equity instrument. Section 43(4) is then used to determine its capital gain or capital loss.

Capital gain or loss on disposal of asset

Proceeds (€23 000 × R12,42)	285 660
Less base cost (€20 000 × R10,10)	202 000
Capital gain (foreign equity instrument) (para 43(4))	83 660

The average exchange rate for the year of assessment in the year the asset was disposed of or the spot rate on the date of disposal or date of incurral may be used to translate the proceeds and the expenditure incurred into rands.

The average exchange rate was used for the translation of the proceeds into rands since it was lower than the spot rate on the date of disposal. The spot rate on the date of incurral of expenditure was used to translate the expenditure into rands since it was higher than the average exchange rate for the year.

Section 24I does not apply to the resident because he does not hold a unit of currency or a loan, advance or debt as trading stock nor does he hold a forward exchange contract or foreign currency option contract. This means that Part XIII of the Eighth Schedule applies (para 85).

Capital gain or loss on settlement of liability

Proceeds (€20 000 × R12,42)	248 400
Less base cost (€12 000 × R9,89)	197 800
Capital loss (para 86(1)(*b*) read with para 93(1))	50 600

This capital loss is not be disregarded in terms of para 93(3). The following net capital gain arises:

Capital gain	83 660
Capital loss	50 600
Net capital gain	33 060

The interest of R24 840 (€2 000 × R12,42) (using the average exchange rate for the year as permitted for natural persons in s 25D(3)) may not be deducted in the determination of his taxable income since it is a domestic expense.

A foreign currency liability incurred before valuation date (1 March 2003 or the date a person becomes a resident) is treated as having been acquired on valuation date (para 93(4)).

Other provisions

A person must disregard a foreign currency gain or foreign currency loss determined for an involuntary disposal of a foreign currency asset by way of expropriation, theft or physical loss (para 94). This is illustrated as follows:

Example

Data

A resident withdraws £3 000 from his foreign bank investment account on 28 February 2009 (see the above example). This money was then stolen.

Suggested solution

Capital gain or loss on disposal of asset

Proceeds (£3 000 × R15,12)	45 360
Less base cost (£3 000 / £15 640 × R226 939)	43 530
Capital gain	1 830

This capital gain is disregarded in terms of para 94.

In terms of para 95, when a person disposes of a foreign currency asset to his spouse

- he is treated as having disposed of it for proceeds equal to its base cost, and
- his spouse must treat its base cost as its value in the currency of the Republic on the date of acquisition.

In other words, a possible foreign currency capital gain or foreign currency capital loss is deferred. The asset also retains its history in the hands of the spouse acquiring it.

Example

Data

On 1 February 2008 a resident deposited £5 000 in a foreign bank investment account. He earned £20 interest for the month of February 2008.

On 1 March 2008 he transferred the £5 020 into another investment account in the name of his wife. She earned £25 interest for the period ending 15 April 2008. On 15 April 2009 she withdrew £5 045 to be used to cover travel expenses on her holiday in London.

(The 'average exchange rate' for a year of assessment that ends on 29 February 2008 is £1 = R14,17 and for a year of assessment that ends on 28 February 2009 is £1 = R15,12.)

Suggested solution

The resident's foreign currency asset pool is as follows:

Date	*Transaction*	*£*	*Average exchange rate*	*R*
1 February 2008	Deposit	5 000	R14,17	70 850
29 February 2008	Interest earned	20	R14,17	283
29 February 2008	Balance	5 020		71 133
1 March 2008	Transfer to spouse	-5 020		-71 133

He is deemed to have disposed of the foreign currency asset for proceeds equal to its base cost (para 95(*a*)):

Capital gain or loss on disposal of asset

Proceeds	71 133
Less base cost	71 133
Capital gain	nil

He will include the foreign interest earned in his gross income. Using the average exchange rate for the year as permitted for natural persons in s 25D(3)), the inclusion is as follows:

In the 2008 year of assessment (£20 × R14,17)	283

His wife's foreign currency asset pool is as follows:

Date	*Transaction*	*£*	*Average exchange rate*	*R*
1 March 2008	Transfer from spouse	5 020		71 133
15 April 2008	Interest earned	25	R15,12	378
15 April 2008	Base cost of total pool before the disposal	5 045		71 511
15 April 2008	Withdraw balance	-5 045		-71 511

She is deemed to have acquired the foreign currency asset at a base cost equal to its rand value on the date of its acquisition (para 95(*b*)).

She is deemed to have disposed of the foreign currency asset when she commences to hold a foreign currency asset that is included in a foreign currency asset pool as a personal foreign currency asset (para 88(5)).

The proceeds is determined by translating the foreign currency to rands using the average exchange rate for the year of assessment when the asset is disposed of (para 92).

Capital gain or loss on disposal of asset

Proceeds (£5 045 × R15,12)	76 280
Less base cost	71 511
Capital gain	4 769

She should include the foreign interest received in her gross income. But it may be deemed to be her husband's accrual in terms of s 7(2) if the sole or main purpose of the transaction was the reduction, postponement or avoidance of the husband's liability for tax. Using the average exchange rate for the year as permitted for natural persons in s 25D(3)) the inclusion in gross income is as follows:

In the 2009 year of assessment (£25 × R15,12)	378

According to para 96(1), if a provision refers to a foreign currency capital gain or a foreign currency capital loss resulting from the disposal of a foreign currency asset then the provisions found in Part XIII must be used in the determination of the foreign currency capital gain or foreign currency capital loss. These provisions are as follows:

- Paragraph 11(2)(*a*), (*e*) and (*i*) – certain non-disposals.
- Paragraphs 12(1) and 12(2)(*a*) – deemed disposal on ceasing to be a resident.
- Paragraph 13 – time of disposal.
- Paragraph 14 – disposal by a spouse married in community of property.
- Paragraph 36 – disposal of a partnership asset.
- Paragraph 38– disposal by way of a donation, consideration not measurable in money or transactions between connected persons not at an arm's length price
- Paragraph 39 – disposal to connected persons (so-called clogged losses).
- Paragraph 40 – disposal to and from deceased estates.
- Paragraph 56 – disposals by a creditor of a debt owed by a connected person.
- Paragraph 62 – donations and bequests to public benefit originations.
- Paragraph 63 – exempt persons.
- Paragraph 68 – reinvested in replacement assets (roll overs).
- Paragraph 69 – attribution of a capital gain to the parent of a minor child.
- Paragraph 70 – attribution of a capital gain subject to a conditional vesting.
- Paragraph 71 – attribution of a capital gain subject to a revocable vesting.
- Paragraph 72 – attribution of a capital gain vesting in a non-resident.
- Paragraph 73 – attribution of income and capital gains.
- Paragraph 80 – a capital gain attribution to a beneficiary.
- Paragraph 82 – death of a beneficiary of a special trust.
- Paragraph 83 – insolvent estate of a person.

Paragraph 96(2) states that if the above-listed provisions make reference to

- market value, it must be treated as a reference to the relevant value in a foreign currency translated to the currency of the Republic at the average exchange rate for the relevant year of assessment, and
- base cost, it must be treated as a reference to the foreign currency base cost.

CHAPTER 5
CONCLUSION

To determine the South African taxable income of a taxpayer, the

- gross income received by or accrued to or in favour of him,
- his exemptions,
- his general or specific deductions and allowances, and
- amounts to be included or deemed to be included in his taxable income,

must all be in rands.

If an amount is in a foreign currency, it must then be translated into rands.

Section 25D contains the so-called general currency conversion provisions. The general rule is that the foreign currency receipt or accrual or expenditure or loss must be translated into rands by applying the spot rate on the date the amount was

- received or accrued, or
- the expenditure or loss was so incurred

(s 25D(1)).

A natural person and a non-trading trust may elect to translate a foreign currency receipt or accrual or expenditure or loss by applying the

- average exchange rate for the relevant year of assessment (s 25D(3)), or
- so-called general rule by applying the spot rate (see above).

For a permanent establishment of a resident outside the Republic, a foreign currency receipt or accrual or expenditure or loss must be translated into rands by applying the average exchange rate for the relevant year of assessment (s 25D(2)).

The s 25D general currency conversion provisions apply to all situations unless a specific provision contains its own currency conversion rules.

Examples of specific provisions that contain their own currency conversion rules are as follows:

- Section 6*quat* (rebate or deduction for foreign taxes on income).
- Section 9D (net income of a CFC).
- Section 9G (taxable income of a foreign equity instrument).
- Section 24I (gains or losses on a foreign exchange transaction) (see above).
- Section 35A (withholding of an amount from the payment to a non-resident seller of 'local' immovable property).
- Section 47J (tax on a foreign entertainer and sportsperson).
- Paragraph 43 of the Eighth Schedule (an asset disposed of or acquired in a foreign currency).
- Paragraphs 84 to 96 of the Eighth Schedule (a foreign currency capital gain or loss).

If a South African taxpayer has a receipt or accrual that must be included in his gross income, an amount that is exempt from normal tax, an expense or loss that may be deducted from income, an amount to be included or deemed to be included in his taxable income that is in a foreign currency, it is then necessary to translate this foreign currency amount into rands using the translation rules as set out in

- s 25D (general translation rules),
- s 9D (the net income of a CFC), or
- s 9G (taxable income of a foreign equity instrument).

If the taxpayer is a non-resident and is an 'entertainer or sportsperson' performing a 'specified activity' as defined in s 47A, the receipt or accrual will be included in gross income but will be exempt in terms of s 10(1)(*l*) because it is subject to the tax on foreign entertainers and sportspersons. This tax would have been withheld by the resident that is paying the foreign entertainer or sportsperson and would have been paid to the Commissioner. Provided the non-resident does not have other receipts or accruals from a source within the Republic, he will not have any further Republic tax liabilities as the tax on a foreign entertainer or sportsperson is a final tax.

If the receipt or accrual, or expense or loss, has a related exchange item, and the taxpayer is a resident (or a CFC), then the provisions of s 24I must be used to determine if there is a foreign exchange gain or foreign exchange loss that must also be taken into account in the determination of his taxable income. If the taxpayer is a non-resident (and not a CFC) and the exchange item is attributable to his permanent establishment in the Republic, then the

provisions of s 24I must also be used to determine if there is a foreign exchange gain or foreign exchange loss that must be taken into account in the determination of his South African taxable income.

If the taxpayer is a resident (or a CFC), and disposes of an asset that was either acquired or disposed of in a foreign currency, then para 43 of the Eighth Schedule (an asset disposed of or acquired in a foreign currency) must be used to calculate the capital gain or capital loss on its disposal.

If the taxpayer is a non-resident, and disposes of immovable property in the Republic (including an interest or right in immovable property in the Republic) or an asset attributable to his permanent establishment in the Republic, and it was either acquired or disposed in a foreign currency, then para 43(4) of the Eighth Schedule must be used to calculate the capital gain or capital loss on its disposal. This is because the capital gain or loss arising on the disposal of this asset is

- from a source in the Republic (for immovable property in the Republic), or
- is deemed to be from a source in the Republic in terms of s 9(2)(*b*)(ii) (for an asset attributable to a permanent establishment of the taxpayer that is situated in the Republic).

The Eighth Schedule applies to non-residents only if they dispose of these two types of assets.

Furthermore, this non-resident taxpayer that sold immovable property in the Republic, would have had an amount withheld from the payment due to him in terms of s 35A. This withheld amount must be treated as an advance towards his liability for normal tax. If the immovable property is sold for an amount that is not in rands, it must be translated into rands at the spot rate on the date when the amount is paid to the Commissioner.

If the taxpayer is a resident and disposes of a foreign currency asset or settles a foreign currency liability, then paras 84 to 96 of the Eighth Schedule (foreign currency) must be used to calculate the capital gain or capital loss on the disposal of the foreign currency or on the settlement of the foreign currency liability.

If the taxpayer is a resident (or a CFC) and foreign taxes were paid on an amount included in his or its income then s 6*quat* (rebate or deduction for foreign taxes on income) provides relief

from double taxation. The foreign taxes paid must be converted into rands by applying the average exchange rate for the relevant year of assessment.

Examples of typical foreign exchange transactions have been provided, discussed and analysed in this dissertation. The provisions in the Act that are relevant to foreign exchange transactions have been identified and the interaction between them has been considered. Yet it is only when numbers are put into the wording of a provision that it is possible to determine precisely how it operates. This was illustrated in a number of examples. Two main issues were identified:

- First, when more than one provision applies to the same transaction and these provisions do not have the same conversion rules, instead of the numbers clarifying the situation they actually complicate it. These potential difficulties do not seem to have been anticipated by the legal draftsman because the legislation either contradicts itself or does not cater for the particular situation. They may also result in tax-saving opportunities. For example, different translation methods are found in s 25D and the proviso to s 11(*e*). Since both methods of translation are provided for in the legislation, it would seem that a taxpayer in this situation is entitled to use the method that is more beneficial to him.

- Secondly, when provisions give the option to translate foreign currency amounts into rands using different exchange rates. For example, in para 43(4) the taxpayer is given the option to translate the proceeds into rands at the average exchange rate for the year of assessment when it was disposed of, or at the spot rate on the date of disposal. The same option is available for expenditure incurred. It is therefore possible for a taxpayer to choose the rate that is most beneficial to him, for example, using the higher rate for the translation of the expenditure incurred as this increases the base cost and reduces the capital gain or increases a capital loss, and the lower rate for the translation of the proceeds as this also reduces the capital gain or increases a capital loss. In the same manner para 43(1) gives the option to translate the capital gain or into rands using the average exchange rate for the year or the spot rate on the date of disposal. Once again it is possible for the taxpayer to choose the rate that is most beneficial to him.

Table 4-1

Ruling Exchange Rates

EXCHANGE ITEMS			
	Loan, advance or debt (L, A or D)	***Forward exchange contract (FEC)***	***Foreign currency option contract***
Transaction date	Spot rate on transaction date (or acquisition rate),[1] or if a related or matching FEC is entered into to hedge the L, A or D and the forward rate in terms of this FEC was used to record the L A or D for accounting purposes, then this forward rate.	Forward rate in terms of the FEC.	Nil rate.
Date of translation	Spot rate on date of transaction, or if a related or matching FEC is entered into to cover the L, A or D and the forward rate in terms of this FEC was used to translate the L, A or D for accounting purposes, then this forward rate.	Market-related forward rate available for the remaining term of the FEC, or if the forward rate in terms of the FEC has been used to translate a L, A or D, then this forward rate, or if a FEC qualifies as an affected contract, then this forward rate.	Rate is determined as follows: Market value / foreign currency amount, or for an affected contract, consideration paid or received / foreign currency amount.
Date of realisation	Spot rate on date of realisation (or disposal rate).[2]	Spot rate on date of realisation.	Rate calculated as follows: (i) If the option is exercised or has matured: Market value / foreign currency amount (ii) If the option is disposed of: Receipt from disposal / foreign currency amount.

Notes

1. If the loan, advance or debt is acquired and the consideration paid or payable for its acquisition was determined by using a rate other that the spot rate on the transaction date, then this other rate (defined as the 'acquisition rate' in section 24I(1)), must be used as the ruling exchange rate.

2. If the loan, advance or debt is disposed of and a consideration received or receivable for its disposal was determined by using a rate other than the spot rate on the date of realisation, then this other rate (defined as 'disposal rate' in section 24I(1)), must be used as the ruling exchange rate.

3. An alternative rate to the aforementioned rates must be approved by the Commissioner, if it is used for accounting purposes in terms of generally accepted accounting practice and his aforementioned rates are inappropriate and inapplicable.

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