A CRITICAL ANALYSIS OF THE TAXATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES IN TERMS OF SECTION 24JB OF THE SOUTH AFRICAN INCOME TAX ACT

by

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Submitted in partial fulfilment of the requirements for the degree

MCom (Taxation)

in the

DEPARTMENT OF ACCOUNTING
at

RHODES UNIVERSITY

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Date of submission:
2015-12-11

ABSTRACT

Section 24JB of the Income Tax Act No. 58 of 1962 was introduced with effect from 1 January 2014 in order to govern the taxation of financial instruments of a covered person as defined. Section 24JB represents a significant departure from the standard tax principles for financial instruments and will therefore directly affect the timing of the imposition of tax on gains and losses on these financial instruments, resulting in a significant adverse cash flow effect for the taxpayer.

The main purpose of the research is to investigate the meaning of the wording in section 24JB through a critical analysis of the domestic tax legislation in the context of practical examples of specific financial assets and liabilities. The research includes an analysis of the scope of section 24JB by examining the definition of a "covered person" as well as the specific financial instruments to which the section applies, with reference to the International Financial Reporting Standards classifications and terms. The interaction of section 24JB with the rest of the Act is examined and whether this section overrides all the other provisions, specifically with reference to the taxation of dividends and the general and specific anti-avoidance provisions contained elsewhere in the Act.

The study aims to highlight anomalies and possible unintended tax consequences arising from the current drafting of section 24JB using practical examples, highlighting the major areas of concern and issues of interpretation of section 24JB. Recommendations are made for amendments to the Act or the provision of guidance in the form of an Explanatory Memorandum or Interpretation Note to be issued by SARS.

Key words: Fair value taxation; financial instruments; International Financial Accounting Standards; sections 24J(9) and 24JB of the South African Income Tax Act, 58 of 1962;

ACKNOWLEDGEMENTS

I thank my supervisor, Professor Elizabeth Stack, for giving me her full support and encouragement at all times and for supporting and guiding me through this process. Despite her extremely busy schedule and workload, she provided feedback and guidance at a drop of a hat. Prof. Stack is indeed a role-model to me and was a source of inspiration, always acting as a motivator for me to persist and put in longer hours. She was such a positive influence throughout.Thank you Prof. for making this possible and for your encouragement. Without you I would not have been able to achieve this!

I would also like to thank my friends for their interest and care throughout this time as well as my family for never letting me throw in the towel. Their support has meant the world to me.

TABLE OF CONTENTS

ABSTRACT I

ACKNOWLEDGEMENTS II

LIST OF TABLES VI

DEFINITION OF KEY TERMS VII

LIST OF ABBREVIATIONS AND ACRONYMS IX

CHAPTER 1 1

INTRODUCTION 1

1.1 THE CONTEXT OF THE RESEARCH 1

1.2 PROBLEM STATEMENT 4

1.3 THE GOALS OF THE RESEARCH 5

1.4 METHODS, PROCEDURES AND TECHNIQUES 5

1.5 OVERVIEW OF THESIS 6

CHAPTER 2 8

CRITICAL ANALYSIS OF SECTION 24JB 8

2.1 INTRODUCTION 8

2.2 COVERED PERSON 9

2.2.1 Authorised user 9

2.2.2 Bank 10

2.2.3 Branch 10

2.2.4 Branch of a bank 10

2.2.5 Controlling company 10

2.2.6 Banking group 11

2.3 ALL AMOUNTS THAT ARE RECOGNISED IN PROFIT OR LOSS IN THE STATEMENT OF COMPREHENSIVE INCOME 13

2.4 IN RESPECT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES THAT ARE RECOGNISED AT FAIR VALUE IN PROFIT AND LOSS IN TERMS OF IAS 39 14

2.4.1 Categories of financial instruments 14

2.4.2 Recognised versus classified 18

2.5 SECTION 24JB(2) EXCLUSIONS 19

2.5.1 In respect of 19

2.5.2 A share 21

2.5.3 An interest in a partnership 21

2.5.4 Financial assets managed on a fair value basis 21

2.5.5 A dividend received or accrued 22

2.6 ANTI-AVOIDANCE PROVISION 25

2.7 PHASING IN AND TRANSITIONAL RULES 26

2.8 CEASING TO BE A COVERED PERSON 27

2.9 INTERNATIONAL FINANCIAL REPORTING STANDARD 9 28

2.10 CONCLUSION 29

CHAPTER 3 31

THE INTERACTION OF SECTION 24JB WITH THE REST OF THE ACT 31

3.1 INTRODUCTION 31

3.2 SPECIFIC PROVISIONS OVERRIDDEN 33

3.2.1 Gross income inclusions 33

3.2.2 Section 9C – deemed capital disposal of shares 38

3.2.3 Specific anti-avoidance provisions 39

3.2.4 Treatment of dividends – section 10 42

3.2.5 Section 10B – Foreign dividends 43

3.2.6 Section 108 – Double Tax Agreements 45

3.3 CONCLUSION 46

CHAPTER 4 48

PRINCIPLES OF INTERPRETATION 48

4.1 INTRODUCTION 48

4.2 THE LITERAL APPROACH 48

4.3 THE PURPOSIVE APPROACH 50

4.3.1 The history of a provision 52

4.3.2 Give every word a meaning 54

4.3.3 Anomalies 55

4.3.4 The *contra fiscum* rule 56

4.3.5 SARS' interpretation 56

4.3.6 *Generalia specialibus non derogant* 57

4.4 CONCLUSION 59

CHAPTER 5 61

CONCLUSION 61

5.1 INTRODUCTION 61

5.2 A SUMMARY OF THE SCOPE AND APPLICATION OF SECTION 24JB 62

5.3 A SUMMARY ON THE INTERACTION OF SECTION 24JB WITH THE REST OF THE ACT 63

5.4 A SUMMARY OF THE RULES OF INTERPRETATION 64

5.5 A SUMMARY OF UNRESOLVED ISSUES AND RECOMMENDATIONS 65

5.6 CONCLUSION 68

LIST OF REFERENCES 70

LIST OF TABLES

Table 1: Definition of key terms used in this document vii

Table 2: Abbreviations and acronyms used in this document ix

DEFINITION OF KEY TERMS

Table 1: Definition of key terms used in this document

Key term	Definition
Authorised Users	A person authorised by a licensed exchange to perform one or more securities services in terms of the exchange rules, and includes an external authorised user, where appropriate (Financial Markets Act (19/2012), Chapter 1)
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction (IAS 39.9)
Financial asset	Any asset that is: (a) cash; (b) an equity instrument of another entity; (c) a contractual right: (i) to receive cash or another financial asset from another entity; or (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or (d) a contract that will or may be settled in the entity's own equity instruments and is: (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own

	equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments. (IAS 32.11)
Financial instrument	Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. (IAS 32.11)
Financial liability	Any liability that is: (a) a contractual obligation: (i) to deliver cash or another financial asset to another entity; or (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or (b) a contract that will or may be settled in the entity's own equity instruments and is: (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments. (IAS 32.11)

LIST OF ABBREVIATIONS AND ACRONYMS

Table 2: Abbreviations and acronyms

Abbreviation	Meaning
BASA	Banking Association of South Africa
IAS 32	International Accounting Standard 32
IAS 39	International Accounting Standard 39
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
JSE	Johannesburg Stock Exchange
SARB	South African Reserve Bank
SARS	South African Revenue Service

CHAPTER 1

INTRODUCTION

1.1 THE CONTEXT OF THE RESEARCH

Section 24JB of the Income Tax Act No. 58 of 1962 (hereafter referred to as "the Act") was introduced with effect from 1 January 2014 in order to govern the taxation of financial instruments of certain financial institutions. The aim of the section is primarily to align the taxation of financial instruments to the accounting treatment prescribed under the International Accounting Standard[1] 39 (IAS 39) (IASB: 2015c). The purpose is to achieve uniformity between the Annual Financial Statements and the tax computation in order to simplify the compliance and audit for both SARS and the taxpayer. In addition, its purpose is to provide for a more meaningful analysis of the financial statements by interested stakeholders, since the taxable income of financial institutions has varied significantly from the accounting net income due to the numerous adjustments to the tax computation in respect of unrealised gains and losses on financial instruments. The purpose of aligning the taxation of financial instruments with the accounting rules is to avoid the need for manual interventions in order to record the differences in the accounting and tax treatment, which previously resulted in numerous inaccuracies (National Treasury: 2012). Section 24J(9) of the Act previously applied to certain instruments if the taxpayer's business comprised the dealing in such instruments, and allowed the taxpayer to elect the so-called fair value taxation on these instruments by obtaining a directive from the South African Revenue Service (SARS). This method was administratively complex for both SARS and the taxpayer and furthermore covered only a limited range of financial assets and did not apply to financial liabilities.

The principal difference between the accounting and previous tax treatment of financial instruments is attributable to the fact that tax principles result in gains and losses only being taxed on realisation (i.e. when the resulting gain or loss on the instrument has crystallised by the disposal or settlement of the instrument), whereas the mark-to-market basis adopted under IAS 39 is based on the principle that financial instruments must be shown in the accounting records at their current market

[1] Earlier versions of Accounting Standard issued by the International Accounting Standards Board were designated "International Accounting Standard" (IAS), with a number. Later Accounting Standards are designated "International Financial Reporting Standard" (IFRS), with a number.

value. Mark-to-market accounting involves assigning a value to a position held in a financial instrument based on the current fair market price, as opposed to its original cost or book value (Ashford, 2011:13). In terms of the accrual principle underpinning the general taxation system in South Africa an amount is only subject to tax when the taxpayer has become unconditionally entitled to it (*Lategan v CIR* 1926 CPD 203, 2 SATC16 and *Mooi v SIR* 1972 (1) SA 675 (A), 34 SATC 1). As far as gains or losses on financial instruments are concerned this would generally be when the instrument is realised. Under this principle, the timing of the incidence of taxation coincides with the cash flowing from the underlying transaction, which can then be applied towards any resulting tax due. The introduction of section 24JB into the Act results in a significant divergence from the normal tax principles insofar as financial instruments are concerned. The basis for the change in tax treatment of financial instruments falling within the scope of section 24JB is the fact that these instruments are generally traded in high volumes by large financial institutions and are thus regarded as highly liquid and therefore the unrealised gains and losses on these instruments can be determined fairly accurately.

Concerns have been raised about introducing a tax provision which is dependent on principles included in International Financial Reporting Standards (IFRS) (Maroun, 2015:153) since accounting principles are predicated on providing forward-looking financial information to investors for decision making purposes, whereas tax principles are not. However, if one considers section 24J(9), which was introduced into the Act in 1997, some of these concerns raised by the author on the shortfalls of section 24JB arguably emanate from the previous regime under section 24J(9) and are therefore not unique to section 24JB. The concern is, however, justified as section 24J(9) provided for an election by the taxpayer, whereas section 24JB applies automatically if all the conditions are met and thus has a more far reaching impact.

Section 24JB(2) states that "all amounts" (relating to financial instruments) that are "recognised in profit or loss" (in the statement of comprehensive income) in respect of "financial assets and financial liabilities . . . that are recognised at fair value in profit or loss", must be included or deducted. Section 24JB(2) then lists the specific amounts or instruments which are excluded from the scope of the section, namely:

> any amount **in respect of** – (emphasis added)
>
> (a) A financial asset that is:
>
> (i) a share;

(ii) an endowment policy

(iii) an interest held in a portfolio of a collective investment scheme;

(iv) an interest in a trust; or

(v) an interest in a partnership . . .

(b) a dividend or foreign dividend received by or accrued to a covered person.

The exclusions listed in (a) above only apply if the financial asset was designated "at fair value through profit or loss" upon initial recognition because the asset is managed and its performance is evaluated on a fair value basis. This classification will be analysed in the present thesis in terms of IAS 39 in order to identify the circumstances in which this exclusion would apply.

The meaning of the phrase "in respect of" will be examined with reference to relevant case law in order to consider the possible interpretations and resulting effects arising from the inclusion of the phrase in relation to both the financial assets listed in (i) to (v) above and to the dividend contemplated in (b). The Supreme Court of Appeal, in *Stevens v Commissioner of SARS,* 2006 SCA 145 (RSA), considered the phrase "in respect of" and "by virtue of" to be similar as both refer to a causal relationship. Thus, in order for an amount to constitute an amount received in respect of a financial asset or a dividend, there has to be a causal relationship between the two. As an example, the phrase could be given the narrower interpretation which would only refer to actual dividends received or accrued or it could be interpreted as referring, not only to dividends, but also to other amounts that are in respect of a dividend or are determined with reference to a dividend, such as manufactured payments or other amounts paid under a derivative contract that refer, wholly or partly, to a dividend.

Section 24JB(3) states that:

> any amount required to be taken into account in determining the taxable income in terms of any provision of Part I of Chapter II, or in determining any assessed capital loss of a covered person in respect of a financial asset or a financial liability contemplated in subsection (2) must only be taken into account in terms of this section.

The thesis will provide a discussion of the possible interpretations of subsection 24JB(3) and the consequences ensuing from the various alternatives. Whether or not section 24JB(3) overrides the remainder of the Act will also be investigated. This may involve identifying the intention of the

legislature and the principles of interpretation that apply where an ambiguity is created by unclear legislation.

Maroun (2015:152) refers to the dangers of the unintended consequences which arise when new laws and regulations are introduced and the fact that the effect is seldom in line with the policy-maker's expectations. Roots (2004, in de Jager, Parsons & Roeleveld 2012:166) states: "If ever there were a society in which laws operated as anticipated by their makers, it is unknown to history". It has never before been necessary to analyse tax principles in the context of IFRS and section 24JB may have introduced unintended consequences, anomalies, uncertainty and complexity. This thesis will therefore highlight areas where clarity is needed, using practical examples and references to case law relating to other sections of the Act where similar wording has been used.

1.2 PROBLEM STATEMENT

Section 24JB introduces a new concept into tax legislation whereby certain taxpayers are required to apply accounting principles in determining the tax consequences relating to their financial assets and liabilities. The only other similar section in the Act was the now repealed section 24J(9). However, this section allowed the taxpayer to elect the mark-to-market treatment on certain financial assets only. Section 24JB is thus a departure from the normal tax principle of taxing gains and losses on a realisation basis and for the first time in South Africa accounting terms and concepts have been legislated into the Act. This may have introduced uncertainty and complexity. Furthermore, since section 24JB is only applicable to a "covered person" as defined, the number of taxpayers affected by the new legislation is limited to banks and brokers, which is the reason why there is a lack of available research material in South Africa on the subject. Section 24JB has only been effective since 1 January 2014, and therefore it has yet to be seen how SARS will apply the principles of this section in practice. This is also the reason why this new approach has not yet been tested in a court of law.

Consequently, it is evident that there may still be uncertainty and unresolved issues with regard to the fair value taxation of financial instruments and how to apply the section in practice to specific instruments. This thesis will therefore highlight the areas where clarity is needed and attempt to resolve the lack of clarity with reference to the intention of the legislature and the interpretation of

the wording of the legislation, using practical examples and with reference to case law on other sections of the Act where similar wording has been used.

1.3 THE GOALS OF THE RESEARCH

The main goal of the research is to investigate the meaning of section 24JB through a critical analysis of domestic tax legislation and case law dealing with similar provisions, in the context of practical examples of specific financial assets and liabilities. The main goal will be addressed through the following sub-goals:

- to determine the scope of section 24JB by examining the definition of a "covered person" as well as the specific financial instruments to which the section applies, with reference to the IFRS classifications and specifically terms used in International Accounting Standard 32 (IAS 32) (IASB: 2015b) and IAS 39 (IASB: 2015c);
- to discuss how section 24JB interacts with the rest of the Act and whether this section overrides other provisions, specifically with reference to the taxation of dividends and the general and specific anti-avoidance provisions contained elsewhere in the Act; and
- to highlight anomalies and possible unintended tax consequences arising from the current drafting of section 24JB, including any ambiguous and unclear meaning of the words, in order to identify possible amendments to the Act, together with an Explanatory Memorandum, or an Interpretation Note or General Binding Ruling to be issued by SARS.

1.4 METHODS, PROCEDURES AND TECHNIQUES

A legal interpretative research approach will be adopted by applying doctrinal research methodology which provides a systematic process of identifying, analysing, organising and synthesising statutes, judicial decisions and commentary (McKerchar: 2014). This methodology includes both a theoretical research approach in order to obtain a complete understanding of the conceptual basis of the legal principles as well as a reform orientated research approach in order to evaluate the adequacy of the existing rules and to recommend any changes to these rules.

The research will be conducted in the form of an extended argument which will critically analyse the legal rules governing the fair value taxation of financial instruments, including an analysis of the relationship between the rules, and an explanation of any areas of difficulty or ambiguity.

The study will only focus on specific examples of transactions concluded by banks, although the section applies equally *inter alia* to authorised users (which include brokers) and the South African Reserve Bank. The discussion will only include a detailed explanation of the accounting treatment of financial instruments under IAS 32 and IAS 39. International Financial Reporting Standard[2] 9 (IFRS 9) (IASB: 2015d) will not be discussed in detail since the standard is only effective from 1 January 2018. The main differences between IAS 39 and IFRS 9 will, however, be highlighted to provide an overview of the increased complexities that will arise on the adoption of IFRS 9.

The documentary data that will be used for this research will include:

- the Income Tax Act and Explanatory Memoranda;
- relevant case law, with emphasis being placed on binding judgements of the Supreme Court of Appeal;
- International Accounting Standards; and
- journal articles and textbooks.

All of the data used for this research is available in the public domain and therefore no ethical considerations will arise in relation to its use.

1.5 OVERVIEW OF THESIS

The research is divided into five chapters. Chapter one serves as the introduction providing the background to the insertion of section 24JB into the Act and an overview of the research. It will provide a historical background discussion of section 24J(9) which was the section in the Act that previously dealt with the fair value taxation of certain instruments in similar circumstances. An explanation will be provided as to the increase in scope of section 24JB and other dissimilarities between the now repealed section 24J(9) and section 24JB. Furthermore, Chapter one will set out the problem statement, the goals of the research and the methodology applied to address these goals.

[2] Refer to footnote 1.

Chapter two will provide an overview of the mechanics of section 24JB, the relevant definitions and the scope of the section, with reference to the "covered person" definition and the "banking group definition". In addition, Chapter two will critically analyse the meaning of specific words and phrases used in section 24JB(2) with reference to case law, where similar terms or words were interpreted, including *inter alia* the meaning of "in respect of a dividend" and "all amounts". The accounting treatment of financial instruments in terms of IAS 32 and IAS 39 will be explained and a brief summary provided of complexities that may arise with the adoption of IFRS 9.

Chapter three will discuss the effect of sub-paragraph 24JB(3), how this section should be reconciled with the remainder of the Act and the practical effects of such interaction in the light of practical examples and specific transactions, primarily in the banking context. This discussion will cover the interplay of section 24JB(3) with sections 8F, 8E, 9C, 108, the "gross income" definition and section 11(a). The treatment of dividends in the context of section 24JB will be a focus area, specifically referring to sections 10(1)(k)(i) and 10B.

Chapter four will discuss the principles applying to the interpretation of tax statutes in the case of ambiguity, which include ascertaining the intention of the legislature in the adoption of the purposive approach. The maxim of *generalia specialibus non derogant* will be discussed when considering whether section 24JB(3) overrides the remainder of the Act. Relevant case law will be referred to in order to support the conclusion reached.

Chapter five will conclude the research by summarising the findings outlined in previous chapters, as well as any unresolved issues and problems which were identified, and where applicable, will propose solutions or areas for further clarification or amendment.

CHAPTER 2

CRITICAL ANALYSIS OF SECTION 24JB

2.1 INTRODUCTION

This chapter will address the main goal of this thesis, which is to investigate the meaning of section 24JB, through a critical analysis of domestic tax legislation. Specifically, this chapter will determine the scope of section 24JB by examining the definition of a "covered person" as well as the specific financial instruments to which the section applies. This chapter will not provide a detailed discussion of subsection 24JB(3) as Chapter 3 is entirely devoted to this analysis.

Section 24JB(2) states that:

> Subject to subsection (4), there must be included in or deducted from the income, as the case may be, of any covered person for any year of assessment, all amounts in respect of financial assets and financial liabilities of that covered person that are recognised in profit or loss in the statement of comprehensive income in respect of financial assets and financial liabilities of that covered person that are recognised at fair value in profit or loss in terms of International Accounting Standard 39 of IFRS or any other standard that replaces that standard or in the case of commodities, at fair value less cost to sell in profit or loss in terms of IFRS for that year of assessment…

The requirements of section 24JB can therefore be summarised as follows:

- an inclusion in or deduction from income of any covered person;
- of all amounts that are recognised in profit or loss in the statement of comprehensive income;
- in respect of financial assets and financial liabilities that are recognised at fair value in profit or loss in terms of IAS 39.

The various terms and concepts relating to these requirements are discussed below.

2.2 COVERED PERSON

The first requirement of section 24JB relates to a "covered person". A covered person is defined in section 24JB(1) as:

(a) any authorised user as defined in section 1 of the Financial Markets Act that is a company;
(b) the South African Reserve Bank;
(c) any -
  (i) bank;
  (ii) branch;
  (iii) branch of a bank; or
  (iv) controlling company
  as defined in section 1 of the Banks Act;
(d) any company or trust that forms part of a banking group as defined in section 1 of the Banks Act excluding -
  (i) a company that is a long-term insurer as defined in section 1 of the Long-term Insurance Act;
  (ii) a company that is short-term insurer as defined in section 1 of the Short-term Insurance Act;
  (iii) a company of which more than 50 per cent of the shares are directly or indirectly held by a company contemplated in subparagraph (i) or (ii) if that company does not form part of the same group of companies as a bank.

2.2.1 Authorised user

The Financial Markets Act No.19 of 2012 defines an authorised user as "a person authorised by a licensed exchange to perform one or more securities services in terms of the exchange rules, and includes an external authorised user, where appropriate." This includes brokers that are members of the JSE (National Treasury: 2013a).

2.2.2 Bank

The Banks Act No.94 of 1990 (hereafter referred to as the Banks Act) defines a "bank" as *a "public company registered as a bank in terms of this Act*". It follows that foreign banks would not be registered as a bank in terms of the Banks Act but would instead be registered under the relevant Act prevailing in the foreign bank's country of incorporation. Foreign banks are therefore not included under subsection (c)(i) of the definition of a covered person.

2.2.3 Branch

A "branch" is defined in section 1 of the Banks Act to mean an institution that is not a public company, but a means by which a foreign institution conducts the business of a bank in the Republic. A foreign institution is not defined in the Banks Act but Government Gazette No. 30627 defines it as an institution which is not registered as a bank in terms of the Banks Act, but which is lawfully established in a country other than South Africa and which conducts a business similar to the business of a bank. In other words, "branch" would simplistically refer to a local branch of a foreign bank (National Treasury: 2013a).

2.2.4 Branch of a bank

"Branch of a bank" is defined in section 1 of the Banks Act as an institution by means of which a bank (as defined) conducts the business of a bank outside the Republic. This would refer to a foreign branch of a local bank that is registered in terms of the Banks Act. Since a branch is not considered to be a separate legal entity, the application of section 24JB to branches of resident banks is consistent with the general principle that branches are regarded as the same legal entity as the resident bank for legal and taxation purposes.

2.2.5 Controlling company

A "controlling company" is defined in section 1 of the Banks Act as a public company that is a controlling company in relation to a bank as defined. Depending on the group structure adopted by the banking group it is possible for a company that is not registered as a bank in terms of the Banks Act to be the controlling group company which acts as the holding company of all the entities

within the group of companies, including the bank. This controlling company would also be included under the definition of a covered person despite the fact that it is not engaged in banking activities and is merely a holding company.

The purpose of the introduction of section 24JB is to govern the taxation of financial instruments that are traded in high volumes and considered to be highly liquid (National Treasury: 2013a). The issue that arises with the inclusion of the controlling company is that it is unlikely that the group holding company would be trading financial instruments in high volumes. Holding companies generally act as passive investment companies whose only activities involve the passive holding of interests in subsidiaries. To the extent that the holding company enters into any financial instrument falling within the scope of section 24JB, for example for purposes of hedging the investment in subsidiaries, any resulting unrealised gains and losses would be taxed. This would result in a considerable cash flow problem for the holding company, which is unlikely to have generated any other profits from which to fund the resulting tax liabilities. It is proposed that SARS should consider issuing a Binding Class Ruling to exclude the controlling companies of banking groups, provided that the holding companies are not engaged in banking activities and do not structure transactions purposely within the controlling company in order to avoid the scope of section 24JB with the sole or main intention of avoiding or postponing the liability for tax.

2.2.6 Banking group

A “banking group” is defined in section 1 of the Banks Act as a group of persons engaged in financial activities, one of which is a bank, and are either associates in relation to each other, or are persons that are so interconnected that should one of them experience financial difficulties, the other one would be likely be be adversely affected, irrespective of where any of the companies are domiciled.

An “associate” in relation to a company is defined in section 37(7) of the Banks Acts as any subsidiary or holding company of that company, any other subsidiary of that holding company (i.e. fellow subsidiaries) and any other company of which that holding company is a subsidiary (i.e. the ultimate holding company).

Subsection (d) of the definition of covered person includes any company or trust that forms part of a banking group as defined but excludes:

(i) a company that is a long-term insurer as defined in section 1 of the Long-term Insurance Act;

(ii) a company that is short-term insurer as defined in section 1 of the Short-term Insurance Act;

(iii) a company of which more than 50 per cent of the shares are directly or indirectly held by a company contemplated in subparagraph (i) or (ii) if that company does not form part of the same group of companies as a bank.

From this definition, it is clear that all foreign subsidiaries that are part of the banking group are included in the definition of covered person and thus fall within the ambit of section 24JB as the definition of banking group specifically states that it is irrelevant where any of the companies are domiciled. This creates the situation that all foreign group entities (even those that are not controlled foreign companies but merely foreign associates with shareholdings of less than 50 percent) could be subject to tax in South Africa due to section 24JB.

Another problem that arises with subsection (d) of the covered person definition is that there is no exclusion for entities that form part of the insurance group, unless each entity of the group is itself a long-term or short-term insurer as defined or is a subsidiary of the long-term or short-term insurer. Therefore, any controlling company of the long-term or short-term insurer would fall within the ambit of section 24JB as a covered person, despite the fact that these insurance group companies are not involved in banking activities and would generally hold investments on capital account as opposed to holding them for trading purposes. A submission was made to National Treasury that the long-term insurer definition should be extended to refer to a controlling company as defined in the Insurance Laws Amendment Bill, 2013 (the Bill). National Treasury's response to the comment raised was that tax legislation cannot be amended to refer to a definition in a Bill. It is therefore submitted that once the Bill is enacted, controlling companies of an insurance group will also be excluded from the scope of section 24JB (National Treasury: 2014b).

2.3 ALL AMOUNTS THAT ARE RECOGNISED IN PROFIT OR LOSS IN THE STATEMENT OF COMPREHENSIVE INCOME

The second requirement of section 24JB refers to "amounts that are recognised in profit or loss in the statement of comprehensive income". The Explanatory Memorandum on the Taxation Laws Amendment Bill 2012 (hereafter referred to as the Explanatory Memorandum 2012) states (at 58), that a covered person is required to include in taxable income most of the fair value measurements that arise during the year (National Treasury: 2012). Similarly, the Explanatory Memorandum on the Taxation Laws Amendment Bill 2013 (hereafter referred to as the Explanatory Memorandum 2013) states that the main impact of section 24JB is to take into account the changes in fair value for certain financial instruments (National Treasury: 2013a). This stated intention is arguably not followed through into the current wording of section 24JB which specifically refers to the inclusion of "all amounts" in respect of "qualifying instruments" that are recognised in profit or loss in the statement of comprehensive income. The use of the words "all amounts" therefore would include any amount that is recognised in profit or loss in respect of that financial instrument and not merely fair value movements.

It is submitted that the word "all" was intentionally used to include not only fair value amounts but all amounts in respect of instruments falling in within the scope of section 24JB, despite the intention according to the Explanatory Memoranda. In *R Koster & Son (Pty) Ltd & another v CIR,* 1985 (2) SA 831 (A), 47 SATC 23, it was stated by Nicholas JA, (at 32), "…The proper way of construing a word like 'all' in such a context as this is to say that 'all' means 'all', and it does not mean 'some' unless you can find a compelling context which forces you to place some limitation on the word."

Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability will be recognised as income or an expense in profit or loss (IASB: 2015a). Therefore the reference to "all amounts" in section 24JB would include other non-fair value amounts such as interest and dividends. This is confirmed by the need for a specific exclusion in section 24JB(2)(b) for dividends received or accrued to a covered person. The unintended consequences arising from the inclusion of all amounts as opposed to only fair value amounts will be explained in conjunction with the discussion of the phrase "in respect of a dividend" under 2.5.5 below.

2.4 IN RESPECT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES THAT ARE RECOGNISED AT FAIR VALUE IN PROFIT AND LOSS IN TERMS OF IAS 39

The aspect of section 24JB(2) that will be discussed under this section relates to the classification of financial assets and financial liabilities in terms of IAS 39. In order to understand the impact of the reference to this specific classification it is necessary to provide a brief overview of the various classification categories provided for in IAS 39.

2.4.1 Categories of financial instruments

IAS 39.9 classifies financial instruments at initial recognition, which determines the subsequent accounting treatment. IAS 39 stipulates four categories for financial assets and two categories for financial liabilities (PricewaterhouseCoopers LLP: 2009). The four categories of financial assets are -

(a) financial assets at fair value through profit or loss;
(b) loans and receivables;
(c) held to maturity investments; and
(d) available-for-sale financial assets.

The two categories of financial liabilities are -

(a) financial liabilities at fair value through profit or loss; and
(b) other financial liabilities (measured at amortised cost).

As indicated above, section 24JB(2) only applies to financial instruments in the first category stated in (a) above, being financial instruments that are recognised "at fair value in profit or loss" in terms of IAS 39. This means that financial assets classified in categories (b) to (d) above and financial liabilities classified in category (b) above will fall outside the scope of section 24JB.

A financial asset or financial liability can be classified as at fair value through profit or loss if either of the following requirements is met -

(a) it is classified as held-for-trading; or
(b) it is upon initial recognition, designated at fair value through profit or loss (IASB 2015c:9).

2.4.1.1 Held-for-trading

In simple terms, a financial asset is classified as held-for-trading if it is acquired for purposes of generating short-term profits, is part of a portfolio of instruments that are managed together for the same purpose or is a derivative.

2.4.1.2 Designated at fair value through profit or loss

An entity may designate a financial asset at fair value through profit or loss in three situations -

(a) in order to eliminate or significantly reduce a measurement or recognition inconsistency (an accounting mismatch);
(b) the instrument is part of a group of financial assets or financial liabilities that are managed and the performance evaluated on a fair value basis; or
(c) the instrument is a hybrid instrument that contains an embedded derivative.

<u>Accounting mismatch</u>
It may happen that financial assets and financial liabilities that are economically related are treated inconsistently in the financial statements. This may arise, for example, where a financial asset is classified as "available-for-sale" (where the gains and losses on the financial instruments are recognised in other comprehensive income) and the corresponding offsetting liability is classified as "loans and receivables" (where the changes in fair value are not recognised). The company may be of the view that it would provide more relevant information if both the financial asset and financial liability are classified as "at fair value though profit or loss". This is specifically relevant where the financial asset and financial liability provide a natural offset because they share the same risk, but where hedge accounting cannot be applied since neither of the instruments is a derivative (PricewaterhouseCoopers LLP: 2009).

There are many subjective decisions that an entity may take in order to conclude that the classification of financial assets and financial liabilities as "at fair value through profit or loss" does in fact eliminate or significantly reduce a measurement inconsistency. For example, there is no definition or prerequisite for what is meant by "significantly reduces" a mismatch. It is also possible

to apply the designation to non-related financial assets and liabilities, provided that the changes in fair value of both instruments are subject to the same risk, which is in itself a subjective view. In addition, it is also not clear to what extent evidence needs to be provided to substantiate that there is an accounting mismatch.

Maroun (2105:154) raises the concern that an instrument that is designated as "at fair value through profit or loss" in order to avoid an accounting mismatch is not automatically excluded from the scope of section 24JB and it is not clear why the legislature failed to deal with this designation. As explained above, the designation of financial instruments as "at fair value through profit or loss" on the basis that it reduces an accounting mismatch, ensures that there is matching of the offsetting gains and losses on both related instruments in the income statement. Section 24JB will include both the financial asset and the financial liability within its scope and thereby also achieve tax symmetry. If instruments designated on this basis were to be excluded this would, in fact, result in a tax mismatch.

Management of the asset on a fair value basis

An entity may manage and evaluate a group of financial assets or financial liabilities in such a way that it results in more relevant information. This designation is based on the manner in which the entity manages and evaluates performance of the instruments, rather than on the nature of the financial instruments (IASB: 2015c). In order to use the designation two requirements must be met, namely, that there must be a documented risk management or investment strategy and that information provided internally to key management must be provided on this basis. The requirement for the use of this designation is that a group of financial assets and liabilities should be managed and performance evaluated on a fair value basis. This means that management should evaluate the portfolio on a full fair value basis and not on a risk-by-risk basis. Therefore, an entity's risk management policy and the resulting management information should look at the entire change in fair value and not for only certain risks, in order to justify use of the fair value designation (PricewaterhouseCoopers LLP: 2009).

No specific requirements are prescribed in order for an entity to demonstrate that financial assets and financial liabilities are measured and their performance evaluated on a fair value basis, nor is there a prescription on the level of detail required with regard to the documentation of the entity's risk management or investment strategy.

Embedded derivative

An embedded derivative refers to the situation where the terms and conditions of a derivative instrument are embedded in a financial instrument, which is referred to as the host contract. The terms and conditions are referred to as the embedded derivative and the combination of the host contract and the embedded derivative is referred to as a hybrid instrument. The objective of an embedded derivative is to change the nature of the cash flows that would otherwise be required by the host contract and effectively shift the risk between the parties (PricewaterhouseCoopers LLP: 2009).

IAS 39.11 prescribes conditions where the embedded derivative must be separated from the host contract and treated as a separate derivative. This would mean that the derivative would be classified as held for trading and the host contract would be classified according to the normal classification that would have applied had there been no embedded derivative. The scope of this thesis does not include a detailed discussion of embedded derivatives and the requirements for bifurcation but suffice it so say that this is a complex area with much scope for subjectivity and the financial accounting treatment would not necessarily be the same in all instances within the same entity or across different entities.

2.4.1.3 Conclusion

What is apparent from the brief overview of the accounting classification of financial instruments is that there is an opportunity for the same kind of financial assets and financial liabilities to be classified differently in terms of IAS 39. Similarly, a covered person could have different views on how to treat the same financial instruments and this creates an opportunity to structure transactions in such a way that the most optimal tax outcome is achieved, based on the fact that section 24JB taxes financial instruments in accordance with the accounting classification.

As concluded by Maroun (2015: 158):

> Perhaps the greatest challenge to the legitimate application of s24JB arises from the opportunity to structure transactions deliberately to achieve specific tax outcomes…The result of s24JB is the need to interpret financial reporting requirements, designed for a specific purpose, in an unintended context leading to a number of unforeseen problems.

2.4.2 Recognised versus classified

The current wording of section 24JB(2) provides for the inclusion in income of a covered person of "all amounts in respect of financial assets and financial liabilities of that covered person that are **recognised** in profit or loss in the statement of comprehensive income in respect of financial assets and financial liabilities of that covered person that are **recognised** at fair value in profit or loss in terms of IAS 39 of IFRS…" (emphasis added).

Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition. It involves the description of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement. Items that satisfy the recognition criteria should be recognised in the balance sheet or income statement (IASB 2015a).

Based on the above explanation, it is clear that an element can only be included in the income statement or balance sheet through recognition. The first reference to recognition relates to the recognition of the amount (that relates to the financial asset or financial liability) in the income statement and therefore it is submitted that the first reference to recognition in section 24JB(2) is correct. The second reference to recognition, however, refers to the recognition of the financial asset or financial liability as opposed to the amount. A financial asset or financial liability can be classified according to one of the categories outlined in 2.4.1 above, which determines how the instrument is measured in the financial statements. Recognition on the other hand refers to the inclusion of amounts in relation to that financial instrument in the income statement and not to the inclusion of the financial instrument itself. It is therefore submitted that the wording (in respect of financial assets and financial liabilities of that covered person that are recognised at fair value in profit or loss in terms of IAS 39 of IFRS . . .) should be changed to read as follows "…in respect of financial assets and financial liabilities of that covered person that are classified as 'at fair value through profit or loss' in terms of IAS 39 of IFRS…" (the terms that are underlined refer to the recommended change).

2.5 SECTION 24JB(2) EXCLUSIONS

Section 24JB(2) excludes certain amounts from its ambit, which are listed as follows:

any amount **in respect of** -

(a) A financial asset that is

- (i) a share;
- (ii) an endowment policy;
- (iii) an interest held in a portfolio of a collective investment scheme;
- (iv) an interest in a trust; or
- (v) an interest in a partnership,

if that financial asset was upon initial recognition designated in terms of International Accounting Standard 39 of IFRS or any other standard that replaces that standard by the covered person at fair value through profit or loss because that financial asset is **managed and its performance is evaluated on a fair value basis;** or (emphasis added)

(b) a dividend or foreign dividend received by or accrued to a covered person.

2.5.1 In respect of

Section 24JB(2)(a) excludes amounts "in respect of" instruments specifically listed in subsection (2)(a)(i) to (v) from the scope of the section. In order to examine the possible interpretations of the phrase "in respect of", an analysis of relevant case law is necessary to determine the meaning of this term in other contexts.

In *CIR v Crown Mines Ltd* 1923 AD 121 it was stated (at 128) that, "the words in respect of may be used in various senses, and in each case it is essential to examine the context in order to ascertain the sense in which [they are] used". In the more recent case of *SIR v Wispeco Housing (Pty) Ltd* 1973 (1) SA 783 (A) 77, the meaning of the phrase was held to suggest a direct or causal relationship. This is contrasted with the meaning conferred in the earlier cases of *CIR v Butcher Bros (Pty) Ltd* 1945 AD 301 and *SBI v Raubenheimer* 1969 (4) SA 314 (A), where the view was

that the words "in respect of" did not necessarily indicate such a causal relationship but instead meant "in relation to" or "with reference to".

In *ITC 1340* 1980 43 SATC 210(C) it was stated by Viviers J (at 213) that:

> ...the context wherein the expression "in respect of" and "in connection with" occur is of vital importance. The true position was, in my opinion, happily summarised by Schreiner, JA in Rabinowitz and Another v De Beer's Consolidated Mines Ltd and Another 1958 (3) SA 619 (AD) at 631, as follows:
>
> > "expressions like 'in respect of' and 'in connection with', though they may sometimes be used to cover a wide range of association, must in other cases be limited to the closer or more direct forms of association indicated by the context."

The Supreme Court of Appeal, in *Stevens v Commissioner of SARS* 2006 SCA 145 (RSA), considered the phrase "in respect of" and "by virtue of" to be similar as both refer to a causal relationship.

Based on the above views it is clear that the words must be interpreted in the context in which they are used and if the judgement in *Stevens v Commissioner* (supra) is followed then in order for an amount to constitute an amount received in respect of a financial asset, there has to be a causal relationship between the amount and the financial asset.

In *CIR v Kotze* (1998) 64 SATC 447 (C), the meaning of "in respect of" was considered in the context of paragraph (c) of the definition of gross income, which includes in "gross income" "any amount, including any voluntary award, received by or accrued to **in respect of** services rendered or any amount....received or accrued **in respect of** or by virtue of any employment or the holding of any office" (emphasis added). It was held by the court that were there where two or more causes for the receipt of a payment, the only relevant cause is the *causa causare* (i.e. the immediate or direct cause), as this would determine whether the payment was received "in respect of" services rendered. The *causa sine quo non* which represents the indirect or secondary cause is not sufficient.

From this discussion it is clear that there must be a causal relationship between the amount and the listed financial assets that are excluded and the amount in respect of a dividend or foreign dividend.

2.5.2 A share

Section 1 of the Act defines a share to mean "in relation to a company, any unit into which the proprietary interest in that company are divided". This definition has been aligned to the definition of a "share" in section 1 of the Companies Act, No. 71 of 2008 (hereinafter referred to as the Companies Act) and includes both equity and preference shares.

2.5.3 An interest in a partnership

The Explanatory Memorandum on the Taxation Laws Amendment Bill 2014 (hereinafter referred to as the Explanatory Memorandum 2014) states that it is the intention that normal tax principles will apply to the business of a covered person carried on via a partnership with another party. Since an interest in a partnership may be treated as a financial asset, an exclusion was inserted into section 24JB (National Treasury: 2014a).

2.5.4 Financial assets managed on a fair value basis

An entity may designate financial instruments "at fair value through profit or loss" if the group of financial assets are managed and the group's performance is evaluated on a fair value basis. This would be based on the manner in which the entity manages and evaluates the performance of the financial instruments, rather than on the nature of such instruments (IASB 2015c:AG4H).

The requirement for this designation of a financial instrument is that the entity must manage the instruments and evaluate their performance in accordance with a documented risk management or investment strategy and such information must be provided internally to the entity's key management to ensure more relevant information. Instruments that would typically fall within this designation are shares that are not held-for-trading but rather for strategic purposes, or a portfolio of assets that the entity manages in order to maximise returns of those assets.

The previous version of section 24JB included an exclusion for equities that are capital in nature. A submission was made to National Treasury that the exclusion of financial assets of a capital nature was not in line with the intention of excluding assets designated solely for management purposes. It

was pointed out that financial accounting treatment does not distinguish between capital and revenue. National Treasury accepted the point raised and agreed to adjust the wording to only exclude items designated as a result of management's decision to manage and evaluate assets on a fair value basis (National Treasury: 2013b).

2.5.5 A dividend received or accrued

The first consideration is whether the words "dividend or foreign dividend received or accrued" refer to the accounting or tax definition of a dividend. Since section 24JB, unlike any other section of the Act, refers to both accounting and tax concepts it must be considered whether the accounting or tax meaning of a dividend is referred to in section 24JB(2). This is of particular relevance with regard to preference dividends which are treated differently from an accounting and tax perspective. In terms of IAS 32, preference shares with a fixed date of maturity will be treated as a financial liability and the dividends classified as interest since there is a contractual obligation to deliver cash for both dividends and repayment of the principal (PricewaterhouseCoopers LLP: 7.18). In terms of the Act, a preference share meets the definition of a share and thus the dividends declared on a preference share meet the definition of a dividend (being an amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company). Therefore, if the accounting definition of a dividend is used, preference dividends would remain within the ambit of section 24JB, as they would be classified as interest and not dividends for accounting purposes, whereas they will be excluded if the tax definition is used. Section 24JB(3) refers to any amount taken into account in Part I of Chapter II, which excludes the definitions in section 1 of the Act. In other words section 24JB(3) does not override the section 1 definitions and therefore it is submitted that the tax definition of a dividend in section 1 must apply.

The next issue for consideration is whether the words "received by or accrued to" bear the accounting or tax meaning. In terms of the Companies Act, a dividend only legally accrues to a shareholder once the dividend is declared. Section 46 of the Companies Act provides that all distributions must be authorised by the board of the company by means of a resolution in which the board must acknowledge that it has applied the solvency and liquidity test. However, for accounting purposes, dividends on preference shares with a fixed date of maturity and with fixed dividend payment dates, which are treated as interest, are thus accrued on a straight line basis using the effective interest rate method in IAS 39 without any regard to whether the dividends have been

declared by the company (IASB: 2014a). It is not clear what is envisaged by section 24JB(2) and whether the accounting or tax meaning should be assigned to the words "received by or accrued to".

Section 24JB(2)(b) excludes from its scope both local and foreign dividends received by or accrued to a covered person. In *Geldenhuys v CIR* 1974 (3) SA 256 (c), 14 SATC 419 the words "received by or accrued to" were held to mean received by the taxpayer on his own behalf for his own benefit. A dividend received by or accrued to the legal owner of the share is thus received by him for his own account and benefit unless he antecedently divests himself of the dividend in favour of another person, in which case the amount will not be "received by or accrued to" him as envisaged in section 24JB(2)(b). This is confirmed in *CIR v King* 1947 (2) SA 196 (A), 14 SATC 184 where it was stated by Watermeyer CJ (at 212), "a taxpayer can, while retaining the ownership of his capital arrange for the fruits of that capital which are in reality part of his income, to be received by someone else, and thus he can free himself from taxation in respect of these monies".

In *Lategan v CIR* 1926 CPD 23, 2 SATC 16 the meaning of accrued was held to be that to which the taxpayer has become entitled. In the case of a dividend a shareholder is only legally entitled to a dividend once it has been declared by the company. Section 24JB(2)(b) refers to a dividend received by or accrued to a covered person and therefore it is not necessary that the dividend is paid to the taxpayer but that it must have accrued to the taxpayer.

Another issue for consideration, specifically with reference to the exclusion of a dividend received by or accrued to a covered person, is the preceding words "in respect of". The meaning of this phrase has been discussed in general in 2.5.1 above, however when the meaning of the phrase "excluding any amount in respect of . . . a dividend or foreign dividend received by or accrued to a covered person" is considered, further ambiguity arises. A possible argument exists that the preceding words "in respect of" are superfluous and add no additional meaning to the exclusion of a dividend. As an example, the phrase could be given the narrower interpretation which would only refer to actual dividends received or accrued, or it could be interpreted as referring, not only to dividends, but also to other amounts that are in respect of a dividend or are determined with reference to a dividend, such as manufactured payments or other amounts paid under a derivative contract that refer, wholly or partly, to a dividend. This can be explained by means of the following examples.

In terms of a securities lending arrangement, a manufactured payment is made by the borrower in order to compensate the lender of the share for the dividend received by the borrower on the borrowed share. This manufactured payment is clearly "in respect of a dividend" since the amount of the manufactured payment is only determined with reference to the amount of the dividend and nothing else. In terms of section 24JB, the manufactured payment would be excluded from the scope of section 24JB in terms of subsection (2)(b) and would arguably not be deductible under section 11(a) of the Act on the basis that section 24JB(3) overrides the rest of the Act for instruments falling within the scope of section 24JB(2), as will be discussed in detail in Chapter 3.

Another issue arises on equity shares on which dividends are declared. The unrealised fair value movement of a share that is held-for-trading by a covered person would fall within the scope of section 24JB(2), since all amounts in respect of a financial asset that are recognised in profit and loss in respect of a financial asset that is recognised "at fair value in profit or loss" in terms of IAS 39, is included in income in terms of section 24JB(2). The exclusion in section 24JB(2)(a)(i) would not apply since the share is held-for-trading and not designated at fair value through profit or loss because the asset is managed and its performance evaluated on a fair value basis. The problem arises when one considers the exclusion under section 24JB(2)(b). Typically, where a dividend has been declared by a company, the market value of a share may arguably increase in line with the dividend declared (commonly known as the *cum div* share price of a share). The question is whether the unrealised gain constitutes an amount "in respect of" a dividend. Based on the discussion above, there could be a causal link or nexus between the gain sought to be included in income under section 24JB(2) and the dividend which has legally accrued to the shareholder as contemplated in section 24JB(2)(b). If this is the case, then the portion of the unrealised gain that is in respect of the dividend must be excluded from section 24JB(2)(b). However, it is argued that the value of a share, specifically a listed share, is not exclusively determined with reference to a dividend but to other factors including *inter alia*, global and local market trends and other domestic determinants such as interest rates, inflation rates, economic cycles and exchange rates, and therefore it cannot be determined which portion of the gain is in respect of a dividend (Van den Berg: 2006).

Contracts for difference (CFD) are over-the-counter derivatives that reference an underlying instrument whereby the party that is long the CFD (i.e. the holder of the CFD) would benefit from an increase in value of the underlying instrument and would be compensated for such increase by the party that is short the CFD (i.e. the issuer of the CFD). As far as dividends accruing on the share

are concerned in the case of a CFD that references a share, the person that is long the CFD would be entitled to be compensated for the dividend that accrues to the legal share owner (i.e. the holder of the long position is treated as if he owns the share). It should be noted that a CFD is not a share and thus the company declaring the dividend would declare the actual exempt dividend (in terms of section 10(1)(k)(i) of the Act) to the registered holder of the share, whereas the CFD holder receives a taxable payment from the CFD issuer as compensation for the dividend (Masondo: 2009).

In this example, if the person that is long the CFD is a covered person, the mark-to-market movements would be taken into account in terms of section 24JB(2) since the CFD is a derivative and is thus automatically recognised "at fair value through profit or loss" on the basis that it is held-for-trading. The problem is that a portion of the mark-to-market movement references the dividend that was declared on the underlying share, however section 24JB(2)(b) only excludes dividends received by or accrued to a covered person. Since the dividend did not accrue to the long CFD holder but instead accrued to the short position holder, the full mark-to-market remains taxable in section 24JB(2). Conversely, if the short position holder is a covered person, the mark-to-market loss that is payable to the long CFD holder would arguably not be deductible in terms of section 24JB(2) since it would be excluded under section 24JB(2)(b) as being an amount in respect of a dividend received by or accrued to a covered person, since the dividend legally accrued to the short CFD holder. It is clear that this creates a disparity in the tax treatment of the same financial instrument. This could not have been the intention of National Treasury when introducing section 24JB.

2.6 ANTI-AVOIDANCE PROVISION

Section 24JB(4) states that subsection (2) will not apply where the section was used to create tax mismatches for the purposes of avoiding or reducing a covered person's tax liability. Specifically, the anti-avoidance provision applies where an agreement is entered into in respect of a financial instrument between a covered person and a non-covered person solely or mainly for purposes of reducing, postponing or avoiding the liability for tax.

The potential for mismatch is greatest within a consolidated group, as the majority of taxpayers fall outside the ambit of section 24JB (National Treasury: 2012). The Explanatory Memorandum 2012 is concerned specifically with the scenario where a derivative contract is entered into between

members of a consolidated group, where one person is a covered person and the other falls outside the scope of section 24JB and where the derivative contract is economically unhedged by the covered person.

The issue is that the parties could structure the transaction in such a way that the covered person claims a deduction of the unrealised loss on the derivative contract in terms of section 24JB(2), whereas the non-covered person not falling within the scope of section 24JB would follow normal tax principles and only be taxed on the opposite gain upon realisation, thereby postponing the liability for tax. In order to explain the concern around the position being unhedged, it is necessary to elaborate on the mechanics of economic hedging. "To hedge a position means to reduce the risk associated with a financial transaction or position, by selling the risk or by taking an opposite financial position, with the effect that a market movement would not result in substantial financial loss" (Van den Berg: 2006). Therefore, if the covered person is unhedged it means that there is no equal and opposite gain that will be included in income in terms of section 24JB, in which case there would be a delay in the tax liability due to the fiscus resulting from the accelerated claiming of an unrealised loss without an offsetting taxation of the unrealised gain.

2.7 PHASING IN AND TRANSITIONAL RULES

Subsection 24JB(5) provides for the inclusion in or deduction from income of a covered person for the post realisation years of an amount calculated in terms of subsection 24JB(6). The term "post realisation years" is defined in section 24JB(1) as the three years immediately succeeding the "realisation year", which in turn is defined as the year of assessment immediately preceding the year of assessment ending on or after 1 January 2014. Therefore, a covered person with a year of assessment that ends on 1 December 2014 would have a realisation year ending on 1 December 2013 and the post realisation years ending on 31 December 2014, 31 December 2015 and 31 December 2016 respectively.

Subsection 24JB(6) effectively requires the realisation year (in the above example this would be 31 December 2013) to be used as the "base year" for purposes of calculating the amount that needs to be phased in over the three-year post realisation period. The phase-in amount is determined by calculating the difference between the net financial reporting value and the tax base amount of all assets and liabilities subject to section 24JB(2). One third of this amount is then either deducted

from or included in the covered person's income in each of the three realisation years. The Explanatory Memorandum 2013 (although it still refers to a phase-in period of four years, which was later changed to three years), explains that the reason for the phase-in approach is to ensure minimal disruption by the shift in approach to taxing financial instruments, since the amounts could be large enough to create cash flow problems (National Treasury: 2013a).

The effect of the phase-in is such that in the post realisation years the deferred tax asset or liability includes a portion of the prior year's deferred tax balance, which results in an accelerated taxation of the unrealised gains or losses which would have only been taxable or deductible upon realisation prior to the introduction of section 24JB. This effectively results in a retrospective application of tax law (Maroun, 2015:157).

Section 24J(9) no longer applies to a covered person with effect from any year of assessment ending on or after 1 January 2014, as section 24JB will be the only regime governing the taxation of financial instruments of a covered person. It is interesting to note that section 24J(9) is also no longer applicable to a non-covered person for any year of assessment on or after 1 April 2014. A non-covered person is forced to revert to sections 24J(2) to (8), 24K and 24L. Section 24J(9A) provides for the transitional arrangement whereby a deemed disposal and deemed acquisition at the market value will arise. This deemed event will apply at the close of business on the last day of the last year of assessment in which section 24J(9) applied to the company.

2.8 CEASING TO BE A COVERED PERSON

Section 24JB(7) applies where a covered person ceases to be a covered person before the expiry of the post realisation years. The subsection provides that all untaxed amounts that were to be spread over the three-year period will be taxed in the year of cessation.

Section 24JB(8) states that where a covered person ceases to be a covered person, a deemed disposal will be triggered and a subsequent reacquisition of the instruments at market value. This ensures that all unrealised gains and losses on financial instruments falling within the scope of section 24JB will be taxed before exiting the regime and such instruments still on hand will be taxed according to sections 24J(2) to (8), 24K and 24L. This is similar to the transitional rules provided for in section 24J(9A).

2.9 INTERNATIONAL FINANCIAL REPORTING STANDARD 9

IFRS 9 is effective from 1 January 2018 but entities may choose to adopt the standard prior to that date. The salient differences between the classification of financial instruments under IFRS 9 and IAS 39 are highlighted below.

The classification of financial instruments determines how such instruments are accounted for in the financial statements and how they are subsequently measured (IASB: 2014b). IFRS 9 has three classification categories for financial assets which are:

(a) amortised cost;

(b) fair value through other comprehensive income; and

(c) fair value through profit and loss.

The existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale have been removed. The IAS 39 classification for liabilities has been retained (KPMG IFRG Limited: 2014). IFRS 9 determines the classification of financial assets according to the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset. Furthermore, as opposed to IAS 39, IFRS 9 applies one classification approach for all types of financial assets.

IFRS 9 only permits a financial asset to be designated as at fair value through profit or loss if doing so eliminates or significantly reduces an accounting mismatch. The other two designation options available under IAS 39, i.e. relating to an embedded derivative or the management of the asset on a fair value basis, have been removed. The exclusions currently provided under section 24JB(2)(a) are only applicable if the financial asset was, upon initial recognition, designated at fair value through profit or loss because that financial asset is managed and its performance is evaluated on a fair value basis. Since this designation option is no longer available under IFRS 9, the wording under section 24JB(2) that refers to "or any other standard that replaces that standard" will not apply since the entire concept no longer applies. This will require a reconsideration and rewording of section 24JB(2).

Furthermore, under IFRS 9, an entity may at initial recognition make an irrevocable election to present in the statement of other comprehensive income subsequent changes in the fair value of an

investment in an equity instrument that is not held-for-trading. Under IAS 39, an entity that holds equity instruments that are not classified as held-for-trading is required to either designate the instruments as "at fair value through profit or loss" (in which case the market-value movements would be recognised in profit or loss) or as "available-for-sale" (in which case the market-value movements would be recognised in other comprehensive income). The election under IFRS 9 may provide an opportunity for an entity to manipulate the financial accounting on certain instruments that are likely to result in mark-to-market gains such that the unrealised gains on these instruments are recognised in other comprehensive income and therefore not subject to section 24JB. This opportunity for manipulation was not as easy under IAS 39 since the recognition of gains in other comprehensive income was only allowed for instruments classified as "available-for-sale" and this classification was only permitted on the basis that none of the other classifications applied.

Maroun (2015:157) raises the issue that section 24JB does not define "held for trade" or "acquired or incurred principally for purposes of selling or repurchasing" and therefore it is not clear whether the option to classify an instrument at fair value through other comprehensive income is available in law. It is respectfully submitted that the accounting classification or election of classifying instruments at fair value through other comprehensive income is not a tax concern. Section 24JB merely provides for the taxation of financial instruments to be congruent with the accounting treatment. A tax provision cannot seek to determine the correctness of the accounting treatment of an instrument and therefore it is not necessary for the Act to define the concept of "held for trade" or "acquired or incurred principally for purposes of selling or repurchasing". If the instrument meets these definitions under IFRS 9 then section 24JB will simply follow the accounting treatment.

There are many other differences between IAS 39 and IFRS 9 relating to the accounting treatment of embedded derivatives, reclassification of financial instruments and the treatment of impairments. However, this is beyond the scope of this thesis and since it is only mandatory to adopt IFRS 9 from 1 January 2018, it is assumed that there will be significant changes to section 24JB before this date.

2.10 CONCLUSION

This chapter provided a critical analysis of the wording of the provisions of section 24JB, which included a consideration of the scope of section 24JB by examining the definition of a "covered person" as well as the specific financial instruments to which the section applies, with reference to a

brief explanation of the classification of financial instruments in terms of IAS 39. Furthermore, the discussion included an analysis of the amounts excluded from the scope of section 24JB in respect of the financial assets listed under subsection 2(a) and (2)(b), which included an enquiry into the meaning of the phrase “in respect of” and the possible interpretations that may be adopted in this regard.

This chapter did not provide a detailed discussion of subsection 24JB(3) as it is submitted that the wording of this specific provision creates the most ambiguity and is open to various interpretations. This necessities a detailed discussion, as provided in Chapter 3.

CHAPTER 3

THE INTERACTION OF SECTION 24JB WITH THE REST OF THE ACT

3.1 INTRODUCTION

Chapter 2 provided a detailed analysis of the provisions of section 24JB apart from the wording of subsection (3) which will be discussed in this chapter. In order to address the research goals of this thesis as set out in Chapter 1, this chapter will provide a discussion of the possible interpretations of subsection 24JB(3) and the consequences ensuing from the various alternatives, specifically with regard to the pertinent question of whether section 24JB(3) overrides the rest of the Act.

Section 24JB(3) states that:

> any amount required to be taken into account in determining the taxable income in terms of any provision of Part I of Chapter II, or in determining any assessed capital loss of a covered person in **respect of a financial asset or a financial liability contemplated in subsection (2)** must only be taken into account in terms of this section. (emphasis added)

As a starting point it is noted that section 24JB(3) refers to "any amount" and therefore does not only refer to the fair value amounts in relation to the financial asset or liability.

De Koker (2015:25) states that:

> the word 'any' is a word of wide and unqualified generality. It may be restricted by the subject matter or the context, but *prima facie* it is unlimited. It is clear therefore that unless the context requires differently, it should be given a wide meaning. It has also been held that the words in a statute of general import, such as 'any offence', cannot be given any other than their proper or natural meaning, unless the legislature has either expressly or by manifest implication restricted such meaning.

Section 24JB(3) refers to any amount in respect of financial assets and liabilities "contemplated in subsection (2)". What is not clear is whether this phrase is qualifying the "amount" or the "financial asset or financial liability". The question is whether the phrase "contemplated in subsection (2)", refers to the fact that the **amount** that relates to the financial instrument must be "contemplated in subsection (2)" or whether the **instrument** itself must be "contemplated in subsection (2)" regardless of the fact that the amount relating to the instrument may not fall within the ambit of subsection (2). It is submitted that the current wording of subsection (3) is interpreted to mean that provided that the financial asset or financial liability is within the scope of section 24JB(2) (i.e. the financial asset or financial liability meets the requirements of section 24JB(2) and is not one of the financial assets that are specifically excluded in section 24JB(2)(a)) then all amounts in respect of that financial asset or financial liability must be dealt with only in respect of section 24JB.

This means that notwithstanding that an amount is not included in or deducted from income in terms of section 24JB(2) (for example because the amount is not included in the statement of comprehensive income as required in section 24JB(2)), provided that the financial instrument itself is contemplated in section 24JB(2), the amount cannot be dealt with under any other section of the Act other than section 24JB. On this basis, section 24JB arguably overrides all other sections of the Act.

Another possible interpretation is that section 24JB(3) can be read as follows: "**any amount** required to be taken into account in determining the taxable income in terms of any provision of Part I of Chapter II, or in determining any assessed capital loss of a covered person (in respect of a financial asset or a financial liability) **contemplated in subsection (2)** must only be taken into account in terms of this section (emphasis added). If the section is read this way then the emphasis is placed on the fact that the amount must have been contemplated in subsection (2) in order for section 24JB(3) to override the rest of the Act.

The Explanatory Memorandum 2013 states that:

> In order to prevent double counting, amounts taken into account in determining the taxable income or assessed loss in respect of a financial instrument within the scope of section 24JB(2) must only be taken into account under that section . . . In essence, if a financial instrument is taxed in terms of section 24JB any amounts in respect of that instrument will not be taken into account as gross income or a deduction under the general deduction provisions.

Therefore, based on the Explanatory Memorandum it is submitted that it is National Treasury's intention that section 24JB must override certain provisions such as the definition of "gross income" in section 1 of the Act, section 11(a) and section 9C for financial instruments of a covered person that are taxed in terms of section 24JB (National Treasury: 2013a). It is unclear whether this intention applies equally to sections such as sections 8E, 8F, section 10 and 10B, for example. However, based on the wording of section 24JB(3), it applies to all sections covered in Part I of Chapter II and therefore must arguably include these sections. The consequences of this interpretation are discussed below with reference to specific examples.

3.2 SPECIFIC PROVISIONS OVERRIDDEN

3.2.1 Gross income inclusions

Section 24JB(3) overrides Part I of Chapter II of the Act, which excludes the definitions contained in section 1. On this basis, section 24JB(3) does not override the gross income definition. However, section 5 of the Act (which falls within Part I of Chapter II) which subjects taxable income to income tax, is overridden by section 24JB. On this basis it is argued that all amounts in respect of financial assets and liabilities that fall within section 24JB(2) can only be included in taxable income as a result of section 24JB and not due to the general provisions of the gross income definition. Furthermore, the Explanatory Memorandum 2013 specifically states that if a financial instrument is taxed in terms of section 24JB any amounts in respect of that instrument will not be taken in account as gross income or a deduction under the general deduction provisions (National Treasury: 2013a).

This interpretation is specifically relevant in relation to instruments such as Funded Participation Agreements, Credit Linked Notes (CLNs), Equity Linked Notes (ELNs) and Exchange Traded Notes (ETNs), to the extent that there is no capital guarantee of upfront amounts advanced on the instruments.

Funded Participation Agreements

Under a Loan Market Association (LMA) Master Funded Participation Agreement (hereinafter referred to as a Funded Participation Agreement), a lender (known as the Grantor under this

agreement) can "sell-down" a portion or all of the credit risks associated with an underlying loan that was provided to a borrower. Under a funded agreement, the guarantee provider (referred to as a Participant) pays the Grantor the capital upfront, equal to the proportional face value of the loan being transferred to the Participant, thereby selling the credit protection to the Grantor (Thomson Reuters: 2015).

From a tax perspective, the amount received from the Participant must be included in the Grantor's gross income as it is an amount "received or accrued" (not of a capital nature) for purposes of the gross income definition. The definition of "gross income" in section 1 of the Act, reads as follows:

> "gross income", in relation to any year or period of assessment, means –
>
> (a) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident; or
>
> (b) in the case of any person other than a resident, the total amount in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic,
>
> during such year or period of assessment, excluding receipts or accruals of a capital nature…

Accordingly, in order to fall within the definition of "gross income" there must be an "amount", "received by or accrued to" the taxpayer in the relevant year of assessment, that must not be of a capital nature. The amount received from the Participant will be in the form of a cash payment and will thus constitute an "amount" as contemplated in the definition of "gross income". The meaning of "received by or accrued to" has been interpreted by the courts in a number of instances. A taxpayer is essentially required to include the relevant amount in his gross income at the earlier of receipt or accrual (*CIR v People's Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A) at 23-24). "Receipt" indicates a receipt of the relevant amount for the benefit of the relevant taxpayer (*Geldenhuys v CIR* 1947 (3) SA 256) (C)). "Accrued" means an unconditional entitlement to an amount. This has been established by the Appellate Division in the case of the *People's Stores* case (supra), confirming the decision of *Lategan v CIR* 1926 CPD 203, where it was held that an amount has "accrued" to the taxpayer where the taxpayer has become entitled to it, even if the amount is only payable after the end of the relevant year of assessment.

Applying the above to the present case, the Grantor receives the amount from the Participant for its own benefit on conclusion of the Funded Participation Agreement. Thus, the amount will accordingly both be "received" by and "accrued" to the Grantor on the day the amount is received. It should be considered whether the principles set out in *CIR v Genn* 1955 (3) SA 293 (A) may be applicable. In this case the Appellate Division held that borrowed money is not received by or accrued to the borrower within the meaning of such terms in the definition of "gross income". In this regard, Schreiner JA held as follows (at 122):

> It certainly is not every obtaining of physical control over money or money's worth that constitutes a receipt for the purposes of these provisions. If, for instance, money is obtained and banked by someone as agent or trustee for another, the former has not received it as his income. At the same moment that the borrower is given possession he falls under an obligation to repay. What is borrowed does not become his, except in the sense, irrelevant for present purposes, that if what is borrowed is consumable there is in law a change of ownership in the actual things borrowed.

Accordingly, should the amount received from the Participant constitute a loan, such amount will, in light of the *Genn* case, not be received by or accrue to the Grantor. In *Western Bank Limited v Registrar of Financial Institutions and Another* 1975 4 SA 37 (T) the court held (at 43):

> At common law the contract known as "verbruiklening", mutuum or loan for consumption, is classified as a contract founded on a thing (rei) and is not completed without delivery. It is a contract where the one person delivers some fungible thing to another person who is bound subsequently to return to the former a thing of the same kind, quantity and quality ... A loan of money is therefore basically a contract whereby money is delivered to another who undertakes to repay an equal sum at some future time.

The court continued to state (at 44) that: "There can thus be no loan of money, not even substantially, unless there is a contract to pay money to another who undertakes to repay an equal sum."

The amount received from the Participant will not be an amount borrowed by the Grantor. This amount is not in the nature of a loan as the Grantor is not under an obligation to return an equal amount to the Participant. The obligation of the Grantor in terms of the Funded Participant Agreement is to pay an amount to the Participant only as and when the Grantor receives the amount

from the client. The amount received from the Participant accordingly does not contain the *essentialia* of a loan of consumption, and the *Genn* case (supra) should accordingly not find application.

Lastly, it should be considered whether the amount will be of a capital nature, in which case it will not be included in the gross income of the Grantor. In determining whether an amount received or accrued is of a capital nature or otherwise, the intention of the taxpayer has to be determined and particularly whether the taxpayer is engaged in a scheme of profit making, which will indicate that the receipt or accrual is of a revenue nature and accordingly not of a capital nature (*CIR v Pick 'n Pay Employee Share Purchase Trust* 1992 (4) SA 39 (A)). Factors which may be taken into account in determining the intention of the taxpayer, include the taxpayer's *ipse dixit,* the length of time the asset is held (if the amount is received or accrued in respect of the disposal of an asset), the frequency of transactions, the nature of the taxpayer's business, the existence of an income flow from the holding of the asset and the reason for the disposal of an asset.

In the present case it is assumed, amongst others, that the business of the covered person comprises the receiving of deposits and amounts under derivative transactions and constitutes one of the profit making activities of the covered person. The hedging of assets for regulatory or credit purposes is a common transaction of covered persons in the normal conduct of banking business. The loans which are subject to this form of hedging are revenue assets in the hands of the covered person. The amount received from the Participant, which is akin to an amount received under derivative swap transactions, will accordingly not be of a capital nature.

Similarity, the Grantor cannot claim a section 11(a) deduction upon receipt of this amount as there is no unconditional obligation to pay any amount to the Participant at inception of the arrangement. There is a suspensive condition in the industry standard Funded Participation Agreement that states that the Grantor only has an unconditional obligation to pay any amount to the Participant if and to the extent that the client pays any amount (of interest and capital) to the Grantor. Thus, the Grantor can only claim the section 11(a) deduction for the payment made to the Participant when and to the extent that the client has paid any amounts to the Grantor. Loans of this nature are generally long term and could possibly span a period of up to five years or more. This results in a timing difference for the Grantor equal to the difference between the capital amount received and included in gross

income on receipt, and the section 11(a) deduction, which is only allowed when and to the extent the client has repaid a portion of the loan in that year.

Credit Linked Notes (CLNs)

In a funded credit derivative, typified by a credit-linked note (CLN), the investor in the note is the credit protection seller and makes an upfront payment to the protection buyer when buying the note. The performance of the CLN, including the maturity value, is linked to the performance of a specified underlying asset or assets as well as that of the issuing entity. If no credit event occurs during the life of the note, the redemption value of the note is paid to the investor on maturity. If a credit event does occur, then on maturity a value less than par will be paid out to the investor. This value will be reduced by the nominal value of the reference asset to which the CLN is linked (Davis, Choudhry & Fabozzi: 2006).

On a similar basis as explained above, the upfront payment received by the issuer on issue of the CLN will be included in gross income. No corresponding deduction will be allowed in terms of section 11(a) on the issue date as the obligation to repay the investor is dependent upon the occurrence of a credit event and thus the deduction will only be allowed on redemption. If the issue date and redemption date of the CLN do not fall within the same year of assessment, this upfront taxation of the purchase amount on the CLN creates a significant timing difference for the issuer.

Exchange Traded Notes (ETNs)

An ETN is an agreement entered into between a Holder and an Issuer, in terms of which the Holder pays an amount to the Issuer and the Issuer undertakes to pay to the Holder an amount calculated with reference to the value of certain specified assets on the maturity date of the ETN. An ETN is a long-term instrument that is traded through the Johannesburg Stock Exchange (JSE) and the maturity date of the ETN will be a minimum of five years after the date of issue. The reference assets may constitute shares, an index, an exchange rate, or a combination of these (SARS: 2012).

Prior to the introduction of section 24JB, and specifically the wording in section 24JB(3), the Binding Class Ruling 034 (BCR 034) received from SARS was relied upon in order to exclude the upfront investment amount received under an ETN from taxable income. In terms of the ruling, the acquisition amount must be included in the gross income of the issuer and a corresponding deduction was allowed on the date of issue of the ETN for an estimate of the redemption amount

which was payable by the issuer. In the absence of the ruling, no deduction would be allowed in terms of section 11(a) for the redemption amount on the issue date of the ETN on the basis that there is no unconditional obligation on the issue date for the issuer to pay any amount to the holder (SARS: 2012).

Conclusion

A derivative is defined in IAS 39 as an instrument that, amongst other requirements, requires no initial net investment, or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors (PricewaterhouseCoopers LLP:200). Funded Participations, CLNs and ETNs would not meet the definition of a derivative as the funded instruments require the initial upfront investment of the full nominal amount. These instruments are likely to be considered to have an embedded derivative (on the basis that the terms and conditions of the agreement change the nature of the cash flows that would otherwise be required by the host contract and effectively shift the risk between the parties). If this is the view adopted for financial accounting purposes, then these instruments will be subject to the provisions of section 24JB as they would be designated as "at fair value through profit or loss". If the argument is accepted that section 24JB(3) overrides the remainder of the Act for purposes of instruments falling within the scope of section 24JB(2) then no further amounts will be included in the covered person's gross income on receipt of the nominal amounts on conclusion of the contracts. This will potentially solve the issues explained above relating to the timing differences that arise on these instruments and other similar instruments. These financial instruments are traded in high volumes by a covered person as part of normal banking activities and risk mitigation strategies and the upfront payments are typically significant in size, therefore this interpretation is paramount to a covered person.

3.2.2 Section 9C – deemed capital disposal of shares

Section 9C of the Act deems the proceeds from the disposal of a qualifying share to be capital in nature under the circumstances provided for in the section. A qualifying share is an equity share that the taxpayer has held for a period of at least three years prior to disposal.

In terms of section 24JB(3), shares which fall within the scope of section 24JB(2) will no longer be subject to the deeming provisions of section 9C. Shares that are specifically excluded from the

scope of section 24JB(2)(a)(i) (i.e. shares that are upon initial recognition designated in terms of IAS 39 as "at fair value through profit or loss" because the shares are managed and their performance is evaluated on a fair value basis) may still meet the requirements of a qualifying share under section 9C. These shares would generally be shares held as strategic investments and not for speculative purposes and are likely to be held with a so-called capital intention. Shares remaining within the scope of section 24JB would be shares held for trading purposes and would therefore most likely not be held for a period of three years and, as such, the gains or losses on disposal would be treated as revenue in nature.

De Jager *et al* (2012:179) points out that a significant negative consequence of the introduction of section 24JB is that the legislation makes no distinction between capital and revenue items. This means that the gain or loss on financial instruments falling within the scope of section 24JB is fully taxable on the basis that the amounts are recognised in profit and loss, without regard to the capital or revenue intention with which the taxpayer holds the instrument. Whilst this point is true, it is submitted that the consequences are not that significant, based on the fact that generally financial instruments that are classified as "held-for-trading" for accounting purposes are classified as such because the instruments were acquired principally for purposes of selling or repurchasing in the near term or where there is evidence of a recent pattern of short-term profit making. Trading is reflected by active and frequent buying and selling of instruments with the objective of generating a profit from short-term fluctuations in price (PricewaterhouseCoopers LLP: 2009). The criteria for classification of financial assets as "held-for-trading" in terms of IAS 39 largely coincide with the requirements for a revenue classification for income tax purposes in terms of common law principles, which dictate that if the intention of the taxpayer when purchasing shares is to enter into a scheme of profit-making, the proceeds will be revenue in nature (*CIR v Pick n Pay Employee Share Purchase Trust* (supra)).

3.2.3 Specific anti-avoidance provisions

Based on the view that section 24JB, by virtue of subsection (3), overrides the rest of the Act, the next question that arises is whether section 24JB(3) also overrides the so-called "specific anti-avoidance provisions" as contained, *inter alia*, in sections 8E, 8F and section 10?

There is no principle of interpretation that prevents specific sections from overriding specific anti-avoidance sections purely on the basis that the sections are anti-avoidance provisions. The general anti-avoidance provisions contained in sections 80A to 80L, however, do apply independently of the rest of the Act (*COT v Ferera* 38 SATC 66, 1976 (2) SA 653 (RAD)).

According to the maxim *generalia specialibus non derogant*, specific provisions are unlikely to be subservient to generalities (De Koker, 2015:25). Section 24JB applies only to a covered person and only to financial assets and financial liabilities of the covered person that meet the requirements of section 24JB(2). Sections 8E and 8F, as an example, apply to all persons with regard to specific instruments. On this basis it is arguable that section 24JB is more specific in nature and therefore, applying the maxim *generalia specialibus non derogant*, would be unlikely to be subservient to the sections referred to.

Section 8F

Section 8F of the Act is an anti-avoidance section that seeks to re-characterise interest paid on a hybrid debt instrument as defined, as a non-deductible dividend *in specie*. A hybrid instrument includes *inter alia* instruments that are convertible into shares; where the obligation to pay an amount in respect of an instrument is conditional upon the solvency of the company; or where the amount is owed to a connected person and is not redeemable within 30 years. The objective of section 8F is to deny a deduction in respect of an amount paid on a hybrid debt instrument on the basis that the hybrid debt instrument is in substance equity and therefore the interest on the hybrid debt should be reclassified as a dividend. This section was inserted to prevent taxpayers from labelling an instrument as debt where in fact the economic substance of the instrument is akin to equity (The Davis Tax Committee: 2014). Section 8F re-characterises the interest for both the payer and the payee as a dividend *in specie*, thereby denying the deduction that would have been claimed by the payer and equally re-characterising the interest as an exempt dividend *in specie* received by the payee.

It is important to note that an instrument is defined as any interest-bearing arrangement or debt, with interest being defined in terms of section 24J. An equity linked note can therefore not be subject to the provisions of section 8F as it is not an interest bearing instrument. A CLN however, is an interest bearing arrangement and would thus be subject to section 8F if the other requirements are met, for example, if a CLN is issued in terms of which the obligation to pay an amount to the

CLN holder is conditional upon the solvency of the issuer (as envisaged in paragraph (b) of the definition of “hybrid debt instrument”).

As explained in 3.2.1 above, it is possible for a CLN to be classified as “at fair value through profit or loss” on the basis that it contains an embedded derivative, in which case it would fall within the scope of section 24JB. If the CLN’s terms are such that the payment of interest and /or the nominal amount is conditional upon the solvency of the issuer, then the interest on the CLN, which is recognised in the statement of profit or loss, will be reclassified as a dividend *in specie* in terms of section 8F. The question that arises is whether the provisions of section 24JB(3) override the provisions of section 8F?

Section 8F arguably only provides for the re-characterisation of the interest as dividends and does not subject the amount to tax. On this basis it could be argued that the provisions of both section 8F and section 24JB can apply as the former re-characterises the amount and the latter includes such amount in the covered person’s income. In this way the two sections can be reconciled and no view needs to be taken as to which overrides the other. A counter argument exists that, based on the wording of section 24JB(3), no other section of the Act applies to instruments contemplated in section 24JB(2). If it is concluded that section 8F does still apply to re-characterise the interest as a dividend *in specie* for purposes of the rest of the Act (including section 24JB) then the question arises whether the dividend is excluded from section 24JB(2)(b) in the case of a covered person that receives the dividend? If the covered person is paying the interest under the CLN (which is then re-characterised as a dividend *in specie* in terms of section 8F) then the exclusion under section 24JB(2)(b) would not apply since the dividend is paid by the covered person and not received or accrued, in which case the otherwise non-deductible dividend *in specie* could now arguably be deducted under section 24JB(2).

Section 8E

Similar to section 8F, section 8E of the Act is an anti-avoidance section that seeks to align the tax consequences of instruments that are in the form of equity, but which contain debt-like features and are in economic substance debt instruments. These sections deem the dividends earned on hybrid debt instruments or third party backed shares to be income in the hands of the person receiving the dividend. The dividend retains its nature as such in the hands of the payer and no deduction is allowed in respect of the payment under a hybrid equity instrument.

Section 24JB(3) would arguably override section 8E for preference shares that fall within section 24JB(2) (i.e. that are recognised “at fair value through profit or loss”). This would result in the presumably unintended consequence of preference shares that meet the definition of hybrid equity instruments not falling within section 8E (i.e. the dividends are not reclassified as interest) which creates the opportunity to structure transactions in such a way that section 8E is specifically avoided. Whilst it is accepted that preference shares are generally classified under IAS 39 as “Loans and Receivables” (and would thus generally fall outside the scope of section 24JB), it is possible under limited circumstances to classify a preference share asset as “at fair value though profit or loss”.

3.2.4 Treatment of dividends – section 10

Section 10(1)(k)(i)(ee), (ff), (gg) and (hh) of the Act are anti-avoidance provisions designed to counter the mismatch achieved through the creation of a deduction in respect of exempt dividend income (The Davis Tax Committee: 2014). Section 10(1)(k)(i)(hh) of the Act denies the exemption for dividends received to the extent that the dividends do not exceed the deductible expenditure incurred by the company or “any amount taken into account that has the effect of reducing income in the application of section 24JB(2)”, where the amount of the expenditure is determined directly or indirectly with reference to the dividend in respect of a share of the same kind and of the same equivalent quality as that share.

The reason for the introduction of section 10(1)(k)(i)(hh) is to counter mismatches that arise where a company holds shares as an offset against the issue of share derivatives (e.g. stock futures, contracts-for-difference and total return swaps) and the company receives exempt dividends in respect of the shares with the dividend proceeds applied to offset deductible payments in respect of the share derivative (National Treasury: 2013a). Section 10(1)(k)(i)(hh) operates in similar fashion to the current rules under 10(1)(k)(i)(ff) and (gg) which prevent dividend mismatches involving share lending schemes.

The reference to section 24JB(2) in section 10(1)(k)(i)(hh) indicates National Treasury’s intention that where a dividend is received or accrued to a covered person, the dividend is excluded from section 24JB(2)(b) and will be dealt with under section 10(1)(k)(i)(hh). The issue that arises is that

the current wording of section 24JB(3) arguably overrides the rest of the Act for instruments falling within the scope of section 24JB(2) and therefore section 10(1)(k)(i)(hh) should not apply. If this is the case then the dividend would be exempt in terms of section 24JB(2)(b) and the payment made under the derivative contract in respect of the dividend would also be excluded from section 24JB(2) if the words " in respect of a dividend" are given the wider meaning as explained above. The net effect on the tax liability would therefore be the same in this scenario whether section 24JB or section 10(1)(k)(i)(hh) is applied. Under section 24JB, the dividend received would be exempt and the payment treated as non-deductible and if section 10(1)(k)(i)(hh) is applied the payment would be treated as deductible, but the dividend would no longer be exempt.

The main difference between applying section 24JB or section 10(1)(k)(i)(hh) is that the former refers to an "amount in respect of a dividend" whereas section 10(1)(k)(i)(hh) refers to an amount determined "with reference to a dividend". It is submitted that the phrase "with reference to" is wider than the phrase "in respect of" since the latter requires a causal link where the former arguably does not. If this interpretation is correct, the taxpayer would benefit from the argument that section 24JB overrides section 10(1)(k)(i)(hh).

Furthermore, if the meaning of the phrase "in respect of a dividend" is given the narrow meaning of referring only to actual dividends received or accrued to the covered person, there will be no denial of the deduction of the payment under the derivative, notwithstanding that a portion thereof includes an amount of a dividend. In this case the dividend remains exempt and the payment remains deductible, thereby creating an opportunity for the taxpayer to claim an amount derived from an exempt dividend.

3.2.5 Section 10B – Foreign dividends

Unlike local dividends, foreign dividends are not exempt in terms of section 10(1)(k)(i) as this exemption only applies to "dividends" which is defined in section 1 of the Act as "any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company…". Since a foreign dividend is not an amount transferred by a resident company it is not a dividend as contemplated in section 10(1)(k)(i) and therefore the exemption does not apply to foreign dividends. Section 10B of the Act provides for an exemption in

certain cases, subject to certain provisos, of foreign dividends received on equity shares. Section 10B(2) states:

> …there must be exempt from normal tax any foreign dividend received by or accrued to a person—
>
> (a) if that person (whether alone or together with any other company forming part of the same group of companies as that person) holds at least 10 per cent of the total equity shares and voting rights in the company declaring the foreign dividend;
>
> (b) if that person is a foreign company and the foreign dividend is paid or declared by another foreign company that is resident in the same country as that person;
>
> (c) who is a resident to the extent that the foreign dividend does not exceed the aggregate of all amounts which are included in the income of that resident in terms of section 9D in any year of assessment, which relate to the net income of—
>
> (i) the company declaring the foreign dividend; or
>
> (ii) any other company which has been included in the income of that resident in terms of section 9D by virtue of that resident's participation rights in that other company held indirectly through the company declaring the foreign dividend,
>
> reduced by—
>
> (aa) the amount of any foreign tax payable in respect of the amounts so included in that resident's income; and
>
> (bb) so much of all foreign dividends received by or accrued to that resident at any time from any company contemplated in subparagraph (i) or (ii), as was—
>
> (A) exempt from tax in terms of paragraph (a), (b) or (d); or
>
> (B) previously not included in the income of that resident by virtue of any prior inclusion in terms of section 9D:
>
> Provided that for the purposes of this paragraph, the net income of any company contemplated in subparagraphs (i) and (ii) must be determined without regard to subsection (3);
>
> (d) to the extent that the foreign dividend is received by or accrues to that person in respect of a listed share and does not consist of a distribution of an asset in specie; or
>
> (e) to the extent that the foreign dividend is received by or accrues to a company that is a resident in respect of a listed share and consists of the distribution of an asset in specie…

Subsection (2) is also subject to the proviso that paragraphs (a) and (b) must not apply to any foreign dividend that is deductible by the foreign company declaring the dividend in the determination of the foreign company's taxable income under the rules in that country. In addition,

the proviso states that the so-called participation exemption provided under paragraph (a) only applies to equity shares.

Foreign dividends received on foreign equity shares that are accounted for "at fair value through profit or loss" are excluded from the scope of section 24JB in terms of the exclusion in subsection (2)(b) so it is not necessary to claim the exemption under section 10B. However, the question that arises is whether the provisions of subsection (3) override section 10B for purposes of taxing the foreign dividend since section 10B only provides an exemption subject to all the requirements and provisos outlined above, whereas section 24JB(2)(b) provides a full exemption with no requirements. On this basis a covered person could ensure that foreign dividends on equity shares falling within the scope of section 24JB are exempt, without having to meet the requirements of section 10B. Based on the interpretation that section 24JB(3) does override the rest of the Act for instruments falling within the scope of section 24JB(2), all foreign dividends of a covered person received on both preference and equity shares that are within the ambit of section 24JB(2) would be exempt from tax.

3.2.6 Section 108 – Double Tax Agreements

Section 24JB(3) refers to any amount that is required to be taken into account in Part I of Chapter II. Section 108 falls outside of Chapter II and therefore section 24JB will not override section 108. In terms of section 108(2) of the Act, read with section 231 of the Constitution of the Republic of South Africa, 1996, when a Double Tax Agreement (DTA) is entered into with the government of another country and ratified and published in the Government Gazette, the provisions of the DTA are as effective as if they had been incorporated into the Act (The Davis Tax Committee: 2014).

The question that arises is whether the provisions of a DTA can be overridden by subsequent domestic legislation such as section 24JB under the normal principles of interpretation of statues which provide that in terms of the maxim *lex posterior derogat priori*, a later statute abrogates an earlier one (*Sasol Synthetic Fuels (Pty) Ltd and Others v Lambert and Others* (7/2001, 8/2001) [2001] ZASCA 133). South Africa is bound by international agreements under section 231 of the Constitution as subsection (2) binds South Africa to an international agreement after it has been approved by resolution in both the National Assembly and National Council of Provinces. Section 233 of the Constitution specifically states that a court must prefer any reasonable interpretation that

is consistent with international law over any interpretation that is inconsistent with international law. As a treaty is an international agreement, it has to be applied in accordance with section 231 of the Constitution. Section 231(4) provides that an international agreement becomes law in the Republic when it is enacted into law by national legislation (in this case section 108 of the Act). It therefore becomes part of domestic law and ranks equally with all other domestic law. There is no automatic treaty override in interpreting conflicting provisions between treaties and domestic law, however the South African courts are constitutionally bound to follow an interpretation consistent with international law, in terms of section 233 of the Constitution.

In *CSARS v Tradehold Ltd* [2012] 3 All SA 15 (SCA), the court held the following (at 21):

> Double tax agreements effectively allocate taxing rights between the contracting states where broadly similar taxes are involved in both countries. They achieve the objective of s 108, generally, by stating in which contracting state taxes of a particular kind may be levied or that such taxes shall be taxable only in a particular contracting state, or in some cases, by stating that a particular contracting state may not impose the tax in specified circumstances. A double tax agreement thus modifies the domestic law and will apply in preference to the domestic law to the extent that there is any conflict.

From the above, it is clear that any amounts not subject to tax in the Republic in terms of a DTA, read with section 108 of the Act, will be excluded from a covered person's income notwithstanding the provisions of section 24JB. In addition, the Explanatory Memorandum 2013 confirms that to the extent that South Africa does not have a right to tax an amount due to the provisions of a tax treaty for the avoidance of double tax, the amount will not be included in income under section 24JB(2) (National Treasury: 2013a).

3.3 CONCLUSION

From the discussion, it is evident that there are many uncertainties and unintended consequences that may arise from the current wording of section 24JB(3). It seems, on the one hand, that National Treasury did intend for section 24JB to override the rest of the Act for instruments falling within the scope of section 24JB(2) as is evidenced by the stated intention in the Explanatory Memoranda, where specific reference is made to the override of gross income, section 11(a) and section 24J.

The crux of the matter is whether section 24JB(3) overrides the rest of the Act for instruments contemplated in section 24JB(2) (i.e. regardless of whether the amount is contemplated in section 24JB(2)) or whether the override is only intended for amounts that are dealt with in terms of section 24JB(2), failing which they will be dealt with under the remainder of the Act. Based on submissions made to National Treasury by the Banking Association South Africa (BASA) on the Draft Taxation Laws Amendment Bill, 2014 and the subsequent amendments to section 24JB(3), it is submitted that the intention is for section 24JB to override the Act for amounts paid up front on instruments such as CLNs, ETNs, etc., notwithstanding that these amounts are not contemplated in section 24JB(2) as they are not recognised in profit or loss. The problem is that one cannot choose which sections of the Act are overridden by section 24JB(3). Based on the current wording of the section and the intention for section 24JB to override certain provisions, it is submitted that section 24JB overrides all the sections of the Act which results in the unintended consequences discussed above.

CHAPTER 4

PRINCIPLES OF INTERPRETATION

4.1 INTRODUCTION

Chapters 2 and 3 of this thesis set out some of the ambiguities and uncertainties created by the current wording of section 24JB(2) and 24JB(3), respectively. The possible interpretations in relation to these uncertainties were considered and the resulting consequences. Since section 24JB was only introduced into the Act with effect from 1 January 2014, the manner in which SARS will interpret and apply the provisions of this section has yet to be seen and similarly no legal precedents have been set as section 24JB has not been tested by the courts. As a result, it is necessary to include a discussion of the principles of interpretation that govern fiscal legislation in order to ascertain the possible approaches that may be followed by the courts if these uncertainties are contested between the taxpayer and SARS in the future. It is not the aim of this thesis to provide a comprehensive discussion of all the principles of interpretation, nor the relevant case law. The purpose of this analysis is to outline the approach that could be adopted in the interpretation of section 24JB and the guiding principles that need to be borne in mind when considering the manner in which to interpret ambiguous and unclear legislation.

This chapter will summarise the literal approach, which was initially followed by the courts in earlier cases, and will then proceed with a brief discussion of the purposive approach, which has now replaced the literal approach in interpreting fiscal legislation. The discussion will also highlight any additional influences and considerations considered useful in interpreting section 24JB.

4.2 THE LITERAL APPROACH

The literal approach, also known as the "golden rule", is based on the principle that where the Act is clear and unambiguous, the court must give effect to the ordinary and natural meaning of the words (*Loewenstein v COT* 1956 (4) SA 766 (FC), 21 SATC 121). Prior to the promulgation of the Constitution of the Republic of South Africa, 1996 (hereinafter referred to as the Constitution), it was the view of the court in the earlier cases that there is no equity in tax legislation and that where

the wording is clear, the Act should be applied, however harsh the results may be (*Cactus Investments (Pty) Ltd v CIR* 1999 1 All SA 345 (A), 61 SATC 43). In *Cape Brandy Syndicate v IRC* 1921 1 KB 64, 12 TC 358 it was stated by Rowlatt J (at 71), "In a taxing Act one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used."

In *CIR v Delfos 1933 AD 242*, the meaning of "received by or accrued to" was considered, particularly in light of the fact that if the plain meaning of the words was used, an amount meeting the definition of both of these phrases could result in the double taxation of the same amount at the time the amount is received and then again when it is accrued. It was held that the fact that an interpretation based on the ordinary meaning of the words results in double taxation is not a sufficient reason for rejecting the plain meaning of the words. Wessels CJ (at 253), quoted the judgement of Lord Cairns in *Partington v Attorney-General 21 LT 370* which stated (at 375):

> As I understand the principle of all fiscal taxation it is this: if the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the law the case might otherwise appear to be.

Wessels CJ added further that in no case in a taxing Act must a section be given a narrower or wider meaning than its apparent meaning. However, he also added that when interpreting statutes the whole statute must be taken into consideration to arrive at the true intention of the legislature. This added comment appears to relate more to the purposive approach to interpretation (see below). These and similar judgements of the court that are based on the irrelevance of the equality and fairness of tax must be considered in light of the fact that all laws of the Republic must promote the spirit of the Bill of Rights and the Constitution (De Koker, 2015:251A).

Several court decisions referred to the *dictum* in *Venter v Rex* 1907 TS 910, which state, that when giving words their ordinary meaning, considering their context, results in absurdity which was clearly not the intention of the legislature, the court may depart from such ordinary meaning to give effect to the true intention of the legislature. Attempting to ascertain the intention of the legislature in interpreting legislation and thus not merely giving effect to the literal meaning of the words,

overlaps to a certain extent with the purposive approach, which considers the intention of Parliament by reading the Act as a whole and the purpose for which the legislation was introduced, as well the relationship between the individual provisions in the Act (Goldswain: 2008).

The automatic application of the literal approach to the interpretation of legislation is no longer an accepted approach, particularly where inequitable and unjust consequences arise (Goldswain: 2008). As pointed out in Chapter 2 and 3, many anomalies arise both for the taxpayer and for SARS when the strict or literal meaning of certain words in section 24JB is applied. Because of these uncertainties and anomalies, the "golden rule" that is based on the notion that where the Act is clear and unambiguous the ordinary and natural meaning of the words must be given effect to (*Loewenstein v COT*), cannot be applied. If section 24JB is interpreted on this basis, this could constitute grounds for a constitutional challenge, if the intention of the legislature is not considered. This is the fundamental principle underlying the purposive approach, which has subsequently been adopted by the judiciary.

4.3 THE PURPOSIVE APPROACH

Section 2 of the Constitution states that "this Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid..." The reference to "law" in this statement would include the Income Tax Act and as such any provisions in the Act which contravene the Constitution, are invalid. The Constitution and specifically the Bill of Rights prompted the shift from the literal approach to to the purposive approach in interpreting legislation, which focuses more on the purpose for which the legislation is introduced and the context in which the language is used. The Constitutional Court, influenced by section 39(2) of the Constitution, stated that legislation should be interpreted purposively to promote the spirit of the Bill of Rights and in doing so the intention of the Act must be deciphered in interpreting the legislation, which must be read in conformity with the Constitution (De Koker 2015:251D).

The decision of the Supreme Court of Appeal in *CSARS vs. Bosch* (394/2013) [2014] ZASCA 171 is clear authority for the fact that one should not adopt a literal interpretation to legislation. It was held in this case that the words of a section must be considered in the light of their context, the apparent purpose of the provision and any relevant background material. It was indicated that there may be rare cases where the words in the statute are only capable of bearing a single meaning.

However, outside of these situations, it was suggested that it is “pointless” to refer to a statutory provision having a plain meaning. It was indicated that in the likely scenario that there may be more than one possible meaning of a provision, the determination of the proper meaning depends as much on context, purpose and background as on the literal and plain meaning of the words (Brinker: 2015).

The following guidelines have been provided by Goldswain (2008:117) in applying the purposive construction of statutes:

- The Act as a whole must be read in context in order to determine the intention of Parliament, the object of the Act and the relationship between the individual provisions of the Act.
- The words in each provision must be given their ordinary meaning in light of the intention of Parliament, if the words are clear and unambiguous.
- If the words are unclear, then the best meaning that accords with the intention of Parliament and the purpose of the Act must be given to the words (Miers & Page 1990:177).

In *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593; [2012] ZASCA 13 (SCA), the meaning of the proviso to the definition of “pensionable emoluments” in the regulations governing the operation of superannuation funds was questioned. Wallis JA stated (at 26):

> Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document consideration must be given to the language used in the light of ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production.

Wallis JA continued to state that he deliberately avoided describing this process as one in which the intention of the legislature is determined as this is misleading in that it conveys the impression that interpretation involves an enquiry into the mind of the legislature, as opposed to the meaning of the language of the provision itself.

In *ITC 1384* (1983) 46 SATC 95, two principles of construction under the purposive approach were formulated. The first relates to determining the intention of the legislature, which, it was said, is primarily determined in the language that the legislature used. The second relates to the presumption that the legislature did not intend an unfair, unjust or unreasonable result and that a statute may be interpreted as being as unoppressive as possible (De Koker 2015:251D).

The basis for the present thesis is to analyse the wording of section 24JB in light of National Treasury's intention and the object of the legislation. The principal issue remains, however, that in order to successfully apply the purposive approach one has to, *inter alia*, attempt to determine the intention of the legislature, which is still unclear at this stage based on the disparities between the Explanatory Memoranda and the current wording of the section, as has been pointed out in Chapter 2 and Chapter 3. The following principles of interpretation may, however, be of assistance.

4.3.1 <u>The history of a provision</u>

When interpreting legislation, the courts must attempt to determine the intention of the legislature and in doing so may consider the history of a provision in the Act (*CIR v Simpson* 1949 (4) SA 678 (A), 16 SATC 268 and *New Union Goldfields Ltd v CIR* 1950 (3) SA 392 (A), 17 SATC 1).

Section 24JB was inserted into the Act by the Taxation Laws Amendment Act No. 22 of 2012 (the Taxation Laws Amendment Act 2012) wherein section 24JB(3) read as follows:

> Any amount in respect of a financial asset or a financial liability that is included in or deducted from the taxable income of a covered person for any year of assessment as contemplated in subsection (2) must not be taken into account in determining—
>
> (a) gross income;
> (b) any deduction in terms of section 11;
> (c) taxable income; and
> (d) any capital gain or capital loss of that person as contemplated in the Eighth Schedule.

In a presentation made to the Standing Committee on Finance by BASA on the 26th August 2014, clarification was requested on the interaction of section 24JB(3) with the rest of the Act. The presentation specifically emphasised that it was the intention for section 24JB(3) to override all other sections of the Act but that the current wording did not clearly achieve this intention and the

question was raised whether section 24JB(3) requires an amount first to be included in section 24JB(2) in order to override the rest of the Act (Banking Association South Africa: 2014). The Taxation Laws Amendment Act No. 44 of 2014 was promulgated on the 20th January 2015 and the following amendments were made to section 24JB(3), seemingly in order to clarify the intention:

> Any amount required to be taken into account in determining the taxable income in terms of any provision of Part I of Chapter II, or in determining any assessed capital loss of a covered person in respect of a financial asset or a financial liability contemplated in subsection (2) must only be taken into account in terms of [that subsection] this section. (The terms that are underlined refer to the insertions into the subsection.)

The wording of subsection (3) was amended in order to refer not only to "gross income", section 11(a) and the Eighth Schedule, as was the case in the Taxation Laws Amendment Act 2012, but to refer to all sections in Part I of Chapter II of the Act. It is submitted that, based on the comments made by BASA, the wording was amended in this manner in order to clarify and give effect to National Treasury's intention that section 24JB(3) should override all provisions falling within Part I of Chapter II. The presentation by BASA posed the question as to whether section 24JB(3) required the amount to first be included in income in terms of section 24JB(2). An example of an upfront investment amount which would not be included in the income statement was used. As explained in Chapter 3 under certain instruments such as *inter alia* funded credit linked notes, an upfront investment amount is paid by the holder to the issuer of the instrument on the issue date. This amount constitutes gross income for tax purposes but does not get recorded in the income statement for accounting purposes. On this basis, the amount will not be included in section 24JB(2) as it is not an amount that is "recognised in the statement of comprehensive income". The question raised by BASA in the presentation was whether section 24JB(3) could override the gross income inclusion despite the fact that such amount was not included in section 24JB(2). It is submitted that the change made to the wording of section 24JB(3) subsequent to this presentation is an indication of National Treasury's intention that subsection 24JB(3) should override the remainder of the Act even if amounts are not included in section 24JB(2) but provided that the instruments are contemplated in section 24JB(2).

4.3.2 <u>Give every word a meaning</u>

Cockburn CJ in *The Queen v Bishop of Oxford* (1879) 4 QBD 245 held that a statute should be interpreted in such a way that no clause, sentence or word should be superfluous or insignificant. In *Loewenstein* (supra) Murray CJ stated (at 127) that:

> The case against entirely disregarding words in a statute is at least as strong as, if not stronger than, the case against declining to give those words their ordinary meaning. As stated by Centlivres C.J. in *Israelsohn v Commissioner for Inland Revenue* , 1952 (3) S.A. 529 (A.D.) at 536:
>
>> I do not know of any principle which would justify one in holding that one is entitled to regard a part of a Statute as being tautologous on the ground that certain absurdities would result. There are cases where one is justified in not giving the ordinary meaning to words, if the ordinary meaning leads to an absurdity. But giving a meaning to words other than their ordinary meaning is not the same as ignoring words. In the case of the former one departs from the ordinary meaning and gives the words in question a different meaning in order to carry out the intention of the Legislature.

As discussed in paragraph 2.5.5 of Chapter 2, the use of the words "in respect of" in the preamble to the exclusion in section 24JB(2)(b) relating to a dividend or a foreign dividend received by a covered person, creates certain anomalies and ambiguities. As mentioned, it is possible to interpret this phrase as only effectively applying to the exclusions listed in section 24JB(2)(a) and thereby giving the phrase in section 24JB(2)(b) its narrower interpretation of only applying to actual dividends received or accrued. Alternatively, the wider interpretation could be followed which would mean that the words refer not only to dividends but also to other amounts that are in respect of a dividend or are determined with reference to a dividend such as manufactured payments made under securities lending transactions and certain derivative contracts.

Based on the principles discussed in the cases, it appears that extreme caution should be taken when attempting to assert that a word is superfluous or should be ignored and since the intention of the legislature has not been expressly dealt with or stated in relation to this matter it would be perilous for any definite view to be taken on this interpretation. It is submitted that until such time as the true

intention of the legislature is determined there can be no conclusion reached as to the meaning of the phrase “in respect of . . . a dividend or foreign dividend…”

4.3.3 <u>Anomalies</u>

In *P v COT; LGM Ltd v COT* 1966 (2) SA 208 (R), 28 SATC 55, it was stated (at 58) that “if the language of the statute is clear, the court must give effect to it, whatever the consequences. It is not the function of the court to redraft statutes – least of all taxing statutes – even if the language of the legislature appears to lead to anomalies.” Consideration of anomalies may, however, be a guide in interpreting a provision in the case where there is more than one possible interpretation and where one particular view results in fewer anomalies than the other (De Koker, 2015:25.6). In *Bell’s Trust v CIR* 1948 (3) SA 480 (A), 15 SATC 255 it was held that if there were no fewer anomalies that arose as a result of taking a particular view over another, then the mere existence of anomalies is not an aid in determining the construction of a provision. In *Manjra v Desai and Another* 1968 (2) SA 249 (N), Milne JP stated (at 254) that, “... I agree that, where the words of a statute are plain, mere anomalies would not justify a departure from their literal meaning unless they are such as to demonstrate that their literal meaning is not the meaning which the legislature intended them to have...”

Based on this, it seems that despite the fact that many anomalies may arise if certain interpretations are adopted in respect of section 24JB, this fact alone is not sufficient to disregard a particular interpretation, unless another interpretation results in fewer anomalies and the intention of the legislature is evident to confirm that such anomalies were not intended. The issues arising from the use of the phrase “in respect of . . . a dividend” were discussed in 2.5.5. of Chapter 2 and again in 4.3.2 above which explains the two interpretations that may be adopted, i.e. one where the narrow meaning is given to the phrase which refers only to actual dividends received and the other where the wider meaning is given to the phrase to refer also to amounts that are calculated with reference to a dividend. In order to conclude that either interpretation results in an anomaly it would first be necessary to determine the legislature’s intention as what may be considered by one person as an anomaly could in fact have been National Treasury’s intended result.

4.3.4 The *contra fiscum* rule

In *Estate Reynolds & others v CIR* 1937 AD 57, 8 SATC 203, it was held (at 203) that where one is dealing with the interpretation of a taxing Act, the court is bound to invoke the *contra fiscum* rule (which literally means "against the fiscus") in interpreting a particular provision.

In *Shell's Annandale Farm (Pty) Ltd v CIR*, 62 SATC 96, the application of the *contra fiscum* rule was extended to apply not only where there was ambiguity in the wording, but also where there was ambiguity in the intention of the legislature. The court held that where there were two possible interpretations the one that is more favourable to the taxpayer must be applied and the aggrieved revenue authorities must amend the legislation accordingly. It is submitted that the *contra fiscum* rule still applies in our common law today and is not in conflict with the Constitution as it ensures the element of equity in the interpretation of fiscal legislation as required by the Bill of Rights (Goldswain: 2008). The *contra fiscum* rule should thus still be borne in mind when considering the alternate interpretations of section 24JB, although it is recommended that this be cautiously applied.

An example evidencing a possible interpretation of section 24JB which results in a more favourable outcome for the taxpayer is if section 24JB(3) were interpreted as overriding the remainder of the Act and specifically the provisions contained in section 8F. If this were the case, hybrid debt instruments that would otherwise be caught by section 8F to reclassify the interest paid under such instruments as non-deductible dividends, will now escape these "anti-avoidance" provisions.

4.3.5 SARS' interpretation

In *Ernst v CIR* 1954 (1) SA 318 (A), 19 SATC 1 it was held that the practice of SARS, albeit for an extended period of time such as thirty years, would not justify attributing a meaning to a section of an Act which the language of such section would not allow. However in the more recent *Bosch* case (supra) the court specifically referred to the Explanatory Memorandum that accompanied the amending legislation and also indicated that evidence of a consistent interpretation by SARS for a long period of time may be relevant when determining the manner in which to interpret legislation as SARS' interpretation provides an indication of the interpretation which a reasonable person would have.

Whilst it has yet to be seen what the practice of SARS is when applying the provisions of section 24JB, the Explanatory Memoranda which accompany the Amendment Acts will, in light of the decision in the *Bosch* case, give an indication of the intention of the legislature in introducing section 24JB and, although not legally binding, these Explanatory Memoranda will influence the interpretation of this section in terms of the purposive approach. As indicated throughout Chapter 2 and 3 of this thesis, there are numerous references made to the intention of National Treasury in relation to the objectives of section 24JB which appear to be in conflict with the current wording in the Act. In the absence of clear and precise wording and any other "practice generally prevailing" by SARS, it is submitted that these Explanatory Memoranda provide the only indication of the intention of the legislature and may be afforded substantial influence by the courts until clarity is provided on some of these issues.

Goldswain (2012:41) states that neither the Hansard Reports nor the Explanatory Memoranda have been used so far by the South African judiciary to assist them in interpreting a fiscal statute. The Hansard Report is the official report of what was said in Parliament when the statute was debated. Reference is made to the case of *More v Minister of Co-operation and Development*, (1986(2) SA 102(A)), where the Appellate Division held that neither Explanatory Memoranda nor the Hansard Reports could be used as an aid to the interpretation of a particular provision. However, In *Davis v Johnson* ([1978] 1 All ER 841) and the House of Lords, in *Pepper (Inspector of Taxes) v Hart* ([1993] 1 All ER 42), it was accepted that the Hansard Reports can be referred to in the appropriate circumstances. Goldswain submits that the Explanatory Memoranda and Hansard Reports may be found to be acceptable aids in the interpretation of statutes as they do provide some enlightenment as to why the statute is being enacted, albeit only from the perspective of National Treasury. It is submitted that the Standing Committee on Finance (SCOF): Report-Back Hearings 2013 referred to in Chapter 3, in order to provide insight into the intention of Parliament, could be used on a similar basis as the Hansard Report.

4.3.6 *Generalia specialibus non derogant*

The maxim, g*eneralia specialibus non derogant*, was discussed in paragraph 3.2.3 of Chapter 3 in relation to whether section 24JB(3) overrides the rest of the Act and specifically the so-called anti-avoidance provisions contained in sections 8F, 8E, 10 and 10B. The maxim articulates that specific provisions are unlikely to be subservient to generalities. In *R v Gwantshu* 1931 EDL 29, it was

stated (at 31) that: "When the Legislature has given attention to a separate subject and made provision for it, the presumption is that a subsequent general enactment is not intended to interfere with the special provision, unless it manifests that intention very clearly. Each enactment must be construed in that respect according to its own subject-matter and its own terms."

In the case of *Sentra-Oes Kooperatief Bpk v KBI* 1995 (3) SA 197 (A), 57 SATC 109, the question arose as to whether the taxpayer, a short-term insurer, could claim losses incurred under section 11(a) or section 28(2)(c) which applied specifically to short-term insurers. The Commissioner for Inland Revenue submitted that section 11(a) of the Act used the expression "expenditure and losses" whereas section 28(2)(c) of the Act only refer to "expenditure". Furthermore, the Commissioner contended that section 11(a) applies to the determination of the taxable income derived by persons generally whereas section 28(2) applies to the determination of the taxable income derived by short-term insurers. The Commissioner sought to apply the maxim *generalia specialibus non derogant*, to disallow a deduction for the taxpayer under section 11(a) on the basis that if a deduction was claimable by a short-term insurer, it was claimable only under section 28(2)(c). It was held that the wording of subsection (2) of section 28, which stated "subject to the provisions of this Act", meant that the general deduction formula contained in section 11(a) prevailed over the specific provision in section 28(2)(c). This was contrasted with the wording in subsection (1) of section 28, which stated "notwithstanding anything to the contrary contained in this Act". The majority judgment in *S v Marwane* 1982(3) SA 717(A) at 747H-748B was quoted, where Miller JA explained that the purpose of the phrase "subject to" when used in a legislative provision, is–

> . . . to establish what is dominant and what subordinate or subservient; that to which a provision is 'subject', is dominant – in case of conflict it prevails over that which is subject to it. Certainly, in the field of legislation, the phrase has this clear and accepted connotation. **When the legislator wishes to convey that that which is now being enacted is not to prevail in circumstances where it conflicts, or is inconsistent or incompatible, with a specified other enactment, it very frequently, if not almost invariably, qualifies such enactment by the method of declaring it to be "subject to" the other specified one.** (emphasis added)

It may appear that this case contradicts the view that a specific provision is unlikely to be subservient to general provisions, since it was held that the taxpayer may still apply the provisions

of section 11(a) notwithstanding that a more specific section, being section 28(2)(c) applied to the taxpayer. However it is important to note that the reason for this decision was based on the wording of subsection (2) of section 28, which states that the section is subject to the provisions of the Act, and this is the reason that the remainder of the Act would still find application. In the case of section 24JB(2) however, the only provision that section 24JB(2) is subject to is subsection (4), therefore in the absence of the wording of section 24JB(3) the rest of the Act would arguably prevail, based on the judgement in the *Sentra-Oes* case (supra). However as discussed in Chapter 3, subsection (3) of section 28 specifically states that any amount required to be taken into account in determining the taxable income of a covered person must only be taken into account in terms of this section. Consequently, it is submitted that if it was the intention of National Treasury for other sections to prevail (such as sections 8F, 8E, 10 or 10B), then section 24JB could easily have been made "subject to" these sections in line with the wording used in section 28(2)(c).

4.4 CONCLUSION

It has been shown in this chapter that the courts have moved away from the literal approach towards the purposive approach in interpreting legislation in line with the Constitution and specifically the Bill of Rights. This does not mean that the courts will not give effect to the clear and ordinary meaning of the words in a statute, it merely suggests that other factors such as the intention of the legislature and the context of the Act as a whole will also be taken into consideration when interpreting a provision of the Act, especially where there are uncertainties and ambiguities. It should be remembered that there is no uniform approach that will be adopted by the courts in the interpretation of legislation as was stated by Sachs J in *S v Mhlungu* 1995 (3) SA 867 (CC) (at 129):

> I regard the question of interpretation to be one to which there can never be an absolute and definite answer and that, in particular... how to balance out competing provisions, will always take the form of a principled judicial dialogue, in the first place between members of this Court [Constitutional Court], then between our Court and other Courts, the legal profession, law schools, Parliament, and indirectly, with the public at large.

This discussion therefore, does not attempt to provide a definitive solution to the interpretation of section 24JB, based on the principles of interpretation that have been highlighted in the chapter. It merely aims to provide a summary of the considerations that the taxpayer and the Commissioner

should be cognisant of when attempting to successfully ascertain the meaning of the provisions of section 24JB and the manner in which SARS and the courts are likely to interpret such provisions.

CHAPTER 5

CONCLUSION

5.1 INTRODUCTION

The main goal of this research is to critically analyse the provisions of the newly introduced section 24JB pertaining to the taxation of financial assets and financial liabilities of a covered person. The following research objectives were identified in Chapter 1:

- to determine the scope of section 24JB by examining the definition of a "covered person", as well as the specific financial instruments to which the section applies, with reference to the IFRS classification and specifically terms used in IAS 32 and IAS 39;
- to discuss how section 24JB interacts with the rest of the Act and whether this section overrides other provisions, specifically with reference to the taxation of dividends and the general and specific anti-avoidance provision contained elsewhere in the Act; and
- to highlight anomalies and possible unintended tax consequences arising from the current drafting of section 24JB, including any ambiguous and unclear meaning of the words, in order to identify possible amendments to the Act, together with an Explanatory Memorandum, or an Interpretation Note or General Binding Ruling to be issued by SARS.

The research objectives listed above have been discussed in detail in the preceding chapters in which a critical analysis of the domestic tax legislation and relevant case law was carried out. This chapter provides a summary of the key findings in each chapter with regard to each research objective, as well as reiterating the major concerns and unresolved issues emanating from the analysis. In conclusion, this chapter will summarise the proposed recommendations for clarifications to the Act or in an Interpretation Note or Binding General Ruling, in an attempt to resolve the concerns that may arise when applying the provisions of section 24JB.

5.2 A SUMMARY OF THE SCOPE AND APPLICATION OF SECTION 24JB

Section 24JB only applies to a covered person as defined in section 24JB(1). This definition was examined in detail in Chapter 2 with reference to the definitions in the Banks Act and the Financial Markets Act. The aim of section 24JB is to govern the taxation of financial instruments that are traded in high volumes by large financial institutions. In summary, section 24JB applies to brokers, banks and their branches as well as any companies forming part of a banking group as defined in the Banks Act. Companies that are long-term or short-term insurers are specifically excluded from the scope of section 24JB.

Section 24JB(2) includes within its scope all amounts that are recognised in profit or loss in respect of certain financial instruments, notwithstanding the reference in the Explanatory Memoranda to the inclusion of only fair value amounts. It is therefore concluded that all non-fair value amounts that are recognised in the income statement for accounting purposes, such as interest, dividends and gains or losses will also be included in section 24JB(2).

An analysis was provided in Chapter 2 in respect of the classification of financial assets and financial liabilities in terms of IAS 39, including an explanation of the designation of a financial asset as "at fair value through profit or loss" with specific reference to the management of an asset on a fair value basis, as this classification forms the basis for the exclusion from the scope of section 24JB(2). The discussion documents the complexities and subjective decisions which are associated with the application of IFRS. It was pointed out that aligning tax provisions to accounting concepts results in the opportunity for taxpayers to structure transactions in a specific manner for accounting purposes in order to achieve the desired tax outcome. Furthermore, due to the complexities in IAS 39 it is possible that taxpayers could treat the same types of financial instruments in different ways for accounting purposes. However, it is important to reiterate at this point that the primary aim of section 24JB is to align the taxation of financial instruments to the accounting treatment prescribed under IFRS, in order to achieve uniformity between the Annual Financial Statements and the tax computation. Consequently, it is submitted that the concerns raised by Maroun (2012:3.1) on section 24JB already exist due to the adoption of IFRS for accounting purposes and are not solely as a result of the introduction of section 24JB. It is submitted therefore that provided that the tax treatment is aligned to the accounting treatment, the aim of the legislation is arguably achieved and the accounting complexities should not be raised in a tax context. It is

therefore concluded that no further amendments to section 24JB are necessary from a tax perspective relating to the classification of financial instruments.

Chapter 2 analysed the amounts excluded from the scope of section 24JB in respect of certain financial assets as listed under subsection (2)(a) and (2)(b). Based on the analysis of the relevant case law, the meaning of the phrase "in respect of" was held to denote a causal relationship between the amount and the excluded financial assets. The issue that arises is the meaning of the phrase "in respect of . . . a dividend or foreign dividend received by or accrued to a covered person" and whether this relates to dividends only, or amounts linked to dividends. A recommendation is provided under section 5.4 of the present chapter in this regard.

5.3 A SUMMARY ON THE INTERACTION OF SECTION 24JB WITH THE REST OF THE ACT

Section 24JB(3) states that any amount that is required to be taken into account (under Part I of Chapter II of the Income Tax Act) in the determination of taxable income of a covered person, in respect of financial assets or financial liabilities contemplated in subsection (2), must only be taken into account in terms of section 24JB. An issue arises with regard to the phrase "contemplated in subsection (2)". It is unclear whether this phrase is qualifying the "amount" or the "financial asset or financial liability". That is, it is ambiguous in relation to whether the phrase refers to the fact that the **amount** that relates to the financial instrument must be "contemplated in subsection (2)" or whether the **instrument** itself must be contemplated in subsection (2), regardless of the fact that the amount relating to that instrument may not be included under section 24JB(2). This may arise, for example, where the amount in question is not included in the income statement for accounting purposes, as is required in order to fall within the ambit of section 24JB(2).

Chapter 3 sets out a detailed discussion of examples of financial instruments where an upfront investment amount is received upon the issue of the instrument which would be included in gross income but which is not included in the income statement for accounting purposes. For example, funded Credit Linked Notes, Equity Linked Notes and Exchange Traded Notes operate on the basis that the holder of the instrument pays an upfront investment amount to the issuer of the instrument on the date of conclusion of the contract. As this investment amount constitutes an amount received by the issuer, not of a capital nature, the amount will be included in the issuer's gross income upon

receipt. Conversely, the obligation of the issuer to repay this amount is conditional upon the occurrence of a future credit event and as such no corresponding deduction is available in terms of section 11(a) upon receipt. This mismatch of the inclusion and deduction creates a significant timing difference in the liability for tax of the issuer of these funded instruments. Instruments of this nature issued by a covered person would typically fall within the scope of section 24JB(2) and thus the pertinent question arises whether the wording of subsection (3) overrides the gross income inclusion and thereby may solve the timing difference problem.

In addition, Chapter 3 discusses other sections of the Act such as sections 9C, 8E, 8F and 10 and the resulting effects that would arise if section 24JB(3) is interpreted such as to override these sections. It is submitted that the current wording of section 24JB(3) may very well achieve the effect of overriding of the rest of the Act, however it is pointed out that it is uncertain whether this was the intention of National Treasury. This ambiguity necessitates the discussion in Chapter 4 relating to the principles that may be applied by the courts when interpreting statutes in order to assist the taxpayer in determining the most appropriate approach to analysing the provisions of section 24JB.

5.4 A SUMMARY OF THE RULES OF INTERPRETATION

"Interpretation, in the context of fiscal legislation, is the cornerstone on which the revenue authorities assess and collect taxes and, correspondingly, the foundation upon which the taxpayers` rights are built" (Goldswain, 2008:107). Chapter 4 sets out a brief discussion of the principles used by the South African judiciary to be applied in the interpretation of statutes, which may assist in deciphering the ambiguous wording of section 24JB.

The literal approach or so-called "golden rule" applies the ordinary grammatical and literal meaning of the words in a statute. This approach was used as the guiding principal for many years by the courts. However, the literal approach can be departed from if the ordinary grammatical language gives rise to absurdity. In such a case, the court is justified from departing from the ordinary effect of the words to the extent necessary to remove the absurdity and to give effect to the true intention of the legislature (Goldswain, 2008:111). The purposive approach to the interpretation of statutes focuses on the purpose for which legislation is introduced and the context in which the language is used and any background material (as was held in *Bosch*). The problem that arises when attempting to interpret section 24JB is that it is not clear what the intention of the legislature is, as the current

wording of the Act is incongruent, to a certain extent, with the purpose of the introduction of section 24JB as set out in the Explanatory Memoranda.

There are many principles of interpretation that the taxpayer may use to assist in ascertaining the meaning of a provision in the Act, certain of which were highlighted in Chapter 4. Fiscal legislation is interpreted using the same principles as when interpreting any other legislation (as was held in *Glen Anil Development Corporation v SIR,* 1975 (4) SA 715 (A) 37 SATC 319). It is important to note, however, that no uniform approach exists to interpreting statutes and the judiciary is seldom consistent in applying the principles of interpretation. In conclusion, the courts will give effect to the ordinary meaning of the words of a provision in light of the context of the provision as a whole, the intention of the legislature and the relationship between the individual provisions of the Act and it is in this light that the meaning of the words and phrases in section 24JB should be interpreted.

5.5 A SUMMARY OF UNRESOLVED ISSUES AND RECOMMENDATIONS

This section provides a summary of the unresolved issues emanating from the detailed analysis of section 24JB in Chapter 2 and Chapter 3. Recommendations are made for possible amendments to the Act or for further clarification by SARS in an Explanatory Memorandum, or an Interpretation Note or General Binding Ruling.

An issue was raised in Chapter 2 in respect of the "covered person" definition relating to insurance holding companies that form part of the banking group, as envisaged in part (d) of the definition. The exclusion for insurers listed under part (d) applies only to companies that carry on the business of either a long term or short term insurer or to their subsidiaries. Therefore any controlling company of the long-term or short-term insurer would fall within the ambit of section 24JB as a "covered person", despite the fact that these holding companies are not involved in banking activities and would generally hold investments on capital account as opposed to holding them for trading purposes. It is therefore proposed that an amendment be made to the definition of a "covered person" in section 24JB, once the Insurance Laws Amendment Bill is enacted, to ensure that controlling companies of an insurance group are also excluded from the scope of section 24JB.

A "controlling company" within the banking group which acts as the holding company of all the entities within the group of companies, including the bank, is also to be included under the

definition of a "covered person". These holding companies are generally not engaged in banking activities and merely serve as holding companies whose only activities involve the passive holding of interests in subsidiaries. Since the purpose of the introduction of section 24JB is to govern the taxation of financial instruments, which are traded in high volumes and are considered to be highly liquid, it is submitted that controlling companies should not fall within the scope of section 24JB. It is proposed that SARS should consider issuing a Binding Class Ruling to exclude the controlling companies of banking groups, provided that they are not engaged in banking activities and do not structure transactions purposely within the controlling company in order to avoid the scope of section 24JB with the sole or main intention of avoiding or postponing the liability for tax.

Section 24JB(2) provides for the inclusion of all amounts in respect of financial assets and financial liabilities that are recognised in profit or loss in respect of financial assets and financial liabilities that are recognised "at fair value through profit or loss". The meaning of the words "recognised" and "classified" in the context of IAS 39 was explained in Chapter 2 and it was submitted that the second reference to recognition in section 24JB(2) is incorrect as financial instruments cannot be **recognised** "at fair value through profit or loss" but are in fact **classified** as such since classification determines the category that an instrument is allocated to whereas recognition is the process of incorporating the item in the balance sheet or income statement. The phrase "at fair value through profit or loss" is one of the categories defined in IAS 39 into which an instrument may be classified and does not refer to the recognition of the amount in the income statement. As a result, it is recommended that the wording "in respect of financial assets and financial liabilities of that covered person that are recognised at fair value in profit or loss in terms of IAS 39 of IFRS…." should be amended to read as follows: "…in respect of financial assets and financial liabilities of that covered person that are <u>classified as "at fair value through profit or loss</u>"….. (the terms that are underlined refer to the recommended change).

Unlike any other section of the Act, section 24JB uses both accounting and tax terms and it is not always clear whether the meaning of the words must be afforded the tax meaning or accounting meaning. It is recommended that a provision should be inserted into section 24JB that clarifies that the words used in the section should be given their ordinary meaning (as opposed to the accounting meaning), unless expressly stated otherwise. This would solve the uncertainties raised in Chapter 2 as to whether to allocate to the words such as "dividends" and "received by or accrued to" their meaning as used in a tax context or accounting context.

The exclusion in section 24JB(2)(b) which reads "…excluding any amount in respect of . . . a dividend or foreign dividend received by or accrued to a covered person" creates uncertainty as to whether this exclusion refers to actual dividends received or accrued only, or if this could be interpreted to include other amounts that are in respect of a dividend or are determined with reference to a dividend. It is proposed that if it is the intention of National Treasury to exclude only actual dividends received or accrued, the wording of the exclusions in section 24JB(2) should be amended as follows (words shown in [brackets] should be removed and words underlined should be inserted):

> …excluding any amount [in respect of]-
>
> (a) <u>in respect of</u> a financial asset that is-
>
> (i) a share;
> (ii) …
> (iii) …
> (iv) …
> (v) …
>
> if that financial asset was upon initial recognition designated in terms of International Accounting Standard 39 of IFRS or any other standard that replaces that standard by the covered person at fair value through profit or loss because that financial asset is managed and its performance is evaluated on a fair value basis.
>
> (b) <u>that is</u> a dividend or foreign dividend received by or accrued to a covered person.

The proposed amendment would ensure that the phrase "in respect of" only applies to the amounts in respect of the instruments listed in subsection (a) and the dividends excluded under subsection (b) would only refer to actual dividends and not to amounts in respect of dividends or to amounts determined with reference to a dividend.

Chapter 2 sets out a very brief summary of the pertinent differences between IFRS 9 and IAS 39. It is evident that many terms, categories and the classification of financial instruments under IAS 39 will no longer exist under IFRS 9. It is not within the scope of this thesis to provide a detailed discussion in this regard, however it is concluded that section 24JB will have to be reworded in order to align with IFRS 9, which is mandatory for entities to adopt from 1 January 2018. It is recommended, based on the complexities arising from accounting concepts as outlined throughout

this thesis, that consultations should be held between National Treasury and all affected stakeholders, including IFRS technical experts, prior to any changes being made to section 24JB.

It is proposed that SARS should clarify the intention of the wording in subsection 24JB(3) in an Explanatory Memorandum or Interpretation Note, to confirm whether an amount must first be included in taxable income under section 24JB(2) before subsection (3) can apply or whether it is merely the instrument itself that needs to fall within the scope of section 24JB(2). This is particularly relevant where upfront cash amounts received under certain financial instruments falling within the scope of section 24JB(2), are not included in the income statement and therefore are not included in taxable income under section 24JB(2).

Section 24JB(2) includes all amounts in respect of financial assets and financial liabilities that fall within the scope of section 24JB and not only fair value movements. Based on this, if section 24JB(3) is interpreted to override the remainder of the Act, it is unclear whether the intention is for section 24JB(3) to override the so-called anti-avoidance provisions contained in *inter alia*, sections 8E, 8F, 10 and 10B. It is proposed that SARS should clarify the intention of section 24JB with regard to the interaction with the rest of the Act in an Explanatory Memorandum or Interpretation Note. If it is not the intention for section 24JB(3) to override certain provisions such as the anti-avoidance provisions, it is proposed that the wording of section 24JB(3) be amended to insert the words "subject to sections…" and then list the sections of the Act that section 24JB will not override. Alternatively, another subsection can be inserted into section 24JB that states that: "Subsection 24JB(3) does not apply to any amount or financial asset or financial liability that would otherwise be dealt with under sections…", and list the sections of the Act that section 24JB will not override.

5.6 CONCLUSION

The view of Asprey as documented in The Asprey Report (the Full Report of the Taxation review Committee under the Chairmanship of Mr Justice Asprey) is that, after equity, simplicity is the most sought after quality of a tax system, which is determined with reference to the costs of administration and compliance on the one hand and the costs to the taxpayer on the other. He states (at 3.20) that:

> …Both costs will be the less if the assessor and the assessed can each establish with certainty what is due: uncertainty entails the cost of consultation with experts and sometimes the yet greater costs of litigation. Both kinds of costs are increased, and certainty is endangered, when a tax, whether in the interest of equity or of efficiency, requires the drawing of fine distinctions between what is and what is not liable, and when these distinctions involve such uncertain ideas as 'purpose' or 'value to the recipient' (Williams: 2005).

The primary aim of section 24JB is to simplify compliance and enforcement and to achieve uniformity between the rules pertaining to income tax and financial accounting for financial instruments. Specifically, it has been stated that the current divergence between accounting and tax in respect of financial instruments has proven costly for financial institutions in terms of the systems required to reconcile the differences (National Treasury: 2012). This stated purpose corresponds to the quality of simplicity as referred to by Asprey. However, it is evident from the critical analysis in this thesis that the intention is not fully achieved as a result of the numerous uncertainties still prevailing in the context of section 24JB.

It was not the aim of this thesis to conclude on the correct interpretation of every ambiguous aspect in section 24JB, but rather to highlight the areas of uncertainty that need to be considered for further clarification or amendment. The primary objective of this research was to perform a critical analysis of the scope of section 24JB as well as its interaction with the rest of the Act, in order to provide suggestions for proposed amendments or clarifications to be made in the future to ensure that a clearly drafted section will satisfy the intention to simplify the taxation of financial instruments for all interested stakeholders.

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