



SAICA

DIFFERENCE  
MAKERS™

Ref #776050

Submission File

25 October 2024

South African Revenue Service  
Private Bag X923  
Pretoria  
0001

BY EMAIL: [mkingon@sars.gov.za](mailto:mkingon@sars.gov.za); [ftomasek@sars.gov.za](mailto:ftomasek@sars.gov.za)  
Cc: [cdavis2@sars.gov.za](mailto:cdavis2@sars.gov.za); [sntombela@sars.gov.za](mailto:sntombela@sars.gov.za);

Dear Mark

## **SAICA SUBMISSION: TAXATION OF COMMUNAL PROPERTY ASSOCIATIONS AND THEIR MEMBERS**

1. The South African Institute of Chartered Accountants (SAICA) has been requested by a number of its members to clarify the required taxation of Communal Property Associations (“CPA”) as there is no specific taxing section related to these taxpayers in the Income Tax Act, No. 58 of 1962 (“ITA”).
2. Our initial views are that the general taxing provisions should apply, though this may be problematic and have a significant detrimental impact on CPA’s and their members.
3. We have been requested by SAICA members to seek clarity from SARS before a SAICA view is publicly expressed to its members on the matter.
4. It appears that the intended and legislated CPA structure has developed over time and has changed from CPA members earning income from land housed within CPAs to CPA’s earning income from this land and distributing profits to members. Individuals administer the CPA which may include renting out land for various purposes (accommodation, farming etc.) and then on-distributing the rental income and other types of income to its members (see below for other forms of income that may arise).
5. We are informed that CPA’s typically distribute at a minimum 80% of their total income (which may include rental and interest income and dividends) to their members. The remaining 20% or less is expended on the salaries of the individuals managing the CPA and other expenses associated with the CPA. We are informed that amounts received by CPAs are in some cases in the hundreds of millions across all CPAs.
6. The concern arises that in practice, some CPA’s consider the income received by the CPA to be taxable in the hands of the members of the CPA and not the CPA itself (i.e. they apply a flow through / conduit-pipe principle). If this is the incorrect tax treatment, then the income should in fact have been taxed in the hands of the CPA and the CPA would be required to retrospectively quantify the taxes payable (and potentially penalties and interest) – in some cases as far back as 28 years.
7. Based on the CPA constitutions that are available publicly and the constitutions that our members have seen, the manner in which the finances of the CPA and taxation thereof should be dealt with, is not specifically detailed in these constitutions. This means that the CPA Act is also not being complied with.



8. We have set out below our understanding of the law relating to CPA's and the taxation thereof to assist SARS in forming a final view.

## BACKGROUND TO CPAs

9. CPAs are established by way of the CPA Act, No. 28 of 1996 ("CPA Act")<sup>1</sup> to enable disadvantaged communities to acquire, hold and manage property in common. The CPA Act was revisited in 2017 and amendments were issued in the form of an amendment Bill<sup>2</sup>. This amendment Bill has been approved by the National Assembly and National Council of Provinces but still requires a Presidential signature and therefore is not yet enacted. The proposed amendments however do not give further insight as to the accounting / financial and tax requirements of a CPA and any distribution to members it may make.
10. All CPA's are required to register with the Department of Rural Development and Land Reform under the requirements of the CPA Act.
11. The constitution of a CPA should provide clear rules as to who can be members of the CPA. These members then have the right to vote on the management of the CPA as well as receive a distribution / share of the profits as a result of their membership.

## APPLICABLE LAW

### General Principles

12. The preamble to the CPA Act states as follows:

*"To enable communities to form juristic persons, to be known as communal property associations in order to acquire, hold and manage property on a basis agreed to by members of a community in terms of a written constitution; and to provide for matters connected therewith."* (our emphasis)

13. The creation of a separate juristic person with legal persona in relation to a CPA is set out in section 8(6) of the CPA Act<sup>3</sup>.
14. In terms of the CPA Act an "association" means "a communal property association which is registered or qualifies for registration in terms of section 8". In terms of section 8, the Director General of Rural Development and Land Reform will consider and approve the application for registration of a CPA if the requirements are met which include *inter alia* an application and constitution in line with the CPA Act. Furthermore, in terms of section 8, "the association shall be established as a juristic person, with the capacity to sue and be sued".
15. In terms of the CPA Act 'community' means:

*"a group of persons, which wishes to have its rights to or in particular property determined by shared rules under a written constitution and which wishes or is required to form an association as contemplated in section 2" and 'property' "includes movable and immovable property and any right or interest in and to movable or immovable property or any part thereof"*

<sup>1</sup> <https://www.gov.za/documents/communal-property-associations-act>

<sup>2</sup> <https://pmg.org.za/bill/704/>

<sup>3</sup> Communal Property Associations Act 1996 s8(6): *Upon the registration of an association- (a) the association shall be established as a juristic person, with the capacity to sue and be sued; (b) the association may acquire rights and incur obligations in its own name in accordance with its constitution; (c) the association may, subject to the provisions of its constitution- (i) acquire and dispose of immovable property and real rights therein; and (ii) encumber such immovable property or real rights by mortgage, servitude, or lease or in any other manner; (d) the association shall have perpetual succession regardless of changes in its membership; (e) the constitution shall be a legally binding agreement between the association and its members and shall be deemed to be a matter of public knowledge...."*



16. Similar to trust beneficiaries, the members of a CPA do not own this property. It is owned by the CPA as a separate legal entity. Accordingly, income earned by the CPA should to the CPA.<sup>4</sup>
17. Furthermore, the CPA Act contains a definition of “similar entity”. We assume that this phrase means a “similar entity” *in relation to a CPA*. The CPA Act allows the Minister of Rural Development and Land Reform to approve a “similar entity” as a CPA. This phrase is defined to mean “*a trust, association of persons or company registered in terms of section 21 of the Companies Act, 1973 (Act No. 61 of 1973).*”
18. The CPA Act is silent on the exact nature of the benefits that can and should be afforded to the members of the CPA as the CPA could have received rent, dividends, interest etc. from its investments. There is therefore no legal requirement that compels the CPA to distribute amounts to / vest amounts in members, for example, on an annual basis such as with trusts in which beneficiaries have vested rights to underlying income (see analysis below). The CPA Act requires the CPA constitution to make this determination. Accordingly, the question arises as to what the nature of amounts distributed to members of CPAs are and how / in whose hands they should be taxed.
19. Furthermore, the law is unclear with regard to how the expenses of a CPA (or usage decisions) should be incurred other than giving the board discretion. The CPA Act simply requires that the land must be managed for “communal benefit” which could yield a number of outcomes such as making land available for grazing or renting it out to third parties for benefit.
20. Therefore, under our current legal framework and similarly to a trust, the income should accrue to the CPA, not the members – with the members being entitled to a distribution of profits by the CPA as determined by the CPA constitution.

## **Taxation of CPA's**

### ***Interpretation 1 – Distribution is a dividend***

21. This is the most likely the correct interpretation.
22. In section 1(1) of the ITA, a ‘company’ is defined to include:

*“any association, corporation or company (other than a close corporation) incorporated or deemed to be incorporated by or under any law in force or previously in force in the Republic or in any part thereof, or any body corporate formed or established or deemed to be formed or established by or under any such law;”*
23. As such, for tax purposes, the CPA would be a “company” as defined.
24. In light of the fact that members have rights to the property of the CPA, one needs to determine where this right fits in the ITA.
25. We have therefore considered the definition of ‘share’ which means “*in relation to any company, any unit into which the proprietary interest in that company is divided*”. The term “*proprietary interest*” is not specifically defined in the ITA, however in practice it is commonly interpreted as a right to participate in the profits of a company<sup>5</sup>. Given that membership per Clause 7 of the constitution (per the CPA Act) is what gives members the right to participate and vote, it follows, in

<sup>4</sup> Communal Property Associations Act 1996, Schedule clause 7: *The rights of members to the use of the association's property.*

<sup>5</sup> See Interpretation Note 43(Issue 8) issued by SARS

our view, that members hold a “share” (or shares as the case may be) of the CPA for income tax purposes.

26. Therefore, it needs to be determined if any payments made to the shareholders / members are “dividends” as defined for tax purposes.

27. A dividend per the ITA means:

*“any amount, other than a dividend consisting of a distribution of an asset in specie declared and paid as contemplated in section 31 (3), 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, whether that amount is transferred or applied—*

*(a) by way of a distribution made by; or*

*(b) as consideration for the acquisition of any share in,*

*that company, but does not include any amount so transferred or applied to the extent that the amount so transferred or applied—*

*(i) results in a reduction of contributed tax capital of the company;*

*(ii) constitutes shares in the company; or*

*(iii) constitutes an acquisition by the company of its own securities by way of a general repurchase of securities as contemplated in subparagraph (b) of paragraph 5.67(B) of section 5 of the JSE Limited Listings Requirements, where that acquisition complies with any applicable requirements prescribed by paragraphs 5.68 and 5.72 to 5.81 of section 5 of the JSE Limited Listings Requirements or a general repurchase of securities as contemplated in the listings requirements of any other exchange, licensed under the Financial Markets Act, that are substantially the same as the requirements prescribed by the JSE Limited Listings Requirements, where that acquisition complies with the applicable requirements of that exchange”*

28. The definition of “share” in section 1 of the ITA means in relation to any company, any unit into which a proprietary interest in that company is divided.

29. Only point 18 of the Schedule at the end of the CPA Act deals with the recording and distribution of profits and compels the following to be included in the constitution of the CPA:

*“Financial matters: How the money of the association will be dealt with, who will have the right to make payments on behalf of the association, how and by whom the financial records will be kept, what provision there will be for independent verification of the financial records, distribution and division of profits, responsibility and apportionment of working expenditure, and access to financial information by members.” (our emphasis).*

### **Taxation of members of a CPA**

30. A member of a CPA would have the right to receive property (i.e. profits) from the CPA as determined in the CPA’s constitution. Point 18 of the CPA Act Schedule, which talks about the division and distribution of profits, infers that the distributions are dividends as defined in the ITA as it aligns with the requirements that an amount is transferred by a company to a person for their benefit. Therefore, distributions received in terms of the CPA Act would be “dividends” as defined in the ITA, which gives rise to a dividends tax liability for the member. This would mean that the CPA should be withholding dividends withholding tax<sup>6</sup> (DWT) on all payments made to the members / shareholders, unless the payment is for some other purpose other than just membership. The member would therefore receive the profits less the DWT.

<sup>6</sup> See Part VIII of the Act



31. Expenses incurred by the CPA on maintenance of the common property are the legal obligation of the CPA, not the members.
32. No other tax seems to be payable in law by members on these amounts received as dividends.
33. Members who are otherwise required to submit tax returns would need to disclose these dividends received in their individual tax returns and the CPA would have to submit DWT returns.
34. The concern is that if there was no DWT withheld, how would the CPA and or member rectify this?

### Taxation of CPAs

35. As a CPA would be a company as defined for tax purposes, dividends received by a CPA (for example, on investments that the CPA may hold) should not be taxable as it is a company as defined in the ITA<sup>7</sup>.
36. Furthermore a CPA is not a public benefit organisation in terms of the requirements in section 30 of the ITA – as such, the section 10(1)(cN) exemption is not available to CPAs.
37. A CPA would also not be a 'property association' per section 10(1)(e)(i)(cc) as these CPAs have not registered with the Commissioner of the South African Revenue Service as an association and the exemption only applies to levy income which is not the type of income CPAs receive.
38. However, it is unclear what the nature of distributions to members would be (given the trade and in production of income requirements for s11(a)).

### Interpretation 2: CPA as "Trust"

39. A second school of thought, that seems more practical but less technically correct, considers the income received by a CPA to be taxable in the hands of the members of the CPA due to the conduit-pipe principle which applies to trusts. The Appellate Division established the conduit-pipe principle in 1938 in *Armstrong v CIR* and confirmed this principle in subsequent cases over the years (this principle has been codified in section 25B of the ITA). If this principle applies, the beneficiary entitled to the "trust" income is liable for tax on the income if the income was distributed in the same year it was received.
40. In terms of tax law, the word "vest" refers only to unconditional rights and is considered a synonym for the word "accrued"<sup>8</sup>. This view was solidified in the decision of *CIR v People's Stores (Walvis Bay) (Pty) Ltd*<sup>9</sup>, in which the court agreed that an amount has accrued once one has received the unconditional entitlement to that amount.

### Taxation of CPAs

41. In light of the 'gross income' definition in section 1(1) of the ITA, it is clear that the income of a discretionary trust accrues to the trust. As quoted in para 23 of *Commissioner for the South African Revenue Services v Wooltru Property Holdings (Pty) Limited* (A395/07) [2008] ZAWCHC 44 (7 August 2008):

<sup>7</sup> Section 64F(a)

<sup>8</sup> ITC 76 (1927) 3 SATC 68 (U) and *CIR v Polonsky* 1942 TPD 249, 12 SATC 11

<sup>9</sup> 1990 (2) SA 353 (A), 52 SATC 9. See also ITC 1642 (1998) 60 SATC 541.



*“Liability for taxation, once income has either been received or accrued, is best illustrated in CIR v The Witwatersrand Association of Racing Clubs (3) SA 291(A), 23 SATC 380. In this case the taxpayer held a horse race with a view to donating the profit to a charitable organisation. From the start it had been the intention to donate the profit to charity. The court held that the moral duty to hand over the profits to charity did not alter the fact that the benefit had first accrued to the taxpayer before it was given to charity.”*

42. The only reason the tax liability for income received by or accrued to a trust does not accrue to the trust as a matter of course with discretionary trusts is because section 25B(2) of the ITA specifically deems the amount to be derived for the benefit of the beneficiary (if all requirements are met).
43. Similarly, in the case of co-operatives a specific provision (section 27) had to be introduced into the ITA to deal with anomalies created by the pooling of resources for a common purpose versus the strict reading of accrual.
44. Therefore, some CPAs are not disclosing any taxable income on the basis that the benefits i.e. the profits of the CPA, are on-distributed to the members, which has the same outcome to that of the conduit-pipe principle for trusts with the relevant distributions retaining their tax nature.

### **Taxation of members of a CPA**

45. The owner of an asset, with a real right (i.e. a right to ownership of a thing like money and not a right against a person for example a trustee) to the benefits thereof, would be the person to whom such income would accrue – after all, they are the ones who have the right to sue for default if the income is not paid.
46. Accordingly, if one applies the conduit-pipe principle to CPAs and their members then the distributed profits would be taxed in the hands of the members as the amounts would not constitute dividends. In terms of this interpretation CPA members who haven't done so already would also need to go back to previous tax returns if they are required to submit tax returns and include further income and pay penalties and interest. These profits may also push non-taxed CPA members into a taxpaying bracket.
47. It is found that both the CPA and members or either should have been historically taxed a final concern is whether the CPAs, which have not been taxed in previous years, would recover financially from having to pay tax, penalties and interest in order to correct their tax position. It would not be an ideal outcome if these worthy organisations would have to shut down. Furthermore, many of the CPA members may would not manage having to pay tax, interest and penalties in order to correct their tax positions. However, going forward the law does need to be clarified.

### **Request for clarification**

48. We kindly request that SARS:
  - a. Confirm our understanding of the applicable legislation as to the legal nature of CPA's;
  - b. Confirm which interpretation above or any other should be applied in the determination of the tax liability for the CPA and its members; and
  - c. Assist CPA's and professionals to be tax compliant, prepare and issue a guide with regard to the taxation of CPAs and its members.
49. Should SARS agree that there is a vacuum in the law that needs to be remedied, we request that SARS assist in engaging National Treasury so that a specific provision can be drafted and included as relates the taxation of CPAs and its members.

### **Conclusion**

50. Should you wish to clarify any of the above matters please do not hesitate to contact us.

*Lisa Kahanovitz*

Yours sincerely

Lisa Kahanovitz  
**Project Director: Tax**

*The South African Institute of Chartered Accountants*

Pieter Faber  
**Executive: Tax**