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Submission File

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South African Revenue Service
Private Bag X923
Pretoria
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BY E-MAIL: policycomments@sars.gov.za

Dear SARS

COMMENTS ON THE DRAFT INTERPRETATION NOTE: RECOUPMENT OF AMOUNTS DEDUCTED OR SET OFF WHEN AN ASSET COMMENCES TO BE HELD AS TRADING STOCK WHICH WAS PREVIOUSLY NOT SO HELD

1. We herewith take an opportunity to present our comments on behalf of the South African Institute of Chartered Accountants (SAICA) on the draft Interpretation Note (IN) – Recoupments of amounts deducted or set off when an asset commences to be held as trading stock which was previously not so held published by SARS on 22 February 2022.
2. We once again thank SARS for the ongoing opportunity to provide constructive comments on this draft IN as. SAICA continues to believe that a collaborative approach is best suited in seeking solutions to complex challenges, especially in these very difficult economic times.

COMMENTS

General

3. The purpose of the draft IN is to provide guidance on the interpretation and application of section 8(4)(k)(iv) of the Income Tax Act (the Act) that applies when any asset on which an allowance or deduction under a provision referred to in section 8(4)(a) has been granted, commences to be held as trading stock.
4. It is, however, concerning that this draft IN only uses an example to clarify the tax treatment of a change in use of an asset (from capital to trading stock) before 15 January 2020 – see our specific comments in this regard in paragraph 11 to 19.
5. We also wish to point out that the tax outcomes in the above circumstances are also dependent on paragraph 20(3) of the Eighth Schedule that deals with the base cost that should be reduced by any amount that has been recovered or recouped to the extent that such amount is not, *inter alia*, taken into account as a recoupment in terms of section 8(4)(a) or paragraph (j) of the definition of 'gross income' or has been applied to reduce an



amount of expenditure incurred in respect of trading stock as contemplated in section 19(3) or any other asset as contemplated in paragraph 12A(3).

6. Submission: Paragraph 20(3) and its implications in these circumstances should be included in the draft IN.

Paragraph 4.2 – Meaning of “asset” for the purposes of section 8(4)(k)(iv)

7. This paragraph commences with the following statement: “*The word “asset” is not defined in the Act.*” This is incorrect as the word “asset” is defined in the Eighth Schedule of the Act, which is part of the Act albeit that it is only defined for purposes of the Eighth Schedule.

8. Submission: Paragraph 4.2 should be amended to correctly reflect that the word “asset” is defined in the Act, albeit in the Eighth Schedule and only defined for purposes of the Eighth Schedule. It could be stated that the word “asset” is not defined in the *main body* of the Act.

Paragraph 4.5 – Meaning of “recovered” or “recouped”

9. This paragraph explains the meaning of “recovered” or “recouped” as these terms are not defined in the Act.

10. Submission: The discussion in this paragraph around the meaning of “recoupment” is not entirely relevant to the matter being clarified as section 8(4)(k) is a deeming provision, i.e. it deems the amounts to have been recouped, irrespective of whether there is an actual recoupment.

Paragraph 4.6 – Example 1: An allowance asset commences to be held as trading stock before 15 January 2020

11. The comment at the end of example 1 is, with all due respect, confusing as it states under the heading “Capital gain”, that the allowance of R60,000 granted to Company X before the asset commenced to be held as trading stock will only be recouped once the asset has been sold.

12. Submission: The heading “Capital Gain” appears out of context and should perhaps have been “Recoupment” or “Allowances previously claimed”.

13. Furthermore, by the time the asset is sold, it is no longer in the Eighth Schedule as an asset but in the main body of the Act as trading stock. Also recoupments of allowances previously claimed are relevant in the Eighth Schedule only for purposes of determining the proceeds for CGT purposes.

14. We suggest that Example 1 be expanded to show the tax implications when the trading stock, that used to be held as a capital asset, is eventually disposed of.

15. Below is an attempt at illustrating the impact of the above, but the correct version should be clarified by SARS in the draft IN – that is, is the total proceeds gross income, or is a portion of the proceeds a recoupment?

Tax implications 2019 when asset is sold for R 115,000:

	Gross income		Gross income
Proceeds = gross income	R 115,000	s8(4)(a) recoupment:	R 60,000
No s8(4)(a) recoupment: double tax		Proceeds (reduced by recoupment)	R 55,000
Opening stock	R 110,000	Opening stock	R 110,000
Taxable income	R 5,000	Taxable income	R 5,000

16. It is submitted that the proceeds of R115,000 received in respect of the disposal of inventory cannot be gross income in addition to a recoupment of allowances previously claimed as this will mean that the same amount is taxed twice.

17. In addition, it will mean that the capital gain that arose when the asset commenced to be held as trading stock will be overstated as the deemed market value proceeds was not reduced by the future recoupment, which is correct in terms of the legislation as it read at the time (i.e. before 15 January 2020). This implies that a portion of the amount is taxed three times. This is against the basic principles of taxation.

18. Submission: We suggest that draft IN include an additional example using the facts in Example 1 but including an explanation of what the tax consequences would be should the change in use have occurred after 15 January 2020.

19. For both examples (before and after 15 January 2020), the tax consequences on the subsequent sale of the trading stock should also be included.

Annexure

20. The Annexure to the draft IN, containing the relevant legislation applicable to this draft IN, does not include paragraph 20(3) as referred to in points 3 to 5 of this submission.

21. The Annexure does include paragraph 12(2)(c) of the Eighth Schedule, but it does not include paragraph 12(1). Without paragraph 12(1), paragraph 12(2)(c) does not make sense.

22. Submission: The Annexure should include paragraphs 20(3) and 12(1) of the Eighth Schedule.

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

Yours sincerely

Dr Sharon Smulders
Project Director: Tax Advocacy

Piet Nel
Project Director: Tax Education

The South African Institute of Chartered Accountants