

An analysis of the income tax treatment of South African collective investment schemes in securities

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ABSTRACT

This dissertation analyses the legal nature of the relationship between a South African collective investment scheme in securities and the investors in such a scheme and on the basis of these findings identifies how the income tax treatment of such schemes differs, in law and in practice, from the tax treatment which would apply in the absence of any specific provisions in the Income Tax Act relating to these parties.

The investment industry, and collective investment schemes in securities in particular, play a very important role in enabling and encouraging savings in South Africa and a huge portion of South Africa's wealth is under the care of collective investment scheme managers. It is therefore imperative that the tax treatment of such schemes results in a fair contribution to state funds while simultaneously encouraging a culture of saving. The purpose of this dissertation is to critically analyse the South African income tax legislation as it relates to the parties to a collective investment scheme in securities so as to identify the tax advantages, disadvantages and uncertainties which arise from the income tax treatment of these parties. This is achieved by contrasting the income tax treatment which applies to these parties in terms of the Income Tax Act to that which would apply where no specific provisions relating to such schemes existed.

Significant differences arise between the income tax treatment of a collective investment scheme in securities from that which would apply in the absence of any special dispensation relating to these schemes. On analysis tax benefits are generally afforded to the investors in such schemes however certain anomalies, uncertainties and distortions also arise. The potential for a collective investment scheme in securities to exist in legal form as either a company or a trust is, in particular, an issue which has not been well catered for in the Income Tax Act.

It is submitted that there is significant scope for legislative changes to ensure certainty in the tax treatment of collective investment schemes in securities. In addition it is suggested clarity

should be sought by the collective investment scheme industry on the application, in practice, of legal precedent relating to the determination of the capital or revenue nature of the proceeds resulting from the disposal of the underlying securities of such schemes.

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ABBREVIATIONS

the Act	the Income Tax Act (No 58 of 1962)
CFC	controlled foreign company
CIS	collective investment scheme
the CISCA	the Collective Investment Schemes Control Act (No 45 of 2002)
CISS	collective investment scheme in securities
CISP	collective investment scheme in property
the Companies Act	the Companies Act (No71 of 2008)
FSB	Financial Services Board
the old Companies Act	the Companies Act (No 61 of 1973)
OEIC	open-ended investment company
SARS	the South African Revenue Service

Unless otherwise indicated references to:

- *'sections'*, refer to sections of the Act;
- *'paragraphs'* refer to paragraphs of the Eighth Schedule to the Act.

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1. Introduction

The provisions of the Act as they relate to the taxation of a local CIS and the investors in such schemes were significantly amended for years of assessment commencing on or after 1 January 2010. Prior to this date all portfolios of a local CIS other than a CISP were defined, for income tax purposes, as companies¹. Various exemptions provided that the income accruing to these 'companies' was, for the most part, not taxable in the hands of the CIS² but instead 'flowed through' to the investors in the CIS, retaining its nature³.

The amendments to the Act aimed to better reflect conduit principles in respect of the ordinary distributions of a CIS⁴. As a result, for years of assessment commencing on or after 1 January 2010, a portfolio of a CIS is no longer defined as a company but is (other than a CISP) specifically included in the section 1 definition of a 'person'. Essentially a CIS other than a CISP is now, for tax purposes, treated roughly akin to a vesting trust⁵ with the investors in the CIS being the 'beneficiaries' of the trust.

This change in the tax classification of a portfolio of a CIS (other than a CISP) from a company to a vesting trust was made despite the fact that the CISCA, which replaced the Unit Trust Control Act in 2003, specifically permits the incorporation of a CIS as a company⁶.

The concession in the CISCA allowing a CIS to be established as an entity other than a unit trust was initially welcomed as it allows South African investment structures to more closely align with international investment structures (Kunene 2003), such as the USA's mutual funds which are established as limited liability companies⁷. Trust law is considered a creation of English

¹ Paragraph (e)(i) of section 1 definition of a 'company' – deleted effective 1 January 2010

² Section 10(1)(iA) provided that **income** accruing to a portfolio of a CISS was exempt in the hands of the portfolio to the extent that it had been distributed (or would be distributed) as a dividend to holders of participatory interests.

³ Section 10(1)(k)(i)(bb) provided that dividends paid by a portfolio of a CISS to its investors were not exempt from tax where the dividends had been paid by the portfolio out of income which was exempt from tax in terms of section 10(1)(iA). Effectively this meant that interest income accruing to a portfolio of a CISS which was paid out to the investors in the form of a dividend retained its nature and was not exempt from tax in terms of section 10(1)(k). Such non-exempt dividends were subject to the fixed value non-dividend exemption provided by section 10(1)(i)(xv). In addition, section 10(1)(h) provided that non-exempt dividends received by a non-resident holder of a participatory interest in a portfolio of a CISS were deemed to be interest (and were therefore exempt).

⁴ National Treasury – Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009 – at 3.7.

⁵ National Treasury – Explanatory Memorandum on the Taxation Laws Amendment Bill, 2009 – at 3.7.

⁶ CISCA, section 1 definition of 'collective investment scheme'

⁷ PROFILE, 2012. *Profile's unit trusts & collective investments*. March edn. Johannesburg: Profile Media. at p25

jurisprudence (Cameron, De Waal et al. 2002at s1) and is not widely understood in countries not influenced by English law. In addition, trust law has developed differently in the various countries in which trusts are recognised with the result that the rights and obligations of the parties to a trust differ between jurisdictions⁸ resulting in uncertainties in an international context. The move to allow a CIS to be established in South Africa as a company was therefore thought a positive one in attracting foreign investment into South African funds. Despite this not a single South African CISS has been incorporated as a company to date⁹. This is partly due to the fact that the provisions of the CISCA and the Companies Act conflict in some respects and do not lend themselves to the establishment of a CISS as a company¹⁰. The CISCA is however in the process of being rewritten by the FSB¹¹ and it is thought that the amended CISCA will resolve these conflicts so as to facilitate the establishment in South Africa of CISS's as companies. For this reason the taxation of a CISS incorporated as a company has been included in the scope of this dissertation.

The principal provisions of the Act relating to the taxation of a CIS (other than a CISP) and the flow through of income of the CIS to its investors are set out in section 25BA and in paragraph 61 of the Eighth Schedule to the Act. Numerous other references to CIS's exist in the Act which serve to either include or exclude CIS's from certain provisions.¹²

1.1. Research Question and Structure

This dissertation analyses the legal nature of the relationship between the investors in a local CISS and the CISS itself both where the CISS is established as a trust and where it is incorporated as a company and, in the light of these findings, aims to identify how the tax treatment of a CISS and its investors, both in terms of the Act and in practice, differs from the tax treatment which would be applied where no provisions unique to CISS's existed. Where anomalies or uncertainties regarding the taxation of a local CISS are identified either in the Act or in practice recommendations are made for improvements.

The research question that this dissertation seeks to answer is:

⁸ See (Honiball, Olivier 2009) for the differences between South African and English trusts.

⁹ Per discussion with Peter Blohm, Senior Policy Advisor at ASISA

¹⁰ See section 3.4

¹¹ Per discussion with Peter Blohm (*supra*), the amended version of the CISCA is expected to be released in 2013 and to become effective in 2014.

¹² For a list of provisions in the Income Tax Act which make reference to a portfolio of a CISS see table 8.1

How does the taxation of a local CISS and its investors, both in terms of the current income tax legislation and practice, differ from the treatment which would apply to these parties if no specific provisions relating to a local CISS existed?

In chapter two the background information relevant to conducting a critical analysis of the taxation of a CISS and the parties to such a scheme is provided. This chapter seeks to define what a CISS is, who the role players in such a scheme are, how it is regulated and why the CISS industry is an important aspect of South Africa's economy.

Chapter three examines, from a non-tax point of view, the legal nature of the relationship between the investors in a CISS, the trustee or custodian and the portfolio of a CISS itself. In particular this chapter seeks to establish the rights of the investor in relation to the underlying assets of the portfolio of a CISS both where a CISS is established as a trust and where it is incorporated as a company. The outcomes of this chapter are used as the basis for analysing how the tax treatment of the portfolio of a CISS and its investors differs from the treatment which would apply where no special provisions relating to CISS's existed.

Chapter four aims to identify the nature of a portfolio of a CISS in the eyes of the Act. The view of the legislature has important tax consequences for the way in which a portfolio of a CISS and its investors are taxed and it is therefore important to establish the tax framework applicable to a CISS in terms of the income tax legislation.

With reference to relevant case law, chapter five seeks to establish the capital or revenue nature of the proceeds derived by a portfolio of a CISS on the disposal of its underlying securities. This chapter considers how the proceeds on the disposal of the underlying securities of a CISS are currently being taxed in practice in South Africa and whether this practice is in line with established legal precedent.

Chapter six seeks to answer the research question by comparing the income tax treatment currently applied by the Act to a portfolio of a CISS and its investors to that which would apply where the Act did not make any specific reference to these parties. This chapter analyses the income tax, capital gains tax and dividends tax consequences for a CISS and its investors to determine how the provisions of the Act either benefit or disadvantage the CISS and its investors.

The final chapter summarises the conclusions reached from this study.

1.2. Research Methodology

The primary research methodology is legal research. It involves answering the research question through *identifying, analysing and organising*¹³ tax legislation, court cases and commentary on legislation.

Chapter six includes a comparison of the effect of the inclusion of the specific provisions in the Income Tax Act relating to a CISS on the taxation of a CISS. This aspect of the work is a numerical case study and therefore encompasses quantitative research.

1.3. Limitations of Scope

The scope of the dissertation is limited to the South African income tax treatment of local collective investment schemes in **securities** and the investors in such schemes.

This dissertation considers South African income tax legislation promulgated to 31 December 2012 but provides commentary, where appropriate, on the proposed changes to the Act in terms of the Taxation Laws Amendment Bill of 2012.

An analysis of collective investment schemes in properties has been excluded because such schemes are taxed in terms of an entirely separate regime which is currently in a state of flux due to a very substantial proposed legislative overhaul¹⁴.

Other types of collective investment schemes considered in the Act (collective investment scheme in participation bonds and declared collective investment schemes) are not considered in terms of this dissertation as the quantum of the assets under management in these kinds of schemes is currently insignificant in comparison to collective investment schemes in securities.

The dissertation will not include an analysis of foreign collective investment schemes as such schemes are considered companies in terms of section 1 of the Act¹⁵ and are therefore subject to substantially different income tax treatment.

For purposes of considering the income tax treatment of the various types of income accruing to a CISS only those forms of income most likely to accrue to a CISS are considered. These include only:

¹³ McKerchar, Margaret – eJournal of Tax Research, volume 6 no 1 pp 5 - 22

¹⁴ In terms of the Taxation Laws Amendment Bill of 2012 which introduces a new section, 25BB, to the Act

¹⁵ Paragraph (e)(ii) of the section 1 definition of 'company'

- i) local and foreign dividends;
- ii) interest; and
- iii) revenue and capital gains or losses on the disposal of the underlying securities in the portfolio.

2. Overview of Collective Investment Schemes

2.1. Introduction

A collective investment scheme is defined in the CISCA as follows:

“a scheme, in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which –

- (a) two or more investors contribute money or other assets to and hold a participatory interest in a **portfolio of the scheme** through shares, units or any other form of participatory interest; and*
- (b) the investors share the risk and benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed,*

But not a collective investment scheme authorised by any other Act;”

A **portfolio** of a collective investment scheme is essentially a pool of funds created through the contributions of a number of investors. The pool of funds (the portfolio) is managed by a professional manager who, depending on the mandate of the collective investment scheme will use the contributions of the investors to invest in listed shares, cash, property, bonds or other securities.

In exchange for their contribution to a portfolio of a CIS each investor receives a participatory interest in that portfolio which may be referred to either as shares or as units and which represent the investor’s proportionate interest in the assets of the portfolio. The value of the investor’s participatory interest in the portfolio will therefore increase or decrease in proportion to the increase or decrease in the value of the underlying assets held in the portfolio.

A single CIS could, based on the above definition, include more than one portfolio of underlying assets. The different portfolios within a scheme may represent different investment strategies of the manager of the scheme, may have different risk profiles or may be differentiated in terms of the types of assets included in the portfolio.

The proportionate ownership of the underlying assets in a portfolio of a CIS is one of the main advantages and attractions of investing in a CIS as it enables ‘ordinary’ investors to achieve a

diversity of investment which would not otherwise be possible without vast amounts of investment capital. Further advantages of investing through a CIS include the benefit of professional management of assets, low initial investment amounts, the ability to liquidate the investment on demand and tax efficiency.

The following types of CISs are contemplated in the CISCA:

- collective investment schemes in securities;
- collective investment schemes in property;
- collective investment schemes in participation bonds; and
- declared collective investment schemes.

Each type of CIS listed above has specific administrative provisions in the CISCA which apply to it and are each restricted in terms of the type of assets which may be held in the underlying portfolios of the scheme.

2.2. Establishing a CIS

The deed of a CIS is the defining document in terms of which a CIS is established¹⁶. In the case of a CIS which is legally established as a trust it is an agreement entered into between the manager and the trustee which creates the trust¹⁷. In terms of a CIS which is legally established as a company it is the document of incorporation of the company¹⁸. The deed defines the parameters in terms of which the CIS is administered and managed and it sets out the duties, rights and obligations of the various parties to a CIS¹⁹.

2.3. The parties to a CIS

The parties to a CIS are the investors, the manager and the trustee or custodian (as applicable).

2.3.1. The Manager

The CISCA requires that the manager of a CISS be a company incorporated in terms of the Companies Act and that the manager be registered with the registrar of collective investment

¹⁶ CISCA, section 1 definition of 'deed'

¹⁷ Supra

¹⁸ Supra

¹⁹ CISCA, section 97 read together with Schedule 1

schemes (appointed by the FSB)²⁰. The role of the manager is to administer the collective scheme which includes making investment decisions regarding the underlying assets in the portfolio²¹, marketing the CIS, creating, selling and redeeming participatory interests, maintaining proper accounting records, investor reporting and compliance. The manager is the central coordinator of a CIS and is usually the party that conceives of and launches the CIS.

The duties of the manager of a CIS may be outsourced to a third party however overall responsibility for the administration of a CIS remains with the manager. It is fairly common for the management of the portfolio i.e. the making of investment decisions regarding the assets comprising the portfolio, to be outsourced to a separate *asset manager* (*Profile 2012 at 66*).

The manager of a CIS is entitled to charge fees in exchange for the portfolio management and administration service rendered by it (or outsourced by it). Such fees are, in terms of the CISCA, deductible from the portfolio of a CIS²² and as they reduce the value of the underlying portfolio are indirectly payable by the investors in the scheme.

2.3.2. The Trustee or Custodian

The CISCA requires that the manager of a CISS appoint a trustee or custodian²³ (as appropriate depending on whether the CISS is established as a trust or as a company) to safe guard the underlying assets of a portfolio of a CISS. The trustee or custodian must be a public company and must be registered with the Registrar of collective investment schemes²⁴.

The duties of the trustee or custodian include: ensuring the safe custody of the assets and income of the portfolio, ensuring that the administration of the CISS is being carried out in terms of the deed entered into between it and the manager and carrying out the instructions of the manager²⁵.

2.4. The regulation of a CIS

CISs are regulated by the CISCA which replaced the Unit Trust Control Act with effect from 3 March 2003. The result is that what was formerly referred to as a 'unit trust' is now just one of the various forms of a CIS contemplated in the CISCA.

²⁰ CISCA, sections 41 - 42

²¹ CISCA, section 1 definition of 'administration' and 'manager'

²² CISCA, section 93

²³ CISCA, section 68(1)

²⁴ CISCA, section 69

²⁵ CISCA, section 70

A CIS which is established in terms of the CISCA as a trust is not subject to the Trust Property Control Act (no 57 of 1988)²⁶. This is because the Trust Property Control Act largely deals only with the administration of trusts which in the case of a trust which is a CIS is covered by the CISCA.

A CIS which is established in terms of the CISCA as an open-ended investment company is subject to the provisions of the Companies Act except to the extent that certain provisions of the Companies Act, as they relate to the manager of the scheme are excluded by the CISCA²⁷.

CISs are able to market themselves to the general public and therefore also fall under the regulation of the FSB which is responsible for the regulation of all publicly held investments in South Africa. Every CIS must be registered with the FSB and must report periodically to the FSB. The executive officer and deputy officer of the FSB are respectively the registrar and deputy registrar of all CISs²⁸.

Part III of the CISCA provides for the licensing of an association representing the interests of the CIS industry. The Association for Savings and Investments in South Africa (ASISA) is the body which currently holds this license and which is tasked with the self-regulation of the CIS industry (to the extent provided by schedule 4 of the CISCA). Membership of ASISA by a CIS is not compulsory but is encouraged by the FSB.

2.5. The growth and importance of the CIS industry in South Africa

The first CIS (known at the time as a unit trust) was established in South Africa by Sage in 1965 (Profile 2012 at p24). The industry has grown significantly and as at 31 December 2011 there were 947 rand denominated CIS's in South Africa with total assets under management of just over R1 trillion²⁹. A huge portion of South Africa's savings and investments are therefore under the control of CIS managers. The asset management industry and CISS's in particular provide an important mechanism which allows 'ordinary investors' easy access to investing in diversified portfolios of equity shares.

The huge size of the asset management industry coupled with the fact that its existence enables and encourages a culture of saving makes it imperative that the taxation of these

²⁶CISCA, section 113

²⁷CISCA, section 111

²⁸CISCA, section 7

²⁹ASISA, 2012. *ASISA Annual Review : 2011*. at p 45

investment schemes collect its fair share of revenue for the country without detracting from their appeal.

3. The legal nature of a collective investment scheme

3.1. Introduction

A 'collective investment scheme' is defined in part I of the CISCA as:

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

- (a) Two or more investors contribute money or other assets to and hold a **participatory interest** in a portfolio of the scheme through shares, units or any other form of participatory interest; and*
- (b) The investors share in the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed"*

A 'participatory interest' is defined as:

"an interest, undivided share or share whether called a participatory interest, unit or by any other name, and whether the value of such interest, unit, undivided share or share remains constant or varies from time to time, which may be acquired by an investor in a portfolio"

From the above definitions it is clear that a CISS can, in terms of the CISCA, either be established as a trust or incorporated as a company. The rights of the investors in relation to the underlying assets of the portfolio of a CISS will depend greatly on which kind of entity is used to house the scheme.

This chapter will aid the analysis of the taxation of a CISS and its investors by establishing the legal nature (from a non-tax point of view) of the relationship between the parties to a CISS both where the CISS is established as a trust and where it is established as a company.

3.2.The rights of the investors in a CISS in relation to the assets of a CISS which is established as a trust

3.2.1. The rights of beneficiaries of a trust

A trust is defined in section 1 of the Trust Property Control Act as:

“the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –

- (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of person designated in the trust instrument or for the achievement of the object stated in the trust instrument; or*
- (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trusts instrument or for the achievement of the object stated in the trust instrument;”*

The South African concept of a trust as defined above therefore includes a *bewind trust* which is an arrangement in terms of which the control but not the ownership of property is transferred to the trustees of the trust (Geach, Yeats 2007 at 2.2)

In the case of a trust in the traditional sense (i.e. a trust which is not a *bewind trust*) the assets, liabilities, rights and duties of the trust vest in the trustees however this vesting is in the trustee’s official capacity as trustee and not in a beneficial capacity. The trustee is therefore the owner and administrator of the trust property but does not personally acquire any beneficial rights in respect of the trust property (Cameron, De Waal et al. 2002 at s31).

The rights of the beneficiary of a trust are determined by the terms of the trust deed and may depend upon whether the trustees have exercised their discretion in terms of the trust deed. The rights of the beneficiaries of a trust can be described in terms of discretionary rights, vested rights, income rights, capital rights or any combination of these rights (Geach, Yeats 2007 at 2.3).

A beneficiary with a discretionary (contingent) right to the income or capital of a trust will only receive a benefit from that right to the extent that the trustees exercise their discretion in terms of the trust deed to grant such benefits to the beneficiary. A discretionary right is merely

a *spes* or hope and the holder of such right has no right of enforcement against the trustees apart from the right to have the trust administered in accordance with the trust deed. A beneficiary with a vested right on the other hand has a right to the capital, income or a specific asset of the trust which is not subject to the discretion of the trustees and which can be enforced against the trustees. A beneficiary could obtain a vested right through the provisions of the trust deed or through the exercise of the discretion of the trustees in terms of the trust deed (Geach, Yeats 2007 at 2.3)

A vested right to the capital or income of a trust is a personal right or a right *in personam*. This is contrasted with the rights of ownership held by the beneficiary of a *bebind* trust which are real rights or *rights in rem*. In the case of a *bebind* trust the beneficiary has an interest *in* an asset (ownership) of the trust as opposed to the right *to* that asset in the case of beneficiary holding a vested right to a particular asset (Geach, Yeats 2007 at 16.11). As there is a distinct difference between a vested right and ownership, it is possible for the ownership of trust property to be held by the trustee while a vested right to that property be given to a beneficiary (Cameron, De Waal et al. 2002 at s347).

In the case of a *bebind* trust the assets of the trust in which the beneficiary has an interest would form part of the estate of that beneficiary and would be subject to the claims of the creditor's of that beneficiary. In the case of a vesting trust it is the **right to** the assets or income of the trust which forms part of the beneficiary's estate and not the assets or income themselves (Cameron, De Waal et al. 2002 at s347).

3.2.2. The rights of investors in a CISS as beneficiaries of the CISS

Where a CISS is established in terms of the CISCA as a trust, the trust instrument by which the trust is created is the deed entered into between the manager of the CISS and the trustee of the CISS. The contents of the deed sets out the rights and obligations of the manager, the trustee and the investors and it is therefore to this document that one must look to establish what rights the investors in a CISS (as the beneficiaries of the trust) have over the assets of the CISS.

The contents of such deeds will, in practice, vary from scheme to scheme however the CISCA prescribes that a deed must *inter alia* provide for the requirements applicable to the

administration of a CISS³⁰ in terms of the CISCA and that any provision of a deed which is inconsistent with the CISCA is void³¹.

The following sections of the CISCA are therefore relevant in determining the rights of the investors in a CISS over the underlying assets and income of the CISS:

Section of the CISCA	Wording
Section 1 definition of “assets”	<i>“the investments comprising or constituting a portfolio of a collective investment scheme and includes any income accruals derived or resulting from the investments in the portfolio which are held for or are due to the investors in that portfolio” (emphasis added)</i>
Section 70(1)(i):	<i>“A trustee or custodian must ensure that there is legal separation of assets held under custody and that the legal entitlement of investors to such assets is assured”;</i>
Section 15(1)(e)	<i>After an investigation the registrar may: “require a manager to take steps, in accordance with the registrar’s directions and the provisions of section 102, for the winding-up of a portfolio of its collective investment scheme, and for the realization of the assets and the distribution of the net proceeds thereof, together with any income accruals or other moneys available for distribution among the investors in proportion to their respective participatory interests”</i>
Section 102:	<i>Winding-up of portfolio of collective investment scheme “...upon the winding-up of a portfolio in terms of this section the manager must under the control and supervision of the trustee or custodian realise all the assets of such portfolio as soon as possible having regard to the interest of investors,... the net proceeds of the realization of such assets must be deposited in the trust account... and must under the control and supervision of the trustee or custodian be distributed by the manager or the trustee or custodian, as the case may be, amongst the investors and the manager in proportion to their respective participatory or other interests in the portfolio.</i>
Section 71:	<i>“For purposes of this Act any –</i>

³⁰ Schedule 1 to the CISCA

³¹ CISCA s98(1)

- (a) money or assets received from an investor; and
(b) any asset of a portfolio,

are regarded as being trust property for the purposes of the Financial Institutions (Protection of Funds) Act, 2001 (Act No. 28 of 2001), and a manager, its authorized agent, trustee or custodian must deal with such money or other assets in terms of this Act and the deed and in the best interests of investors.

An investor's right as a beneficiary of a CISS is represented by their participatory interest in the CISS. In terms of the above sections of the CISCA this participatory interest represents a right to a proportionate share of the net income of the portfolio and, on dissolution of the scheme, to the capital derived from the securities in the portfolio.

In addition, the deed of a CISS must provide that a manager is obligated to repurchase any participatory interest in a CISS offered to it.³² The repurchase price must reflect the market value of the investor's proportionate share of the underlying securities in the portfolio as well as the investor's proportionate share of any accrued but undistributed income. This repurchase mechanism represents the investor's right of enforcement against the trustees of the CISS.

The rights of an investor in a CISS, as embodied by the CISCA, must be provided for in the trust deed. It is clear that such rights are not subject to the discretion of the trustees.

A CISS which is established as a trust can be distinguished from a *bewind* trust in that the participatory interest of an investor in a CISS represents an interest *in* rather than a right *to* the underlying assets and the income of the portfolio of the CISS. It is submitted that a CISS cannot be a *bewind* trust because the investor's right against the trustee is *in personam* only (Cameron, De Waal et al. 2002 at s392). The investors in a portfolio do not individually own an undivided share of every underlying asset in the portfolio and have no right against the trustee to claim delivery of the assets. Instead ownership of the assets of the portfolio vests in the trustee who holds those assets for the benefit of the investor. The investor's right against the trustee is limited to being able to require the trustee to redeem the investor's participatory interest at the net asset value per unit / share of the portfolio.

³² Paragraph 2(a) of Schedule 1 to the CISCA

Despite the ownership of the underlying securities of a CISS vesting in the trustee, the assets of a portfolio of a CISS do not form part of the assets of the trustee. This is because the trustee holds only bare ownership over the assets. The assets are held for the benefit of the investors; the trustee acquires no beneficial interest in the assets. The CISCA specifically provides that: *“For the purposes of a claim against a manager, trustee or custodian there must be excluded from the assets of the manager, trustee or custodian –*

- (a) any money or other assets handed to that manager, trustee or custodian or its authorised agents by an investor for the sale or repurchase of a participatory interest; and*
- (b) the assets of a portfolio”³³*

It can be concluded from the above that where a CISS is established as a trust, the investors in the CISS, as beneficiaries, have a vested right to the assets and accrued income of the portfolio of the CISS. The CISS can be said to be a vesting trust.

3.3. The rights of the investors in a CISS in relation to the assets of a CISS which is incorporated as a company

The provisions of the CISCA make it possible for a CIS to be housed in an *“open-ended investment company”³⁴*. This is significant as prior to the promulgation of the CISCA a CIS could only be operated through a unit trust structure³⁵.

An *“open-ended investment company”*, commonly referred to as an ‘OEIC’ is defined in the CISCA as: *“a company with an authorised share capital, which is structured in such a manner that it provides for the issue of shares to investors, each class of share representing a separate portfolio with a distinct investment policy.”³⁶*

A *“company”* is defined in the CISCA as: *“a company incorporated or registered under the Companies Act (Act No. 61 of 1973)”³⁷*

³³Section 104 of the CISCA

³⁴CISCA, section 1 definition of *“collective investment scheme”*

³⁵Section 37 of the Unit Trusts Control Act prohibited any person from operating a CIS which did not comply with the provisions of that Act.

³⁶CISCA, section 1 definition of *“open-ended investment company”*

³⁷CISCA, section 1 definition of *“company”*

Note that the Companies Act referred to in the CISCA ('the old Companies Act') was replaced by the Companies Act (No 71 of 2008) ('the Companies Act') with effect from 1 May 2011. The references in the CISCA to the old Companies Act are however yet to be updated.

South Africa, unlike the United Kingdom, has no specific legislation governing the formation and administration of an OEIC³⁸. In addition neither the old nor the new Companies Acts define or make any reference to an OEIC. Therefore, because an OEIC is defined as a company, all of the provisions of the Companies Act, as they relate to profit companies, apply to a CIS established as an OEIC.

3.3.1. The rights of the shareholders of a company in relation to the assets of the company

A company is a legal person. It is a juristic entity which is separate from its shareholders. As such, a company can acquire ownership in assets and incur liabilities in its own name.

Section 19(1) of the Companies Act states that: *"From the date and time that the incorporation of a company is registered, as stated in its registration certificate, the company –*

(a) Is a juristic person..."

The recognition of a company as a juristic person has a number of important consequences one of which is the limited liability of shareholders and another being that the assets of a company are the exclusive property of that company and do not vest in the shareholders (Davis, Cassim et al. 2009 at 2.5)

The concept of a company as a separate legal person is supported by case law. In *Dadoo v Krugersdorp Municipal Council*³⁹ Innes CJ said the following on the matter:

"...the existence of a company as a separate entity distinct from its founders is no merely artificial technical thing. It is a matter of substance; property vested in the company is not, and cannot be, regarded as vested in all or any of its members."

A share in a company represents a bundle of rights which grants the shareholder defined rights in terms of dividend distributions, the participation in liquidation distributions and shareholder voting. A company may, in terms of its Memorandum of Incorporation, differentiate between

³⁸ In the United Kingdom the Open-Ended Investment Companies Act governs OEICS

³⁹ 1920 AD 530 at 550 -1

the rights of its various shareholders by creating multiple classes of shares which each confer a different bundle of rights on the shareholders⁴⁰.

A share in a company is an asset to the shareholder as the shareholder has real rights to ownership of the share. A share in a company would therefore form part of the estate of the shareholder. A share in a company does not however, represent any vested interest in the assets of the company (Geach, Yeats 2007 at 9.2.2).

3.4. The difficulties of establishing an OEIC in South Africa

In his article *Establishing an OEIC in South Africa: Some Salient Issues* (Kunene 2003) the author, legal advisor at the time to the Association of Collective Investments sets out some of the barriers which have prevented the incorporation of OEICs in South Africa. Most fundamental is that there is no specific legislation in South Africa pertaining to OEICs and as a result these entities must comply with the Companies Act which does not cater for an entity which repurchases its own shares as a matter of routine⁴¹. The CISCA 'overrides' the provisions of the Companies Act relating to the repurchase of shares by an OEIC by excluding these provisions⁴². It is not clear however whether these exclusions are of any effect as it is not apparent that the Companies Act is in fact subject to the provisions of the CISCA.

The Companies Act sets out that the board of directors together with a general meeting of shareholders are responsible for acting on behalf of the Company and for managing it. The CISCA on the other hand prohibits any person from performing any act or entering into an agreement for the purpose of administering a CIS unless such person is registered as a 'manager' as defined in the CISCA. This presents a conflict as the CISCA prescribes that a manager of an OEIC must be a company⁴³ while the Companies Act prohibits the appointment of a director which is a juristic person⁴⁴. Further, the involvement of shareholders as decision makers on behalf of an OEIC (as required by the Companies Act) is both impractical and may lead to problems where larger investors have more of a say over the affairs of an OEIC than smaller investors.

⁴⁰ Companies Act, section 36

⁴¹ It is a basic common law principle that a company may not purchase its own shares. This principle is part of the capital maintenance rule which is intended to protect the creditors of companies. The Companies Act modifies this common law principle by allowing the repurchase of shares where the specific repurchase is authorised by a special resolution of shareholders. The involvement of shareholders in authorising the repurchase of the shares issued by an OEIC is contrary to the provisions of the CISCA which require an OEIC to repurchase its shares on demand by the shareholder.

⁴² CISCA, section 111

⁴³ CISCA, section 41

⁴⁴ Companies Act, section 69(7)(a)

It is anticipated that the new version of the CISCA, expected to be promulgated in 2014 will fully address the above issues and will pave the way for the incorporation of OEIC's in South Africa⁴⁵.

3.5. Conclusion - Contrasting the rights of investors in relation to the assets of a CISS established as a trust to the rights of investors in a CISS established as a company

From the view point of the investor there may, in practice, be little difference between their rights as an investor in a CISS established as a trust to those in a CISS established as a company. Essentially both schemes give the investor the right to redeem their shares or units at a value which reflects the investor's proportionate share in the assets and accrued net income of the portfolio.

The difference between the juristic nature of a company and the lack thereof in the case of a trust does however create differences in the legal nature of the rights of the investors in relation to the assets of the portfolio in which they have invested. Such differences would (had the Income Tax Act not intervened to treat all CISS's and their investors the same regardless of their legal nature) lead to very different tax treatments of the two kinds of CISS's and the investors in them.

The table below summarises the key differences between the investors' rights to the assets of a portfolio of a CISS where it is established as a trust and where it is established as a company.

CISS established as a trust	CISS established as an OEIC
The investor has a vested right, in terms of the trust deed, to a proportionate share of the net assets of the portfolio.	The investor has no right to the underlying assets and accrued income of the portfolio. The investor holds a share in the company which has a value determined by the underlying assets and liabilities in the portfolio.
Legal title to the assets of the portfolio is held by the trustees of the CISS but beneficial ownership vests in the investors.	The assets and accrued income of the CISS vest in the CISS itself.

⁴⁵Per discussion with Peter Blohm, Senior Policy Advisor - ASISA

The investor realises the investment by exercising the right of enforcement (inherent in the vested right) against the trustees to liquidate their proportionate share of the portfolio.

The investor realises the investment through exercising the right to demand the repurchase of the shares by the company at a price which reflects the underlying assets in the portfolio.

4. The nature of a CISS from the point of view of the Income Tax Act

4.1. Introduction

With effect from 1 January 2010 a portfolio of a CISS was removed from the section one definition of ‘*company*’ and is now, regardless of whether it forms part of a CISS established as a trust or as a company, included in the definition of a ‘*person*’. It appears to be generally accepted that a portfolio of a CISS is treated as a vesting trust for tax purposes however this conclusion is not obvious and requires some investigation. The classification of a portfolio of a CISS as a vesting trust has important knock-on effects on the way that such a portfolio and its investors are taxed.

4.2. Identifying the taxpayers

The provisions of the Income Tax Act make reference only to a **portfolio** of a CISS which is defined in section 1 with reference to the CISCA. The portfolio of a CISS is recognised in the Act as a ‘*person*’. The CISS itself, of which the portfolio is a part, is not specifically considered in the Act. This results in the recognition of multiple and overlapping taxpayers as the CISS itself (as either a trust or a company) as well as each individual portfolio (by virtue of its inclusion in the definition of a ‘*person*’) is, strictly speaking, recognised in terms of the Act as a taxpayer.

In the case of a CISS which is established as a company in terms of the Companies Act, the CISS itself (with each of its portfolios represented by a different share class) falls within the definition of a single company. This is because the definition of a ‘*company*’ in section one of the Act includes:

“(a) 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...”

There is no exclusion in the section 1 definition of a ‘*company*’ for a local CISS. The CISS itself is therefore subject to all the provisions of the Act as they relate to companies.

A similar problem exists with a CISS established as a trust. The trust exists as a result of the trust deed entered into between the manager and the trustee⁴⁶. A single trust (the CISS itself) could feasibly include multiple portfolios⁴⁷. The Income Tax Act recognises each of these individual portfolios as a separate person with the result that for tax purposes each portfolio is

⁴⁶ CISCA, section 1 definition of ‘*deed*’

⁴⁷ This is clear from the definitions of ‘*collective investment scheme*’ and ‘*portfolio*’ in section 1 of the CISCA

a *person* which exists within the CISS which itself is legally a trust and which therefore automatically also falls within the definition of a *person*.

The jump in the Act from treating the CISS (as a whole) as a taxpayer to treating each portfolio within the CISS as a taxpayer is not documented. It appears however that it is the intention of legislature to administer the taxation of these schemes on a portfolio level as opposed to a scheme level.

It may be reasonable, in the case of a CISS established as a trust, that each individual portfolio could in itself constitute a trust. This treatment makes sense because each portfolio's underlying assets must be kept separate by the trustee or custodian (as applicable) and because each investor has a right to only the assets and income of the specific portfolio in which it is invested. It is submitted that it is not unreasonable for the nature of the portfolio to mimic the nature of the scheme of which it forms part.

It is submitted that the problem of the creation of multiple taxpayers as explained above is likely an oversight in the Act and that it is likely the intention of the legislature that the local CISS itself (as a whole) be specifically excluded from the section one definitions of a '*company*' and of a '*person*' so that whether the CISS is established as a trust or as a company, it is only each individual portfolio which is recognised as a taxpayer.

It is assumed, for purposes of the remainder of this document, that it is the intention of the legislature that the actual CISS, whether established as a company or a trust should be ignored for tax purposes and that it is only each portfolio within the CISS which should be recognised as a taxpayer.

4.3. The nature of a portfolio of a CISS in the eyes of the legislature

The inclusion of a portfolio of a CISS in the definition of a '*person*' does not in itself add any colour to how the portfolio is viewed by the legislature apart from the fact that the portfolio is recognised as a taxpayer⁴⁸.

The definition in section one of '*connected person*' does however indicate that from the point of view of the Act that a portfolio of a CISS is seen to be a trust. This is because the definition of a *connected person* specifically excludes a portfolio of a CISS from the connected person rules as they relate to trusts.

⁴⁸A portfolio of a CISS is required by section 70A of the Act to submit an annual return.

“connected person” means

(a) In relation to a natural person –

(i) any relative; and

*(ii) any trust (**other than a portfolio of a collective investment scheme in securities**) of which such person or such relative is a beneficiary;*

(b) ...

*(bA) in relation to a connected person in relation to a trust (other than... and **other than a portfolio of a collective investment scheme in securities**), includes any other person who is a connected person in relation to such trust.” (emphasis added)*

SARS and National Treasury documentation on the subject further indicates that a portfolio of a CISS is viewed by these bodies as a trust. The Explanatory Memorandum to the Taxation Laws Amendment Bill of 2009 (which introduced the current legislation relating to CISS’s which became effective 1 January 2010) does not unfortunately make any mention of a **portfolio** of a CISS but does however refer in general to a CISS which it states will be treated ‘*roughly akin to a trust*’ in that its tax treatment will embody conduit / flow through principals⁴⁹. The SARS guide to Capital Gains Tax (Issue 4) does, in its commentary on paragraph 61, specifically refer to a **portfolio** of a CISS and states that “*a CISS⁵⁰ or so-called ‘equity unit trust’ is no longer a company for the purposes of the Act, and reverts to its **true status**, namely, a vesting trust*” (emphasis added). The conclusion that a portfolio of a CISS is **vesting** trust does not stem from any of the provisions of the Act. It is likely that this view is instead derived (in the case of a CISS established as a trust) from the legal nature of the arrangement entered into between the manager, custodian/ trustee and the investor as governed by the CISCA and from the document establishing the CISS which gives the investor the right (exercisable against the trustee) to realise their investment in the portfolio for a consideration equal to the investor’s proportional share of the net asset value of the portfolio.

In the case of a portfolio of a CISS which is incorporated as a company it cannot be deduced that the portfolio is a vesting trust for tax purposes (since this is not stated in the Act and since the legal nature of the arrangement does not indicate this). The taxation of a vesting trust is subject to very different provisions, case law and principles than those which apply to companies and certain differences arise as a result between the application of the Act to a CISS established as a trust and the application of the Act to a CISS incorporated as a company (see

⁴⁹At 3.7

⁵⁰The term ‘CISS’ is defined in the SARS Guide to Capital Gains Tax (issue 4) as a **portfolio of a collective investment scheme in securities**.

discussion below). In the absence of any CISS's yet being incorporated in South Africa as companies this would not have resulted in any problems to date. However, in light of the redrafting of the CISCA to better cater for OEICs, amendments to the Act to more clearly define the nature of a portfolio of a CISS may well have to be considered if it is the intention of the legislature that such schemes be taxed equally regardless of their underlying legal nature.

4.3.1. Differences in the application of the Act to a CISS incorporated as a company compared to a CISS established as a trust

The following anomalies would arise in terms of the current tax legislation if there were currently any CISS's established as companies. These differences arise because while the legislation recognises the individual portfolio as a taxpayer it does not make it clear that a portfolio of a CISS which is established as a company is in fact to be treated in terms of the Act as a vesting trust. These issues need to be addressed by the legislature prior to the incorporation in South Africa of a CISS as a company.

4.3.1.1. *The realisation by an investor of a participatory interest*

The realisation by an investor of their interest in a portfolio of a CISS would, in terms of the current provisions of the Act (and specifically the lack of identification of the nature of a portfolio of a CISS) have very different tax consequences depending on whether the CISS was legally a trust or a company.

In the case of a company the repurchase of shares is either a return of capital or a dividend in the hands of the shareholder depending on whether or not the repurchase consideration has been funded by the company out of contributed tax capital⁵¹. Contributed tax capital reserves are essentially made up of pure share capital and share premium. The nature of the consideration for the repurchase of shares is to a certain extent (where sufficient reserves of each kind exist) left to the discretion of the directors of the company⁵² however contributed tax capital cannot be allocated to a shareholder in excess of that shareholders proportionate share of the total contributed tax capital.⁵³ The result is that the repurchase of an investor's participatory interest in a CISS incorporated as a company is likely to partly include a return of capital and to partly include a dividend. Each of these elements has different tax consequences for the investor which, in the case of the dividend element, are not overridden by paragraph 61

⁵¹ Section 1 definition of 'dividend'.

⁵² See subparagraph (bb) of each paragraph (a) and (b) of the section 1 definition of 'contributed tax capital'

⁵³ Proviso to the section 1 definition of 'contributed tax capital'

of the Eighth Schedule. Dividends tax would be payable (provided the shareholder is not an exempt entity in terms of section 64F) on the dividend portion while capital gains tax would be calculated on the portion that is a return of capital.

The above treatment is very different to that which would apply in the case of vesting trust where the realisation of a participatory interest by the investor is merely the physical distribution of previously vested assets (because paragraph 11(1)(d) of the Eighth Schedule provides that a '*disposal*' includes the vesting of an interest in an asset of a trust in a beneficiary). As a result of this prior vesting of the underlying assets and by virtue of paragraph 61 of the Eighth Schedule the realisation of a participatory interest will (where that participatory interest is held by the investor as a capital asset⁵⁴) give rise only to capital gains tax in the hands of the investor.

4.3.1.2. The existence of controlled foreign companies in relation to a portfolio of a CISS

A portfolio of a CISS may hold a significant direct or indirect interest in a foreign company which raises the question of whether a foreign company could be a CFC in relation to a local portfolio of a CISS. This question is very relevant as in practice, many local CISSs operate as a 'fund of funds' which hold significant interests in foreign CISSs.

A foreign CISS is specifically included in the definition of a '*company*' in section 1⁵⁵ of the Act (regardless of the fact that its legal form may be something other than a company) and this read together with proviso (c)(ii)⁵⁶ to the definition of a CFC in section 9D makes it clear that the legislature **does envisage** that in certain circumstances a foreign CISS held by a portfolio of a local CISS could be a CFC in relation to the South African residents who hold the *participation rights* in that foreign CISS.

⁵⁴ Where the participatory interest is held by the investor as a revenue asset the disposal of the interest will result in normal tax on the increase in the value of the participatory interest over the time it was held.

⁵⁵ Paragraph (e)(ii) of the section 1 definition of '*company*'

⁵⁶ Proviso (c)(ii) to the CFC definition excludes persons who hold less than 5 per cent of the participation rights in a foreign CISS from the definition of '*resident*' for the purpose of determining whether residents hold more than 50 per cent of the participation rights in the foreign CISS (unless more than a five percent interest is held by connected persons in relation to the investor).

In order to determine whether a foreign company is a CFC one must consider whether fifty percent or more of the *participation rights* in that foreign company are held by South African residents.

"Participation Rights" in relation to a company are defined in section 1 of the Act as:

"(a) the right to participate directly or indirectly in the share capital, share premium, current or accumulated profits or reserves of that company, whether or not of a capital nature; or

(b) in the case where no person has any right in that company as contemplated in paragraph (a) or no such rights can be determined for any person, the right to exercise any voting rights in that company."

In determining whether an interest in a foreign company held in a local portfolio of a CISS is a CFC in relation to South African residents, the parties holding the *participation rights* in that foreign company must be identified. If, due to the legal nature of the CISS⁵⁷, the participation rights in the foreign company are found to be held by the **investors** in the local CISS (as opposed to by the local portfolio itself) then the foreign company cannot be a CFC in relation to the local portfolio of a CISS but can be a CFC in relation to the investors in the local CISS. Alternatively, where the *participation rights* in the foreign company are found to be held by the local portfolio of a CISS then the foreign company is a CFC in relation to the local CISS itself with the consequence that attributed 9D income is included in the income of the portfolio.

In the case of a local CISS established as a company the holder of the participation rights in the underlying assets is clear. The company is a separate legal entity with the result that the assets of the company vest in the company itself. The shareholders in a company have no right to or interest in the underlying assets of the company. The participation rights in the underlying assets are therefore held by the company. A foreign company or foreign CISS could (provided that more than 50 percent of the participation rights are held by South African residents as required) therefore be a CFC in relation to a local portfolio of a CISS established as a company.⁵⁸ This result is contrary to the treatment of a portfolio of a CISS as a 'conduit' because where section 9D income is attributed to a portfolio of a CISS it will be taxed in the portfolio and will not flow through to the investors. It is not possible for the portfolio to pass on the tax liability

⁵⁷ See chapter 3

⁵⁸ Proviso B to section 9D(2) makes it clear that where a local CISS is established as a company, that the investors in that CISS are out of the picture in determining whether a foreign company included in the portfolio of that local CISS is a CFC.

relating to 9D income to its investors as it is impossible to *'distribute'* this notional income to investors as required by section 25BA. In addition it is submitted that section 25BA which refers to *'any amount received by or accrued to'* would not apply to section 9D income attributed to the local portfolio which is neither received nor accrued.

In the case of a local portfolio of a CISS established as a trust it is submitted that as a vesting trust the participation rights in the underlying assets in the portfolio are held by the investors in the portfolio (Honiball, Olivier 2009 example 3.22 in 6.3.4). Where this view is held the portfolio itself is out of the picture in determining whether South African residents hold more than 50% of the participation rights in a foreign company. The foreign company could therefore be a CFC in relation to the investors in a local portfolio of CISS⁵⁹ but not in relation to the local portfolio itself.

The effect of section 9D on the parties to a local CISS is fundamentally different where a CISS established as a trust to the effect on the parties to a CISS incorporated as a company. The blanket identification in the Act of a portfolio of a CISS as a 'person' does little to create equality in the treatment of these two different kinds of entities and it is submitted that amendments to the Act are required prior to the incorporation in South Africa of a CISS as an OEIC.

4.4. Conclusion

It seems that it is the overall view of the legislature and of SARS is that each individual portfolio within a CISS should be viewed and taxed separately as a vesting trust (subject to the numerous sections in the Act which result in a deviation from this treatment). This view is in line with the legal nature of a CISS where it is established as a trust (as set out in the previous chapter such a trust would be a vesting trust). This view however completely disregards the fact that a CISS may in fact be legally incorporated as a company with each portfolio within that company represented by a different share class.

It is submitted that there is scope for the tightening up of the definitions within the Act so as to avoid the creation of overlapping taxpayers. It is further submitted that if (as indicated by the specific exclusion of a portfolio of a CISS from a trust in relation to the connected party rules) a portfolio of a CISS is in fact recognised by the Act as a trust, that it may have been clearer for

⁵⁹ Provisos (a) and (c)(ii) to the section 9D(1) definition of a *'controlled foreign company'* make it unlikely (but not impossible) that where a local portfolio of a CISS has numerous investors, that a foreign company will be a CFC in relation to the investors.

the Act to specifically include a portfolio of a CISS in the definition of a *'trust'* as opposed to in the definition of a *'person'* which in any event includes a trust.

The lack of certainty regarding the status, in terms of the Act, of a portfolio of a CISS incorporated as a company results in differences in the tax treatment applied to the investors and to the portfolio of such a CISS compared to the tax treatment which applies to a portfolio of a CISS established as a trust. It is recommended that in order to ensure consistency in the taxation of all CISS's regardless of their nature, that the Act go further than simply including the portfolio as a *'person'* and actually define the nature of that person. Alternatively, the individual sections of the Act which create inconsistency between the two tax treatments should be individually amended (although this would likely be much more cumbersome). For example, the Act should clarify that a portfolio of a CISS itself should not be subject to the attribution of section 9D income and that the legislation relating to a repurchase of shares does not apply to an investor in a portfolio of a CISS which is established as a company.

5. The nature of the income generated by a portfolio of a CISS on the disposal of its underlying securities

5.1.Introduction

The nature of the income earned by a taxpayer greatly affects the way in which it is taxed. The *gross income* definition in section 1 of the Act, which is the starting point of any tax calculation, specifically excludes from a person's gross income amounts received or accrued which are of a capital nature.

As a result of the general exclusion from gross income of capital amounts, such income was not (unless specifically included in gross income) taxable in South Africa until the introduction of capital gains tax in 2001. The introduction of capital gains tax aimed, in part, to provide greater parity in the taxation of capital and non-capital (revenue) amounts (*SARS Guide to CGT issue 4 at 1.2.2*) however significant differences between the taxation of the two types of income still exist. Most notable is the difference between the effective tax rates which apply to revenue and capital income. By virtue of the favourable inclusion rates⁶⁰ provided by the Eighth Schedule only a certain percentage of a taxpayer's net capital gain is included in their income with the result that capital gains are taxed at a significantly lower effective rate than are revenue gains. It is therefore generally more favourable for a taxpayer to earn income that is capital rather than revenue in nature.

This chapter aims to establish, with reference to the principles developed through case law, to determine whether the proceeds on the disposal of the underlying assets of a portfolio of a CISS give rise to proceeds which are revenue or capital in nature.

5.2.Determining the nature of the proceeds on disposal of the underlying securities

The Act does not attempt to provide a definition of what makes an amount capital in nature however as this concept has been the subject of numerous tax cases there is an abundance of case law which serves to establish important legal precedent for determining the nature of an amount. No single 'test' developed by the courts to determine the nature of an amount can however be taken as decisive in its own right and it is imperative that one examine all the facts and circumstance of each particular disposal before concluding on the matter.

⁶⁰Set out in paragraph 10 of the Eighth Schedule to the Act

In general if an asset is acquired and sold in pursuance of a scheme of profit making then the proceeds on that sale are revenue in nature. In other words, if a taxpayer is conducting a trade of buying and selling an asset for the purpose of realising a gain on the disposal of the asset then the proceeds are revenue in nature and the asset is the taxpayer's stock-in-trade.

Arguably the most important of the tests laid down by the courts in determining the nature of an amount is determining the **intention** of the taxpayer in acquiring and holding the asset in question. Where an asset is acquired with the purpose of realising a profit on its sale the proceeds will be revenue in nature. On the other hand, if an asset is acquired with the purpose of holding that asset in order to generate income from the asset the sale of the asset will result in a capital receipt. It is important to look at each case individually as an asset which is clearly trading stock to one taxpayer may be a capital asset in the hands of another taxpayer.

In determining intention of the taxpayer relative to a particular asset one must first consider the taxpayer's *ipse dixit* (what the taxpayer says their intention is). This subjective statement of intention must then be tested against objective factors (the various facts and circumstances surrounding the acquisition and disposal of the asset) in order to determine the taxpayer's true intention.⁶¹

Where the asset in question is a share in a company the intention of the shareholder on the acquisition of that share could feasibly be one or a combination of the following:

- i) To hold the share for long term or short term capital appreciation (i.e. to realise a profit through the sale of the share at higher price than the price at which the share was purchased);
- ii) To hold the share in order to earn dividend income;
- iii) To hold the share in order to control the activities or assets of the company (for e.g. a company may acquire a controlling shareholding in another company which owns a strategic asset which it wants to control).

The first intention indicates that the proceeds on disposal of the share would be revenue in nature as the share is being treated as trading stock (the share was acquired with the intention of resale at some stage in the future at a profit). The view that the proceeds on the disposal of a share acquired **not as an income producing asset** but rather either for **long term or short**

⁶¹(de Koker, Williams 2012) at 3.2

term capital appreciation is revenue in nature is supported by Silke (de Koker, Williams 2012 at 3.42) which states:

*“It must be emphasised that profits on share transactions do not become taxable only when the frequency and volume of the number of transactions are so great as to constitute the carrying on of a business. Profits and losses resulting from share transactions are of a revenue nature if the shares were **acquired for the purpose of resale at a profit.**”*(emphasis added)

The view that even shares acquired with the intention of making a gain on the disposal in the **long term** yield proceeds of a revenue nature is supported by Schreiner JA in his judgment in *LHC Corporation of SA (Pty) Ltd v CIR*⁶² where he states:

“It is **not** the law that if an investment-dealing company buys shares for a purpose that will probably involve a retention of the shares for even a considerable period the shares are for that reason to be regarded as fixed capital the enhanced value of which is a capital accrual. (cf. *Punjab Co-operative Bank Limited, Amritsar v Income Tax Commissioner, Lahore*, [1940] A.C. 1055).”

The second and third intentions set out above indicate that the proceeds would be capital in nature as the share has been acquired and held for the purpose of earning income either directly in the form of dividends or indirectly through other benefits flowing to the shareholder (some utility to owning the shares exists).

It is likely however that in the context of portfolio investment a shareholder’s intention with regards to a share includes a combination of the first two intentions to a certain extent (the third intention is unlikely to be applicable from a portfolio investment point of view). Where the intention of a shareholder in respect of a share is a combination of revenue and capital intentions then in order to determine the nature of the amount derived on the disposal of the share one must determine which intention is dominant.⁶³ It is however important to note that having a dominant purpose or intention does not make all other purposes incidental.⁶⁴ The sale of a share which was held for the primary purpose of earning dividend income does not result in proceeds of a capital nature where the facts and circumstances surrounding the acquisition and disposal of the share indicate a secondary business of share dealing which is not incidental.

⁶² 17 SATC 125 at 133 - 134

⁶³ *Bloch v SIR* (42 SATC 7) at 14: “If the taxpayer has mixed purposes, it is his ‘dominant purpose’ which is decisive”.

⁶⁴ *African Life Investment Corporation (Pty) Ltd v SIR* (31 SATC 163)

The objective factors which must be considered in determining whether the disposal of shares results in capital or revenue proceeds include: whether an 'active' investment policy has been followed, the frequency of transactions, the desire for profits, the types of shares acquired, the objects and operations of the taxpayer and restrictions on the use of the proceeds⁶⁵

5.3. Whose intention should be considered in relation to the underlying securities in the portfolio of a CISS?

A portfolio of a CISS as a 'person' in terms of the Act is a taxpayer in its own right and it could therefore be said that it is the intention of the portfolio in relation to its underlying assets which must be established in determining whether the proceeds realised on the disposal of the assets in the portfolio are capital or revenue in nature. This view is most likely correct in the case of a CISS incorporated as a company as the assets of the portfolio vest in the company itself.

In the alternative, it could be argued (in the case of a CISS established as a trust) that it is the intention of the investors as vested beneficiaries which must be determined in relation to the assets of the portfolio. This is because as a vested trust the portfolio is deemed, in terms of paragraph 11(1)(d) to have disposed of each of the underlying securities held in the portfolio to the investors in proportion to their participatory interest. Paragraph 11(1)(d) specifically includes in the definition of a *disposal*:

"the vesting of an interest in an asset of a trust in a beneficiary"

The result is that the underlying securities are owned, for capital gains tax purposes at least, by the individual investors and not by the portfolio of the CISS⁶⁶. Any subsequent disposal of the securities therefore takes place and is taxable, **for capital gains tax** purposes, in the hands of the investors.

The timing of the abovementioned disposal from the portfolio to the investors is at the time of *vesting* in terms of paragraph 13(1)(a)(iiA) which states that:

*"The time of disposal of an asset by means of a change of **ownership** effected or to be effected from one person to another because of an event, act, forbearance or by operation of law is, in the case of -*

⁶⁵ *African Life Investment Corporation (Pty) Ltd v SIR* (supra)

⁶⁶ See 6.3.1.1 for more on the difficulties of applying paragraph 11(1)(d) to a vested right to the capital as opposed to a specific asset of a trust.

*(iiA) the distribution of **an asset** of a trust by a trustee to a beneficiary to the extent that the beneficiary has a vested interest in the asset, the date on which the interest vests;”*

There is some difficulty in applying this concept to a vesting trust in the form of a portfolio of a CISS because the investor does not have an interest in any one particular asset of the portfolio but rather in the net capital of the portfolio which is made up of all the underlying assets (including unrealised gains on these assets) and any accrued income reduced by the accrued expenses. In addition, the portfolio would not typically distribute any of its assets to its investors (other than in cash in the form of dividends or interest or on the repurchase of an investor’s participatory interest).

Regardless of which of the above views is correct it is submitted (both in the case of a CISS which is a trust and in the case of a CISS which is a company) for the following reasons that it is neither the portfolio itself nor the investors whose **intention** in relation to the underlying assets should be considered:

- the portfolio is an inanimate being which cannot itself have any intention with regard to the assets in the portfolio;
- the investor on the other hand has no control over the underlying securities (the investor simply relies on the manager to administer the scheme according to its mandate) and therefore cannot exercise any intention over the underlying securities. The investor has an intention with regard to its own individual participatory interest but not with regard to the underlying assets in the portfolio.

It is therefore to the person who controls the securities in the portfolio that one must look to establish the imputed intention of the investors / the portfolio. The concept of establishing the intention of a taxpayer in relation to an asset by looking through to the intention of the person(s) in control of the asset is well established in case law and has been frequently applied in determining the intention of non-natural persons such as companies. In *CIR v Richmond Estates (Pty) Ltd*⁶⁷ Centilivres CJ said the following on the matter: “A company is an artificial person ‘with no body to kick and no soul to damn’ and the only way of ascertaining its intention is to find out what its directors acting as such intended”. This view is confirmed in a number of cases including: *SIR v Trust Bank of Africa Ltd*, *SIR v Rile Investments (Pty) Ltd*⁶⁸ and *Tati Company Limited v CIT*.⁶⁹

⁶⁷20 SATC 355

⁶⁸40 SATC 135 at 141

⁶⁹37 SATC 68

In the case of a portfolio of a CISS the 'person' effectively controlling the acquisition and disposal of the underlying securities in the CISS is the manager of the CISS. This is clear from section 41 of the CISCA which provides that:

*"(1) No person other than a company which has been registered as a manager under section 42 and its authorized agent may **administer** any collective investment scheme in securities"*

The term '*administration*' is defined in section 1 of the CISCA as:

"any function performed in connection with a collective investment scheme including –

- (a) The management or control of a collective investment scheme;*
- (b)*
- (c)*
- (d) The buying and selling of assets or the handing over thereof to a trustee or custodian for safe custody".*

It is submitted that based on the abovementioned case law and from the provisions of the CISCA that it is the intention of the manager of a CISS in relation to the assets of the portfolio which must be considered in determining whether the disposal of the securities in the portfolio results in capital or revenue proceeds.

The CISCA requires that the manager itself be a company⁷⁰ however the problem of establishing the management company's intention in respect of the underlying assets in a portfolio of a CISS may be overcome by referring to the deed in terms of which the CISS was established, the fund mandate and the general marketing material provided by the manager to entice prospective investors.

Schedule 1 of the CISCA sets out the matters which must be provided for in the deed of a CISS. These requirements include *inter alia* that the deed set out the investment policy to be followed in respect of each portfolio of the CISS. The fund mandate is a document prepared by the manager of a CISS describing the objectives and investment strategy of a particular portfolio. The fund mandate must be lodged with ASISA and is regarded as a public document (Profile 2012 at p66). The website of a CISS as well as the application forms provided to investors provide further information regarding the objectives of the manager in regard to the

⁷⁰Section 41 of the CISCA

assets in a particular portfolio. This information taken together forms the *ipse dixit* of the manager. The intention thus established must however be tested against objective factors observed by the way the manager actually conducts the affairs of the portfolio such as whether the portfolio is 'actively managed' or not, the actual length of time securities are held in the portfolio, the number of transactions and the timing of when securities are bought and sold.

5.4. Establishing the intention of the manager of a CISS

The manager of a CISS, or the asset manager where the task of portfolio management is outsourced, will have a specific investment strategy and philosophy which it follows with respect to a particular portfolio of a CISS. Such investment strategies and philosophies are numerous and may be differentiated in many ways including by the types of securities to be included in the portfolio (identified for example by region, sector or size of the company) or by the manner in which the manager determines which securities to buy (for e.g. value or growth investing) or the timing of when to sell the securities (for e.g. a sale may be triggered automatically once a certain price of a security is reached).

Despite the huge variation in the investment strategies which may be followed by a manager of a portfolio of a CISS it is only relevant for tax purposes whether the securities were acquired and held for the purpose of earning dividend income or for capital appreciation or for a combination of these two purposes.

Certain portfolio managers focus on securities which deliver a high dividend yield (funds which follow such an investment approach are known as 'income funds') other portfolio managers are less interested in generating dividend income for their investors and are more focused on acquiring securities which will appreciate in value and which will deliver investment returns through an increase in the market value of the securities.

In the case of a portfolio manager whose primary aim it is to realise gains for the investors in the CISS through an increase in the market value of the securities in the portfolio and who regards the earning of dividend income as an incidental bonus, the situation is clear: the portfolio (through the portfolio manager) is conducting a scheme of profit making and is treating the underlying securities as its stock-in-trade. The proceeds on the disposal of the securities in such a portfolio are revenue in nature (unless the securities have been held in the portfolio for a period exceeding 3 years in which case section 9C of the Act will deem the proceeds to be capital in nature).

In the case of a portfolio manager whose primary aim it is to invest in underlying securities for the purpose of generating dividend income for the investors the situation is less clear. A

security which is acquired and held **purely** for the purpose earning of dividend income is a capital asset. However, shareholders with such a primary purpose very often have a secondary purpose of realising a gain on the ultimate disposal of the share which is not incidental to the dividend earning purpose and therefore as *one* of the main purposes renders the profits on disposal of the share revenue in nature.

In the case *CIR v Tod*⁷¹ the court was called upon to determine the nature of the proceeds of the disposal of certain shares held by an individual. The taxpayer was a retired gentleman who lived off the dividend income generated by his substantial share portfolio. The management of the portfolio had been delegated to the taxpayer's accountant who, acting on the advice of a stockbroker began a process aimed at increasing the taxpayer's annual aggregate dividend income. In order to do this the accountant bought shares whose dividend payment was imminent, received the dividend and then sold the share in order to re-invest the capital in another share whose dividend payment was imminent. By following this procedure the taxpayer was able to earn three or four dividends per year off a single capital sum instead of just a single dividend as had previously been earned. The court found that despite the primary purpose of the acquisition and disposal of the shares being the earning of a larger dividend income this intention did not necessarily relieve from taxation the profits derived from the sale of shares in pursuance of that objective. What had to be determined was whether or not there was a 'co-existent intention' to achieve a profit on the realisation of the shares. The court found ultimately that there was another co-existent intention which was to realise a gain on the disposal of the shares and that consequently, as one of the main intentions, these profits were revenue in nature and were subject to tax.

In coming to this decision the court, relying on the principals developed in *African Life Investment Corporation (Pty) Ltd v SIR*,⁷² reasoned that it could not have been the intention of the taxpayer to dispose of his shares at a loss (even in pursuance of further dividend income) as the consequent reduction in capital would have nullified the effectiveness of the strategy and that it was the intention of the taxpayer to at least recoup the initial capital outlaid for the acquisition of the shares. In examining the time and price at which the shares were sold it was clear that the shares had not been sold as soon as the share price represented a recoupment of the initial capital outlay and that in fact in many cases a profit had been realised on the disposals. It was found that it was not the intention of the taxpayer to hold the shares 'more or less permanently' in order to realise dividend income and that the sale of the shares at a profit had always been contemplated.

⁷¹ 45 SATC 1

⁷² 31 SATC 163

In light of the above case it is submitted that where the stated objective of a manager of a portfolio of a CISS is to realise dividend income from the underlying securities in the fund the proceeds from the ultimate disposal of those securities will not necessarily result in proceeds which are capital in nature. Instead it is quite likely that, if challenged in court, such an investment strategy would be found to co-exist with a secondary intention to realise profits on the realisation of the securities and that the proceeds could therefore be revenue in nature.

5.5. What is happening in practice in South African CISS

In many, if not most, cases it is the unashamed intention of the manager of a CISS to realise a profit in the portfolio through the increase in the share price of the underlying securities held in a portfolio. This is supported by the fact that in many cases a portion of the manager's fee is based on the performance of the portfolio and is calculated with reference to the increase in the net asset value of the portfolio in relation to some pre-determined benchmark. The manager itself is a profit seeking entity and therefore desires the largest possible increase in the value of the underlying securities in a portfolio so as to generate the highest possible performance fees.

Two popular investment philosophies a manager may follow in relation to a portfolio of securities include value investing and growth funds (Profile 2012 at p114 - 1115).

Managers who follow a value investing philosophy aim to seek out and invest in shares in companies which are trading at a discount to their net asset value. The aim of the manager is to realise medium to long term capital appreciation on the share which arises when the market adjusts to recognise that the trade price of the share does not reflect its underlying value.

Growth funds aim to maximize capital appreciation through investing in companies which are expected to display dramatic increase in profits from one year to another.

The above two investment philosophies, when considered in the light of relevant case law, place beyond doubt the conclusion that the proceeds on the disposal of the shares held in a portfolio managed in such a way are revenue in nature. This is because the intention of the manager (on behalf of the investors and the portfolio) is to make a profit through realising an increase in the share price. This revenue nature in respect of a share exists regardless of the fact that it may be the intention of the manager to hold a particular share in a portfolio on a long term basis i.e. where it is the intention to realise the increase in the value of the share many years in the future. Holding a share on a **long term basis** for capital appreciation as opposed to dividend income does not, per discussion above, necessarily have any impact on determining the **purpose** for which the share was purchased and held. It is therefore submitted

that the proceeds derived from securities acquired pursuant to an investment philosophy seeking out 'long term capital appreciation' are (in the absence of section 9C of the Act) as much revenue in nature as those derived from securities acquired for short term gains.

It is clear that in many cases a portfolio of securities managed with the purpose of earning dividend income for its investors would have a secondary purpose of realising a gain from an increase in the value of the securities as it would be counter intuitive to purchase shares for the purpose of earning income without also considering whether the initial capital outlay would retain its value. (see *Tod's case* discussed above).

It can be concluded that in cases where section 9C of the Act does not apply to render the proceeds on the disposal of a share capital in nature (i.e. where the share has been held in the portfolio for a period of less than 3 years) the proceeds on the disposal of such shares is in most cases likely to be revenue in nature.

In terms of section 25BA the non-capital income of a portfolio of a CISS is taxable in the hands of the portfolio itself (at the trust rate of tax of 40%) where that income is not distributed within one year of its receipt⁷³ by the CISS. It would be very unusual for a CISS to distribute the gains realised on the disposal of its underlying securities (as this would erode the capital of the portfolio). As such these undistributed gains, if revenue in nature as is likely except where section 9C applies, should strictly speaking be subject to tax in the portfolio of the CISS.

There seems to be a general perception however that the proceeds on disposal of the underlying securities in a CISS are inherently capital in nature and that these gains are taxable only in the hands of the investor in terms of paragraph 61 read together with paragraph 11(1)(d) of the Eighth Schedule.⁷⁴ This perception in the industry may stem from the notion that as a 'conduit' type entity the portfolio of a CISS is not itself generally subject to tax. There is however no legislative justification for the blanket treatment of all gains and losses on the disposal of the underlying securities of a CISS as capital amounts and it is likely that SARS would have sufficient grounds to attack such treatment, should it choose to do so.

Per discussion with Johan de la Rey (Legal and Policy division at SARS) no official statement regarding the revenue or capital nature of the proceeds from securities disposed of by a portfolio of a CISS has been made by SARS. The vast number of different strategies and

⁷³ The Taxation Laws Amendment Bill of 2012 proposes that this section be amended such that non-capital income is taxable in the portfolio itself where the income is not distributed within one year of its *accrual* to the portfolio.

⁷⁴ The Taxation Laws Amendment Bill of 2012 proposes the addition of sub-paragraph 61(3) which specifically exempts a portfolio of a CISS from capital gains tax.

products offered in the CISS industry would make the issuing of such a statement very difficult and it is his view that the facts and circumstances of each case must be taken into account individually.

SARS has however, in one instance at least, indicated that it may turn a 'blind eye' to the nature of the gains and losses derived by a portfolio of a CISS. In Binding Private Ruling 31 issued on the 29 May 2009 SARS ruled that the applicant, a CISS, would not be regarded as having entered into a "scheme of profit-making" in respect of the gains and losses realised by the portfolio on the acquisition and disposal of JSE listed shares acquired and disposed of such that the securities in the portfolio mimic or 'track' a certain index. This ruling was given despite the fact that it is stated in the description of the proposed transaction that *"if the value of the Applicant increases, the Applicant will, on a quarterly basis, sell shares representing such increase (the shares will be sold in such a manner as to ensure that the shares held by the Applicant will continue to reflect the composition of the applicable index)."*

It is submitted that this ruling is contrary to legal precedent as there can be little purpose in any person acquiring securities representing a specific index other than to realise an expected increase in the value of that index. It is clear that the strategy followed by the Applicant in this case excluded any consideration of the earning of dividend income. It should be noted that this private ruling is not binding on any party besides the Applicant and therefore cannot be relied upon as the treatment to be generally applied by SARS.

In addition, the income tax legislation around the treatment of the proceeds of the disposal of the underlying securities of a CISS does not lend itself to these proceeds being revenue in nature. Where revenue proceeds are not distributed to the investors but rather re-invested in other securities (as is likely) negative tax consequences result. The undistributed revenue gain is first subject to tax in the portfolio at a rate of 40% following which the investor is subject, on the disposal of their participatory interest in the CISS, either to capital gains tax in terms of paragraph 61 of the Eighth Schedule (where that participatory interest is held as a capital asset) or to normal tax where the interest is held as trading stock and where section 9C does not apply. The value of the participatory interest (which dictates the proceeds on disposal by the investor) includes these realised undistributed revenue gains (subsequently re-invested in new securities) with the result that the same gains are taxed twice (once as revenue in the hands of the CISS and once as either capital or as revenue in the hands of the investor).

This potential double taxation of the same gain is anomalous with the treatment of a CISS as a vesting trust. In order to avoid such double taxation a portfolio of a CISS would have to distribute its trading profits following which the investor (presuming the investor wants to stay

invested) would then have to immediately use the distribution to re-invest in additional units. This treatment would add a huge burden to the administration of a portfolio of a CISS and the tax effect for the investor would severely detract from their appeal as an investment vehicle.

5.6. Conclusion

Neither the investors nor the portfolio itself has any control over the securities in the portfolio and it is therefore submitted that it is the intention of the person in effective control of the underlying assets in the portfolio that one must establish in order to impute the intention of the investors in the portfolio or the portfolio itself. The person in control of a portfolio of a CISS is the manager of the CISS whose intention in relation to the securities of the portfolio can be determined by the investment philosophy followed by that manager.

It is submitted that based on legal precedent created through the wealth of case law on the matter that the proceeds on the disposal of the underlying securities of a portfolio of a CISS are (where section 9C doesn't apply) likely to be revenue in nature where the shares are acquired for the purpose of realising an increase in the market price of these securities. This intention is likely to be the dominant or one of the dominant purposes in acquiring the securities even where the manager acquires securities in the portfolio for the purpose of earning dividends.

The treatment in **practice** of the proceeds on disposal of the underlying securities in a portfolio both from the point of view of the players in the CISS industry and SARS is however not clear. It appears that despite much evidence pointing to the conclusion that the proceeds on the disposal of the underlying assets is revenue in nature that such gains are seen by SARS as being capital in nature. This is supported by the lack of distribution in practice by the portfolios of the proceeds realised on the disposal of the underlying assets. The result, where this practice is applied, is that none of the taxpayers who are party to a CISS are taxed on revenue account on the disposal of the underlying assets in the portfolio despite legal precedent which suggests that a scheme of profit making in the form of share trading is being carried on.

In addition, the application of section 25BA and paragraph 61 of the Eighth Schedule do not lend themselves to the treatment of the proceeds being revenue in nature. Undistributed revenue gains results in the double taxation of those gains. This double taxation is contrary to the legislatures intended treatment of a portfolio of a CISS as a conduit entity.

In the interests of certainty it is suggested that ASISA lobby on behalf of the CISS industry for legislative certainty regarding this issue.

6. An analysis of how the income tax treatment of a portfolio of a CISS and its investors differs from that which would apply in the absence of any special provisions in the Act relating to those parties

6.1.Introduction

The specific provisions of the Act which relate to a portfolio of a CISS and the investors in such a portfolio provide significantly different tax treatment from the provisions which would apply were these schemes to be taxed in terms of the Act in accordance with their legal nature. In order to determine what ‘special treatment’ is afforded by the Act to a CISS and its investors it is necessary to compare the tax treatment which would prevail in the absence of the provisions of the Act which relate specifically to a portfolio of a CISS to the tax treatment currently applied to the parties to such schemes in terms of the Act.

6.2.The revenue receipts and accruals of a portfolio of a CISS

Section 25BA is the principal provision of the Act dealing with the taxation of revenue receipts and accruals of a portfolio of a CISS. It states the following:

“Any amount, other than an amount of a capital nature, received by or accrued to any portfolio of a collective investment scheme, other than a portfolio of a collective investment scheme in property, must –

(a) to the extent the amount is distributed by that portfolio –

- (i) to any person who is entitled to the distribution by virtue of the person being a holder of a participatory interest in that portfolio; and*
- (ii) within 12 months of its receipt⁷⁵ by that portfolio,*

Be deemed to have directly accrued to the person on the date of the distribution; and

(b) to the extent that the amount is not distributed as contemplated in paragraph (a) within 12 months of its receipt⁷⁶ by that portfolio –

- (i) be deemed to have accrued to that portfolio on the last day of the period of 12 months commencing on the date of its receipt⁷⁷ by that portfolio; and*

⁷⁵Note that the Taxation Laws Amendment Bill of 2012 proposes the replacement of the word ‘receipt’ with the word ‘accrual’ in section 25BA. The taxation of a portfolio of a CISS based on accrual rather than receipt is in line with the timing of taxation imposed by the gross income definition in section 1.

⁷⁶See comment above

⁷⁷See comment above

- (ii) *to the extent that the amount is attributable to a dividend received by or accrued to that portfolio, be deemed to be income of that portfolio.*

In the absence of section 25BA section 25B which sets out the taxation of trusts and trust beneficiaries would apply to a portfolio of a CISS which is established as part of a trust. It is a general rule of legal interpretation that the specific overrides the general (*generalia specialibus non derogant*⁷⁸) and as a result, the provisions of section 25B are effectively overridden by section 25BA.

In the case of a CISS which is established as a company, section 25BA overrides the provisions of the Act as they relate to the revenue receipts and accruals of a company and its shareholders.

In order to determine whether tax advantages or disadvantages are afforded a portfolio of a CISS and its investors and to determine how section 25BA deviates from the treatment of a CISS as a vesting trust (where the CISS is established as a trust) and from the treatment of a CISS as a company (where the CISS is incorporated as a company), it is necessary to compare the treatment of the revenue receipts of a portfolio of a CISS as applies in terms of section 25BA to that which would apply if a portfolio of a CISS was taxed in accordance with its legal nature.

For purposes of this section, only the revenue receipts which are most likely to accrue to a portfolio of a CISS are considered. These types of income are: local dividends, foreign dividends and interest. Revenue gains realised on the disposal of the underlying securities of the portfolio have not been considered because, as set out in chapter five, the gains and losses on the disposal of underlying securities are (whether correctly or incorrectly) generally treated as capital gains or losses.

⁷⁸ DE KOKER, A. and WILLIAMS, R., 2012. *Silke on South African Income Tax*. Online edn. www.lexisnexis.co.za: lexisnexis. at 25.15A

Investors	Mr and Mrs Money Penny, natural persons, each taxed at marginal tax rate 40%								
Year-end of investor	28-Feb-13								
participatory interest of investors in the portfolio of CISS	100%								
Income Statement of the portfolio of the CISS									
Interest	70,000								
- Distributed within 12 months	38,769								
- Retained to pay portfolio expenses	31,231	***							
Local Dividends	195,000								
- Distributed within 12 months	108,000								
- Retained to pay portfolio expenses	87,000	***							
Foreign Dividends	60,000								
- Distributed within 12 months	33,231								
- Retained to pay portfolio expenses	26,769	***							
management fees	(110,000)								
audit fees	(15,000)								
custodian fees	(20,000)								
	180,000								
Tax Calculation									
	CISS is taxed as a Company		CISS is taxed as a Vesting Trust (s25B)			CISS is taxed in terms of section 25BA			
	Company	Shareholders	Total	Vesting Trust	Beneficiaries	Total	portfolio of		
							CISS	Investors	Total
Gross Income									
Interest	70,000	0	70,000	0	70,000	70,000	31,231	38,769	70,000
Local Dividends (after dividends tax)	195,000	153,000 Δ	348,000	0	165,750 ж	165,750	87,000	91,800 Φ	178,800
Foreign Dividends	60,000	0	60,000	0	60,000	60,000	26,769	33,231	60,000
	325,000	153,000	478,000	0	295,750	295,750	145,000	163,800	308,800
Less Exemptions									
Interest (s10(1)(i)(ii))	0	0	0	0	(22,800)	(22,800)	0	(22,800)	(22,800)
Local Dividends (s10(1)(k))	(195,000)	(153,000)	(348,000)	0	(165,750)	(165,750)	0	(91,800)	(91,800)
Foreign Dividends (s10B(3)(b))*	(27,857)	0	(27,857)	0	(37,500)	(37,500)	(12,428)	(20,769)	(33,198)
Income	102,143	0	102,143	0	69,700	69,700	132,572	28,431	161,002
Less Deductions**									
management fees	(34,571)	0	(34,571)	0	(25,924)	(25,924)	(100,572)	0	(100,572)
audit fees	(4,714)	0	(4,714)	0	(3,535)	(3,535)	(13,714)	0	(13,714)
custodian fees	(6,286)	0	(6,286)	0	(4,713)	(4,713)	(18,286)	0	(18,286)
Taxable Income	56,571	0	56,571	0	35,528	35,528	0	28,431	28,431
Income Tax	15,840	0	15,840	0	14,211	14,211	0	11,372	11,372
Dividends Tax at 15%	0	27,000 Γ	27,000	0	29,250 Ђ	29,250	0	16,200 †	16,200
Total Tax	15,840	27,000	42,840	0	43,461	43,461	0	27,572	27,572
Total effective rate of taxation applying to all parties to the CISS	23.80%			24.15%			15.32%		
* Assuming the participation exemption does not apply and assuming the foreign company is not a CFC									
** Deductions apportioned on basis of exempt income to total gross income (s23(f))									
*** Income retained to pay portfolio expenses - retained in ratio of income to total income									
Δ Sum of all distributions by the company less dividends tax withheld at 15%. (38,769 + 108,000 + 33,231) * 0.85									
ж Sum of all local dividends accrued to the trust less dividends tax at 15%. (195,000) * 0.85									
Φ Local dividends received by and distributed by the CISS less dividends tax at 15%. (108,000) * 0.85									
Γ (38,769 + 108,000 + 33,231) * 0.15									
Ђ (195,000) * 0.15									
† (108,000) * 0.15									

For a detailed discussion of this table see 6.2.1 and 6.2.2 below.

From the above scenario analysis it is clear that tax advantages for the portfolio and consequently for the investors are created by the inclusion of section 25BA in the Act. These advantages exist both where the CISS is incorporated as a company and where the CISS is established as a trust. The quantum of the overall tax benefit would however change

depending on the mix of income earned by the portfolio and depending on the nature of the investors.

6.2.1. The tax advantages of section 25BA for a CISS which is incorporated as a company

In the absence of section 25BA and the inclusion of a portfolio of a CISS in the section one definition of a *person*, a CISS incorporated as a company would be treated as any other company for tax purposes. A company is a separate legal entity and therefore all the receipts and accruals of the CISS would be taxed in the hands of the CISS regardless of whether or not they are distributed to investors. The distributions made by the CISS to its investors would fall within the definition of a dividend and would be subject to the dividends tax.

From the above scenario analysis it is clear that a lower overall effective rate of taxation (taking both the CISS and investors' tax into account) applies where a portfolio of a CISS is taxed in terms of section 25BA of the Act as opposed to the provisions of the Act which apply to a company. This lower effective tax rate exists despite the fact that a company is taxed on its income at a rate of 28% while a portfolio of a CISS is taxed at a rate of 40%. The difference in the overall effective tax rate can, on analysis, be attributed mainly to the following:

- i) The local dividend⁷⁹ income of a portfolio of a CISS which is not distributed within 12 months of its accrual by the CISS is, in terms of section 25BA(b)(ii), taxable in the CISS as income i.e. no tax exemption in terms of section 10(1)(k) would apply to such undistributed dividend income. This can, provided the portfolio has sufficient expenses⁸⁰, actually be a tax advantage for the portfolio because the portfolio is able to deduct its expenses **in full** against such local dividend income without the requirement for it to apportion its expenses in order to meet the requirements of deductibility from that dividend income in terms of section 23(f). This advantage exists provided that the portfolio is carefully managed – where revenue amounts in excess of the expenses of the portfolio remain undistributed for 12 months following the date of accrual to the portfolio additional taxation will result in the portfolio. It is common practice for the manager of a portfolio of a CISS to ensure that all income believed to be revenue in nature⁸¹ which accrues to a portfolio in excess of the

⁷⁹ Note that section 25BA(b)(ii) refers to a '*dividend*' which in terms of the section 1 definition of that term includes only distributions from resident companies.

⁸⁰ in practice only so much income as is required to set off the expenses of the portfolio would be retained in the portfolio

⁸¹ See chapter five for a discussion of the nature of the proceeds of the disposal of the underlying securities of a portfolio of a CISS.

expenses of the portfolio is distributed on a timely basis such the portfolio has zero taxable income.

- ii) In terms of section 25BA, the revenue receipts and accruals of a portfolio of a CISS which are distributed to the investors in that CISS within 12 months of their accrual retain their nature in the hands of the investors. This is because section 25BA(a) deems these distributed amounts to have accrued directly to the investor on the date of distribution. This treatment of the portfolio as a conduit in terms of distributed revenue income by section 25BA may result in a benefit to the investor depending on the nature of the income earned by the portfolio. In the scenario set out above significant advantage is afforded the investor in terms of section 25BA because the distribution includes amounts other than local dividends which are exempt from tax in the investor's hands such as foreign dividends partially exempt in terms of section 10B(3)(b) and interest which is partially exempt in terms of section 10(1)(i). Were the CISS to be taxed according to its true legal nature as a company, the full distribution to the investor would be classified as a local dividend regardless of the underlying source of that income and dividends tax at 15% would be payable by the investor on the full distribution. In terms of section 25BA on the other hand, only the portion of the distribution which is paid out of local dividends received by the CISS is subject to dividends tax.

It is clear from the above that the taxation of the revenue receipts and accruals of a CISS incorporated as a company in terms of section 25BA can have significant tax advantages for both the CISS and its investors. The tax treatment of a CISS which is a company and its investors / shareholders in terms of section 25BA is fundamentally different from the treatment which would apply to these parties in the absence of section 25BA.

6.2.2. The tax advantages of section 25BA for a CISS which is established as a trust

In the absence of section 25BA a CISS established in terms of the CISCA as a trust and its investors would be subject to taxation on the revenue receipts and accruals of the CISS in terms of the provisions of section 25B(1). This is because, as established in chapter two, the legal nature of such a CISS is a vesting trust with the investors in the CISS being the beneficiaries of the trust.

In terms of section 25B(1) the receipts and accruals of a trust which are *'derived for the immediate or future benefit of any ascertained beneficiary who has a vested right to that amount during that year'* are deemed to accrue directly to that beneficiary retaining their nature. The trust is treated as a conduit with such vested amounts being taxable only in the hands of the beneficiary in whom such amounts vest.

In line with the treatment of a vesting trust as a conduit is section 25B(3) which allows a beneficiary in whom income vests a deduction for expenditure incurred in the production of that income (regardless that such expenditure may not have been actually incurred by the beneficiary but rather by the trust).

"25B(3) Any deduction or allowance which may be made under the provisions of this Act in the determination of the taxable income derived by way of any amount referred to in subsection (1), must, to the extent to which that amount is under that subsection deemed to be an amount which has accrued to –

- (a) a beneficiary, be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by that beneficiary; and*
- (b) the trust, be deemed to be a deduction or allowance which may be made in the determination of the taxable income derived by that trust."*

Section 25BA overrides the conduit principle to a certain extent in that it suspends the automatic and immediate vesting in the beneficiary of income earned by the CISS. Instead, income (excluding capital amounts) is deemed to accrue directly to the investor only on **distribution** of that income to the investor by the CISS, provided that distribution takes place within 12 months of the accrual of the income amount to the CISS.

Section 25BA does however maintain the conduit principle in that the income distributed to investors within the required time frame retains its nature in the hands of the investor.

Section 25BA does not provide for the deduction by the investor of expenditure incurred by the portfolio of a CISS in the production of that income. Instead, expenditure incurred by the portfolio is deductible only in the hands of the portfolio and is only deductible from income which is not distributed to investors. Further, any local dividend income which is not distributed by the portfolio loses its nature as a dividend and is deemed to be income in the hands of the portfolio.

The above scenario analysis makes it clear that a lower overall effective rate of taxation (taking both the CISS and investors' tax into account) applies where a portfolio of a CISS is taxed in terms of section 25BA of the Act as opposed to section 25B. The difference in the overall effective tax rate can, on analysis, be attributed to the following:

- i) In the absence of section 25BA all income accruing to a vesting trust would automatically, in terms of section 25B be deemed to accrue to the beneficiary in whom such amount vests. The expenses incurred by the vesting trust would likewise in terms of section 25B(3) be deemed to have been incurred by the beneficiary. This is not the case with section 25BA in that undistributed income accumulating in the portfolio is taxed in the portfolio. The expenses of the portfolio are only deductible in the portfolio itself. The managers of the CISS would, as a matter of practice, retain only sufficient income in the portfolio so as to offset the expenses of the portfolio with the result that zero taxable income arises in the portfolio. In terms of section 25BA, the retained dividend income loses its nature in the hands of the portfolio (i.e. becomes income) with the effect that the expenses of the portfolio are fully deductible against such income without the requirement of apportioning the expenditure⁸² between exempt and non-exempt income which would be the case in the hands of the investors were section 25B to apply.
- ii) A portfolio of a CISS is a '*regulated intermediary*' as defined in section 64D. As a result no dividends tax is withheld on dividend payments made by a company to a portfolio of a CISS (section 64G(2)(c)). It is only on the distribution of accrued dividends by a portfolio of a CISS to the investors (as beneficial owners of that dividend) that dividends tax is deducted and paid over to SARS. Where dividend income is retained in the portfolio in order to defray the expenditure incurred by the portfolio no dividends tax arises⁸³. This is a major concession on the part of the legislature and provides a significant benefit to investing through a portfolio of a CISS. In the absence of section 25BA dividends tax would have to be deducted on all dividends accumulating in the portfolio whether on- distributed or not and as a result the expenditure of the portfolio would have to be defrayed out of post-dividends tax income.

⁸² In terms of section 23(f) of the Act

⁸³ This treatment is confirmed and clarified by the proposed addition to the Act, in terms of the Taxation Laws Amendment Bill of 2012, of section 64F(k) which states that a dividend is exempt from dividends tax if the beneficial owner of the dividend is a portfolio of a CISS.

It is clear from the above that the taxation of the revenue receipts and accruals of a portfolio of a CISS in terms of section 25BA can have significant tax advantages for both the portfolio and its investors. The tax treatment of a portfolio of a CISS and its investors in terms of section 25BA differs fundamentally from the treatment which would apply to these parties in the absence of section 25BA.

6.3. The capital receipts and accruals of a portfolio of a CISS

The principal section of the Act relating to the taxation of the capital receipts and accruals of a portfolio of a CISS is paragraph 61 of the Eighth Schedule. It states⁸⁴:

*“(1) A holder of a participatory interest in a portfolio of a collective investment scheme in securities must determine a capital gain or capital loss in respect of the participatory interest **only** upon the disposal of that participatory interest. (emphasis added)*

(2) The capital gain or capital loss to be determined in terms of subparagraph (1) must be determined with reference to the proceeds from the disposal of that participatory interest and its base cost.”

6.3.1. The capital gains tax effect of the provisions of the Act for investors in a CISS which is established as a trust

6.3.1.1. Paragraph 61 of the Eighth Schedule

In the case of a CISS established as a trust paragraph 61 as stated above overrides the provisions of the Act which would normally apply to the realisation of a capital gain by a vesting trust.

The various events which constitute a ‘disposal’ for capital gains tax purposes are set out in paragraph 11(1) of the Eighth Schedule to the Act. Specifically included in this list is:

“(d) The vesting of an interest in an asset of a trust in a beneficiary”

As the vesting of the assets of a trust is a disposal of those assets to the beneficiary the tax consequences of any subsequent disposal of that asset would trigger capital gains tax in the hands of that beneficiary (provided the securities are held in the portfolio as capital assets). In other words, where a beneficiary has a vested right to a specific asset the actions by the

⁸⁴ The Taxation Laws Amendment Bill of 2012 proposes the addition to paragraph 61 of sub-paragraph 3 stating: “Any capital gain or capital loss in respect of a disposal by a portfolio of a collective investment scheme must be disregarded”

trustees are actions on behalf of the beneficiary. Any subsequent disposal of the asset is regarded as a disposal by the beneficiary (Geach, Yeats 2007 at p257).

This is in line with SARS' view, as expressed in their Comprehensive Guide to CGT,⁸⁵ that the investors in a portfolio of a CISS have a vested interest in the assets of the portfolio and that as a result of the application of paragraph 11(1)(d) such assets have been disposed of by the portfolio to the investors. In applying this view any capital gain or loss realised on the disposal of the underlying securities in the portfolio would automatically accrue to the investors and in the absence of paragraph 61 would be taxed in the investors' hands.

Paragraph 61 of the Eighth Schedule overrides the taxation of each and every capital gain realised by the investors on the disposal of the underlying securities in the portfolio. This override is aimed at relieving the administrative difficulties which would arise as a result of the high number of trades which could potentially be concluded in a portfolio of a CISS each year. The administration of a portfolio of a CISS would, in the absence of paragraph 61 be hugely complicated and administratively burdensome as every trade in the underlying securities in the portfolio (including those necessitated by the disposal by an investor of their interest) would, where those securities are held as capital assets, result in the recognition of a capital gain in the hands of each investor in the portfolio.

Some difficulty in applying paragraph 11(1)(d) to a portfolio of a CISS arises where it is considered that an individual investor does not acquire an interest in the underlying assets of the portfolio but rather acquires a vested right to the capital of the portfolio. The capital of the portfolio is a composite which includes all assets of the portfolio plus accrued income less the liabilities of the portfolio (Geach, Yeats 2007 at 256). The distinction between a vested right to the capital as opposed to a specific asset of a trust is not well catered for in the Act (Williams 2005 at p79). It is submitted however that as the capital of the trust includes its assets paragraph 11(1)(d) does find application in the case of the assets of portfolio of a CISS established as a trust and that paragraph 61 overrides the tax implications which would otherwise arise in the hands of the investors by the application of paragraph 11(1)(d).

From the above it is clear that the treatment of capital gains and losses on the disposal of the assets of a portfolio of a CISS in terms of paragraph 61 completely overrides the tax treatment which would apply were that portfolio and its investors to be taxed in terms of the true legal nature of the relationship between these parties. Effectively, for capital gains tax purposes, the participatory interest of an investor in a portfolio of a CISS is treated the same as a

⁸⁵SARS Comprehensive Guide to CGT (issue 4) at 12.10

shareholder in a company with a capital gain or loss being realised only on disposal of that interest.

Not only does paragraph 61 ease the tax compliance burden on the investor, it also serves to accumulate individual gains and losses which would otherwise be realised over the period of investment into a single gain or loss. This treatment may be a cash flow advantage for the investor as it may avoid the situation where in one year of assessment net capital gains are attributed to the investor while in a subsequent year net capital losses arise which cannot be utilised except to reduce capital gains realised in future years. In other circumstances this may be a tax disadvantage for the investor as it may be preferable, from the point of view of the investor's effective tax rate and use of the annual capital gains exclusion⁸⁶, to realise smaller capital gains in each year of assessment in which the investment is held instead of as a single large capital gain on the disposal of the investment.

Note that where an investor holds their participatory interest in a portfolio of a CISS as a revenue asset paragraph 61 would still apply to the investor to the extent that it would prevent the realisation, in the hands of the investor, of a capital gain on each capital disposal made by the portfolio. On disposal of the participatory interest the investor would (provided section 9C did not apply) realise a revenue gain calculated as the difference between the proceeds on disposal of their interest and its acquisition cost.

6.3.1.2. Section 9C

Section 9C of the Act sets out the circumstances in which the proceeds on the disposal of a 'qualifying share' are deemed to be capital in nature. In brief, provided that an 'equity share' has been held by the owner of that share for a continuous period of at least three years, the share will be a 'qualifying share' and the proceeds on the disposal of that share will be capital in nature regardless of the fact that the share may have been acquired and held as trading stock.

The definition of an 'equity share' for purposes of section 9C specifically includes: "*a participatory interest in a portfolio of a collective investment scheme*".

The inclusion of a participatory interest in a portfolio of a CISS as a *qualifying share* is a further tax benefit afforded to the investors of a CISS which, if established as a trust, would not in the absence of such a concession be subject to section 9C.

⁸⁶ as provided for by paragraph 5 of the Eighth Schedule

6.3.2. The capital gains tax effect of the provisions of the Act for investors in a CISS which is incorporated as a company

No direct tax advantage is granted by virtue of paragraph 61 to an investor in a CISS which is legally incorporated as a company when compared to the tax treatment which would apply were that CISS and its investors to be taxed in terms of the legal nature of the relationship between them (shareholder and company). This is because a shareholder in a company has no right to the assets of the company and therefore would, in any event, only realise a capital gain or loss on the disposal of their shareholding in the company. The capital gain to be realised by a shareholder in a company on disposal of a share held as a capital asset would, in any event, be calculated in line with paragraph 61(2) being the proceeds on disposal less the base cost of the shares.

The inclusion in the Act of sub-paragraph 61(3) proposed in terms of the Taxation Laws Amendment Bill of 2012 will however result in a significant indirect benefit for the investors in portfolio of a CISS incorporated within a company. Were a portfolio of a CISS to be taxed as if it were a company (where that was its true legal form) and in the absence of paragraph 61(3), the CISS itself would be liable for capital gains tax on the capital gains realised by it. The CISS would pay capital gains tax (at the effective rate for companies of 18.65%) and the investor would, on disposal of the participatory interest, be subject to additional capital gains tax on the increase in the value of that participatory interest (which would include the realised capital gains of the portfolio). Paragraph 61(3), once effective, will state definitively that a portfolio of a CISS is exempt from capital gains tax with the result that the capital gains of the portfolio would not first be taxed in the hands of the portfolio and then again indirectly in the hands of the investor on disposal of the participatory interest.

The inclusion of a participatory interest in a portfolio of a CISS in the section 9C definition of a '*an equity share*' does not afford any tax benefit to an investor in a CISS which is legally incorporated as a company. This is because if the CISS were taxed in accordance with its true form the investors interest would in any event qualify as an equity share.

6.4. The tax advantages afforded to a portfolio of a CISS and its investors by virtue of the corporate rules

The 'corporate rules' as set out in sections 41 to 47 of the Act provide for the tax neutral transfer of assets between companies (or from any person to a company in the case of section 42) where certain requirements are met. The definitions specifically applicable to the corporate rules are set out in section 41.

The definition of a “company” in section 41 specifically includes a portfolio of a collective investment scheme in securities for purposes of section 42 (asset-for-share transactions) and for section 44 (amalgamation transactions).

The definition of an “equity share” in section 41 likewise specifically includes a participatory interest in a portfolio of a collective investment scheme in securities for purposes of sections 42 and 44.

The result is that a portfolio of a CISS and its investors are able to take advantage of the tax benefits provided by sections 42⁸⁷ and 44. The corporate rules could be used in a CISS context to achieve the following *inter alia*:

- The tax neutral transfer of securities from an incoming investor to a portfolio of a CISS in exchange for a participatory interest in the portfolio (section 42);
- The tax neutral transfer of an investor’s participatory interest in a portfolio to company or to a second portfolio (to create a fund of funds) in exchange for shares or a participatory interest as applicable (section 42);
- The tax neutral amalgamation of two portfolios into a single portfolio (section 44)⁸⁸.

The use of the corporate rules in the abovementioned scenarios has some important practical, tax and other cost saving advantages. A significant benefit is that the acquisition of securities involves the incurral of securities transfer tax which can be avoided by a portfolio of a CISS where the corporate rules are utilised.

For example, a potential investor ‘X’ wishes to invest R100,000 in a portfolio of a CISS. X has an existing portfolio of listed securities, held in his own name, worth R100,000. The listed shares held by X are also held by the portfolio of the CISS. X could either:

- i) sell his listed securities in the open market and invest the proceeds in the CISS; or alternatively
- ii) he could transfer the securities to the CISS in exchange for a participatory interest in the CISS in terms of section 42

⁸⁷ Note that for purposes of section 42 an equity share (i.e. a participatory interest) in a portfolio of a CISS is included in the definition of a ‘qualifying interest’.

⁸⁸ Note that as a result of section 44(14)(bA) it is not possible to amalgamate a company into a portfolio of a CISS however it seems that it would be possible to amalgamate a portfolio of a CISS into a company.

Where the first option is followed X has an immediate taxable gain or loss on the disposal of his securities and is only able to invest the net proceeds in the portfolio. The portfolio of the CISS, on the other hand, must use the invested cash to acquire securities and will incur brokers fees and securities transfer tax in doing so.

Closer analysis reveals that the use of section 42 and section 44 as a means of transferring assets can, in certain circumstances, be even more beneficial to a portfolio of a CISS and its investors than the benefits which would apply to other taxpayers making use of the same provision.

6.4.1. Additional benefits of section 42 and section 44 to a CISS

Section 42 applies (subject to certain other criteria) where a *person* transfers an asset to a *company* in exchange for consideration in the form of equity shares issued by that company. In brief, the provisions of section 42 provide that the *person* is deemed to have disposed of the transferred assets at its base cost or tax cost (as applicable) and that the *company* is deemed to have acquired the asset for that same base cost or tax cost on the date as the asset was originally acquired by the person. The *person* is further deemed to have acquired the shares in the *company* on the date and for the cost at which the asset was originally acquired by the person. As a result the transfer of the asset does not give rise to any immediate capital gains tax or normal tax in the hands of the person and the taxable gain on the transfer of the asset is deferred until the subsequent disposal of the asset by the *company*.

One of the major criticisms of section 42 is that it creates two centres of deferred taxable gains – one which is realised on the eventual disposal by the company of the transferred asset and the other which is realised by the person on the disposal of the equity shares acquired in the company. The result is that the use of section 42 can be distinctly disadvantageous as a single inherent normal tax or capital gains tax liability relating to a particular asset is ‘converted’ by the use of section 42 into two inherent tax gains of the same amount (one in the hands of the transferor, the other in the hands of the transferee).

However, where the acquiring ‘company’ in relation to a section 42 transaction is a portfolio of a CISS which acquires securities as capital assets⁸⁹ from a person in exchange for the issue of a participatory interest this problem does not arise. This is because the portfolio is, by virtue of

⁸⁹ See Chapter 5 for more on the nature of the underlying securities held in a portfolio of a CISS

its treatment as a vesting trust and the workings of paragraph 11(1)(d), not itself subject to capital gains tax⁹⁰.

For the same reason, the anti-avoidance provisions of section 42(7) and section 44(5) which come into effect where the transferee company (or portfolio in this case) disposes of an asset acquired in terms of section 42 or section 44 within 18 months of the transaction would have no effect on a portfolio of a CISS where that asset is a capital asset⁹¹. Essentially a portfolio of a CISS which has acquired securities in terms of a section 42 asset-for-share transaction or a section 44 amalgamation transaction can, unlike a company, dispose of those securities at any stage without incurring any negative capital gains tax consequences. Note that the fact that the provisions of section 42 and 44 override paragraph 61 (by virtue of section 41(2)) does not negate this advantage as sections 42(7) and 44(5) provide how a capital gain or loss is to be calculated and in addition provide that it should be ring-fenced while the proposed wording of the new paragraph 61(3) states that any capital gain or loss realised by a portfolio of a CISS should be disregarded.

This of course assumes that the securities are in fact disposed of by the person and acquired and held by the portfolio as capital assets⁹². No such advantages would result where the securities are acquired by the portfolio as trading stock as revenue gains are taxed (if not distributed within the required time) in the hands of the portfolio.

In fact, the transfer in terms of section 42 or section 44 of securities which are trading stock in the hands of the transferor to a portfolio of a CISS to be held as trading stock by the portfolio may be detrimental to the existing investors in the portfolio who will each 'acquire' (in terms of their participatory interest) a proportionate share of the unrealised tax gain on the transferred securities. The size of the participatory interest in the portfolio issued to the person (the transferor) in exchange for the securities would have to take the negative tax effect for the existing investors into account.

⁹⁰ This is further supported by the Taxation Laws Amendment Bill of 2012 which proposes a new subparagraph to paragraph 61 specifically stating that a portfolio of a CISS is exempt from capital gains tax.

⁹¹ It is clear from section 41(2) that the provisions of sections 42 to 47 override all other provisions of the Act apart from sections 24B(2), 103 and Part IIA of Chapter III. This does not however result in a portfolio of a CISS being liable for CGT in terms of the application of section 42(7) as this provision does not impose a capital gain but merely sets out how the gain should be calculated. A portfolio of a CISS would therefore still be out of the picture for CGT purposes by virtue of paragraph 11(1)(d).

⁹² See 'like-for-like' requirement for an asset-for-share transaction in terms of section 42(1)(a)(ii). The exception to the 'like-for-like' requirement (per the proviso to that section) only applies where the asset transferred is a listed share or a participatory interest in a portfolio of a CISS and where the transferee acquires a significant interest in the listed share or portfolio.

6.5. The potential distortion of the type of income earned by an investor in a portfolio of a CISS as an effect of section 25BA

The value of an investor's interest or unit in a CISS is reflected in the net asset value of the underlying portfolio. The trustee of the CISS is obligated in terms of the trust deed to repurchase an investor's interest on request by the investor at the net asset value per unit.

The net asset value of the portfolio may at any one time comprise one or a combination of the following:

- Initial capital invested in underlying securities;
- Unrealized gains / losses on underlying securities;
- Cash;
- Undistributed accrued interest;
- Undistributed accrued local and foreign dividends;
- Accruals for portfolio expenses (management fees, audit fees, custodian fees)

The suspension by section 25BA of the automatic vesting on accrual of the income earned by the portfolio until the distribution of that income and the similar suspension by paragraph 61 of the realisation by the investors of the capital gains or losses of the portfolio may lead to a distortion of the kinds of income earned by an investor and may result in significant tax advantages or disadvantages for the investor.

6.5.1. The distortion created by the timing of the disposal of a participatory interest

A distortion of the kind of income accruing to an investor may arise as a result of the timing of the disposal by an investor of a participatory interest. This is illustrated in the following example where an investor, a natural person who pays tax at the maximum marginal rate disposes of their participatory interest in a portfolio of a CISS in three different scenarios:

Scenario 1: The disposal of the participatory interest takes place immediately prior to any distributions of accrued income by the portfolio.

Scenario2: The disposal of the participatory interest takes place immediately following a distribution by the portfolio of its accrued interest income.

Scenario 3: The disposal of the participatory interest takes place immediately following a distribution by the portfolio of its accrued dividend income.

In practice the nature of a distribution of revenue income by a portfolio of a CISS would be determined pro-rata in relation to the relative amount and nature of the accrued income in the portfolio. In other words where the accrued income of a portfolio consisted of interest and dividends a pure interest or a pure dividend distribution (as used in the scenario analysis set out below) would not be possible. The example serves only to illustrate the distortions which may occur due to the timing of a disposal of a participatory interest where the accrued income of a portfolio is predominantly of one nature.

Investor	Mrs Money Penny, natural person taxed at marginal rate of 40%		
Units to be disposed of by investor	500		
Base cost to investor per unit	150		
	Scenario 1 - NAV immediately prior to any distribution to investors	Scenario 2 - NAV immediately following interest (only) distribution to investor	Scenario 3 - NAV immediately following dividend (only) distribution to investors
Net asset value ('NAV') of portfolio immediately prior to disposal by investor of 500 units			
Market value of securities	2,450,000	2,450,000	2,450,000
Accrued but undistributed interest income*	180,000	0	180,000
Accrued but undistributed local dividends*	200,000	200,000	0
Accrued management fees	(10,000)	(10,000)	(10,000)
Accrued audit fees	(2,000)	(2,000)	(2,000)
Accrued trustee fees	(4,500)	(4,500)	(4,500)
Net asset value of portfolio	2,813,500	2,633,500	2,613,500
Number of units in issue	1,000	1,000	1,000
Net asset value per unit	2,813.50	2,633.50	2,613.50
Tax effect for investor on income distribution and subsequent disposal of units			
<i>Gross Income</i>			
Interest (section 25BA)	0	90,000	0
Local dividends (after dividends tax)	0	0	85,000
<i>Exemptions</i>			
Interest exemption (section 10(1)(i))	0	(22,800)	0
Exemption for local dividends (section 10(1)(k))	0	0	(85,000)
<i>Capital Gain</i>			
Proceeds (net asset value per unit x 500 units)	1,406,750	1,316,750	1,306,750
Base cost (R150 x 500 units)	75,000	75,000	75,000
Capital gain	1,331,750	1,241,750	1,231,750
Taxable Capital Gain (Inclusion at 33.3%)	443,473	413,503	410,173
Taxable income	443,473	480,703	410,173
Income Tax at 40%	177,389	192,281	164,069
Dividends Tax	-	-	15,000
Total Tax	177,389	192,281	179,069
Pre tax cash flow (distribution + proceeds on disposal of units)	1,406,750	1,406,750	1,406,750
After tax cash flow	1,229,361	1,214,469	1,227,681
* Accrued to the portfolio within 12 months			

In scenario 1 no revenue income accrues to the investor as no distributions are made by the portfolio. The disposal by the investor of her participatory interest results in the undistributed income of the portfolio which is in fact partly attributable to the investor being taxed as a capital gain in the investors hands. Capital gains are taxed at a lower effective rate (13.3% for natural persons at the maximum marginal rate) than revenue income (40%). It is therefore advantageous for the investor in the example to dispose of his participatory interest prior to a distribution of interest by that portfolio (as shown in scenario 2). This would however only be

true provided that the benefit of the lower effective capital gains tax rate is not negated by the annual interest exemption applicable to the investor.

Comparing the tax outcome of scenario 1 with that of scenario 3 illustrates that, where the investor is a natural person (as opposed to a South African resident company which is exempt from dividends tax) it is preferable for the investor to dispose of his participatory interest prior to the distribution of any accrued local dividend income by the portfolio. This is because the effective rate of tax which applies to local dividends paid to a natural person who is a resident is 15% which is higher than the effective rate of capital gains tax to that person of 13.3%.

Were our investor in the example a South African resident company then the greatest tax advantage would be derived where the investor disposes of its participatory interest in the portfolio immediately following a dividend distribution. This is because the distribution of a dividend to a South African resident company is exempt from dividends tax. The investor would be liable for only capital gains tax and this calculated on reduced proceeds as a result of the net asset value of the portfolio decreasing by the amount of the dividend distribution.

As a result of the distorting effect of section 25BA two similar investors who dispose of their interests in the same portfolio of a CISS at different times may, as illustrated above, suffer different tax consequences. A tax advantage or disadvantage may arise inadvertently without being anticipated by the investor. On the other hand, a tax advantage may result from the intentional timing of disposal transactions by tax savvy investors.

Many portfolios of CISS have distribution policies with income being distributed at fixed intervals (for example quarterly or bi-annually). It would be possible for an investor in a portfolio of a CISS to minimise their overall tax liability by either disposing of their participatory interest in a portfolio prior to or following a distribution. The timing of the disposal so as to achieve a tax benefit would depend on:

- a) the kind of income to be distributed;
- b) the exemptions applicable to the specific investor in relation to the income to be distributed.

This kind of manipulation would require the investor knowing the nature of the income which has been accrued in the portfolio. It is not however unreasonable that an investor may have access to this kind of information from the fund performance reports distributed by the manager of the CISS to the investors or by virtue of the potentially close relationship between

the manager and the investor (a CISS is only required, in terms of the CISCA to have 2 investors and there is nothing from precluding the manager from investing in its own CISS).

6.5.1. The distorting effect of section 25BA on dividends tax

A portfolio of a CISS is a '*regulated intermediary*' in terms of paragraph (e) of the definition of that term in section 64D of the Act. As a result of this, dividends earned by the portfolio in respect of the securities held in that portfolio are received by the portfolio prior to the deduction of any dividends tax (section 64G((2)(c)). The rationale behind this treatment is that the company paying the dividend to the portfolio of a CISS (or any other regulated intermediary) has no visibility as to who the beneficial owner of the share is. The responsibility for deducting the dividends tax is therefore shifted to the regulated intermediary.

Dividends tax is only deducted by the portfolio of a CISS on the **distribution** of that dividend to the investors in the CISS (section 64H(1)). Any dividend which is not distributed by the portfolio within 12 months of its accrual is deemed to accrue to the portfolio itself and in doing so loses its identity as a dividend and becomes income (section 25BA(b)(ii)). No dividends tax is therefore paid on dividends which are deemed to accrue to the portfolio of a CISS. This, as discussed above, creates a distinct tax advantage for a portfolio of a CISS and its investors as the expenses of the portfolio can be set off against gross dividend income.

The suspension of the conduit principle until the distribution of income received by a portfolio of a CISS in terms of section 25BA combined with the effects of section 64H(1) creates a distortion in the collection of dividends tax. This is because the investors in a portfolio of a CISS (the beneficial owners of the underlying securities in the portfolio) may change between the date on which the dividend is declared by the company and the date on which the dividend is distributed (and the date on which dividends tax is withheld) by the CISS.

For example, a portfolio of a CISS may, on the date on which a dividend is declared by a company in which the portfolio holds shares, have investors which are all resident companies exempt from dividends tax (section 64F(a)). These investors are, on the assumption that the CISS is a vesting trust, the beneficial owners of the shares in respect of which the dividend is being paid. Should an additional investor who is a natural person resident in South Africa subscribe for a participatory interest in the CISS after the declaration of the dividend by the underlying company but prior to its distribution by the CISS then on distribution of the dividend to the investors dividends tax will be withheld by the CISS on the portion of the dividend paid to the investor who is a natural person. This deduction of dividends tax occurs despite the fact that the natural person investor had no interest in the underlying company at the time the dividend was declared.

The distortion described above could be advantageous or disadvantageous to a particular investor. The tax benefit or tax loss to the investor would depend on a number of factors including:

- the nature and amount of the undistributed income in the portfolio of CISS at the time of subscription to a participatory interest;
- the 'status' of the investor in terms of dividends tax i.e. exempt, not exempt or subject to a reduced rate of withholding by virtue of a double taxation agreement;
- the timing of subscription or disposal of a participatory interest relative to the dates of dividend accrual and the dates of distribution of income by the portfolio of the CISS;

It is clear that it would be distinctly disadvantageous for an investor who is not exempt from dividends tax to subscribe for a participatory interest in a portfolio at a time when the portfolio has a large balance of undistributed dividend income. It would likewise be disadvantageous for a South African resident company to dispose of a participatory interest in a portfolio at a point at which the portfolio has a large balance of undistributed local dividend income.

6.6. Conclusion

The Act provides for special tax treatment to apply to a portfolio of a CISS and its investors which differs significantly from the treatment which would apply were those parties to be taxed in terms of the true legal nature of the scheme to which they are party. This is not in itself unusual as there are numerous examples of special tax dispensations in the Act which serve to encourage certain behavior amongst taxpayers.⁹³ In the case of a CISS one can speculate that the special provisions relating to these investment vehicles is designed to encourage savings through participation in these schemes by making them tax efficient investment vehicles for investors and by easing the administrative burden on the managers of the schemes.

As revealed by the analysis in this chapter, some of the key advantages provided by the Act to a CISS and its investors (when compared to the treatment which would apply in the absence of any specific provisions in the Act relating to a CISS) include the following:

- Where accrued dividends are retained in a portfolio in order to settle the portfolio's expenses that income loses its nature and becomes income in the hands of the portfolio (in terms of section 25BA(b)(ii)) with the result that expenses of the

⁹³ For example section 13quat provisions encouraging building improvements in certain urban areas and section 11D which by its very generous deductions encourages research and development.

portfolio can be set off against such dividend income in full without the need to apportion the expenses between exempt and non-exempt income as required by section 23(f). This advantage afforded to a CISS in terms of the Act applies both where the legal nature of the CISS is a trust and where the CISS is legally a company.

- Where dividend income is retained by the portfolio for purposes of settling the portfolio's expenses no dividends tax is payable by the portfolio. In effect the expenses of the portfolio are settled using gross dividends as opposed to net dividends which would be the case (in the hands of the investors) were the portfolio to be taxed as a vesting trust. This advantage is only relevant to a CISS legally established as a trust as a CISS established as a company would in any event be exempt from dividends tax.

- The suspension of the realisation of capital gains by the investors in a portfolio of a CISS until the disposal of their participatory interest in terms of paragraph 61 may be either an advantage or a disadvantage to the investor where the CISS is established as a trust. Whether the treatment results in an advantage or disadvantage depends on the size of the capital gain or loss and on the nature of the investor. The potential advantage is that instead of an investor realising a capital gain each time the portfolio disposes of a capital asset (which may result in cash flow problems where large capital gains arise in one year of assessment and large capital losses in another) these cumulative gains or losses are realised by the investor only on disposal of their units. This may however be a disadvantage to the investor who, if a natural person may wish to realise gradual capital gains which can be reduced by the annual exclusion rather than a single large capital gain. This treatment is however a practical advantage as it significantly eases the administrative burden on the CISS of having to maintain records of the capital gains realised by each investor each time the portfolio disposes of a capital asset.

- The suspension of the realisation of capital gains in the hands of the investor does not have any benefit to the investor where the CISS is established as a company as this treatment mimics the treatment of a shareholder's interest in a company. The pending addition of sub-paragraph 61(3) will however, once enacted, be a significant advantage to investors in a CISS incorporated as a company as the portfolio will, unlike regular companies, be excluded from capital gains tax. In the case of a portfolio of a CISS which is incorporated as a company the introduction of paragraph 61(3) will avoid the double taxation of capital gains on the disposal of underlying

securities (once in the hands of the portfolio and once in the hands of the investor on disposal of their participatory interest).

- A portfolio of a CISS is specifically included in the definition of a 'company' for purposes of section 42 and section 44 of the Act. This concession is important for a CISS established as a trust as the 'corporate rules' are otherwise reserved for companies. In certain cases the treatment afforded a portfolio of a CISS using these sections is even more beneficial than that which would apply to a regular company making use of the same section.

The treatment in terms of the Act does not however only result in tax advantages to the investors in a CISS. Certain distortions of the kind of income earned by investors in a CISS arise as a result of the suspension of the conduit principle until distribution by section 25BA. These distortions arise as a result of the timing of the acquisition and disposal by an investor of a participatory interest. The significance of the distortion and whether the distortion is a tax benefit or disadvantage to the investor is dependent on the nature of the accrued income in the portfolio on the date of acquisition or disposal of a participatory interest and on the nature of the investor (natural person, company, exempt entity).

7. Conclusion

This dissertation sought to determine how the tax treatment of a portfolio of a CISS and its investors, both in terms of the Act and in practice, differs from the tax treatment which would apply to those parties in the absence of any special tax dispensation relating to a CISS.

In order to create a framework for the purpose of conducting a comparison between the abovementioned tax treatments the legal nature (from a non-tax point of view) of a CISS was first considered. A CISS may be established, in terms of the CISCA, either as a trust or as a company. In the case of a CISS established as a trust it was concluded that the CISS is specifically a vesting trust with the vested beneficiaries being the investors in the trust. In the case of a CISS incorporated as a company the investors are the shareholders in the company⁹⁴. The rights of the investors in a CISS to the underlying assets of the CISS differ significantly, from a legal point of view, depending on whether the CISS has been established as a trust or as a company and the tax treatment of each would, in the absence of blanket provisions in the Act which override the normal tax treatment which would apply, have very different tax consequences for the two kinds of entities.

Despite the abovementioned 'blanket treatment' it was found that a number of deficiencies in the Act exist which would, in certain circumstances, result in a CISS which is incorporated as a company being taxed differently to a CISS which is established as a trust. This is because the classification of a portfolio of a CISS as a '*person*' in the Act does not make a CISS which is incorporated as a company a vesting trust in terms of the Act and does not override the rights and obligations created by the legal nature of the CISS. It is recommended that in light of the anticipated incorporation of OEICs in South Africa, that these discrepancies be resolved if it is the intention of the legislature that all CISS's (regardless of their legal nature) be treated the same for tax purposes.

It appears that in practice special tax treatment is afforded a CISS on the disposal of its underlying securities. The purpose of a CISS is to generate investment returns for its investors (and consequently management fees for the CISS manager). The desired investment returns come in the form of either or a combination of dividends and an increase in the market value of the underlying securities in the portfolio. Where the purpose in acquiring the underlying

⁹⁴Despite the fact that no CISS's have been incorporated as companies in South Africa to date, it was considered important to include these entities in this analysis as it is thought that the redrafting of the CISCA will pave the way for the incorporation of OEIC's in South Africa.

securities is predominantly for capital appreciation then legal precedent provides that the proceeds on the sale of the securities are revenue in nature. It is submitted that in a large percentage of cases CISSs in South Africa are, regardless of whether the earning of dividend income is one of the main purposes, conducting a trade of buying and selling securities for the purpose of realising an increase in the market price and that the proceeds from this trade are (in the absence of the application of section 9C) revenue in nature.

There seems to be a perception however (both in the case of SARS and in the case of the investment industry) that these proceeds are capital in nature and that as a consequence no tax at all is levied on these proceeds until the disposal of a participatory interest by an investor (in terms of paragraph 61). The existence of this perception is supported in that the application of section 25BA to revenue proceeds of a CISS which are not distributed to investors (as is likely in the case of trading profits) leads to double taxation of the same gains (once on revenue account in the hands of the portfolio when the gain arises and once in the hands of the investor on disposal of the participatory interest). This negative tax treatment of the proceeds on disposal of the underlying securities would make a CISS a hugely tax inefficient investment vehicle and would force a portfolio of a CISS to distribute the proceeds on disposal of its underlying securities (creating a huge administrative burden on the manager of a CISS).

The blanket treatment of the proceeds on the disposal of the underlying securities of a CISS as capital in nature is not supported by the Act nor by legal precedent and it is submitted that SARS would have the grounds to attack such treatment if it chose to do so. It is suggested that in the interests of certainty that ASISA address this issue with SARS and that the CISS industry obtain legislative clarity on the matter.

A comparison of the treatment of a CISS in terms of the Act to that which would apply in the absence of any specific provisions relating to these investment vehicles reveals that certain significant tax advantages are afforded a CISS and its investors by the legislature. It is possible that these concessions are specifically designed to encourage a culture of savings through participation in CISSs and to ease the administrative tax burden on the managers of such schemes.

A number of anomalies do however arise as a result of the suspension by section 25BA of the conduit principle until the physical distribution of an amount to the investors has occurred. The anomalies arise firstly as a result of the timing by an investor of the acquisition or disposal of a participatory interest in relation to a distribution by the portfolio and secondly as a result of the nature of the accrued income in the portfolio at those points in time. In short different tax consequences may arise for an investor depending on whether a participatory interest is

disposed of immediately prior to or immediately following an income distribution. This may lead to inequitable tax treatment of different investors or may lead to manipulation of the type of income earned by investors.

8. Tables

8.1. Table of references in the Act to a portfolio of a collective investment scheme in securities

Provision of the Act	Effect
Section 1, definition—"company", paragraph (e) (ii)	Includes a foreign portfolio of a CISS in the definition of a ' <i>company</i> '
Section 1, definition—"connected person" paragraph (a)(ii) paragraph (bA) paragraph (d)(vi)(bb) proviso to paragraph (e)	Prevents investors in a portfolio of a CISS from being <i>connected persons</i> in relation to one another and from being <i>connected persons</i> in relation to the portfolio itself. Provides that for the purpose of the <i>connected person</i> definition that a portfolio of a CISS should be treated as a company.
Section 1, definition—"financial instrument", paragraph (a)	Includes a participatory interest in a portfolio of a CISS in the definition of ' <i>financial instrument</i> '
Section 1, definition—"person"	Includes a portfolio of a CISS in the definition of ' <i>person</i> '
Section 1, definition—"portfolio of a collective investment scheme"	Includes a portfolio of a CISS in the definition of ' <i>portfolio of a collective investment scheme</i> '
Section 1, definition—"portfolio of a collective investment scheme in securities"	Defines a portfolio of a CISS in terms of the CISCA
Section 1, definition—"year of assessment"	Defines a ' <i>year of assessment</i> ' of a portfolio of a CISS as being the financial year of the portfolio ending in the calendar year in question.
Section 9C. Circumstances in which certain amounts received or accrued from disposal of shares are deemed to be of a capital nature.	Includes a participatory interest in a portfolio of a CISS in the definition of ' <i>equity share</i> ' for purposes of section 9C
Section 9D. Net income of controlled foreign companies Paragraph (c)(ii)(e) of the definition - "controlled foreign company"	excludes a person who holds less than 5% of the participation rights or voting rights in a foreign CISS or a foreign company held through a foreign CISS from the definition ' <i>resident</i> ' for the purposes of determining whether a foreign CISS is a controlled foreign company.
Section 10 (1) (iB)	Provides that any amount distributed by a portfolio of a CISS to an investor which has been taxed in the hands of the portfolio in terms of section 25BA(b) is exempt from tax in the hands of the investor.
Section 10B(4)(b). Exemption of foreign dividends and dividends paid or declared by headquarter companies.	Provides that the participation exemption for foreign dividends provided by section 10B(2)(a) and the exemption for foreign dividends paid between foreign companies in the same country do not apply to dividends received by or accrued to a person from a foreign portfolio of a CISS
Section 12E. Deductions in respect of small business corporations subsection (ii)(b) of the definition of "small business corporation"	Permits a shareholder in a <i>small business corporation</i> to hold an interest in a foreign CISS
Section 18A. Deduction of donations to certain organisations.	Sets out that for a portfolio of a CISS the section 18A deduction from income for donations shall not exceed 5% of the aggregate daily net asset value of the portfolio during the year of assessment

Section 25BA. Amounts received by or accrued to certain portfolios of <i>collective investment</i> schemes and holders of participatory interests in portfolios.	Non-capital amounts received by or accrued to a portfolio of a CISS are taxable in the portfolio unless distributed to investors within 12 months of accrual of the amount by the portfolio. Where non-capital amounts are distributed to investors within 12 months of receipt or accrual by the portfolio the amount is deemed to have accrued directly to the investor (i.e. the amount retains its nature in the hands of the investor). Dividend income which is retained in a portfolio of a CISS is deemed to be ' <i>income</i> ' to the portfolio.
Section 41 (1), definition— "company"	Includes a portfolio of a CISS in the definition of a ' <i>company</i> ' for purposes of section 42 and section 44
Section 41 (1), definition— "equity share"	Includes a participatory interest in a portfolio of a CISS in the definition of ' <i>equity share</i> ' for the purposes of section 42 and section 44
Proviso to sub-paragraph (a)(ii) of the section 42 (1), definition— "asset-for-share transaction"	Provides that where the asset to be transferred in terms of an <i>asset-for-share</i> transaction is a participatory interest in a portfolio of a CISS, then that interest can be acquired as a capital asset or trading stock regardless of how the interest was held by the transferor as long as after the transaction and any other transaction concluded on similar terms within 90 days, the acquiring company holds at least 35% of the participatory interests in the portfolio of the CISS or holds at least 25% of the participatory interest in the portfolio of the CISS if no other person holds an equal or greater amount of participatory interests in that portfolio.
Section 42 (1), definition— "qualifying interest"	Includes a participatory interest in a portfolio of a CISS in the definition of ' <i>qualifying interest</i> ' for purposes of section 42
Section 42 (2) (b)	Provides that where the asset to be transferred in terms of an <i>asset-for-share</i> transaction is a participatory interest in a portfolio of a CISS, then provided that after the transaction and any other transaction concluded on similar terms within 90 days, the acquiring company holds at least 35% of the participatory interests in the portfolio of the CISS or holds at least 25% of the participatory interest in the portfolio of the CISS if no other person holds an equal or greater amount of participatory interests in that portfolio, the acquiring company does not take on the base cost and date of acquisition of the interest from the transferee.
Section 44 (14)	Provides that section 44 does not apply to an amalgamation transaction if the resultant company is a portfolio of a CISS and the amalgamated company is not a portfolio of a CISS
Section 64D. Definitions - "regulated intermediary"	Includes a portfolio of a CISS as a ' <i>regulated intermediary</i> ' for purposes of the dividends tax
Section 70A. Return of information by <i>portfolio of collective investment scheme</i> .	Provides that portfolio of a CISS is required to submit an annual return to the Commissioner
Section 101. Public officers of companies.	Provides that a portfolio of a CISS must at all times be represented by a public officer
Section 106. Authentication and service of documents.	Provides the circumstances in which communication from the Commissioner will be considered effectively issued, given, sent or served to a portfolio of a CISS
Sixth Schedule, paragraph 4(b)	Includes a portfolio of a CISS in the list of permissible shares and interests of a shareholder in a micro business

Eighth Schedule, paragraph 11 (1)(c)	Provides that the issuing of a participatory interest in a portfolio or an option to acquire a participatory interest in a portfolio is not a disposal by that portfolio
Eighth Schedule, paragraph 20 (1) (g)	Provides that two thirds of the interest incurred on money borrowed to finance the acquisition of a participatory interest in a portfolio of a CISS can be included in the base cost of that interest
Eighth Schedule, paragraph 31 (1) (c) (i)	Provides that the <i>market value</i> of a participatory interest in a portfolio of a CISS on a specified date is the price at which that interest can be sold to the management company of the scheme on that date
Eighth Schedule, paragraph 61	Provides that the holder of a participatory interest in a portfolio of a CISS must determine a capital gain or loss in respect of the participatory interest only upon the disposal of that participatory interest. The capital gain or loss to be determined on disposal of the participatory interest must be determined with reference to the proceeds from the disposal of the interest and its base cost.
Eighth Schedule, paragraph 64B(6)	The 'participation' exemption from capital gains on the disposal of a foreign equity share or a foreign return of capital provided by paragraph 64B does not apply to any capital gain or loss determined in respect of the disposal of a share in a foreign CISS.

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