

BINDING GENERAL RULING (INCOME TAX): NO. 8 (Issue 2)

DATE: 4 October 2012

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : SECTION 1(1), DEFINITION OF “GROSS INCOME”
**SUBJECT : APPLICATION OF THE PRINCIPLES ENUNCIATED BY THE
BRUMMERIA CASE**

Preamble

For the purposes of this ruling –

- “**BGR**” means a binding general ruling issued under section 89 of the Tax Administration Act, 2011;
- “**SCA**” means the Supreme Court of Appeal of South Africa;
- “**section**” means a section of the Act unless otherwise stated;
- “**Tax Administration Act, 2011**” means the Tax Administration Act No. 28 of 2011;
- “**the *Brummeria* case**” means the judgment handed down by the SCA in *Commissioner, SARS v Brummeria Renaissance (Pty) Ltd* 2007 (6) SA 601 (SCA), 69 SATC 205; and
- “**the Note**” means Interpretation Note No. 58 (Issue 2).

1. Purpose

This BGR reproduces paragraph 7 of Interpretation Note No. 58 (Issue 2) “The *Brummeria* Case and the Right to Use Loan Capital Interest Free” dated 4 October 2012, which comprises a BGR under section 89 of the Tax Administration Act, 2011.

2. Background

Issue 1 of the Note was issued on 30 June 2010 as a result of the judgment in the *Brummeria* case. Issue 2 of the Note substitutes references to section 76P with references to the Tax Administration Act, 2011 and updates the dates in the examples. The principles dealt with by the Note and hence in this BGR remain unchanged.

3. Ruling

Paragraph 7 of the Note, which comprises a BGR, is reproduced in the **Annexure**.

4. Period for which this ruling is valid

This BGR applies with effect from the commencement of years of assessment ending on or after 31 December 2008 and will apply for an indefinite period.

Group Executive
Interpretation and Rulings
Legal and Policy Division
SOUTH AFRICAN REVENUE SERVICE
Date of first issue: 11 April 2011

ANNEXURE – PARAGRAPH 7 OF INTERPRETATION NOTE NO. 58

7. Granting of life rights over units in a retirement village – Binding General Ruling (BGR)

The contents of this paragraph constitute a BGR under section 89 of the Tax Administration Act, 2011 and relate to the definition of the term “gross income” in section 1(1). This BGR applies with effect from the commencement of years of assessment ending on or after 31 December 2008 and will apply for an indefinite period.

Agreements in the retirement industry are frequently structured in such a way that one person (the owner of a unit) grants a lifelong right of occupation over that unit to another person (the life-right holder). As compensation the life-right holder advances the owner an interest-free loan for the duration of the period of occupation.

Only amounts received by or accrued to a taxpayer during a particular year of assessment must be included in that taxpayer’s gross income for that year of assessment.¹ The value of a right that accrues to a taxpayer in a particular year of assessment must be determined in that year.²

In calculating the monetary value of the right to use an interest-free loan in the year in which it is granted, it should be taken into account that the owner of the unit has given something in exchange to the life-right holders. The *quid pro quo* is the granting of the lifelong right of occupation of the unit. The owner is therefore left only with the bare *dominium* of the unit for the full period of the loan. Only when the loan is repaid and the life right is re-united with the bare *dominium*, will the owner be in a position to deal freely with the complete ownership of the unit.

The value of this *quid pro quo* given by the owner of the unit to the life-right holder should therefore be determined and taken into account in the valuation of the right to use the interest-free loan.

The right to use an interest-free loan granted by an occupant in a retirement village to the owner of that unit in exchange for the granting of a life right of occupation in respect of that unit usually does not relate to a fixed period. Instead, the period over which the right to the use of the loan is to be enjoyed depends on the life expectancy of the life-right holder and certain other contractually agreed contingencies (such as the possibility that the life-right holder may cancel the loan before his or her death).

In view of the above, it may be accepted that the value of the right to use the interest-free loan should be calculated in the year that the loan is granted with reference to the following factors:

- A = The monetary value of the right of use of the interest-free loan which must be included in gross income
- B = The amount of the interest-free loan
- C = The present value of R1 a year over the life expectancy of the life-right holder*, or in the case of more than one life-right holder, the youngest of them

¹ Definition of “gross income” in section 1.

² *CIR v People’s Stores (Walvis Bay) (Pty) Ltd* 1990 (2) SA 353 (A), 52 SATC 9.

- D = The weighted-average prime overdraft rate for banks in respect of the relevant year of assessment
- E = 93,1% (The percentage to be allocated to the monetary value of the life right of a unit, as opposed to the value of the complete ownership of the unit. This average percentage has been determined actuarially and is acceptable to SARS for all life rights granted.) SARS has accepted this method as a basis for calculating the amount to be included in gross income. This deduction accommodates the owner of the unit who gives a right to occupy the unit as a *quid pro quo* for the right to use an interest-free loan.

Formula:

$$A = (B \times C \times D) - E \times (B \times C \times D)$$

* The life expectancy of the life-right holder and the present value of R1 a year for the life of the life-right holder may be determined by using the life-expectancy table issued under Government Notice No. R1942 of 23 September 1977 under section 29 of the Estate Duty Act No. 45 of 1955 (see **Annexure**).

The monetary value of the right to use the interest-free loan in the year in which it is granted and paid must be determined by multiplying the amount of the loan by the present value of R1 a year for the lifetime of the life-right holder and the weighted-average prime overdraft rate determined for the relevant year of assessment. The amount so calculated is then reduced by 93,1%. **Note:** This is a once-off calculation of the amount to be included in the gross income of the borrower in the year of assessment in which the borrower becomes entitled to the right to use the loan. The amount is therefore not re-calculated and included in the borrower's gross income in each subsequent year until the loan is repaid (see **6.1.2**).

Example 1 – Calculation of the monetary value to be included in gross income

Facts:

A retirement village is held under sectional title by the owner. The scheme is governed by the Housing Development Schemes for Retired Persons Act No. 65 of 1988. On 1 June 2011 the owner enters into an agreement, under which the owner grants a life right of occupation over a sectional title unit in the village to a person aged 75.

Under the agreement, the 75-year-old person and that person's spouse will be entitled to occupy the unit in exchange for the grant to the owner of the use of an interest-free loan of R400 000. The life-right holder advanced the loan on 1 July 2011.

The person turned 75 on 16 February 2011.

According to the life-expectancy table (see **Annexure**) the present value of R1 a year for the life of the 75-year-old male is 4,59354 (age next birthday = 76).

The interest-free loan is repayable by the owner of the village to –

- the life-right holder upon cancellation of the agreement under various circumstances, which include the life-right holder falling ill and requiring full-time medical care; or
- his or her estate when he or she dies.

The weighted-average prime overdraft rate for banks during the relevant year of assessment is 13,44%.

The financial year of the owner of the retirement village commences on 1 March 2011 and ends on 29 February 2012.

Result:

The monetary value of the right to the use of the interest-free loan is calculated as follows:

$$\begin{aligned}
 A &= (B \times C \times D) - E \times (B \times C \times D) \\
 &= (R400\,000 \times 4,59354 \times 13,44\%) - 93,1\% \times (R400\,000 \times 4,59354 \times 13,44\%) \\
 &= R246\,948,71 - R229\,909,24 \\
 &= R17\,039,47
 \end{aligned}$$

An owner that is obligated to refund only a portion of the loan on death or cancellation of the agreement must include the amount not refundable in gross income in the year of assessment in which the loan is granted and paid by the person acquiring the life right.

Example 2 – Full loan amount not refundable

Facts:

The agreement between the owner and the life-right holder provides that only 80% of the interest-free loan of R900 000 is refundable on death.

Result:

The owner must include R180 000 (20% x R900 000) in gross income in the year of assessment in which the loan is granted and paid by the life-right holder.

In addition, an amount equal to the monetary value, calculated in respect of the right to use the interest-free loan, must be included in the owner's gross income in the year of assessment in which the loan is granted and paid.

Note: For purposes of calculating the monetary value, symbol "B" in the formula is 80% x R900 000 = R720 000.

In the case of an interest-free loan, the benefit to retain and use the interest-free loan will accrue to the owner on the date the loan has been granted and paid by the person acquiring the life right.

Example 3 – Date of accrual of an interest-free loan*Facts:*

B retired on 30 March 2012 and entered into an agreement with a retirement village owner. Under the agreement, B will be entitled to occupy a particular unit in exchange for the grant of the use of an interest-free loan of R400 000. The agreement is concluded on 15 February 2012. B undertook to pay the R400 000 on receipt of his lump sum benefit from his pension fund. He paid over the R400 000 to the retirement village owner on 12 June 2012. The year of assessment of the owner ends on 31 December 2012.

Result:

The date of accrual for purposes of calculating the monetary value of the right to use the interest-free loan is 12 June 2012.