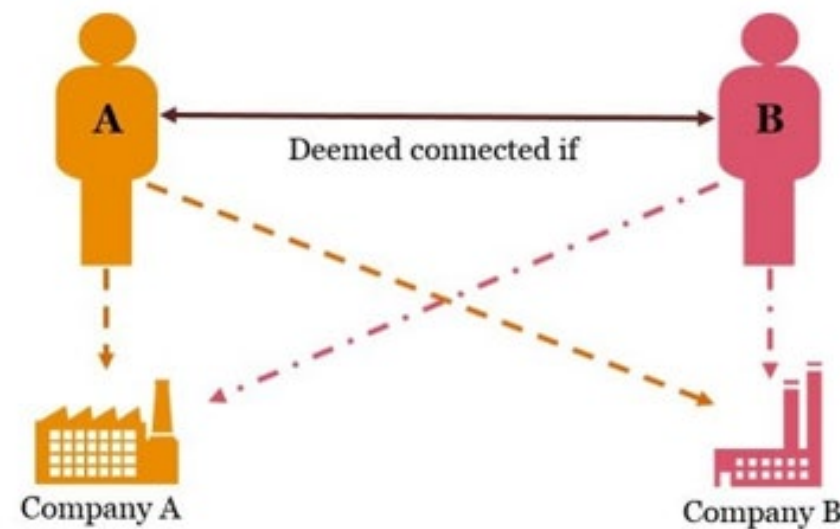


## Tax & Legislative Information Series...

### ... about Connected Persons



Last updated – July 2025  
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- **Some Background**

- A "connected person", as defined in **section 1(1) of the Income Tax Act, goes beyond just relatives**—it includes trusts, companies, partnerships, and anyone who might have an economic or personal interest in another's financial dealings.
- The concept is not about your friendly neighbourhood mechanic hookup—SARS uses this term to **identify relationships that could skew the fairness of transactions for tax purposes**.
- Think spouses, kids, uncles, aunts, in-laws, and even your granny's trust—if there's a **potential for mutual benefit**, SARS wants to know about it.
- SARS' **Interpretation Note 67** goes deep into how this term applies differently depending on the **context**: natural persons, trusts, partnerships, companies, and close corporations.
- The law is especially vigilant when it comes to **non-arm's-length transactions**—deals that are **too sweet to be legit**, often used to avoid tax, shift profits, or smuggle funds across borders.

- **Some Background**

- **Transfer pricing and inflated asset sales** between connected persons are key areas SARS monitors, particularly in cross-border transactions.
- For companies and CCs, holding **20% or more of equity or voting** rights generally triggers connected person status—it's not just about who you know, but how much control you have.
- **Partnerships** are a hot topic too—every partner is connected to the other, and their relatives and trusts, even if they don't know each other.
- The Minister is considering amendments here, especially around **“qualifying investors” in en commandite partnerships**.
- SARS doesn't ban connected transactions, but they **must be at market-related values and arms-length terms**.
- Having a transfer pricing **policy** and, for complex deals, even getting an **Advance Tax Ruling**, is good practice.

- **Definition and Legal Basis**

- "Connected person" is **defined in section 1(1) of the Income Tax** .
- Subsection 1(1)(e) confirms that a person is also connected if they are **related to someone already considered a connected person**.
- The **relationship is reciprocal**, meaning both parties are regarded as connected.

- **Purpose and Importance**

- The definition is central to **anti-avoidance measures** in the Income Tax Act.
- These rules aim to **prevent manipulative transactions** between related parties that could reduce taxable income or shift profits.
- Such transactions are **scrutinised by SARS** more closely than those between unrelated parties.

- **What does the Income Tax Act say?**
  - “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) of which such natural person or such relative is a beneficiary;
    - (b) in relation to a trust (other than a portfolio of a collective investment scheme)—
      - (i) any beneficiary of such trust; and
      - (ii) any connected person in relation to such beneficiary;
    - (bA) in relation to a connected person in relation to a trust (other than a portfolio of a collective investment scheme), any other person who is a connected person in relation to such trust;
    - (c) in relation to a member of any partnership or foreign partnership—
      - (i) any other member; and
      - (ii) any connected person in relation to any member of such partnership or foreign partnership;

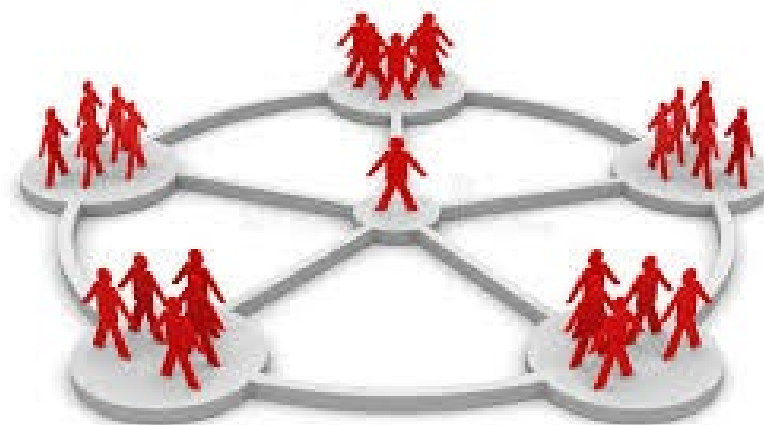
- **What does the Income Tax Act say?**
  - “connected person” means—
    - (d) in relation to a company—
      - (i) any other company that would be part of the same group of companies as that company if the expression “at least 70 per cent of the equity shares in” in paragraphs (a) and (b) of the definition of “group of companies” in this section were replaced by the expression “more than 50 per cent of the equity shares or voting rights in”;
      - (iv) any person, other than a company as defined in section 1 of the Companies Act that alone or together with any connected person in relation to that person, holds, directly or indirectly, at least 20 per cent of—
        - (aa) the equity shares in the company; or
        - (bb) the voting rights in the company;[words preceding item (aa) substituted by section 4(1)(b) of Act 20 of 2021; effective date 19 January 2022, date of promulgation of that Act]

- **What does the Income Tax Act say?**
  - “connected person” means—
    - (cc) any other close corporation or company which is a connected person in relation to—
      - (i) any member contemplated in item (aa); or
      - (ii) the relative or trust contemplated in item (bb); and
    - (e) in relation to any person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person:
  - Provided that for the purposes of this definition, a company includes a portfolio of a collective investment scheme;



- **Interpretation Note 67**

- On 28 January 2020, SARS issued Interpretation Note 67 to provide **clarity on the term “connected persons”** as defined in section 1(1) of the Income Tax Act .
- This guidance is important, as individuals and entities may **unknowingly fall within this definition**, which has **implications for tax compliance** and anti-avoidance provisions.





- **Interpretation Note 67**
  - **Categories of Connected Persons**
    - The note sets out different contexts in which a person or entity is considered connected:
      - **Natural Persons:** Includes close relatives (such as spouses, children, parents, siblings) and any trust where the person or their relative is a beneficiary. Collective investment schemes are excluded.
      - **Trusts:** Any beneficiary and those connected to the beneficiary fall under this category.
      - **Partnerships:** All members are connected to each other, as well as to anyone connected to the other members.
      - **Companies:**
        - Other companies forming part of the same group (i.e., where 50% or more of shares or voting rights are held).
        - Individuals or entities (excluding companies) who, alone or with a connected person, hold at least 20% of shares or voting rights.
        - Companies controlled or managed by a connected person, or by someone connected to that person.

- **Interpretation Note 67**

- Categories of Connected Persons

- The note sets out different contexts in which a person or entity is considered connected:

- **Close Corporations (CCs):** Includes any member, their relatives, related trusts, and any company or CC connected to those individuals or trusts.
      - **General Rule (Subsection 1(1)(e)):** If a person is connected to someone, that other person is also automatically connected to them, forming a reciprocal relationship.

- **Why It Matters**

- The concept of “connected persons” is **crucial to many anti-avoidance rules in the Income Tax Act.**
  - These rules are designed to **prevent tax manipulation** through transactions between related parties, which may not be conducted at market value or on fair commercial terms.

## About – Connected Persons

- **Timing of the Relationship**
  - The timing of determining whether parties are connected is **typically assessed at the point of the transaction**.
  - However, some provisions consider a **broader timeframe**, such as whether the connection existed at any time during the tax year.
- **Practical Considerations**
  - Taxpayers should be aware of how easily they may fall within the connected persons net, even without intent.
  - These rules can trigger significant tax consequences, particularly where non-arm's-length transactions occur.



- **What is a connected person?**

- A Connected Person (in terms of a human being) is defined as either:
  1. A relative of yours, including your -
    - Spouse (i.e a partner in a marriage or union recognised in terms of law or any religion, or in a same sex or heterosexual union which the Commissioner is satisfied is intended to be permanent)
    - Children
    - Grandchildren
    - Great-grandchildren
    - Parents
    - Grandparents
    - Great-grandparents
    - Brothers and sisters
    - Nephews and nieces
    - Uncles and aunts

In addition, all of the above relatives of that person's spouse would be relatives of the person, as well as the spouses of any of those relatives.

2. Any trust of which you or a relative of yours is a beneficiary

- **Practical Risks and Concerns**

- SARS is concerned that **connected party transactions may not reflect market value or commercial intent.**
- Common risk areas include:
  - **Overstated asset sales** (e.g., selling personal business assets to a company at inflated prices to claim larger tax deductions).
  - **Transfer pricing abuse** in cross-border setups where profits are shifted to low-tax jurisdictions.
  - **Exchange control violations** where funds are moved out of South Africa without proper authorisation.



- **Compliance Expectations**

- Legitimate transactions between connected persons **are allowed**, provided they **occur at arm's length and fair market value**.
- **SARS audits** frequently focus on such transactions, so maintaining a formal transfer pricing policy is encouraged.
- In complex cases, obtaining an **Advance Tax Ruling from SARS** may be advisable.



- **Proposed Legislative Review: Partnerships**

- The connected person definition in relation to partnerships is seen as overly broad and complex.
- Under **paragraph (c)** of the definition, **all partners are automatically connected**, including those who **may not even know each other**.
- This has practical implications in **limited partnerships** (e.g., en commandite), where partners may be unaware of their connection status.
- The Minister has **proposed reviewing** the definition, particularly in relation to “qualifying investors” (partners whose liability is limited to their contribution).
- It is unclear how the review will proceed, but it may seek to exclude passive investors from being automatically treated as connected persons.

- **Why is this important from a payroll perspective**
  - **Employment Tax Incentive (ETI):**
    - If an employee is a connected person (e.g., the child of a director), they may be excluded from ETI eligibility.
    - Claiming ETI for such individuals could result in penalties or SARS disallowing the incentive on audit and ultimately interest on understated payments.
  - **Tax-Free Bursaries (Section 10(1)(q)):**
    - A bursary granted to a relative of an employee (i.e., a connected person) is only tax-exempt if the employee earns less than R 600 000.00 annually and other conditions are met.
    - Misclassifying relationships can cause bursaries to be taxable (or not taxable) in error.



- **Why is this important from a payroll perspective**
  - **Fringe Benefits & Remuneration Planning:**
    - Providing company cars, loans, or other benefits to connected persons must be handled with care to ensure these are taxed appropriately at arm's length values.
    - SARS may reclassify or revalue fringe benefits if transactions are not market-related.
  - **Payroll Compliance & Disclosure:**
    - Connected person rules are central to disclosure obligations under anti-avoidance legislation.
    - Failure to correctly identify and disclose connected relationships may flag non-compliance during payroll tax audits.
  - **Share Option and Equity Schemes:**
    - When allocating shares and options, employees or persons related to directors/owners must be assessed for connected person status, which can affect section 8C taxation and anti-avoidance provisions.

- **Why is this important from a payroll perspective**
  - **UIF/SDL and Remuneration Reporting:**
    - Certain connected person arrangements may distort remuneration calculations, especially where independent contractor status is incorrectly applied to family members or trusts.
    - This impacts UIF/SDL declarations and SARS reconciliations.
  - **Independent Contractor vs Employee Tests:**
    - Connected relationships raise red flags during SARS audits—particularly when payments are made to individuals or entities closely tied to the employer.
    - This can result in SARS reclassifying contractors as employees for tax purposes.

- **In Summary**

- Defined in section 1(1) of the Income Tax Act, a connected person includes relatives, trusts, business partners, and shareholders with significant influence (typically 20%+ ownership).
- SARS' Interpretation Note 67 outlines how this applies to natural persons, trusts, partnerships, companies, and close corporations.
- The concept is vital to anti-avoidance rules, which aim to prevent tax manipulation through non-arm's-length transactions between related parties.
- Timing matters: connected person status is generally assessed at the time of a transaction, but some rules apply over the full year of assessment.
- Being connected can have unintended tax consequences, even if the relationship is not obvious or intentional.
- It's good practice to ensure market-related pricing and consider SARS compliance steps like a transfer pricing policy or Advance Tax Ruling.



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