



# Tax & Legal - News Alert

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## Change in VAT treatment of scrip-lending transactions

Practice Note 5 (PN 5) issued by SARS on 14 April 1999 deals, *inter alia*, with the Income Tax and Value-Added Tax (VAT) treatment in respect of scrip-lending transactions.

In essence, scrip-lending involves the lending of shares and other securities (hereinafter collectively referred to as “securities”) to a borrower, who agrees to return the same quantity of similar securities to the lender on an agreed future date. Despite the term “lending”, it is important to note that ownership in the securities transfers to the borrower, with the result that the borrower takes the risk and/or benefit in the price fluctuation of the securities and is entitled to any dividends which may be declared in respect of such securities for the period of the loan. Lenders generally charge a scrip lending fee to the borrower and the loan agreement most often provides that the borrower also needs to pay any dividends or interest accrued to it to the lender (i.e. so-called manufactured dividends or manufactured interest). Since scrip lending is not without risks, the loan agreement typically requires that the borrower provides collateral to the lender and the borrower is generally entitled to receive interest from the lender on the collateral provided.

From a VAT point of view, PN 5 provides that the scrip lending transaction is a deemed financial service in terms of sections 2(1)(c) or (d) or (f) of the VAT Act, depending on the nature of the securities, with the result that the transfer of ownership in the securities, manufactured dividends and manufactured interest are exempt from VAT in terms of section 12(a) of the Act. However, since the proviso to section 2(1) provides, *inter alia*, that the activities contemplated in sections 2(1)(c), (d) and (f) are deemed not to be financial services to the extent that the consideration payable in respect thereof is any fee, commission, merchant’s discount or similar charge, PN 5 provides that the scrip lending fee is subject to VAT.

SARS issued a Draft Binding General Ruling (Draft BGR) on 9 December 2022, which is to replace PN 5 with effect from 1 April 2023. In terms of the Draft BGR, SARS now considers scrip lending transactions to constitute the provision of credit, envisaged in section 2(1)(f). SARS further considers that since the scrip lending fee does not relate to any other service forming part of the scrip lending transaction, but solely for the use of the securities, the proviso to section 2(1) does not apply, with the result that the scrip lending fee is also an exempt financial service.

The change in interpretation by SARS is consistent with a recent Binding Private Ruling issued by SARS dealing with the VAT treatment of gold loans. Here too, ownership in the gold transfers to the borrower, who is often obligated to pay an amount to enter into the loan, to provide collateral, to pay interest for the duration of the loan and to return an identical quantity and purity of the gold borrowed from the lender to the lender.

Vendors entering into scrip lending transactions will also need to consider the impact of the above when calculating the apportionment ratio to be applied to VAT incurred on dual use expenses.

Should you have any queries, please do not hesitate to contact us.



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Kind Regards

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