TAX UPDATE

For period: 1 October 2018 to 31 December 2018

Prepared by: Johan Kotze

JK TAX SPECIALISTS

Shepstone & Wylie ATTORNEYS

TABLE OF CONTENTS

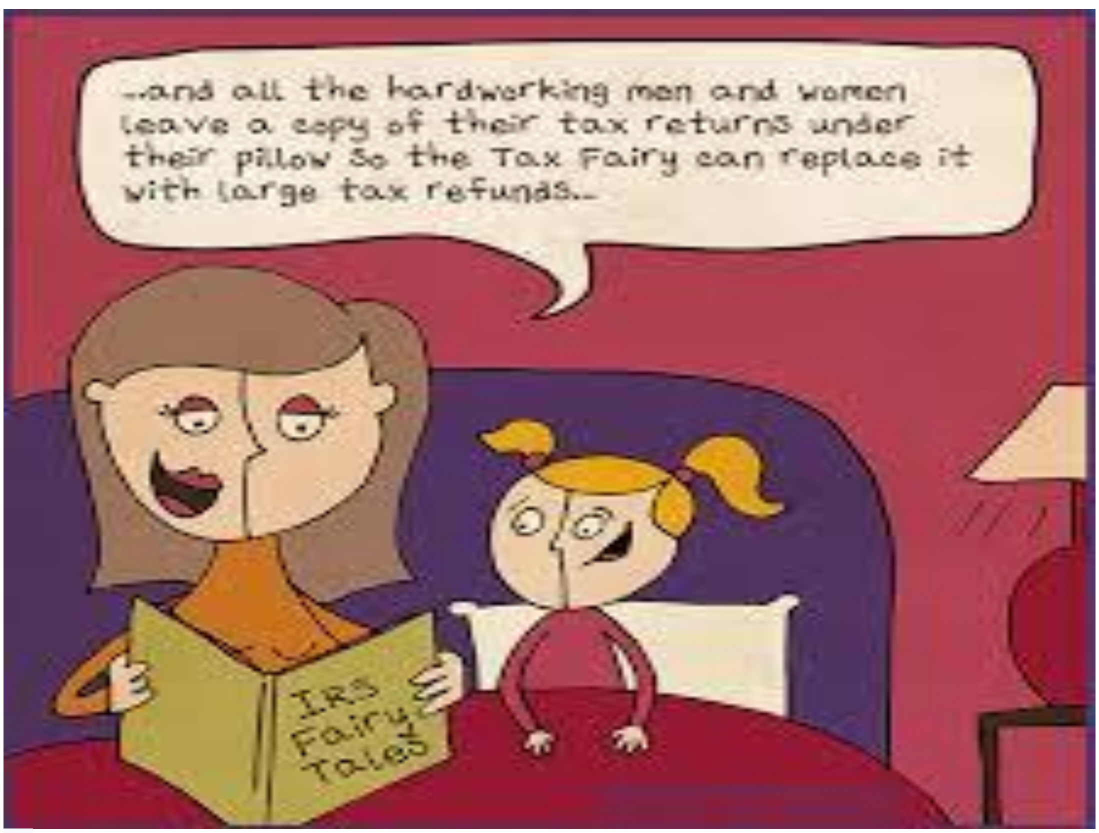
1. INTRODUCTION

The purpose of this update is to summarise developments that occurred during the fourth quarter of 2018, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

The aim of this summary is for readers to be exposed to the latest developments and to consider areas that may be applicable to their circumstances. Readers are invited to contact Johan Kotze to discuss their specific concerns and, for that matter, any other tax concerns.

Interpretation notes, rulings and guides are all important aspects of the developments that took place, as they give taxpayers an insight into SARS' application of specific provisions.

Enjoy reading on!



…

2. REGULATIONS

2.1. Physical impairment or disability expenditure prescribed by SARS in par. (c) of the definition of 'qualifying medical expenses' under section 6B(1) of the Income Tax Act

Expenditure prescribed by SARS and which is necessarily incurred and paid for by the taxpayer in consequence of a physical impairment or disability is a qualifying medical expense in terms of section 6B of the Act, subject to certain limitations.

The terms 'necessarily incurred' and 'in consequence of' are not defined in the Act.

Therefore, they retain their ordinary dictionary meaning. This means that a prescribed expense does not automatically qualify as a qualifying physical impairment or disability expense by mere reason of its listing. The expense must also be necessary for the alleviation of the restrictions on a person's ability to perform daily functions.

For example, if a wheelchair user without visual impairment buys a hand-held Global Positioning System (GPS), the cost of the hand-held GPS will not qualify under section 6B of the Act even though the expense is prescribed in the list. This is so because the hand-held GPS is not directly connected to this person's disability and hence is neither necessarily incurred nor incurred in consequence of this person's disability. In the case of a person who is, for example, visually impaired, the cost of the hand-held GPS may qualify.

Definitions

Disability

The term 'disability' is defined in section 6B(1) of the Act as follows:

'disability' means a moderate to severe limitation of any person's ability to function or perform daily activities as a result of a physical, sensory, communication, intellectual or mental impairment, if the limitation:

(*a*) has lasted or has a prognosis of lasting more than a year; and (*b*) is diagnosed by a duly registered medical practitioner in accordance with criteria prescribed by SARS.

Physical impairment

The term 'physical impairment' is not defined in the Act. However, in the context of section 6B of the Act it has been interpreted as a disability that is less restraining than a 'disability' as defined. This means the restriction on the person's ability to function or perform daily activities is mild.

Qualifying medical expenses

Paragraph (*c*) of the definition of 'qualifying medical expenses' in section 6B(1) of the Act refers to expenditure that is prescribed by SARS (other than expenditure recoverable by a person or his or her spouse) necessarily incurred and paid by the person during the year of assessment in consequence of any physical impairment or disability suffered by the person or any dependant of the person.

Dependant

For purposes of section 6B of the Act, the term 'dependant' means a person's spouse; a person's child (or child of his or her spouse); any other member of a person's family in respect of whom he or she is liable for family care and support; and any other person who is recognised as a dependant of that person in terms of the rules of a registered medical scheme or similar foreign fund at the time that the qualifying medical expenses were necessarily incurred and paid.

School

For purposes of this list, any reference to a school means a public school or an independent school which enrols learners in one or more grades from grade R (Reception) to 12.

Additional medical expenses tax credit

Disability

In terms of section 6B(3)(*b*) of the Act, a taxpayer who has or whose spouse or child has a 'disability' as defined (that is, in accordance with criteria prescribed by SARS for SARS in the ITR-DD form), will be able to claim qualifying medical expenses (inclusive of VAT) under section 6B of the Act as an additional medical expenses tax credit. The additional medical expenses tax credit equals 33% of the aggregate of:

- qualifying medical expenses paid by the person; and
- medical scheme fees as exceeds three times the medical scheme fees tax credit as calculated under section 6A of the Act.

Physical impairment

In terms of section 6B(3)(*c*) of the Act, a taxpayer who has or whose dependant has a physical impairment that is not a 'disability' as defined, will be able to claim qualifying medical expenses (inclusive of VAT) under section 6B of the Act as an additional medical expenses tax credit. The additional medical expenses tax credit equals 25% of the aggregate of:

- qualifying medical expenses paid by the person; and
- medical scheme fees in excess of four times the medical scheme fees tax credit as calculated under section 6A of the Act,

as exceeds 7,5% of the person's taxable income (excluding taxpayers 65 years and older, who would be entitled to an additional medical expenses tax credit).

The prescribed list of expenditure for purposes of paragraph (*c*) of the definition of 'qualifying medical expenses' in section 6B(1) of the Act is set out below: NATURE OF EXPENSE

PERSONAL CARE ATTENDANT EXPENSES

Expenditure prescribed by SARS under this category is as follows:

- A salary paid to a person who is employed on a full time basis to care and look after the needs of a person with a disability. However, if the person is employed on a full time basis to perform housekeeping activities, the salary paid to such person will not qualify.

- Living-in expenses for a live-in personal care attendant, which is limited to the additional cost of electricity, water and food as a result of a live-in personal care attendant, is deemed to be 20% of the annual domestic worker minimum wage under Area A of the Sectoral Determination 7 for Domestic Workers.

  If more than one live-in personal care attendant is employed on a full time basis at the same time, the amount which can be claimed may not exceed 20% (per personal care attendant) of the annual domestic worker minimum wage under Area A of the Sectoral Determination 7 for Domestic Workers.

  Note:

  - Spouses as defined in section 1 of the Act, and your or your spouse's parents or grandparents are not regarded as personal care attendants for the purposes of this list.
  - If the live-in personal care attendants alternate days, the living-in expenses are limited to one live-in personal care attendant.

- Cost of training a personal care attendant or a family member to take care of a person with disability. This refers to relevant courses or training undergone by a personal care attendant or family member who will care for a person with a disability. The cost must be paid to a service provider who is in the business of providing such training.
- Accommodation expenses paid for a personal care attendant for the purposes of training or business and holiday travel of the person with a disability.
- Accommodation expenses for the purposes of training for a family member.

<u>TRAVEL AND TRANSPORTATION</u>

Expenditure prescribed by SARS under this category is as follows:

- Travelling expenses incurred and paid by the taxpayer to acquire qualifying goods or services under this list, including the maintenance of such goods.

- Travelling expenses incurred and paid by the taxpayer for the purposes of training as contemplated under A3 of this list.
- Transportation costs specifically incurred and paid in respect of a learner with a disability who attends a special educational needs school (under the circumstances referred to in F7) in instances where such school is not available within a 10 km radius from where the person lives. Please note that only the transportation costs in respect of kilometres exceeding the 10 km radius can be claimed.
- Transportation costs incurred and paid to transport a person with a disability to and from home to a protective workshop, if the following conditions are met:
    - The person must, due to the nature of his or her disability, have no reasonable prospect of finding employment in the open labour market;
    - The person must need daily care and supervision;
    - The person must be a 'child' as contemplated in section 6B(1) of the Act, who has a 'disability' as defined in section 6B(1) of the Act; and
    - The protective workshop must be a Public Benefit Organisation approved by SARS in terms of section 30(3) of the Act.

    Note:

    For purposes of this list, a crèche will not qualify as a protective workshop.
- Transportation costs incurred and paid in respect of a personal care attendant while away from the primary residence of a person with a disability. For example, if the person with a disability is going away on business or on holiday accompanied by a personal care attendant, the actual cost of travel by air, train, bus or taxi, in respect of the personal care attendant, will be deductible.

    Note:

    - Where a taxpayer has used a private motor vehicle for transportation other than in respect of B5, and accurate records of qualifying kilometres are kept, SARS will accept the estimate of the expenses incurred by using the rate per kilometre prescribed by the Minister of Finance under paragraph 4 of the Income Tax Regulation titled ‘Fixing of rate per kilometre in respect of motor vehicles’.

- Travelling must be to the nearest place where the goods or services can be acquired, serviced or repaired.
- Transportation costs incurred and paid in respect of transporting care attendants from home to work or *vice versa* do not qualify.

INSURANCE, MAINTENANCE, REPAIRS AND SUPPLIES

Expenditure prescribed by SARS under this category is:

Insurance, maintenance, repairs and supplies (including batteries), only in respect of qualifying goods that fall under this list.

Note:

The qualifying goods insured must be specified in the insurance policy.

PROSTHETICS

Expenditure prescribed by SARS under this category is:

Cost of prosthetic limbs.

AIDS & OTHER DEVICES

Expenditure prescribed by SARS under this category is as follows:

- Computer devices and related equipment (for example, track ball) including the software to operate such devices, required by a person with a disability due to a moderate to severe impairment in hand function or visual ability.
- Cell phone applications required by a person with a disability due to a moderate to severe impairment in visual or hearing ability (note that this excludes the actual cost of the cell phone).

- Computer software or other electronic equipment required in order to convert printed material or image files into text, Braille, speech or any other accessible format, including peripheral equipment such as scanners and Braille printers.
- Converted, printed and graphical material, including talking, Braille and large print textbooks and maps or drawings for a person with a disability.
- Helmets (protective gear) used by persons with epilepsy to prevent injury, especially head injuries during seizures.
- Home assistive tools (without which performing a task would not be possible) that enable a person with a disability to perform tasks of daily living.

  Examples:

  - Utensil hand-clip eating aid for persons who struggle to grasp and hold small utensils; reaching aids that assist a person to grasp hard-to-reach items more easily.
  - Adhesive bump dots used to differentiate settings on, for example, home appliances like an oven.
- Magnification and image-enhancement devices that enable a person to read, such as optacons, large-screen computer monitors, magnifiers, video magnifiers, CCTV readers, video goggles, electronic magnifiers (that plug into a computer, monitor or TV) and telescopic spectacles.
- Mobile ramps and tie-downs used to assist wheelchair users to move in and out of vehicles or buildings that have no ramps.
- Mobility aids, including wheelchairs, wheelchair carriers, crutches and walking frames.
- Bathroom aids to help a person in or out of a bath or shower or to get on or off a toilet.
- Navigation aids, including white canes, sonic or obstacle learning

(echolocation) devices and hand-held GPS devices and related software required by a person with a moderate to severe visual impairment.

- Orthopaedic shoes, boots and inserts, including braces, as well as standard shoes and boots used by a person who walks with an unsteady gait when not using such aid.
- Page-turning devices used to assist a person to turn the pages of a book or other bound document where the disability moderately or severely restricts their ability to use arms or hands.
- Prescription spectacles and contact lenses will qualify to the extent that these amounts have not been recovered from a medical scheme.
- Pressure care mattresses and body positioners to prevent pressure sores and correct postural alignment for persons with a spinal cord injury.
- Signalling devices – emits light instead of sound (for example, light emitting doorbell).
- Amplification, loop systems specifically designed to assist hearing and other ssistive listening devices to be used by a person who has a hearing impairment (including related accessories), excluding cochlear implants and FM systems.
- Money templates used to differentiate between various denominations of notes and coins.
- Speech-generating devices and communication boards that enable a person to communicate, including a relevant keyboard for a person with a moderate to severe speech impairment. Specialised anti-glare and flicker free screens – for televisions and computers used by a person with photosensitive epilepsy to minimise exposure to seizures. This includes laryngectomy speaking valves and accessories.
- Talking, sound-making and vibrating devices that enable a person to perform daily tasks. For example, talking calculators, adapted watches and clocks, shake awake alarms, talking kitchen scales, light detectors and

liquid level indicators, etc.

- Seizure alert devices (e.g. mattress sensor alarms, watch devices, anti-suffocation pillows, seizure alert camera), excluding standard camera devices.
- Teletypewriters or similar devices required by a person with a hearing impairment to make or receive phone calls where the impairment is moderate to severe.
- Television closed-caption decoders or readers required by a person with a moderate to severe hearing or visual impairment.
- Word-to-text devices – for a person with a disability that causes a moderate to severe impairment in hand functions; or visual or hearing impairments as experienced by some persons with Cerebral Palsy.
- Toilet seats, bath seats, shower seats or commode chairs specially designed for use by persons with a physical disability.
- Lifts specially designed to move persons with physical disabilities.
- Grab rails or hoist placed in such a way as to aid a person with a physical disability.
- Stair chairs specifically installed to aid a person with a physical disability.

  Note:

  The cost of electricity needed to operate these devices will not be a qualifying expense.

<u>SERVICES</u>

Expenditure prescribed by SARS under this category is as follows:

- Deaf-blind intervening services.
- Lip-speaker services.
- Note-taking services, including real-time captioning.
- Reading services.

- Rehabilitative therapy to teach a person to function or perform basic daily activities (for example, how to use a wheelchair, dressing, grooming etc.).
- Sign-language interpretation services used by a person with a hearing impairment.
- Special education needs schools mainly for learners with disabilities. Qualifying expenses will include –
    - school assistant, if not part of the school fees;
    - school fees in respect of a private special education needs school, limited to the amount in excess of the fees that would ordinarily be payable if the person attended the closest fee-paying private school (not specialising in learners with special education needs) to where they live; and
    - school fees in respect of a public special education needs school, limited to the amount in excess of the fees that would ordinarily be payable if the person attended the closest fee-paying public school (not specialising in learners with special education needs) to where they live.
- School not mainly for learners with special educational needs – limited to the difference between fees paid for the learner with disability and a leaner without disability in the same school.
- An amount paid by a taxpayer, who is a parent of a child with a physical disability, to make the school accessible to the child, for example, building a ramp (which the school could not afford to do). However, should the school issue a section 18A donation receipt in this regard; the amount will not be a qualifying disability expense under this list. The amount, for which the receipt was issued, can be claimed as a deduction against income under the provisions of section 18A of the Act.
- Tutoring services used by a person with a disability, and which are supplementary to the primary education of a person with a learning

disability or impairment in intellectual or mental functions, and paid to someone in the business of providing such services who is not related to the person being tutored.

- Motor vehicle driving services for a person with a disability.
- The cost of adjustments to clothing in order to ensure ease of dressing.

Note:

Only services that are acquired from an independent service provider, who is not a connected person (as defined in section 1(1) the Income Tax Act) in relation to the taxpayer (unless the spouse or family member is in the business of providing such service), will qualify.

CONTINENCE PRODUCTS

Expenditure prescribed by SARS under this category is as follows:

- Catheters, catheter trays, tubing and associated products required for catheter use, as a concomitant to the disability.
- Colostomy, urostomy, and ileostomy and colostomy products, and associated products and aids, as a concomitant to the disability.
- Nappies, disposable briefs, pads, linen and mattress savers used by a person for the management of continence, as a concomitant to the disability.
- Anal-irrigation kits (in respect of bowel management).
- Disposable examination gloves or disposable sterile gloves used by a person in the management of continence, as a concomitant to the disability. Washable undergarments and other washable accessories used by a person in the management of continence, as a concomitant to the disability.

SERVICE ANIMALS

Expenditure prescribed by SARS under this category is as follows:

- The cost of an animal specifically trained to be used as an aid to perform daily functions.

- The care and maintenance (including food and veterinary care) of such an animal.

ALTERATIONS OR MODIFICATIONS TO ASSETS ACQUIRED OR TO BE ACQUIRED

Expenditure prescribed by SARS under this category is the cost of:

- Buying and installing outdoor ramps to a person's primary residence where a stairway impedes the person's mobility with a physical disability.
- Enlarging passage ways, bathrooms and doorways to give the person wheelchair-access to the various rooms of the primary residence.
- Lowering existing kitchen or bathroom cabinets to give the person with a disability access to them.
- Auxiliary driving controls to a motor vehicle that enable a person with a disability to operate the motor vehicle.
- Modifying a motor vehicle to adapt it for transporting persons with a physical disability.
- If you received the International Trade Administration Commission (ITAC) rebate on the fully imported modified motor vehicle, then no modification cost can be claimed. If you did not receive the ITAC rebate, only the ascertainable costs in respect of the modification of the motor vehicle are a qualifying expense under this list.

  Note:

  If the vehicle is imported unmodified and only modified in South Africa, the taxpayer can claim the cost of the modification less the rebate.
- Alarm systems – modifications to an alarm system to enable a person with a disability to use or operate it. For example, modifications to the alarm system to emit a red light instead of making a sound (used to warn a person with a hearing impairment that the alarm has been activated) will

qualify.

- The cost of automating doors and gates for a person with a physical disability.

  Note:

  Renovation and construction expenses covered under I1 to I3 must be reasonable and meet the following conditions:

  - They would not typically increase the value of the asset; and
  - They would not typically be incurred by persons who do not have a moderate to severe mobility impairment.

  Expenses are more likely to be considered reasonable if the materials used are similar to existing materials.

3. TAX CASES

3.1. Red Ant Security Relocation and Eviction Services (Pty) Ltd v C:SARS

Red Ant, who had been tax compliant, derived some 96% of its income from the provision of public services to public and municipal entities, including essential services such as emergency accommodation and temporary water supply.

Red Ant, without a valid tax clearance certificate, could not receive payment for its services, nor tender to provide new services, thus creating severe financial constraints and it was not disputed that its business was on the brink of closure and that some 11 000 employees' jobs were at risk and that some nine municipalities would be left without services if Red Ant's business ceased to operate.

The documents before the court revealed that SARS, had in November 2017 approved Red Ant's deferred tax payment request which lapsed on 31 March 2018 and there was still an outstanding tax liability for which no payment arrangement had been made.

SARS contended that once the deferred payment agreement had lapsed by operation of law, Red Ant was no longer entitled to a tax clearance certificate because of its outstanding tax liability and that outstanding tax liability was in dispute between the parties.

Following termination of Red Ant's tax compliance status by SARS, it sought urgent interdictory relief in the High Court aimed at reinstatement of its tax compliance status so that it could generate a tax clearance certificate pending the determination of review proceedings instituted by it.

Red Ant contended that SARS had failed to comply with the procedural requirements of section 256(6) of the Tax Administration Act, the Promotion of Administrative Justice Act (PAJA) and the Constitution in revoking Red Ant's tax compliance status without affording it the required notice.

Red Ant contended that the only provision in terms of which its tax compliance status could be altered was under section 256(6) of the Tax Administration Act which regulated tax compliance status.

It was common cause between the parties that no notice was given by SARS of its intention to revoke Red Ant's tax compliance status and the failure to provide any notice formed the subject-matter of the review application.

SARS contended that it was not necessary to provide notice or to afford Red Ant an opportunity to be heard as a payment deferral agreement concluded between the parties had lapsed on 31 March 2018 and there was still an outstanding tax liability for which no payment arrangement had been made.

SARS further denied that it had revoked Red Ant's tax compliance status and contended that it had lapsed by operation of law.

SARS further relied on sections 256(3) and 167(3) of the Tax Administration Act and contended that it had no duty in law to notify Red Ant as the deferral agreement only remained in effect for the term of the agreement and once the agreement had lapsed by operation of law, Red Ant was no longer entitled to a tax clearance certificate because of its outstanding tax liability and this was in dispute between the parties.

SARS further disputed the urgency of the application on the basis that it was self-created.

Judge Dippenaar held the following:

As to the requirement of establishing a prima facie right

(i) That the application was indeed urgent and that Red Ant had illustrated that it would not be afforded substantial redress at a hearing in due course.

(ii) That the first requirement for the granting of interim interdictory relief was that Red Ant must illustrate a prima facie right, although open to some doubt.

(iii) That the central dispute between the parties relevant to the present application was one of law, rather than fact. The merits of the tax dispute between the parties was not an issue which the court could determine and will be dealt with in an appropriate forum in due course.

(iv) That the primary complaint of Red Ant was SARS' failure to afford it the right to be heard ('the audi principle'), a right integral to the constitutional scheme and the procedural aspect of the rule of law and it was common cause that the audi principle was not adhered to.

(iv) That the court was mindful not to pre-empt determination of the issues which will ultimately be determined by the review court and did not attempt to interpret the various sections in the Act on which the respective parties relied or express any view regarding the ultimate success of the review application.

(v) That, irrespective of whichever statutory interpretation is ultimately determined to be correct, on the available facts Red Ant had sufficiently illustrated on a prima facie basis that it had the right to administrative justice and procedural fairness consistent with the provisions of section 3 of PAJA.

As to the issue of irreparable harm

(vi) That SARS had put up no facts to controvert the undisputed evidence put up by Red Ant of the present and ongoing harm suffered by Red Ant and the court was satisfied that Red Ant had illustrated a threat by an impending or imminent irreparable harm.

As to the balance of convenience

(vii) That in adjudicating the balance of convenience, a comparison is required of the prejudice suffered by Red Ant if the interim relief is not granted, but its review is upheld, and the prejudice which SARS will suffer if the interim relief is upheld but the review dismissed.

(ix) That the prejudice to Red Ant and its employees was self-evident and the assessment of the wider general public must also be taken into account in assessing the balance of convenience.

(x) That, on the other hand, SARS contended that if the interim relief were granted, it would be constrained to afford Red Ant tax compliance status pending the determination of the review application, irrespective of whether Red Ant is tax compliant or not and it would restrain SARS, a state functionary, from exercising its statutory or constitutionally authorised power.

(xi) That there was merit in the aforementioned contention if relief was to be granted in broad terms without any suitable qualification and SARS was prevented from exercising its statutory powers against Red Ant for any future tax transgressions pending the determination of the review application.

(xii) That an appropriate qualification to the interdictory relief sought, would ensure that there was no risk to SARS being constrained from exercising its statutory rights in a lawful manner, pending the determination of the review application. If there are any grounds on which Red Ant's tax clearance certificate should be revoked and due process is followed, the interim relief will not present a bar to any future lawful action on the part of Red Ant.

(xiii) That, in the circumstances, the balance of convenience favours the granting of interim relief.

As to whether an alternative remedy is available to Red Ant

(xiv) That SARS contended that Red Ant had a suitable alternative remedy, being to approach it for the conclusion of a further deferral agreement, which would render Red Ant tax compliant and result in it being able to obtain a tax clearance certificate. However, this argument assumes that such an agreement would indeed be concluded and did not cover the eventuality that the parties are unable to conclude such an agreement on mutually acceptable terms. Moreover, such request is not a remedy for appealing SARS' decision or its failure to apply the audi alteram partem principle.

(xv) That, therefore, the court was satisfied that Red Ant had no alternative remedy in the circumstances.

(xvi) That, accordingly, Red Ant was entitled to the interdictory relief sought, subject to a proviso which ensured that SARS' performance of its statutory duties was not hampered or infringed.

As to the costs

(xvii) That both parties had sought a punitive costs order against the other based on its conduct in relation to the matter but the court was not convinced that the granting of a punitive costs order would serve the interests of justice and hence the normal principle that the costs should follow the result should apply as there were no grounds to deviate from this principle in the circumstances of this matter.

SARS ordered to restore Red Ant's tax compliance status within 24 hours to enable it to generate a tax clearance certificate subject to the proviso that SARS was not prohibited thereby from exercising any of its statutory rights and duties in relation to Red Ant's future tax compliance status in accordance with section 256(6) of the Tax Administration Act.

3.2. Crookes Brothers Ltd v C:SARS

Crookes Brothers was a member of a group of companies which produced a variety of agricultural products in South Africa, Swaziland, Zambia and Mozambique.

Crookes Brothers' subsidiary, Murrimo Macadamias Limitada (MML) was 99% owned by it and was incorporated in Mozambique where it farmed macadamia nuts as well as grain and vegetables.

Upon MML's incorporation in 2012, Crookes Brothers had approved a loan to it in the sum of $1 717 000 to enable it to fund certain costs associated with the establishment of a 700 ha farm from which a macadamia nut crop was expected to be harvested from 2018 and further additional loans totalling $13 750 000 were made by Crookes Brothers to MML in terms of two written loan agreements dated 2 October 2015 and the terms of all the loan agreements were identical.

The following provisions of the loan agreements were relevant for present purposes:

- Clause 3.5 provided that MML shall not be obliged to repay the loan amount in full within 30 years of the approval date, as stipulated in each agreement, or the date on which the loan amount was advanced by Crookes Brothers to MML.
- Clause 3.6 provided that any repayment or redemption of the loan amount in full by MML to Crookes Brothers shall not take place if the market value of the assets of MML are less than the market value of its liabilities as of the date of the payment or redemption.
- Clause 3.7 provides that no interest shall accrue or be payable in respect of the loan amount during any year of assessment.
- Clause 7 provides that, in the event of an application being made for the liquidation of MML, or MML going into bankruptcy or business rescue or similar type proceedings, or judgment having been taken against MML and remaining unsatisfied for a period of 14 days, the agreement shall terminate with immediate effect without the necessity of notice and the loan amount,

or any balance then outstanding, shall immediately become due and payable to Crookes Brothers.

At the end of each year of assessment, after the initial loan was extended by Crookes Brothers to MML, Crookes Brothers and MML entered into a subordination agreement in relation to Crookes Brothers' claim against MML for the repayment of the loan amount outstanding as at the end of the particular financial year.

The relevant subordination agreement provided, inter alia, that the claims of the creditors of MML, both present and future, would rank preferentially to the subordinated claim of Crookes Brothers and the subordination of Crookes Brothers' claim would remain in force and effect for so long only as the liabilities of MML exceed its assets, fairly valued and shall lapse immediately upon the date that the assets of MML exceed its liabilities and shall not, except by further agreement in writing, be reinstated, if thereafter the liabilities of MML shall be deemed to continue to exceed its assets unless and until auditors of international standing have certified in writing that they have been furnished with evidence which reasonably satisfies them that the liabilities do not exceed the assets.

Crookes Brothers, in its income tax return for the 2015 year of assessment, which was submitted to SARS on 25 September 2015, made a transfer pricing adjustment to its taxable income in terms of section 31(2) of the Income Tax Act and a further adjustment in terms of section 31(3) of the Act bringing about a deemed dividend in specie being declared and paid to MML.

Section 31(2) provided, inter alia, that where any transaction constitutes an 'affected transaction', which is defined in section 31(1), the relevant part of which refers to any transaction where that transaction has been entered into or for the benefit of either or both a person that is a resident and a person that is a non-resident, and where any term or condition of that transaction is different from any term or condition that would have existed had those persons been independent persons dealing at arm's length, and results in a tax benefit being derived by a party to that transaction, the taxable income or tax payable by any such person must be calculated as if that transaction had been entered into on the terms and conditions that would have existed had those persons been independent persons dealing at arm's length.

Crookes Brothers had, accordingly, calculated its income tax payable in its return of income for the 2015 year of assessment, based on sections 31(2) and (3) of the Act and it also accounted for payment of dividends tax that was deemed to have been declared and paid to MML in terms of section 31(3).

Crookes Brothers was duly assessed by SARS on 25 September 2015 on the basis of the aforementioned calculations.

Crookes Brothers stated in its founding affidavit in its application to the High Court that it had subsequently established that the adjustment which it had made to its taxable income in terms of section 31(2) of the Act had been incorrectly made, having regard to the terms of the loan agreements as read with the subordination agreement and it relied, in this regard, on the provisions of section 31(7).

Section 31(7) provided, inter alia, that a debt would not be subject to the section 31 transfer pricing provisions where:

- any transaction . . . has been entered into between a company that is a resident . . . and any foreign company in which that resident company . . . directly or indirectly holds in aggregate at least 10 per cent of the equity shares and voting rights and that transaction. . . comprises the granting of financial assistance that constitutes a debt owed by that foreign company to that resident company . . .'
- that foreign company is not obliged to redeem that debt in full within 30 years from the date the debt is incurred;
- the redemption of the debt in full by the foreign company is conditional upon the market value of the assets of the foreign company not being less than the market value of the liabilities of the foreign company; and
- no interest accrued in respect of the debt during the year of assessment.

Crookes Brothers, on 18 December 2015, had submitted a request to SARS for a reduced assessment in terms of section 93(1)(d)(ii) of the Tax Administration Act on the ground that it had met the criteria referred to in section 31(7) and it had highlighted the relevant provisions of the loan agreements as set out above.

Crookes Brothers had submitted that it had made an undisputed error in failing to apply the provisions of section 31(7) in the calculation of its taxable income and, accordingly, pointed out to SARS that its taxable income for the 2015 year of assessment had erroneously reflected normal tax payable in the amount of R6 064 602-52 instead of R4 182 242-12 after reversing the interest adjustment made in terms of section 31(2).

Crookes Brothers, in addition, had submitted a request for a reduced dividends tax assessment in respect of the 09-2015 period based on the application of section 31(7) to the 2015 loans.

Crookes Brothers pointed out that it had made an undisputed error in failing to apply the provisions of section 31(7) in the calculation of its taxable income for the 2015 year of assessment, which gave rise to a higher deemed dividend resulting in an erroneous amount of dividend tax being paid in the sum of R1 062 109 instead of R63 344-25.

The Commissioner for SARS rejected Crookes Brothers' requests for reduced assessments as described above and Crookes Brothers thereafter brought the present application to the High Court to review and set aside the two decisions taken by the Commissioner in terms of section 93(1)(d)(ii) of the Tax Administration Act 28 of 2011.

The question for determination before the court was whether section 31(7) of the Act applied to the loans in issue and therefore such loans were to be excluded from the transfer pricing provisions.

The Commissioner for SARS contended that he was not satisfied that the criteria of section 31(7) of the Act had been met in that the existence of clause 7 of the loan agreement meant that the requirements of ss 31(7)(b) and (c) had not been met and therefore the loan was more akin to debt rather than equity.

The Commissioner was of the view that the possibility existed that any one of the eventualities referred to in clause 7 of the loan agreements may occur within the 30 year period of the loan, that the loans may therefore become repayable in less than

30 years and that the loan agreements did accordingly not meet the requirements of ss 31(7)(b) and (c) and he also disagreed that the subordination agreement rendered clause 7 of the loan agreements inapplicable.

Judge Louw held the following:

(i) That the requirements of section 31(7) were clearly aimed at the nature of the transaction and not at the prevailing facts in a particular year. If, in a particular year, the market value of the assets of the foreign company exceeded the market value of its liabilities, such fact would not trigger the obligation of the foreign company to repay the loan as the foreign company is not obliged to redeem the loan in full within 30 years from the date on which the debt is incurred. It was only after expiry of the 30 year period that the obligation of the foreign company to redeem the loan will depend on whether or not the market value of its assets exceeded the market value of its liabilities.

(ii) That in terms of clause 7 of the loan agreements, the agreements terminate with immediate effect and the loan amount, or any balance then outstanding, becomes immediately due and payable to Crookes Brothers in the event of an application being made for the liquidation of MML, or MML going into bankruptcy or business rescue or similar type proceedings, or judgment having been taken against MML and remaining unsatisfied for a period of 14 days. A situation may therefore arise which obliges the foreign company to repay the loan before the expiry of 30 years and it followed that the loan agreements therefore did not comply with the requirement of section 31(7)(b) and the decision of SARS that the criteria of section 31(7)(b) had not been met, was therefore correct.

(iii) That Crookes Brothers obviously realised what the problem was after its first request for a reduced assessment was rejected, whereafter it submitted its second request which was founded on the contention that the subordination agreement made clause 7 of the loan agreements inapplicable. It was apparent from the terms of the subordination agreement that they did not override clause 7 of the loan agreements or make it inapplicable. They simply regulated the subordination of Crookes Brothers' claim against MML to the claims of other creditors for such time as the liabilities of MML exceeded its assets, during which time Crookes Brothers will not be entitled to the amount or sue for or accept payment of any part of the amount subordinated owing to Crookes Brothers by MML.

(iv) That the clauses in the agreement cannot be interpreted to mean that Crookes Brothers shall not be entitled to claim immediate payment from MML in the event of an application being made for the liquidation of MML or any of the other eventualities provided for in clause 7 of the loan agreements occurring. Its claim will just be subordinated to the claims of other creditors of MML in circumstances where the liabilities of MML exceed its assets, fairly valued.

(iv) That, accordingly, the finding of SARS that the subordination agreement merely changes Crookes Brothers' ranking amongst the creditors of MML, and did not detract from the fact that the loans will become immediately due and payable under the circumstances provided for in clause 7 of the loan agreements circumstances, was therefore correct.

Application dismissed with costs.

3.3. Top Watch (Pty) Ltd v C:SARS

Top Watch had claimed that four sums, being VAT refunds, were due to it in respect of the February 2014, July 2014, August 2014 and July 2017 VAT periods.

There was no dispute that the first three amounts were due and payable but, as to the fourth, being the July 2017 VAT period, SARS had alleged that no refund was due but, rather, the sum of R3 991,67 was owed by Top Watch which had been paid on 29 September 2017.

It was common cause that, notwithstanding the above, SARS had refused to authorise payment of what it had conceded was due and payable, i.e. the VAT refunds claimed by Top Watch.

A legal specialist in the employ of SARS, one Pretorius, had on 7 June 2018 deposed to an affidavit in which he had alleged that Top Watch had been assessed with an income tax liability of R1 760 432,79 and to substantiate this allegation he relied on the supporting affidavit of one Oberholzer, an operational specialist, in which it was said that he had audited the 2012/03-2015/02 income tax of Top Watch between 25 November 2016 until 8 March 2018 and he had concluded that Top Watch owed income tax of R1 760 432,79 as at 16 May 2018.

In order to substantiate the aforementioned allegation, Oberholzer had cited a document attached as POC1 which the court stated was mostly illegible and in regard to which the court was told from the bar that it was an extract of SARS' accounting system and the heading of which read: 'Assessed account remittance data view' and near the bottom was a figure that could be made out to read, probably, R1 760 432,79.

SARS, based on the aforementioned facts, contended that his refusal to pay the VAT refunds in issue was legally correct as there had been a set-off of the income tax liability as evidenced against any VAT refund indebtedness.

Top Watch contended that while the stance of SARS was wrong in law, it did constitute an unequivocal acknowledgement that the VAT refunds were due and payable because that would be a pre-condition for set-off to operate and this submission was confirmed by the court.

The issue to be determined by the court was whether SARS was legally entitled to refuse to pay the VAT refunds in issue to Top Watch on the ground that Top Watch had owed an income tax debt which SARS had alleged was due and payable.

Judge Sutherland held the following:

(i) That the duty to refund tax overpaid was regulated by section 190 of the Tax Administration Act which provides, inter alia, that SARS must pay a refund if a person is entitled to a refund, including interest thereon, of an amount properly refundable under a tax Act and if so reflected in an assessment or the amount erroneously paid in respect of an assessment in excess of the amount payable in terms of the assessment.

(ii) That section 190(2) of the Act provides further that SARS need not authorise a refund as referred to in section 190(1) until such time that a verification, inspection or audit of the refund in accordance with Chapter 5 of the Tax Administration Act has been finalised.

(iii) That the critical contention of SARS was founded on section 190(2) of the Act which provided that 'SARS need not authorise a refund as referred to in subsection (1) until such time that a verification, inspection or audit of the refund in accordance with Chapter 5 has been finalised', and premised on this provision, SARS contended that what Pretorius and Oberholzer attested to sealed the fate of the case against Top Watch.

(iv) That Top Watch contended, firstly, that on a textual interpretation of section 190(2) of the Act, the 'verification, inspection or audit' referred to therein did not apply to all and any aspect of a taxpayer's affairs but, rather, it was narrowly focussed on the 'refund' itself. The implication of this perspective was that the power to refuse to pay a refund was limited to an examination of the contemplated refund itself and, accordingly, an examination of the income tax affairs of the taxpayer cannot be relevant as a brake on the invocation of section 190(1) entitling the taxpayer to the refunds.

(iv) That Top Watch contended, secondly, that no tax debt had been established on the papers and thus, by an application of the principles of set-off, there cannot be a set-off against the admitted indebtedness in respect of the VAT refunds.

(v) That, however, independently of the interpretation of section 190(2), SARS, in order to invoke the provisions of section 191 (Refunds subject to set-off and deferral), to set-off a tax debt against a refund, had to be able to prove 'an outstanding tax debt.' Section 191 states, inter alia, that if a taxpayer has an outstanding tax debt, an amount that is refundable under section 190, must be treated as a payment by the taxpayer that is recorded in the taxpayer's account under section 165, to the extent of the amount outstanding, and any remaining amount must be set-off against any outstanding debt under customs and excise legislation.

(vi) That Top Watch had contended that the document POC1 referred to above was not an assessment and only an assessment which had been communicated to the taxpayer was eligible for a set-off.

(vii) That a tax debt is defined in section 169(1) of Act and stated that 'An amount of tax due or payable in terms of a Tax Act is a tax debt due to SARS' and the appropriate enquiry was into the effect of the document, if any, put up to allege an indebtedness in the form of an assessment which is defined in section 1 of the Income Tax Act as 'the determination by SARS, by way of a notice of assessment, served in the manner contemplated in section 106(2) . . . of an amount upon which any tax leviable under this Act is chargeable.'

(ix) That in Singh v C:SARS 65 SATC 203 the Supreme Court of Appeal considered the meaning of 'assessment' and 'tax debt' and was of the view that it was not sufficient for the assessment to exist purely in SARS' head as the law is not generally concerned with thoughts but with their outward manifestations and 'the tax cannot be regarded as having become recoverable through judicial intervention until the taxpayer has been informed of the assessment . . . ' The court also stated that 'The primary purpose of giving notice of the assessment is not objection and appeal but payment by the taxpayer.'

(x) That it was trite that set-off requires debts between persons who (1) have reciprocal debts (2) both debts being due and payable and (3) both debts being liquidated.

(xi) That, accordingly, even on SARS' version, no evidence was adduced to prove the existence of a tax debt available to be set-off. In other words, until such time as the alleged income tax liability is captured in an assessment and communicated to Top Watch, it was premature to plead a set-off and there was no allegation that such an assessment had been presented to Top Watch.

(xii) That, therefore, no tax debt was established on the papers before the court and hence no set-off could operate against the admitted debts and an order requiring SARS to pay the admitted debts was appropriate, ie SARS was directed to pay Top Watch's claim for VAT refunds for the relevant periods, including interest on those amounts.

3.4. *ITC 1913 (Mining operations)*

The taxpayer conducted business as a 'contract miner' and concluded contracts with third parties who held mining rights and undertook to render certain services to such parties.

It was common cause that the taxpayer carried on business by contracting with clients to provide mining-related services to its clients in the mining sector.

The taxpayer did not hold any mining rights itself and the mining-related services in question were in respect of open cast mining and included a number of different activities.

The essence of the contracts was that the taxpayer extracted mineral-bearing ore from the ground, on behalf of a client, in return for a fee calculated at a rate per ton of mineral-bearing ore which was delivered to the client's processing plant and the ore extracted by the taxpayer was run-of-mine ('ROM') chromite ore or chrome-bearing ore.

The taxpayer's clients derived their income from the sale of the minerals extracted from the ore delivered by the taxpayer and the taxpayer, in most instances, derived a fee income from rendering the services in question.

The taxpayer had based its income tax returns on the fact that it was carrying on mining operations and, accordingly, its fee income constituted 'income derived from mining' and it claimed the capital allowances in respect of the cost of equipment.

The taxpayer, prior to 26 September 2013, had reflected the income received from the holders of the mining rights as mining income and was so assessed by SARS, being the Commissioner for SARS, and this entailed, *inter alia*, that capital allowances on equipment were deducted in full.

SARS, on 26 September 2013, had raised additional income tax assessments in respect of the taxpayer's 2005 to 2009 years of assessment and in terms of those assessments the taxpayer's income was assessed as non-mining income and, accordingly, capital allowances were added back, and wear and tear allowances were granted.

SARS had also made other adjustments and understatement penalties were levied on the taxpayer as well as interest on underpayment of provisional tax.

The main issue to be determined by the court in this appeal was whether the taxpayer had derived income from mining operations which would have entitled it to the mining capital allowances.

The court had to determine whether the taxpayer had conducted mining operations and mining as defined in section 1 of the Income Tax Act during its 2005 to 2009 years of assessment and, accordingly, whether the taxpayer had derived income from 'mining operations as contemplated in section 15 of the Act.'

If the taxpayer was held not to have conducted mining operations it therefore was only entitled to wear and tear allowances as opposed to the full capital allowance.

A further issue before the court involved recoupments and the issue was whether the proceeds from the disposal of assets in the amounts and in the years of assessment had already been included in the taxpayer's mining income or not, and accordingly, whether SARS had correctly included the amount in the taxpayer's income as recoupments in terms of para (j) of the definition of 'gross income' in section 1 of the Act.

The court also had to determine whether SARS had discharged the burden of proving the facts on which SARS had based the imposition of the understatement penalties and, if so, whether such penalties should be remitted or reduced.

The taxpayer contended that the term 'income derived from the business of extracting minerals from the soil' was wide enough to cover its business and what one needed to look at was the work that the taxpayer did and not how he had been compensated, that is by a third party purchaser or by the holder of the mineral rights.

The taxpayer further contended that income derived from the business of extracting minerals from the soil was income derived from mining operations irrespective of whether the taxpayer sold the minerals in the open market or not.

SARS relied on the fact that taxpayer was not exposed to any commercial risk associated with mining and selling ferrochrome and hence it contended that the activities were non-mining operations. Moreover, there were no lengthy time lags between capital outlay and the generating of income and the taxpayer's fees were not affected by the quality of the ore and that risk was borne by the clients. In addition, the taxpayer's fee was not affected by the volatility of metal prices in the global markets.

Judge Weiner held the following:

(i) That the main issue in this appeal was whether the taxpayer had derived income from mining operations which would have entitled it to the mining capital allowances.

(ii) That miners are subject to the ordinary provisions of the Income Tax Act but there are certain provisions which grant certain beneficial dispensations and for the purposes of the present appeal the following sections of the Income Tax Act were relevant: sections 15, 36(7C) and 11(*e*).

(iii) That the benefit of a section 15(*a*) and section 36 deduction, as opposed to a section 11(*e*) allowance, was that the former sections allowed the expenditure on a capital asset to be deducted in full during the first year of the acquisition, whereas a section 1(*e*) allowance was generally determined by referring to the expected life of the particular asset and the deduction took place over that period of time. Moreover, prior to claiming these concessions, it had to be determined whether the capital expenditure in issue qualified for a special concession.

(iv) That the essence of the contract mining contracts entered into by the taxpayer with third parties was that the taxpayer extracted mineral-bearing ore from the ground, on behalf of a client, in return for a fee calculated at a rate per ton of mineral-bearing ore which was delivered to the client's processing plant. The clients, in turn, derived their income from the sale of the minerals extracted from the ore delivered by the taxpayer and it, in most instances, derived a fee income from rendering the services in question.

(iv) That section 15 of the Income Tax Act provided that the taxpayer must derive income from mining operations for the provisions to apply. 'Mining operations' and 'mining' are defined in section 1 of the Act to include 'every method or process by which any mineral is won from the soil or from any substance or constituent thereof.'

(v) That the taxpayer submitted that the phrase 'income derived from mining operations' meant 'income derived from the business of extracting minerals from the soil' and approved in *Western Platinum Ltd* v *CIR* 67 SATC 1, was wide enough to cover its business and it contended further that income derived from the business of extracting minerals from the soil was income derived from mining operations irrespective of whether the taxpayer sold the minerals in the open market or not.

(vi) That in *ITC 1907* 80 SATC 271 the court had to deal with the question whether contract mining constituted mining operations as defined in the Income Tax Act and held that 'mere extraction was not enough to render a contractor who earns a fee for extraction as a person eligible to fall into the class of persons who are engaged in 'mining operations' as defined. The contract is not in the 'trade' of mining: rather the contractor is in the trade of servicing a miner's requirements by the extraction of material.'

(vii) That SARS contended that the taxpayer's activities did not constitute mining operations and its fees did not qualify as income derived from working of any mine and that, accordingly, it did not qualify for deduction of capital expenditure in terms of section 15(*a*) read with section 36 of the Act but it would, however, qualify for deduction of a depreciation allowance in terms of section 11(*e*) of the Act.

(ix) That the parties were in agreement that, if the taxpayer did not carry on mining operations, the recoupment from the sale of depreciable assets fell to be included in gross income and once it was held that the taxpayer did not qualify for capital expenditure deduction, the recoupment amount remained untaxed and had to be included in gross income.

(x) That, accordingly, taxpayer had not succeeded in demonstrating that it had derived its income from mining operations.

(xi) That, however, the question in this case was somewhat vexed having regard to the definition of 'mining operations' and 'mining' in section 1 of the Income Tax Act which seems to include the taxpayer's business, and the comments made in the *Margo Report* and the *Davis Tax Commission*, which demonstrate why the taxpayer's business is excluded from the definition referred to and the permissible deduction. However, if one takes a purposive view of the legislation, the latter comments must come to the fore in dealing with the interpretation to be placed on such legislation.

(xii) That there had also been no compliance with the relevant subsections of section 36 of the Income Tax Act and, in the circumstances, the relevant deductions claimed could not be allowed.

(xiii) That the assessments in respect of recoupments, penalties and interest could not be challenged.

Appeal dismissed with costs.

3.5. ITC 1914 (Non-resident, Double taxation agreement)

The taxpayer, a non-resident, had been employed by the South African branch of ABC Incorporated in the United States, the branch having been registered in South Africa as an external company.

The taxpayer, on 31 March 2011, had entered into a contract of employment with his employer in Johannesburg and the material terms were that he was to be employed by the Johannesburg branch of the company and that he would be remunerated with an annual salary net of taxes which would be paid to him in equal monthly instalments and he was not allowed to engage in extraneous part-time employment without permission.

It was common cause that the taxpayer's total income from his employment during the period 1 March 2013 to 31 October 2013 was an amount of R10 437 708 and that he had declared the amount of R6 367 943 as income earned from services rendered inside South Africa and R4 069 765 being non-taxable foreign income earned during the 2014 financial year for services that he had rendered to his employer outside South Africa.

It was common cause that in the aforementioned period the taxpayer had for sixty-two non-continuous days worked outside South Africa for his employer.

SARS had disallowed the taxpayer's claim that R4 069 765 was to be regarded as non-taxable foreign income earned during the 2014 financial year.

The taxpayer's employer had issued an IRP5 certificate reflecting his annual income for the 2014 year of assessment as R10 437 708 against which it had paid PAYE.

The taxpayer contended that the certificate incorrectly included an amount of R4 069 765 as taxable gross income as that amount was arrived at by dividing the number of days that the taxpayer had worked outside the country by the total number of working days in the relevant tax period and thereafter by multiplying the result by the total income earned for that period.

The issue for determination before the court was whether the disputed income could be categorised as having been received by the taxpayer from 'a source within the Republic' as contemplated by section 1(ii) in the definition of 'gross income' in the Income Tax Act.

Article 15(1) of the Double Taxation Agreement ('DTA') between South Africa and the United States provided for taxation in South Africa of remuneration derived by a resident of the US, where the employment is exercised in South Africa.

SARS contended that the originating cause of the taxpayer's disputed income was the contract of employment which was entered into in South Africa and exercised in South Africa for all the days that he had worked in South Africa.

SARS contended further that the source of the remuneration was the employment and not the services rendered by the taxpayer to individual clients of the employer outside of South Africa.

The taxpayer submitted that the South African branch of ABC Incorporated was not a separate juristic entity and accordingly it could not have been the entity where the originating cause of the remuneration was located.

The taxpayer further submitted that the originating cause of the taxpayer's remuneration was the services rendered by him to his employer, and that such originating cause was located at the places where the services were rendered.

Judge Allie held the following:

(i) That the entire dispute between the parties hinged on the definition of where the taxpayer's employment was exercised and consequently where the source of the remuneration was located, as set out in the DTA, which became a part of our law upon notification that it had entered into force.

(ii) That interpretation of the provisions of the DTA, which is a Convention, may be in accordance with the *Vienna Convention on the Law of Treaties* ('VCLT') of 1969, which provided a general guide on how a treaty or convention ought to be interpreted under the VCLT, in Articles 31 to 33.

(iii) That the VCLT subscribed to customary international law, applicable to all countries including South Africa and in the view of the court a portion of it may find application in South Africa.

(iv) That the primary rules of interpretation suggested by the VCLT were not at odds with the primary rules of interpretation used in our domestic law, namely the plain meaning of the text in conjunction with a purposive and contextual approach and in view of the court's finding that there was no conflict between the statutory interpretation proposed by the VCLT and those applicable in South Africa, the court applied the latter.

(iv) That the place where '…the employment is exercised…' ordinarily means the place where the employment agreement is implemented. The words were used for the purpose of describing events that occurred in fulfilment of reciprocal rights and duties governed by an employment agreement, as they appeared in the context of Article 15, in the DTA.

(v) That these words were meant to serve as an exception to the rule that the country in which a person is a resident shall levy tax on income of that resident derived from salaries, wages or other remuneration. The exception was that a country in which that person is not a resident but in which his/her employment is exercised, provided that the income is derived from that employment, was the country which may levy tax on that income.

(vi) That if the words were meant to convey the meaning that the non-resident country must be the country in which the person fulfils his/her employment obligations at any given time, then the active voice would have been used in the construction of the relevant phrase. Instead, the phrase was constructed in the passive voice with the employment as the subject and no actor was mentioned.

(vii) That it was left to the laws of the individual contracting states to determine when and how employment was considered to be exercised.

(ix) That *in casu* the contract of employment was entered into by the taxpayer in South Africa and he chose a South African address as his *domicilium*, as did his employer. In the absence of an express provision to the contrary in the contract, the laws of South Africa clearly governed the contract.

(x) That the aforementioned contract was of such a nature that one must assume that the resources, knowledge, skill and expertise that the taxpayer had at his disposal to utilise in his rendering of services, all became those of his employer for the duration of the employment contract and therefore the court came to that conclusion in the absence of evidence to the contrary, and on the understanding that the taxpayer was not an independent contractor.

(xi) That the taxpayer rendered the services outside South Africa not as an independent contractor but as a representative of the employer and he accordingly rendered those services to the employer's clients *qua* the employer and, in effect and in substance, the taxpayer therefore rendered the services to his employer.

(xii) That the taxpayer bore the *onus* of proving his case in terms of section 102(1) of the Tax Administration Act.

(xiii) That there was a sufficiently close connection between the *raison d'etre* for rendering the service outside South Africa and the employment contract to interpret the rendering of the services as no more than reciprocal performance by the taxpayer to his employer. In reciprocal contracts, unless stated to the contrary, there are no grounds for elevating one party's performance as being determinative of implementation of the contract. Both sides are duty-bound to render their respective performance.

(xiv) That the interpretation of 'employment exercised' as only occurring upon the rendering of services by the employee ignores the reciprocal performance required of the employer, which is to provide the employee with the necessary resources to enable him to render his performance; to specify particular services that the employee is bound to render and to remunerate the employee.

(xv) That, accordingly, the source of the remuneration received by the taxpayer during the 62 days that he rendered services for his employer outside South Africa is the same source from which remuneration was derived in the remaining days that he rendered services for his employer inside South Africa.

(xvi) That, therefore, the additional assessment was upheld on the grounds only that the source of the disputed income was from within the Republic of South Africa and the employment was exercised, in substance, in the Republic of South Africa.

(xvii) That, in regard to costs, SARS' grounds of assessment relating to residence were unreasonable and therefore SARS was to bear the taxpayer's costs of opposing the grounds of assessment relating to residence.

4. INTERPRETATION NOTES

4.1. Exemption – Foreign pensions and transfers – No. 104

This Note provides clarity on the interpretation and application of section 10(1)(*g*C)(ii) of the Income Tax Act to a lump sum, pension or annuity received by or accrued to any resident from a source outside South Africa.

Section 10(1)(*g*C)(ii) exempts from normal tax any lump sum, pension or annuity received by or accrued to any resident from a source outside South Africa as consideration for past employment outside South Africa.

This exemption does not apply to a lump sum, pension or annuity received by or accrued to any resident from a local retirement fund (which relates to foreign services rendered) is transferred to that local retirement fund or insurer from a source outside South Africa in respect of that member.

Section 10(1)(*g*C)(ii) exempts from normal tax any lump sum, pension or annuity received by or accrued to any resident from a source outside South Africa as consideration for foreign services rendered. This exemption does not apply to a lump sum, pension or annuity received by or accrued to a resident from a local retirement fund or an insurer, except to the extent that an amount (which relates to foreign services rendered) was transferred to that local retirement fund or insurer in respect of that member.

4.2. Skills Development Levy Exemption: Public Benefit Organisation – No. 10 (Issue 3)

This Note provides guidance on the interpretation and application of section 4(*c*) of the SDL Act, which exempts any PBO contemplated in section 10(1)(*c*N) from the payment of SDL, provided the PBO:

- solely carries on qualifying PBAs; or
- solely provides funds to PBOs that solely carry on qualifying PBAs.

Section 3(1) of the SDL Act imposes an SDL on the total amount of remuneration paid or payable or deemed to be paid or payable by an employer to its employees during any month. The amount of such remuneration is the same as the amount of remuneration determined under the Fourth Schedule from which an employer is obligated to withhold employees' tax taking into consideration certain exclusions referred to in section 3(4) of the SDL Act.

Section 4 of the SDL Act contains a number of exemptions from the SDL. This Note, however, concentrates on the exemption under section 4(*c*) of the SDL Act.

The Commissioner is responsible for the administration of the SDL Act, in so far as it relates to the collection of the levy payable by employers.

A PBO may qualify for exemption from the payment of SDL under section 4(*c*) of the SDL Act, provided certain requirements are met.

4.3. Income Tax Exemption: Bodies Corporate, share block companies and associations of persons managing the collective interests common to all members – No. 64 (Issue 4)

This Note provides guidance on the application and interpretation of section 10(1)(*e*).

Section 10(1)(*e*) exempts from income tax the levy income of a body corporate, a share block company and an association of persons. It also provides a basic exemption for these qualifying entities.

In conclusion:

- only the levy income of qualifying entities is fully exempt from income tax under section 10(1)(*e*)(i);
- the sum of other income received by qualifying entities is subject to a basic exemption under section 10(1)(*e*)(ii);
- bodies corporate and share block companies qualify for an automatic exemption from income tax under section 10(1)(*e*)(i)(*aa*) and (*bb*) respectively and no pre-approval by the Commissioner is required;
- associations of persons are required to apply for approval with the Commissioner at the TEU to qualify for exemption from income tax under section 10(1)(*e*)(i)(*cc*);
- qualifying entities are excluded from the payment of provisional tax and are

not required to submit provisional tax returns;

- donations made by or to a qualifying entity are exempt from donations tax under section 56(1)(*h*);
- the transfer of immovable property in a share block company to a holder of shares in the company will not give rise to a capital gain or capital loss in the company under paragraph 67B(3)(*a*) of the Eighth Schedule;
- a cash dividend paid to a qualifying entity is exempt from dividends tax under section 64F(1)(*a*); and
- a dividend *in specie* declared and paid by a share block company that comprises a disposal contemplated in paragraph 67B(2) of the Eighth Schedule is exempt from dividends tax under section 64FA(1)(*d*).

4.4. Headquarter Companies – No. 87 (Issue 2)

This Note provides guidance and clarity on the interpretation and application of section 9I which deals with headquarter companies.

The Note also briefly discusses other provisions of the Act that provide special tax relief for headquarter companies, as well as the specific anti-avoidance rules that are designed to prevent misuse or abuse of those provisions.

The Note does not discuss all of the sections which are applicable to headquarter companies. For example, the Note does not discuss "gross income" as defined in section 1(1) or section 11(*a*) which, although these sections do not specifically refer to headquarter companies, are applicable to headquarter companies.

The information in this Note is based on the income tax and tax administration legislation (as amended) as at the time of publishing and includes the following:

- The Taxation Laws Amendment Act 17 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41342); and
- The Tax Administration Laws Amendment Act 13 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41341).

- The Rates and Monetary Amounts and Amendment of Revenue Laws Bill of 2018.

The South African government wished to promote South Africa as a gateway for investments into Africa. The *Explanatory Memorandum on the Taxation Laws Amendment Bill, 2010* stated the following:

> "South Africa is the economic powerhouse of Africa. South Africa's location, sizable economy, political stability and overall strength in financial services make South Africa an ideal location for the establishment of regional holding companies by foreign multinationals. Furthermore, South Africa's network of tax treaties provides ready access to other countries in the region. South Africa is therefore a natural holding company gateway into the region.
>
> However, in order to serve as an ideal holding company jurisdiction, three sets of South African tax rules were identified as significant barriers: (i) the CFC rules, (ii) the charge on outgoing dividends, and (iii) the thin capitalisation rules."

As part of the initiative to promote South Africa as a location for headquarter companies, the government amended certain provisions of the Act in order to create a more favourable tax dispensation for parties using South Africa as a gateway for investment into Africa.

A headquarter company is subject to tax in the same way as any other resident company, however, it is entitled to certain relief from income tax, CGT and dividends tax which is not available to resident companies that are not headquarter companies. As a consequence of the special relief granted to headquarter companies they are also subject to special anti-avoidance rules.

In addition to the headquarter companies themselves, a foreign person receiving interest or royalties from a headquarter company will, under specified circumstances, be exempt from withholding tax on interest and royalties respectively.

A company that meets the requirements and elects to be a headquarter company under section 9I for a specific year of assessment will be entitled to the relief outlined in this Note.

A headquarter company potentially qualifies for the following relief:

- Exclusion from the CFC legislation under section 9D(2).
- Exemption from normal tax on foreign dividends received by or accrued under section 10B(2)(*a*) and (3).
- Relaxation of the transfer pricing rules under section 31(5), but accompanied by ring-fencing of interest incurred under section 20C(2) and ring-fencing of royalties incurred under section 20C(2A).
- Relaxation of the income tax and CGT treatment of foreign exchange transactions under section 24I(3), 25D(4) and (7) and paragraph 43(1A).
- Disregarding of the capital gain or capital loss on the disposal of equity shares in a foreign company under paragraph 64B(2) and disregarding of the capital gain on a foreign return of capital received from a foreign company under paragraph 64B(4).
- A possible rebate for foreign taxes under section 6*quat*(1) or a deduction for foreign taxes under section 6*quat*(1C).
- Exemption for a foreign person from withholding tax on interest under section 50D(1)(*a*)(i)(*cc*) on the interest paid by a headquarter company on so much of the financial assistance to which section 31 did not apply as a result of the application of section 31(5)(*a*).
- Exemption for a foreign person from withholding tax on royalties under section 49D(*c*) on the granting of the use, right of use or permission to use intellectual property to which section 31 does not apply as a result of the application of section 31(5)(*c*).
- Exclusion from dividends tax legislation under section 64E(1).

Although a headquarter company qualifies for certain tax relief, anti-avoidance provisions have been introduced to protect the South African tax base:

- A company that becomes a headquarter company is subject to CGT on the deemed disposal of some of its assets under section 9H(3)(*a*), and to dividends tax on a dividend *in specie* deemed to have been declared and paid by that company under section 9H(3)(*c*)(iii) for purposes of section 64EA(*b*). The deemed dividends under section 9H(3)(*c*)(iii) do not qualify for an exemption from or a reduced rate of dividends tax. The deemed disposal and deemed dividend are deemed to have taken place on the day before becoming a headquarter company.
- A headquarter company does not qualify for the relief provided for under the corporate restructuring rules in sections 41 to 47.

4.5. Deductions in respect of buildings used by hotelkeepers – No. 105

This Note provides guidance on the interpretation and application of section 13*bis,* which deals with deductions in respect of buildings used in the trade of hotelkeeper.

Section 13*bis* provides a deduction for buildings used by hotelkeepers if specified requirements are met. The deduction is comprised principally of an annual allowance on the cost of erecting hotel buildings and the cost of effecting improvements to such buildings. A grading allowance, while theoretically still available in some exceptional circumstances, is unlikely to be currently relevant because the buildings and improvements on which it was calculated are likely to have been fully written off by 2012.

The traditional concept of a hotel has changed in recent years. It is therefore necessary to consider the requirements of section 13*bis* as it applies to the modern concept of hotelkeeping.

Different write-off rates apply to buildings erected or improvements effected to buildings used in the trade of hotelkeeper during specified legislated periods.

Taxpayers incurring a cost in erecting or improving a building which they, or a lessee, use for the purposes of conducting the business of hotelkeeper will qualify for the annual allowance on the cost incurred if the requirements of section 13*bis* are met. Section 13*bis* contains detailed requirements in relation to when the erection of the building or the effecting of the improvements was commenced by the taxpayer, when the building was brought into use and, depending on the preceding detail, whether it was wholly or mainly used, or to the extent it was used, by the taxpayer or lessee in carrying on the trade of hotelkeeping during the year of assessment.

The following should be noted in relation to the annual allowance:

- The definition of “hotel keeper” in section 1(1) requires the person concerned to conduct the business of a hotel, boarding house or lodging house in circumstances in which both meals and sleeping accommodation are supplied by that person for consideration.
- The building must be erected. Purchased buildings do not qualify for the annual allowance but improvements to purchased buildings could qualify.
- The annual allowance is granted on the cost to the taxpayer, after adjusting for deferred recoupments and amounts which may qualify for an allowance under section 11(*g*), of erecting a hotel building or of effecting improvements to such a building. There is no requirement that the taxpayer own the building or improvements. Thus the annual allowance applies to a taxpayer who erects a hotel building or effects improvements to such a building:
    - for own use as a hotelkeeper;
    - as lessor when the lessee is a hotelkeeper; or
    - as lessee to the extent that the building or improvements do not qualify for the leasehold improvements allowance under section 11(*g*).
- The annual allowance is available at different rates depending on when erection of the building or the improvements commenced.

- The annual allowance is not apportioned if the building or improvement is used as required for only part of the year.
- The annual allowance on dual-purpose buildings must be apportioned. For example, apportionment would be required when a building is used for both hotelkeeping and for domestic purposes.
- The aggregate of all deductions which may be allowed or deemed to have been allowed under section 13*bis* or any other section in respect of the cost to the taxpayer of the building or improvement may not exceed that cost. The limitation includes, for example, those allowances deemed to have been allowed for years of assessment when the accruals and receipts of the taxpayer were not included in the taxpayer's income.

An additional grading allowance was available but is unlikely to be relevant after 2012, since the relevant building or improvements should in most instances have been fully written off by that date.

The annual and grading allowances are subject to recoupment under section 8(4)(*a*) but this recoupment can be excluded from income under section 13*bis*(6)(*a*) at the election of the taxpayer by reducing the cost of erecting a replacement hotel building which qualifies for the annual allowance.

5. BINDING PRIVATE RULINGS

5.1. BPR 311 – Photovoltaic solar energy plants

This ruling determines the deductibility of expenditure to be incurred to install photovoltaic solar energy plants at sites owned and leased by the applicant.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 28 August 2017. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 12B(1)(*h*)(ii)(*bb*);

- section 12B(2)(*b*); and
- section 12B(3).

Parties to the proposed transaction

The applicant: A resident private company which will be installing photovoltaic solar energy plants

Description of the proposed transaction

The applicant proposes to install solar power systems at each of the sites it rents, to reduce electricity costs. The proposed photovoltaic solar energy systems at each site will comprise of the following components:

- photovoltaic solar panels;
- AC inverters;
- DC combiner boxes;
- racking; and
- cables and wiring.

Distribution boxes do not form part of the photovoltaic solar energy systems and no expenditure is claimed in respect of them under the section.

The system supplements, and does not replace, the electricity provided by the main grid. Each system installed per site will generate less than 1 megawatt of electricity. The applicant will purchase the photovoltaic solar panels, appoint and pay independent contractors to perform installation planning (e.g. site assessment and engineering design), procure and purchase all other relevant equipment comprising the systems and actually install the systems at the relevant sites.

The related expenditure, which the applicant propose to incur as part of the cost of the installation (herein after referred to as the 'related costs'), includes:

- installation planning costs;
- panels delivery costs;
- installation costs; and

- installation safety officer costs.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The applicant is entitled to claim deductions in respect of:
  - each of the photovoltaic solar energy plants to be installed at each of the sites, consisting of the photovoltaic solar panels, inverter, DC combiner box, racking, and cables and wiring, under section 12B(1)(*h*)(ii)(*bb*); and
  - the direct costs of the installation and erection of each of the plants, consisting of the installation planning costs, panel delivery costs and the cost of the installation safety officer to be appointed, under section 12B(3).
- The deduction of the expenditure deductible under section 12B(1)(*h*)(ii)(*bb*) must be calculated under section 12B(2)(*b*).
- No opinion is expressed in relation to the estimation of the amount to be claimed in respect of any of the costs.

5.2. BPR 312 – Tax implications of the variation of employment contracts

This ruling determines the tax consequences of payments made pursuant to the cancellation of a profit share agreement entered into between an employer and certain of its employees.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 23 October 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – paragraphs (*c*B) and (*d*) of the definition of 'gross income';
- section 11(*a*) read with section 23(*g*);
- section 11(*c*A);
- section 11(*n*A); and
- section 23H.

Parties to the proposed transaction

The applicant: A resident company

First co-applicant: A resident company which is a 100% held subsidiary of the applicant

Second co-applicant: A resident company which is a 100% held subsidiary of the applicant

Third co-applicants: Mr X and all other employees who will receive cancellation payments

Restraint Nominees: Third co-applicants who will additionally receive restraint of trade payments

Other employees: Employees who will receive predetermined payments pursuant to the cancellation agreement, but who are not co-applicants, not parties to the cancellation agreement, but who will accept the benefits offered to them

Description of the proposed transaction

The applicant and Mr X previously entered into an employment agreement which included a profit share arrangement between them. Mr X was entitled to nominate and did nominate certain employees to benefit from the profit share arrangement on certain terms.

The parties have agreed to terminate the profit share arrangement by way of a cancellation agreement which will be entered into between the applicant and the co-applicants who benefited from it.

The cancellation agreement will provide, amongst others, that:

- the first and second co-applicant will pay predetermined cancellation fees to the affected third co-applicants as compensation for the cancellation of the profit share arrangement, and also make the payments to the other employees;
- a retained cash portion will be left with the applicant as security for the due compliance with his obligations by Mr X to be released on 31 August 2021. Should Mr X's employment be terminated on the grounds of dismissible conduct, the cash portion will be forfeited;
- the third co-applicants will continue to be employed by the first and second co-applicants;
- the cancellation agreement will also provide for restraint of trade agreements to be entered into by the applicant and the first and second co-applicants with the restraint nominees, and restraint payments to be made to the restraint nominees.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- The cancellation fees and the payments to the other employees will be deductible by the first and second co-applicants under section 11(*a*) read with section 23(*g*).
- The retained cash portion will be subject to section 23H.
- The cancellation fee and retained cash portion will be included in the gross income of each of the third co-applicants under paragraph (*d*) of the definition of 'gross income'.

- To the extent that any amount of the retained cash portion is forfeited by Mr X, such forfeited amounts may be deducted by him under section 11(*n*A) in the relevant year of assessment during which the forfeited amount is refunded by him.
- The restraint payments will be included in the gross income of the Restraint Nominees under paragraph (*c*B) of the definition of 'gross income'.
- The restraint payments will be deductible by the first and second co-applicants under section 11(*c*A).
- No ruling is made on the apportionment between the first and second co-applicants of the cancellation fee mentioned in a) and the restraint payments mentioned in f).

5.3. BPR 313 – Foreign share buyback

This ruling determines the income tax effect of a share buyback by a non-resident company from a resident trust.

In this ruling references to sections are to sections of the Income Tax Act and references to paragraphs are to paragraphs of the Eighth Schedule to the Act applicable as at 10 October 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of:

- section 1(1) – definitions of 'foreign dividend' and 'foreign return of capital';
- section 10B(2)(*a*);
- paragraph 20(1)(*a*);
- paragraph 64B(4); and
- paragraph 20(3)(*a*).

<u>Parties to the proposed transaction</u>

The applicant: A resident discretionary trust established for the benefit of an individual and his family

Company A: A company incorporated in South Africa but resident in the United Kingdom

Company B: A resident company incorporated in South Africa

Description of the proposed transaction

The applicant previously held shares in Company B, which it disposed of to Company A in an asset-for-share transaction, in exchange for shares in Company A. As a result the applicant currently holds more than 10% of the total equity shares and voting rights in Company A.

Company A will repurchase the shares held by the applicant in exchange for shares it holds in Company B (the 'repurchase consideration shares').

Conditions and assumptions

This binding private ruling is subject to the additional condition and assumption that Company A is indeed a resident of the United Kingdom at all material times.

Ruling

The ruling made in connection with the proposed transaction is as follows:

- To the extent that the amount to be received by the applicant from Company A on the share repurchase will constitute a 'foreign dividend' as defined in section 1(1), the amount will be exempt under section 10B(2)(*a*);
- To the extent that it will constitute a 'foreign return of capital' as defined in section 1(1), any capital gain must be disregarded under paragraph 64B(4);
- The base cost of the repurchase consideration shares for the applicant as contemplated in paragraph 20(1)(*a*) will be an amount equal to the market value of the repurchase consideration shares on the date of the distribution of those shares to the applicant.

6. BINDING GENERAL RULINGS

6.1. *BGR 20 – Interpretation of the expression 'substantially the whole' – Issue 3*

For the purposes of this BGR:

- 'association' means any 'entity' as defined in section 30B(1), which has been approved by the Commissioner under section 30B(2);
- 'recreational club' means a 'recreational club' as defined in section 30A(1), which has been approved by the Commissioner under section 30A(2); and
- 'SBFE' means a 'small business funding entity' as defined in section 1(1), which has been approved by the Commissioner under section 30C(1)

<u>Purpose</u>

This BGR provides clarity on the interpretation of the expression 'substantially the whole' as referred to in:

- section 10(1)(*c*N)(ii)(*aa*)(B)
- section 10(1)(*c*O)(ii)(*bb*)
- section 10(1)(*c*Q)(ii)(*aa*)(B)
- section 30B(2)(*b*)(iv), (vi) and (ix)
- section 30C(1)(*d*)(v) and (viii)
- paragraph 63A(*b*) of the Eighth Schedule
- paragraph 63B(1)(*b*) of the Eighth Schedule
- section 9(1)(*c*) of the Transfer Duty Act

<u>Background</u>

The expression 'substantially the whole' was introduced in the revised tax system for PBOs in 20001 to achieve a more supportive fiscal environment and to give effect to the proposals and recommendations by the Katz Commission set out in the Ninth Interim Report. In considering comparative international law with regard to trading activities conducted by non-profit organisations (NPOs) the Report stated that it was significant that:

> 'the United States' federal tax law exempts profits derived from a business which is 'substantially related' to a NPOs tax-exempt purposes. Substantially related in this context means that the conduct of the business activity must have a significant causal relationship to the achievement of a tax-exempt purpose. Thus, for the conduct of a trade or business from which a particular amount of gross income is derived to be exempt from taxation, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of the organisations' exempt purposes.'

The Report stated further that:

> 'United Kingdom Revenue Practice is to accept ancillary trades provided they are 'small in absolute terms and the turnover of that part of the trade is less than 10 per cent of the turnover of the whole trade' '.

The expression 'substantially the whole' has also been introduced into legislation dealing with:

- the exemption from normal tax of a recreational club;
- the exemption from normal tax of an SBFE;
- the requirements for approval as an association;
- the requirements for approval as an SBFE;
- capital gains tax affecting PBOs and SBFEs; and
- transfer duty affecting PBOs and institutions, boards or bodies contemplated in section 10(1)(*c*A)(i).

Discussion

The exemption from normal tax of public benefit organisations, recreational clubs and small business funding entities

The expression 'substantially the whole' allows a PBO, recreational club and

SBFE5 to carry on business undertakings or trading activities within certain parameters, while at the same time ensuring that the sole or principal object of:

- a PBO remains the carrying on of public benefit activities (PBAs);
- a recreational club remains the provision of social and recreational amenities or facilities for its members; and
- an SBFE remains the provision of funding for small, medium and micro-sized enterprises.

The receipts and accruals derived by any of the aforementioned entities from any business undertaking or trading activity will be exempt from normal tax to the extent that substantially the whole of such undertaking or activity is directed towards the recovery of cost.

<u>The requirements for approval as an association</u>

Section 30B sets out the conditions and requirements that an 'entity' as defined in section 30B(1) must comply with to obtain and retain approval as an association for its receipts and accruals to be exempt from normal tax under section 10(1)(*d*)(iii) or (iv).

The Commissioner must approve an entity for the purposes of section 10(1)(*d*)(iii) or (iv) if the constitution or written instrument under which it has been established provides, among other things, that:

- substantially the whole of its funds will be used for the sole or principal object for which it has been established;
- substantially the whole of its activities will be directed to the furtherance of its sole or principal object and not for the specific benefit of an individual member or minority group; and
- substantially the whole of its funding will be derived from its annual or other long-term members or from an appropriation by the government of the Republic in the national, provincial or local sphere.

<u>The requirements for approval as a small business funding entity</u>

Section 30C sets out the conditions and requirements that an entity must comply with to obtain and retain approval as an SBFE for certain of its receipts and accruals to be exempt from normal tax under section 10(1)(*c*Q).

The Commissioner must approve an SBFE for the purposes of section 10(1)(*c*Q) if the constitution or written instrument under which it has been established provides, among other things, that:

- substantially the whole of its funds will be used for its sole or principal object for which it has been established; and
- substantially the whole of its activities will be directed to the furtherance of its sole or principal object.

Capital gains tax

Public benefit organisations

A PBO must disregard any capital gain or capital loss determined on the disposal of an asset if substantially the whole of the use of that asset by that PBO on and after valuation date was directed at:

- a purpose other than carrying on a business undertaking or trading activity; or
- carrying on a business undertaking or trading activity that qualifies for exemption under section 10(1)(*c*N)(ii)(*aa*), (*bb*) or (*cc*).

Small business funding entities

An SBFE must disregard any capital gain or capital loss determined on the disposal of an asset if substantially the whole of the use of that asset by that SBFE was directed at:

- a purpose other than carrying on a business undertaking or trading activity; or
- carrying on a business undertaking or trading activity that qualifies for exemption under section 10(1)(*c*Q)(ii)(*aa*), (*bb*) or (*cc*).

Transfer duty

To qualify for exemption from the payment of transfer duty under section 9(1)(*c*) of the Transfer Duty Act, the whole property, or substantially the whole of the property acquired by a PBO or institution, board or body contemplated in section 10(1)(*c*A)(i) must be used for purposes of carrying on any PBAs.

If at any time subsequent to the acquisition of property that has qualified for the exemption from transfer duty the whole or substantially the whole of the property is used for a purpose other than for carrying on any PBA, transfer duty will become payable.

Ruling

In the strict sense the expression 'substantially the whole' is regarded by SARS to mean 90% or more. However, since PBOs, recreational clubs, associations and SBFEs operate in an uncertain environment making proper planning difficult, SARS will accept a percentage of not less than 85% for purposes of:

- section 10(1)(*c*N)(ii)(*aa*)(B);
- section 10(1)(*c*O)(ii)(*bb*);
- section 10(1)(*c*Q)(ii)(*aa*)(B);
- section 30B(2)(*b*)(iv), (vi) and (ix);
- section 30C(1)(*d*)(v) and (viii);
- paragraph 63A(*b*) of the Eighth Schedule;
- paragraph 63B(1)(*b*) of the Eighth Schedule; and
- section 9(1)(*c*) of the Transfer Duty Act.

The percentage must be determined using a method appropriate to the circumstances.

7. BINDING GENERAL RULINGS

7.1. *No-value provision in respect of the rendering of transport services by any employer*

Purpose

This BGR provides clarity on the no-value provision in respect of the rendering of transport services by an employer to employees in general, and must be read with BGR 42 dated 22 March 2017 “No-value provision in respect of transport services”.

Background

Employers may provide employees with transport services from their homes to the place of their employment. These transport services are a taxable benefit in the hands of the employee, but may attract no value where certain requirements have been met.

There is uncertainty as to the application of the no-value provision as provided for in paragraph 10(2)(*b*) in terms of what is envisaged for transport services rendered *by the employer*, especially where the employer does not provide the transport service directly, but contracts another person to provide the transport service to employees.

Discussion

Paragraph 2(*e*) provides that a taxable benefit is deemed to have been granted by an employer to an employee if any service has, at the expense of the employer, been rendered to the employee (whether by the employer or some other person) for his or her private or domestic purposes.

Paragraph 10(2)(*b*) provides that the taxable benefit will attract *no value* if a transport service is rendered by the employer to its employees in general for the conveyance of such employees from their homes to the place of their employment (and *vice versa*).

The focus on paragraph 10(2)(*b*) is that, for the no-value provision to apply, the transport service must be rendered by the employer (and not, for example, some other person as is provided in paragraph 2(*e*)).

In order for the no-value provision to apply, the employer needs to render the service and not *some other person*. One therefore needs to distinguish between the employer rendering the transport service and the provision of transport by some other person, such as general public transport, in order for the no-value provision to apply.

Ruling

It is accepted that transport services rendered by the employer to employees in general for the conveyance of such employees between their homes and the place of their employment, will fall within the provisions of paragraph 10(2)(*b*), if the following conditions have been met:

- The transport service is rendered directly by the employer.
- Where the transport service is not rendered directly by the employer (for example, where it is outsourced to a specific transport service provider), the employer makes it clear in the service conditions that:
  - the transport service is provided exclusively to employees on the basis of predetermined routes or under defined conditions;
  - the employees cannot in any manner request such transport service from the service provider on an *ad hoc* basis; and
  - the contract for providing the transport service is between the employer and the transport service provider, and the employee is not a party to the contract.

The provision of and access to general public transport will not be regarded as a transport service rendered by the employer and will therefore not qualify for the no-value provisions of paragraph 10(2)(*b*).

8. GUIDES

8.1. Comprehensive Guide to Capital Gains Tax (Issue 7)

The purpose of this guide is to assist the public and SARS's personnel in gaining a more in-depth understanding of capital gains tax (CGT). The foundation for this guide can be found in the various Explanatory Memoranda that supported the legislation. These initial explanations have been completely revised, with the addition of many more explanations, examples and illustrations. Much of the additional material was inspired by the many e-mail and written queries submitted by the public.

This guide is not an 'official publication' as defined in s 1 of the Tax Administration Act and accordingly does not create a practice generally prevailing under s 5 of that Act. It is also not a binding general ruling under s 89 of Chapter 7 of the Tax Administration Act. Should an advance tax ruling be required, visit the SARS website for details of the application procedure.

This work reflects the law as at 18 December 2017 as amended by the Taxation Laws Amendment Act 17 of 2017. The 2018 tax rates have generally been used in this guide, but in some instances reference is made to the 2019 rates. The 2018 rates apply to companies with years of assessment ending between 1 April 2017 and 31 March 2018 and to persons other than companies with years of assessment commencing on 1 March 2017.

8.2. Guide on the calculation of the tax payable on lump sum benefits (Issue 3)

This guide provides general guidance on the calculation of the tax payable on the taxable portion of lump sum benefits from retirement funds in South Africa.

A member of a retirement fund becomes entitled to a lump sum benefit when his or her membership of that retirement fund terminates. The taxable portion of the lump sum benefit is determined under the provisions of the Second Schedule, which takes into account certain allowable deductions. Once determined under the Second Schedule, the taxable portion of the lump sum benefit is included in the taxpayer's gross income1 and is subject to the rates of tax applicable to lump sum benefits.

This guide focuses on the determination of the tax payable on the taxable portion of the lump sum benefit, and not on the actual calculation of the taxable portion in terms of the Second Schedule.

A lump sum benefit is any amount payable by a retirement fund to a member or former member in consequence of his or her membership or past membership in that specific retirement fund.

Types of lump sum benefits payable by a retirement fund are:

- withdrawal benefits; and
- retirement benefits.

A 'severance benefit'is not a lump sum benefit as it is an amount payable by an employer to an employee and not an amount payable by a retirement fund to a member or former member of that retirement fund.

8.3. Tax Guide for Share Owners (Issue 6)

This guide provides general guidance on the taxation of share owners.

The guide examines:

- the tax consequences of holding shares as trading stock compared to holding them as capital assets;
- how to distinguish between profits of a capital and revenue nature using common law principles and statutory rules;
- the determination of a taxpayer's liability for capital gains tax;
- how dividends are taxed; and
- various corporate actions that can impact on the determination of a person's liability for tax.

This guide is based on legislation as at 18 December 2017 and primarily focuses on the 2018 year of assessment although much of the commentary will also apply to earlier years of assessment.

8.4. *Brochure on the Special Economic Zone Tax Incentive*

The special economic zone (SEZ) tax incentive was introduced into the Income Tax Act to promote investment, growth and job creation in the South African manufacturing sector and the development of designated regions.

Qualifying criteria

The taxpayer must be a 'qualifying company' to be able to qualify for this incentive. The term 'qualifying company' is defined, as a company that is:

- carrying on business in a SEZ that is designated by the Minister of Trade and Industry and approved by the Minister of Finance in consultation with the Minister of Trade and Industry;
- incorporated or effectively managed in South Africa;
- carrying on business from a fixed place of business within a SEZ;
- at least 90% of the income of that company must be derived from the carrying on of business or provision of services within that SEZ; and
- no more than 20% of the deductible expenses incurred or 20% of the income received by or accrued to the company are from transactions with connected persons that are residents or with non-residents and those transactions are attributable to a permanent establishment in the Republic.

Qualifying companies can benefit from the following preferential benefits:

- A reduced corporate income tax rate of 15% instead of the current 28% rate.
- An accelerated depreciation allowance of 10% on cost of any new and unused buildings or improvement owned by the qualifying company.

Exclusions

A company engaged in the following activities, based on the Standard Industrial Classification (SIC) code issued by Statistics South Africa is excluded from the tax incentive:

- Distilling, rectifying and blending of spirits
- Manufacturing of wines
- Manufacture of malt liquors and malt
- Manufacture of tobacco products
- Manufacture of weapons and ammunition
- Manufacture of Bio-fuels, if their manufacture negatively impacts food security in the Republic

In addition to the above excluded activities, which are specified directly in the enabling legislation, provision is also made for a government gazette to be issued, which may specify other types of activities that give rise to companies being subject to exclusion from the tax benefit. *Government Gazette* 39930 was duly issued on 15 April 2016, specifying certain activities (mainly activities that are non-manufacturing in nature) for purposes of preclusion from the SEZ tax incentive.

Detailed categories of activities that are excluded in terms of *Government Gazette* 39930 can be accessed at www.gov.za/sites/www.gov.za/files/39930_gon446.pdf

<u>Designation and approval of SEZs</u>

A qualifying company can only benefit from the tax incentive if the SEZ has been approved by the Minister of Finance based on financial considerations to the state, as required by section 12E(3) of the Income Tax Act.

On 6 July 2018, the Minister of Finance issued *Government Gazette* 41758, and in the process approved qualifying companies contained in the following SEZ's eligible for purposes of the income tax incentives:

- Coega Special Economic Zone
- Dube Tradeport Special Economic Zone
- East London Special Economic Zone
- Maluti-a-Phofung Special Economic Zone

- Richards Bay Special Economic Zone
- Saldanha Bay Special Economic Zone

The effect of the Minister's approval is that 'qualifying companies' with year-ends ending on or after July 2018 can benefit.

It remains possible for the Minister of Finance to designate further SEZs for purposes of enjoying the benefits of the incentive in the future.

8.5. Guide on Valuation of Assets for Capital Gains Tax purposes

This guide provides general guidance on valuations.

The rules for determining capital gains and losses for CGT purposes are largely contained in the Eighth Schedule and apply on or after 1 October 2001.

A capital gain or loss on disposal of an asset is determined by subtracting its base cost from the proceeds.

<u>Pre-valuation date assets</u>

> The base cost of an asset acquired before valuation date is equal to its valuation date value plus any further allowable expenditure incurred on or after the valuation date under paragraph 20.

The valuation date is generally 1 October 2001 but for certain previously exempt entities it can be a later date. For example, the valuation date of a public benefit organisation approved by the Commissioner under section 30(3) is the first day of its first year of assessment commencing on or after 1 April 2006. The valuation date of a recreational club which applied for approval under section 30A on or before 31 March 2009 is the first day of its first year of assessment ending on or after 1 April 2007.

A recreational club approved under section 10(1)(*d*)(iv) that failed to apply for approval under section 30A by 31 March 2009 will have a valuation date equal to the first day of its first year of assessment ending after 30 September 2010.

Three methods are potentially available for determining the valuation date value of a pre-valuation date asset, namely:

- 20% × (proceeds less allowable expenditure incurred on or after valuation date) (generally used when no records have been kept and no valuation was obtained at valuation date);
- market value; or
- Time-apportionment (This method of calculating the value of the asset takes into account how long the asset has been owned before and after valuation date).

<u>Post-valuation date assets</u>

The base cost of an asset acquired on or after valuation date is generally equal to the qualifying expenditure listed in paragraph 20, which includes amongst other things, the cost of acquiring or improving the asset and specified costs of acquisition and disposal. In some situations, however, a post-valuation date asset will be deemed to be acquired at market value, such as when it is acquired by:

- donation, for consideration not measurable in money, or at a non-arm's length price from a connected person;
- inheritance from a deceased estate on the date of death of the testator; and
- distribution in specie from a company.

In some circumstances a taxpayer is deemed to dispose of an asset for an amount received or accrued equal to market value. Some examples include:

- the disposal of an asset by donation, for a consideration not measurable in money or to a connected person at a non-arm's length price;
- cessation of residence, ceasing to be controlled foreign company or becoming headquarter company;
- commencement of residence or foreign company becoming a controlled

foreign company;

- asset ceasing to be part of a person's permanent establishment otherwise than by disposal under paragraph 11;
- conversion of a capital asset to trading stock;
- asset that becomes a personal-use asset; and
- upon the death of a person.

9. INDEMNITY

Whilst every reasonable care has gone into the preparation and production of this update, no responsibility for the consequences of any inaccuracies contained herein or for any action undertaken or refrained from taken as a consequence of this update will be accepted.