TAX UPDATE

For period: 1 January 2019 to 31 March 2019

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1. INTRODUCTION

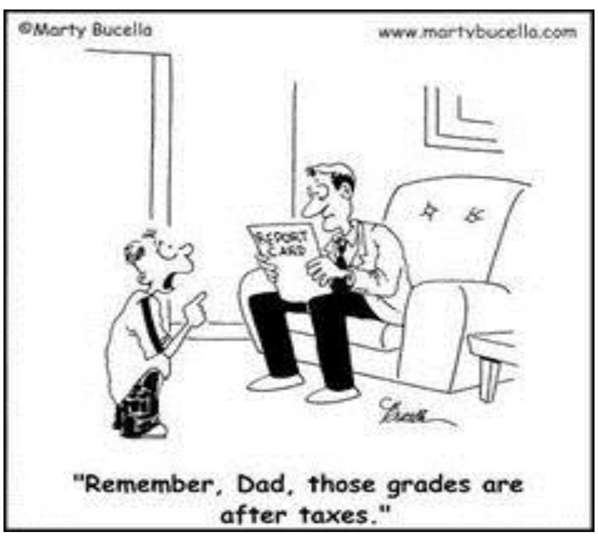
The purpose of this update is to summarise developments that occurred during the first quarter of 2019, specifically in relation to Income Tax and VAT. Johan Kotze, a Tax Executive at Shepstone & Wylie Attorneys, has compiled this summary.

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.

This first quarter of a year is normally dominated by the National Budget, and this year was no exception, other than it being flat compared to previous years. Still, go through the table of contents and consider any aspect that may be of interest.

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. NATIONAL BUDGET

2.1. Personal income tax

2018 year of assessment		2019 year of assessment	
Taxable Income	**Rates of tax**	**Taxable Income**	**Rates of tax**
R0 – R195 850	18% of each R1	R0 – R195 850	18% of each R1
R195 851 – R305 850	R35 253 + 26% of the amount above R195 850	R195 851 – R305 850	R35 253 + 26% of the amount above R195 850
R305 851 – R423 300	R63 853 + 31% of the amount above R305 850	R305 851 – R423 300	R63 853 + 31% of the amount above R305 850
R423 301 – R555 600	R97 225 + 36% of the amount above R423 300	R423 301 – R555 600	R97 225 + 36% of the amount above R423 300
R555 601 – R708 310	R147 891 + 39% of the amount above R555 600	R555 601 – R708 310	R147 891 + 39% of the amount above R555 600
R708 311 – R1 500 000	R207 448 + 41% of the amount above R708 310	R708 311 – R1 500 000	R207 448 + 41% of the amount above R708 310
R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000	R1 500 001 and above	R532 041 + 45% of the amount above R1 500 000
Rebates		**Rebates**	
Primary	R14 067	Primary	R14 220

Secondary Third rebate	R7 713 R2 574	Secondary Third rebate	R7 794 R2 601
Tax threshold		**Tax threshold**	
Below age 65 Age 65 and over Age 75 and over	R78 150 R121 000 R135 300	Below age 65 Age 65 and over Age 75 and over	R79 000 R122 300 R136 750

2.2. Medical tax credits

The 2018 *Budget Review* announced that medical tax credits would be increased below the rate of inflation over a three-year period to help fund the rollout of national health insurance. To generate additional revenue of R1 billion in 2019/20, there will be no change in the monthly medical tax credit for medical scheme contributions.

2.3. Employment tax incentives

In 2018, government extended the employment tax incentive by 10 years. In addition, the eligible income bands will be adjusted upwards to partially cater for inflation. From 1 March 2019, employers will be able to claim the maximum value of R1 000 per month for employees earning up to R4 500 monthly, up from R4 000 previously. The incentive value will taper to zero at the maximum monthly income of R6 500.

2.4. Employment tax incentive boosts job creation

The employment tax incentive was introduced on 1 January 2014 to share the cost of hiring young, inexperienced workers between employers and government. The incentive was reviewed and extended in 2016 and 2018. The most recent review found that the incentive's positive benefits are more pronounced in small firms.

In 2015/16 about 31 000 employers claimed the incentive for 1.1 million individuals. The tax expenditure associated with the incentive amounted to R4.3 billion in 2017/18.

The National Economic Development and Labour Council conducted a review of the incentive, drawing on independent research on the effects of the programme in 2014/15 and 2015/16. The review found that:

- The number of employees and employment growth rates increased significantly in firms claiming the incentive.
- Effects were most pronounced in firms with less than 50 employees, though positive effects held for all firm sizes.
- There is no significant evidence that the incentive displaces older workers.
- The incentive improves employment growth in firms that were growing before claiming, and firms with shrinking employment, demonstrating that it also plays a role in halting job losses.
- Employers tend to retain workers after the two-year eligible period passes because the employees have gained experience and on-the-job training. Young workers indicated that the incentive created opportunities they would not otherwise have.

An additional incentive for special economic zones came into force during 2018. This enables employers to claim for all eligible workers hired in these zones, taking into account wage criteria but not age.

2.5. Additional zero-rating for VAT

A one percentage point increase in the VAT rate took effect on 1 April 2018. To mitigate the effects of this increase on low-income households, the 2018 MTBPS announced that the list of zero-rated items, where VAT is charged at 0%, would be expanded. From 1 April 2019, the list will include white bread flour, cake flour and sanitary pads.

2.6. *Ensuring transparency in tax administration*

To raise the revenue needed to fund its social and economic policy commitments, South Africa requires its tax administration to be efficient, effective and impartial. Reports by the SARS Commission highlight maladministration and abuse of tender procedures that occurred at the entity between 2014 and 2017.

The Commission's main finding is that these failings stem from a 'massive failure of governance and integrity' after the appointent of the entity's previous commissioner in 2014.

Government has started implementing the most urgent recommendations, as discussed below. A new commissioner is expected to be appointed in the near future. The Minister of Finance intends to introduce legislative amendments this year giving effect to a number of the Commission's governance recommendations. These matters will be included in this year's draft tax legislation. Recommendations relating to the creation of an inspector-general for tax administration will be considered in a discussion document.

Government is considering a comprehensive response to the SARS Commission's report. In the interim, it is implementing the Commission's most pressing recommendations, including the following:

- The Presidency has started the recruitment process for a new SARS Commissioner, who will have to consider the Commission's recommendations concerning management of the revenue service.
- SARS is re-establishing a division that will focus on large businesses. This process, which includes the recruitment of specialists, is expected to be completed by April 2019.
- In August 2018, SARS launched an Illicit Economy Unit to investigate syndicated tax evasion schemes in high-risk sectors, including the tobacco trade. This unit has also begun to investigate potential tax-related offences in relation to some of the activities highlighted by various commissions of inquiry.
- SARS has taken steps to strengthen the management of its information

technology systems, rebuild its technical prowess, and harness opportunities arising from information-sharing agreements between national tax authorities.

- Through internal processes, SARS is implementing recommendations concerning inappropriate actions, fruitless and wasteful expenditure, unfair labour practices and maladministration.
- SARS is reviewing contracts that breached public procurement regulations and will act to recover funds spent.

2.7. Clearing the VAT refund backlog

The 2018 MTBPS announced that SARS would pay out overdue VAT refunds, which rose from R30.4 billion at the beginning of the fiscal year to R41.8 billion in September 2018. In subsequent months, SARS has been working to reduce the VAT credit book, which shows the total amount of refunds owed, by paying out an average of R22.2 billion each month.

By end-January 2019, the credit book had decreased from R41.8 billion to R31 billion.

In October 2018 SARS estimated that the credit book should be about R19 billion if verified VAT refunds are paid out without delay.

After further analysis, it has revised that estimate to about R22 billion as a result of rising VAT refund claims, a higher-than-anticipated level of taxpayers who are not submitting the required documents and suspected fraud. The extent of VAT refunds submitted to SARS will also be influenced by general economic conditions, such as imports.

2.8. Energy-efficiency savings tax initiative

The energy-efficiency savings tax incentive was introduced in November 2013 to offset the tax burden on industry from the introduction of the carbon tax. The incentive expires on 31 December 2019. It provides companies with a tax deduction for energy-efficient investments, contributing to environmental goals while reducing energy costs. To encourage additional investment in energy efficiency, government proposes to extend the incentive to 31 December 2022. During 2019, government will review the design and administration of the incentive to improve its ease of use, effectiveness and economic impact.

2.9. Combating base erosion and profit shifting

In recent years, South Africa has taken steps to protect its tax base by closing loopholes exploited by multinationals to artificially shift profits and avoid paying tax. South Africa has played an active role in these efforts through the Organisation for Economic Co-operation and Development/Group of Twenty Inclusive Framework, and intends to expand the work already under way to combat base erosion and profit shifting.

Domestic legislation is already aligned with some measures recommended by the framework, such as limiting double deductions. Although South Africa has measures in place to curb excessive debt financing, which erodes the tax base, government is reviewing these rules against best practice. It is important to strike a balance between attracting capital and investment, and adequately protecting the corporate tax base.

2.10. Review of the urban development zone tax incentive

This incentive was introduced in 2003 to encourage investment in urban development zones in 16 municipalities. It is due to expire on 31 March 2020. Government will review the incentive in 2019 to determine whether it should be extended.

2.11. Review of tax treatment of oil and gas activities

Taxation of the oil and gas industry is currently governed by the Tenth Schedule to the Income Tax Act, which makes provision for the Minister of Finance to approve a fiscal stability agreement to any qualifying company. A fiscal stability agreement guarantees that both the headline rates of tax and the rules behind the calculation of tax liabilities will continue to apply for the duration of a company's oil and gas right.

Government has not approved any fiscal stability agreements in the past five years. South Africa will review its oil and gas tax regimes in 2019.

2.12. Refining the foreign employment income tax exemption for South African residents

From 1 March 2020, South African residents who spend more than 183 days in employment outside the country will be subject to South African taxation on any foreign employment income that exceeds R1 million. To prevent monthly withholding of income tax both in South Africa and the host country, it is proposed that South African employers be allowed to reduce their monthly local pay-as-you-earn (PAYE) withholding by the amount of foreign taxes withheld on the employment income. Before implementation, a workshop will be held to consult taxpayers on their administrative concerns. Any resulting amendments will be processed during the 2019 legislative cycle.

2.13. Extending the scope of amounts constituting variable remuneration

In 2013, section 7B was introduced in the Income Tax Act (1962) to match the timing between the accrual and payment dates of some forms of variable cash remuneration. Section 7B deems certain amounts to accrue when they are actually paid. However, because the scope of this section is limited, it is proposed that it be extended to include certain qualifying payments.

2.14. Retirement reforms – Exemption relating to annuities from a provident preservation fund

Once a member of a retirement fund retires and receives an annuity as a retirement benefit, any contributions to the retirement fund that did not qualify for a deduction when determining the member's taxable income are tax-exempt. This exemption does not apply to annuities received from a provident or provident preservation fund. To encourage annuitisation (regular payments in retirement), it is proposed that this exemption be extended to provident and provident preservation fund members who receive annuities. The exemption would apply for contributions made after 1 March 2016.

2.15. Retirement reforms – Tax treatment of bulk payments to former members of closed funds

Retirement funds are permitted to make certain extraordinary payments to their members tax free, provided that these payments are approved by the Minister of Finance in a Government Gazette notice.

In 2009, the Minister of Finance issued a notice in Government Gazette No. 32005 approving retirement funds to make tax-free payments of 'secret profits', 'surplus calculations' and 'unclaimed benefits'.

When the notice was issued, some deregistered retirement funds had already paid fund administrators, but the amounts were not yet paid to the affected members and/or beneficiaries. It is proposed that these payments currently held by fund administrators on behalf of deregistered retirement funds qualify as tax-free payments, provided they meet the relevant criteria.

2.16. Retirement reforms – Reviewing the tax treatment of surviving spouse

Members of a pension fund can deduct contributions to their retirement funds from their taxable income when determining their monthly employees' tax and annual income tax payable. Upon the death of a member, the surviving spouse may be entitled to receive a monthly spousal pension from the retirement fund. These spousal pension payments are subject to PAYE by the retirement fund.

If the surviving spouse also receives a salary or other income, it is added to the spousal pension to determine his or her correct tax liability on assessment. The result of the assessment is often that the surviving spouse has a tax liability that exceeds the employees' tax withheld by the employer and retirement funds during the year of assessment, since the aggregation of income pushes them into a higher tax bracket. In most cases, the surviving spouse does not foresee the additional tax liability and does not save money to settle the liability. This creates a cash flow burden and a tax debt for the surviving spouse. It is proposed that:

- Surviving spouses are provided with effective communication relating to tax and financial issues
- The monthly spousal pension be subject to PAYE withholding at a specified flat rate
- Tax rebates should not be taken into account in the calculation of spousal pensions.

Any PAYE excessively withheld as a result of this proposal will be refunded upon assessment.

2.17. Retirement reforms – Reviewing the non-resident employer requirement

Every employer who pays remuneration (as defined in the fourth schedule to the Income Tax Act) is required to register with the South African Revenue Service (SARS) and submit monthly and bi-annual tax returns for employees' tax to SARS. If the employer is not a resident of South Africa, this requirement applies irrespective of whether the employer is obliged to withhold PAYE. It is proposed that this requirement be reviewed to determine whether an exclusion from registration is warranted for this type of employer.

2.18. Addressing abusive arrangements aimed at avoiding the anti-dividend stripping provisions

In 2017, the rules governing share buy-backs and dividend stripping were changed to prevent taxpayers from avoiding taxation of share disposals by companies. In 2018, these rules were again adjusted to prevent harm to legitimate corporate reorganisations. However, some taxpayers are now undermining the adjusted rules. These arrangements involve the target company distributing a substantial dividend to its current company shareholder and subsequently issuing shares to a third party. As a result, the value of the current company shareholder's holding in the shares of the target company is diluted and these shares are not immediately disposed of. This differs from the previous avoidance arrangements that involved disposing of the same shares in return for a tax-exempt dividend. To curb this new form of abuse, it is proposed that the rules governing share buy-backs and dividend stripping be amended. These amendments will take effect on 20 February 2019.

2.19. Correcting anomalies arising from applying value-shifting rules

Clarifying the effect of deferred tax liability on the market value of issued shares:

Current anti-avoidance provisions target value shifting through asset-for-share transactions that apply when the market value of the assets acquired differs from the market value of the shares issued in exchange. However, the current provisions do not include the effect of a deferred tax liability (related to the acquired asset) on the market value of the shares. It is proposed that the Income Tax Act be amended to clarify that any difference in value due to the deferred tax liability should not be subject to the relevant provisions.

Clarifying the effect of a capital gain from the operation of the anti-avoidance rules on the base cost of shares acquired in exchange for assets:

In 2012, rules were introduced to prevent the transfer of high-value assets to a company in return for shares issued by the company with a different value. These rules trigger a capital gain or a deemed *in specie* dividend event for one of the parties. Other rules state that a company issuing shares in exchange for assets is deemed to have acquired the assets for expenditure equal to the market value of the shares. However, this deemed acquisition value does not include any capital gains previously triggered by the anti-value shifting rules, thereby resulting in possible double taxation when the company disposes of the assets later. It is proposed that the rules be amended to prevent this.

2.20. Refining provisions around the special interest deduction for debt-funded share acquisitions

Special interest deduction following company reorganisations after an acquisition:

Current provisions allow a special interest deduction relating to debt-financed acquisitions of controlling shares in an operating company, but require that the acquirer of those shares assess whether they still qualify for the deduction under certain circumstances. It is proposed that this requirement be reconsidered if the acquirer remains a (direct or indirect) controlling shareholder of the specific entity after certain reorganisation transactions.

Anti-avoidance rules targeting shareholders claiming the special interest deduction for start-up companies:

Some taxpayers are claiming the special interest deduction for debt-funded capitalisation of newly established companies. This deduction is intended for debt-funded acquisitions of a controlling interest in companies that already generate income. It is proposed that changes be made to ensure that taxpayers do not claim the deduction for unintended purposes.

2.21. Clarifying the interaction between corporate reorganization rules and other provisions of the Income Tax Act

Clarifying corporate reorganisation rules relating to exchange items and interest-bearing instruments:

The current corporate reorganisation rules allow the tax-neutral transfer of assets between companies that are part of the same group. However, the provisions do not specify how exchange items and interestbearing assets should be treated during corporate restructuring. It is proposed that the legislation clarify that the transfer of these items and assets is excluded from the rules. This is because unrealised values on the date of transfer should be triggered in the transferor companies.

Refining the interaction between the anti-avoidance provisions for intra-group transactions:

The corporate rollover provisions regarding intra-group transactions contain multiple anti-avoidance measures. However, it is not always clear how these measures interact with each other. In particular, separate measures often cause punitive tax consequences that are not taken into account should another measure subsequently apply, which results in potential double taxation. It is proposed that these provisions be refined by clarifying how the measures interact.

Harmonising the degrouping charge provisions for intra-group transactions and controlled foreign companies:

If a company leaves a group but retains an asset acquired within the last six years through the relief provided in the corporate reorganisation rules, a degrouping charge applies. This charge is intended to revoke the tax-neutral status of the original transaction and is designed to deem a capital gain to arise in the year of assessment in which the degrouping takes place. However, provisions relating to controlled foreign companies in sections 9D and 9H of the Income Tax Act determine that the year of assessment in which the degrouping takes place starts and ends on the same day. It is proposed that changes be made to harmonise these provisions across the corporate reorganisation and controlled foreign company rules.

2.22. Amending rules to allow company deregistration by operation of law

In some corporate reorganisation rules, to qualify for the tax-neutral transfer of assets, one or more of the companies involved should cease to exist after the transaction. The legislation lists steps that show a taxpayer meeting this requirement. However, the steps do not take into account deregistration by operation of law. It is proposed that the rules be amended to include this option.

2.23. Study on the tax treatment of amounts received by portfolios of collective investment schemes

In 2018, amendments were proposed in the Taxation Laws Amendment Bill to tax the profits of some collective investment schemes as revenue instead of capital. After reviewing the public comments on this draft, government decided that more time is needed for it to work with industry to find solutions that will not negatively affect the relevant groups. This study is proposed for the 2019 legislative cycle.

2.24. REIT – Tax treatment of unlisted REITs

The implementation of the Financial Sector Regulation Act (2017) and the establishment of the Financial Sector Conduct Authority allows regulation of unlisted REITs. It is proposed that government consider the regulation and tax treatment of unlisted REITs that are widely held or held by institutional investors, in line with the announcement in the 2013 *Budget Review*.

2.25. REIT – Clarifying inconsistencies in the current REIT tax

regime

The current REIT tax regime contains various inconsistencies, including the definition of rental income as applied to foreign exchange differences and the interaction between the REIT tax regime and corporate reorganisation rules. It is proposed that the legislation be amended to clarify these inconsistencies. Government undertakes to review the efficacy of the current REIT regime.

2.26. Refining taxation of risk policy funds

From 2016, risk policy funds were introduced to tax long-term insurers. However, if a policy allocated to a risk policy fund is paying benefits in the form of an annuity, then the transfer of assets between that fund and the untaxed policyholder fund of the insurer creates an administrative burden. It is proposed that the legislation be amended to address this.

2.27. Aligning income tax provisions with the Insurance Act

The Insurance Act (2017), which came into effect during 2018, replaced provisions of the Long-Term Insurance Act (1998) and the Short-Term Insurance Act (1998). It is proposed that definitions in the Income Tax Act be revised in line with the new Insurance Act.

2.28. Refining the special economic zone regime

Reviewing anomalous provisions:

As taxation provisions relating to special economic zones preceded implementation of the programme, there is now some misalignment between the provisions and the stated objectives of the programme. Government proposes to review these provisions to clarify the policy intent and address unintended misalignment with the Special Economic Zone Act (2016).

Reviewing the anti-avoidance measures relating to transactions between a company and connected persons:

Qualifying companies deriving taxable income from within the special economic zone regime can benefit from a reduced corporate tax rate of 15%. To counter potential profit-shifting, a qualifying company cannot claim this benefit if more than 20% of its deductible expenditure or its income arises from transactions with connected persons. This anti-avoidance measure may harm legitimate business transactions as some business models in special economic zones were accepted before the antiavoidance measure was introduced. It is proposed that the measure be reviewed and clarified to meet its original intent.

2.29. Reviewing the venture capital company tax regime

In 2018, changes were made to the venture capital company tax regime to prevent abuse of various aspects of the system. It has come to government's attention that some taxpayers are attempting to undermine other aspects of the regime to benefit from excessive tax deductions. It is proposed that these rules be reviewed to prevent this abuse.

2.30. Reviewing controlled foreign company rules

Reviewing the comparable tax exemption:

As noted in the 2018 Budget, the global trend towards reducing corporate tax rates affects the current controlled foreign company comparable tax exemption. It is proposed that the exemption threshold be reduced from the current percentage, taking into account the sustainability of the tax base.

Addressing circumvention of anti-diversionary rules:

The rules for controlled foreign companies aim to prevent South African taxpayers from shifting income that should be taxed in South Africa to an offshore jurisdiction with a beneficial taxation regime. These rules are inadequate for multi-layered transactions. Government has identified schemes where controlled foreign companies (that are part of a group) are interposed in the supply chain between

South African connected parties and independent non-resident customers or suppliers. It is proposed that additional measures be introduced to prevent this circumvention.

2.31. Reviewing the definition of permanent establishment

The current definition of permanent establishment in the Income Tax Act is based on the definition developed by the Organisation for Economic Co-operation and Development (OECD). In November 2017, the OECD expanded this definition. When South Africa signed the OECD multilateral convention, it did not expand the permanent establishment definition. As a result, South African tax treaties use the narrow definition of permanent establishment. However, the definition in the Income Tax Act uses the expanded OECD definition. It is proposed that the permanent establishment definition in the Income Tax Act be reviewed to determine whether a limitation is warranted.

2.32. Revising tax relief for blocked foreign funds

The Income Tax Act provides tax relief for a South African tax resident when funds are blocked in a foreign country due to currency restrictions or foreign legal limitations. The resident can claim foreign tax credits for foreign taxes paid on foreign income. These credits are lost if the blocked funds are released more than seven years from the tax year in which the foreign income accrued. It is proposed that this seven-year limitation be reconsidered.

2.33. Definition of 'domestic treasury management company'

The domestic treasury management company regime allows qualifying companies to expand into other African countries. Within this regime, a company is so defined if it is incorporated in South Africa, deemed to be incorporated in South Africa, or effectively managed from South Africa and is not subject to exchange control restrictions. In 2017, the Income Tax Act was amended to remove the incorporation requirement. However, the Reserve Bank definition in Circular 5/2013 still includes this requirement. As a result, the 2017 changes are not aligned with the Reserve Bank requirements. It is proposed that the definition of 'domestic treasury management company' is changed in the Income Tax Act to reintroduce the incorporation requirement.

2.34. Revising the Income Tax criteria for recognized exchanges

The Income Tax Act defines a recognised exchange as a stock exchange licensed under the Financial Markets Act (2012) or a similar exchange in another country that has been recognised by the Minister of Finance in the Government Gazette. Since 2001, the criteria used to recognise foreign exchanges have not been revised. It is proposed that a review of these criteria be considered.

2.35. Reviewing the 'affected transaction' definition in the arm's length transfer pricing rules

The 'affected transaction' definition relating to arm's length transfer pricing rules in the Income Tax Act applies to transactions between connected persons as defined in the act. However, in the OECD Model Tax Convention, the transfer pricing rules apply to transactions between associated enterprises.

Government proposes to review the scope of these rules to determine whether the definition in the act should be changed in line with the OECD definition.

2.36. Clarifying the interaction of capital gains tax and foreign exchange transaction rules

Assets disposed of or acquired in foreign currency are subject to taxation under both the foreign exchange transaction rules and capital gains tax rules. To prevent double taxation of assets, foreign debt is currently excluded from the specific capital gains tax rules. However, it is unclear how the general rules apply if foreign bonds are disposed at a capital gain or loss. It is proposed that these rules be reviewed to prevent potential double taxation.

2.37. VAT - Reviewing the definition of 'group of companies' for electronic services regulations

From 1 April 2019, regulations prescribing electronic services will expand the scope of electronic services required to pay value-added tax (VAT) in South Africa. These regulations exclude electronic services supplied between companies in a 'group of companies', if a non-resident company supplies such services to a domestic company within the same group. The regulations define 'group of companies' to include two or more companies that hold shares in at least one other company such that 100% of equity shares in each controlled company are directly held by the controlling company in the group. However, this 100% shareholding requirement may exclude companies because of employee incentives or other empowerment programmes. It is proposed that the definition be changed to reflect this understanding. The change will come into effect on 1 April 2019.

2.38. VAT - Clarifying financial services to include the transfer of long-term reinsurance polivy

The VAT Act (1991) makes provision for the activities of providing or transferring ownership of a longterm insurance policy, or providing reinsurance relating to any such policy, to be deemed to be financial services. However, the act does not specify how to treat the transfer of a long-term reinsurance policy. It is proposed that the act be amended to clarify this treatment.

2.39. VAT – Aligning provisions of the VAT Act with the Insurance Act

It is proposed that certain definitions referenced in the VAT Act are revised to align with the Insurance

Act.

2.40. VAT – Refining the VAT corporate reorganization rules

In line with the Income Tax Act, the VAT Act provides relief for companies in the same group by treating the supplier and the recipient of goods or services as the same person during corporate reorganization transactions. If these transactions take place in terms of sections 42 or 45 of the Income Tax Act, VAT relief is only permitted if the transfer relates to a going concern. However, transfers of fixed property under these sections may not always involve a going concern, especially in sale and lease-back situations. It is proposed that the VAT Act be amended to clarify treatment in these instances.

2.41. VAT – Treatment of rental stock paid in terms of the National Housing Programme

In the VAT Act, a vendor (such as a municipality) is deemed to supply services to any public authority (for example, the Department of Human Settlements) if the vendor is paid or makes a payment in line with the National Housing Programme outlined in the Housing Act (1997). However, it is difficult to interpret the VAT treatment of payments relating to rental stock. It is proposed that the VAT Act be amended to clarify the treatment of rental stock in these instances.

2.42. VAT – Reviewing section 72

Section 72 of the VAT Act gives SARS discretionary powers to apply provisions relating to the calculation or payment of tax or the application of any provision, exemption or zero rate, in cases where 'difficulties, anomalies or incongruities have arisen' due to the business conduct of a particular vendor or vendors. It is proposed that a constitutional review of section 72 of the VAT Act be conducted given the challenges that arose as to its application in respect of mandatory wording of the VAT Act.

2.43. VAT – Refining the treatment of foreign donor-funded projects

The VAT Act provides relief for foreign donor-funded projects if they meet specified criteria. However, the criteria and the type of projects that qualify are unclear, especially if the project is sub-contracted to different contractors. It is proposed that these provisions be amended to clarify the policy intention.

2.44. Tax Administration – Model mandatory disclosure rules and non-compliance penalties

It has emerged internationally that offshore structures and arrangements are being designed in an attempt to circumvent financial account reporting under the OECD's Common Reporting Standard. The standard is used for the exchange of information between countries. It is proposed that the OECD's model mandatory disclosure rules be implemented in South Africa to identify and counter such structures and arrangements, and that similar penalties to those currently in force for non-compliance with the reportable arrangement legislation be imposed for non-compliance with the rules.

2.45. Tax Administration – Tax compliance certificates

The legislative provisions relating to tax compliance certificates will be updated to include recent system requirements.

3. REGULATIONS

3.1. Media Statement – Publication of the 2018 Tax Act and accompanying documentation

The President has signed into law the three 2018 tax bills:

- Rates and Monetary Amounts and Amendment of Revenue Laws Act, 2018 (Act No. 21 of 2018) (2018 Rates Act),
- the Taxation Laws Amendment Act, 2018 (Act No 23 of 2018) (2018 TLAA), and
- the Tax Administration Laws Amendment Act, 2018 (Act No 22 of 2018) (2018 TALAA).

The Acts are available on the National Treasury and SARS websites. These Acts give legislative effect to the tax proposals as outlined by the Minister of Finance in his annual National Budget Speech delivered on 21 February 2018.

The 2018 Rates Act gives effect to significant tax proposals, such as changes in tax rates and monetary thresholds and excise duties on alcoholic beverages and tobacco products, as well as an increase in the VAT rate from 14% to 15%. This Act further gives effect to consequential proposals that were announced in the 2018 Medium Term Budget Policy Statement (MTBPS), such as the zero-rating of white bread flour, cake flour and sanitary pads. These proposals followed the work of the Independent Panel of Experts, established by the Minister of Finance, to investigate potential mechanisms of mitigating the impact of the VAT rate increase on poorer households, after a lengthy public consultation process.

The 2018 TLAA deals with technical and anti-avoidance measures aimed at forcing certain taxpayers to cease using certain tax planning techniques that have an adverse effect on the amount of taxes available for collection.

The 2018 TALAA contains tax proposals that are technical and administrative in nature. It also contains a consequential amendment, proposed by the Standing Committee on Finance, that requires the Minister of Finance to evaluate the impact of the VAT rate increase on revenue collection and the poor. The Minister of Finance will be expected to table a report in Parliament by no later than 30 June

2021.

A Final Response Document on the 2018 Rates and Monetary Amounts and Amendment of Revenue Laws Bill, Final Response Documents and Explanatory Memorandum to the 2018 Taxation Laws Amendment Bill (TLAB) and Memorandum of object to the 2018 Tax Administration Laws Amendment Bill (TALAB) are also published.

The Final Response Documents update the Draft Response Documents to take into account submissions and decisions made following further inputs by stakeholders and the Standing Committee on Finance during public hearings on the 2018 Rates Bill and 2018 TLAB and TALAB.

3.2. Regulation prescribing electronic services for the purpose of the definition of 'electronic services' in the VAT Act

I INTRODUCTION

In 1998 the OECD hosted a conference entitled 'A Borderless World: Realising the Potential of Electronic Commerce'. This conference was held in Ottawa. The taxation framework that was developed at the conference came to be known as the 'Ottawa Taxation Framework'.

Some of the recommendations of the Ottawa Taxation Framework were that in developing domestic laws to deal with electronic commerce, jurisdictions must seek to ensure that VAT should be as neutral and equitable as possible for vendors, the VAT system and laws should be efficient, effective and create certainty and fairness in treatment for all taxpayers. It also proposed that tax rules should be simple and clear to understand.

In 2006 the OECD Committee on Fiscal Affairs (CFA) launched a project to develop a guideline relating to international VAT/GST (the International VAT/GST Guidelines). The intention of the Guidelines was to develop a framework for internationally agreed principles relating to VAT. This initial guideline discussed the principles set out in the Ottawa Taxation Framework. With regard to electronic commerce across borders, this guideline referred to existing taxation frameworks such as 'VAT on imported services'/'reverse charge mechanisms'.

In 2012 the CFA created the Global Forum on VAT in order to engage and involve more countries in discussions relating to global VAT issues.

In 2013 the OECD launched an action plan to address tax revenue losses due to Base Erosion and Profit Shifting (BEPS) practices, as requested by the G20 Finance Ministers. On the 19 July 2013 the OECD released a report entitled 'Addressing Base Erosion and Profit Shifting' (the BEPS report) in which it pointed out that base erosion and profit shifting not only constituted a serious risk to tax revenues, but also to the tax sovereignty and tax fairness for both OECD countries and non-member countries.

The OECD proposed 15 action items to address BEPS concerns. Action Plan 1 which deals with the challenges of the digital economy, called for work to be done to address the tax challenges of the digital economy. The OECD's Working Party 9 (which was created due to Action Plan 1) was tasked with developing guidelines relating to International VAT/GST. These guidelines were to focus more specifically on internationally agreed principles relating to the BEPS concerns from a VAT perspective.

In the realm of VAT, the cross border supply of goods posed less of a threat to revenue loss than the cross border supply of services supplied via electronic means. Goods are tangible and would be required to pass through border posts that are generally strictly controlled across jurisdictions. Depending on domestic legislation and value thresholds, these goods could be subject to both Customs Duty and VAT, thereby placing the foreign supplier in a similar tax position as a domestic supplier and thus reducing distortions in trade competitiveness.

The same could not be said of the cross border supplies of services supplied electronically since these are provided via the internet or cloud or through other forms of electronic agents or communication methods. These were largely invisible to tax authorities.

Countries relied on domestic legislation such as those dealing with 'imported services' or 'reverse charge mechanisms' for the collection of VAT on these supplies of services. The heavy reliance on recipients declaring VAT on imported services in South Africa (as in most jurisdictions) was problematic since it could not be monitored for compliance and collection purposes.

As the digital trade in goods and services grew, so too did the potential for tax avoidance. Often these were done within the ambit of domestic legislation. The BEPS report highlighted the need to introduce domestic legislation to combat the potential unintended non-taxation and to provide clarity and certainty with regard to taxing the digital economy. The OECD's revised 'International VAT/GST Guidelines' provides broad guidelines on the framework for developing domestic legislation in this area. It encompasses internationally agreed upon principles and discusses the various options available to countries.

It was the view that if countries reached agreement on matters such as which country has the taxing rights in the cross border supplies of services, then entities doing business across borders as well as consumers would have certainty on what the VAT implications of the transactions would be and issues relating to double taxation and double non-taxation would be reduced.

The Ottawa Taxation Framework further endorsed the destination principle of VAT which is the one that the South African VAT Act is based on. This in essence means that the place of taxation is generally the place of consumption.

II BACKGROUND

Prior to 2014, the Value-Added Tax Act, No. 89 of 1991 provided for the inbound supply of electronic services to be taxed by means of the 'imported services' provisions. In terms of these provisions, in certain instances, the domestic recipient of these services was to declare VAT on the services received.

On the 28 March 2014, Government published Regulations Prescribing Electronic Services for the purpose of the definition of 'Electronic Services' in section 1(1) of the VAT Act in terms of Government Notice No.R221 published in Government Gazette No. 37489 (Regulations) that gave effect to the 2013 amendments, which changed the way that certain imported electronic services were taxed. This effectively shifted the onus of the VAT from the domestic recipient to the supplier of electronic services that is situated in an export country. The effective date of the

Regulations was 1 June 2014.

Further, in keeping with the OECD Guidelines, SARS provided for a streamlined VAT registration and administrative process that significantly reduced the compliance burden on businesses that are required to register in terms of the Regulation.

In line with measures to address base erosion and profit shifting, Government made proposals in the previous Budget Reviews to update these Regulations to include software and other electronic services, to remove some uncertainties and to broaden the scope of electronic services.

III DETAILED EXPLANATION OF REGULATIONS

The main purpose of the Regulations is to prescribe those services that are 'electronic services' for the purposes of the definition of 'electronic services' in section 1(1) of the Act. However, the current regulations limit the scope of electronic services that are taxable under these regulations. The intention of these amendments to the Regulations is to widen the scope of the Regulations to apply to all 'services' as defined in the VAT Act that are provided by means of an electronic agent, electronic communication or the internet for any consideration. In doing so, the policy intention is to reduce the risk of distortions in trade between foreign suppliers and domestic suppliers where VAT is one of the reasons for such distortions.

The policy intention is to subject to VAT those services that are provided using minimal human intervention. Hence, for example, legal advice prepared outside the Republic by a non-resident and sent to a person in the Republic via email, will not be subject to these Regulations. The download of a movie or the provision of the right to use an APPLICATION (APP), for example, may be subject to these Regulations if all other requirements are met.

A. Persons required to register for VAT

The supplier of the electronic services will be required to register for VAT in the Republic if the supplier meets the following:

1. Where electronic services are supplied by a person from a place in an

export country (an electronic service supplier); and

2. Such person is conducting an 'enterprise' in the Republic, as defined in section 1(1) of the VAT Act; and at least two of the following circumstances are present:

   a. The recipient of the electronic services is a resident of the Republic;

   b. Any payment made to the supplier in the export country (for the supply of the electronic services) originates from a bank registered or authorised in South Africa, in terms of the Banks Act 94 of 1990;

   c. The recipient of those electronic services has a business, residential or postal address in the Republic; and

3. The total value of the taxable supplies made by that person in the Republic has exceeded R1 million within any consecutive 12-month period (section 23 (1A)). This compulsory registration threshold is consistent with the domestic compulsory registration threshold.

The provisions of the VAT Act apply to all supplies of electronic services that are supplied by an electronic service supplier that is required to be registered for VAT in the Republic. Persons who are registered or required to be registered for VAT in the Republic are called 'vendors'. This is defined in section 1(1) of the VAT Act.

Supplies that are exempt from VAT in the Republic will not be subject to these Regulations. For example, financial services that could normally be subject to these Regulations will not be subject to these Regulations if they are the type of 'financial services' as contemplated in section 2 of the VAT Act and would have been exempt if provided by a person in the Republic.

Where the supplier is not required to register for VAT in terms of these Regulations or is required to register and levy VAT but fails to do so, the recipient of the services in the Republic will still be liable to declare VAT on imported services, where the requirements for such are met.

B. Exclusions

It is proposed that the following services should be excluded from the definition of 'electronic services' in the Regulations:

B1. Educational services provided by a person from an export country which person is regulated by an educational authority in terms of the laws of that export country;

B2. Telecommunications services; and

B3. Certain supplies within a group of companies

B2. 'Telecommunications services' is defined in the Regulation and excludes the content of telecommunications.

B3. Currently, the VAT Act does not make any distinction between B2B (Business to Business) and B2C (Business to Consumer) domestic supplies. Introducing this concept for non-resident suppliers would create an unfair cash-flow advantage for the non-resident suppliers which domestic suppliers would not be in a position to benefit from.

However, in order to limit the administrative burden, electronic services supplied between companies in the same group may be excluded from these Regulations. Electronic services that are supplied by a non-resident company to a resident company that forms part of the same group of companies will be excluded from these regulations provided that the services are supplied exclusively for the purposes of consumption by the resident company. The term 'group of companies' is defined in the Regulations.

An example of these supplies would be where an IT non-resident company supplies IT solutions of its own to a company in the Republic, where both such companies are members of the same group of companies. Where, for example, such non-resident company procures the IT services from a third party and then on-supplies them to a company within the Republic (where both such companies are members of the same group of companies), such services will not qualify for the exclusion. These would typically be global contracts entered into with third party suppliers for the benefit of all the companies within the group.

The policy rationale for excluding these supplies between companies within the same group of companies is to prevent the situation where a non-resident company within the group meets the requirements for compulsory registration in terms of these regulations purely on the basis of supplies that it makes to a resident company within the same group of companies, which supplies of electronic services are utilised or consumed within the same group of companies.

The policy rationale for excluding global contracts from this 'carve-out' is that this approach is an anti-avoidance measure.

C. Intermediaries and Platforms

Currently, the VAT Act and Regulations do not provide for 'intermediaries' and 'platforms' to be the principal supplier of the electronic services. In order to broaden the scope, further amendments are proposed in the VAT Act and Regulations to specifically deal with 'intermediaries' and 'platforms'.

It is proposed that where suppliers provide electronic services using the electronic platform of another 'person', as defined, such 'person' (referred to as an 'intermediary') will be deemed to be the supplier for VAT purposes where that person facilitates the supply of the electronic services and is responsible for, amongst other things, the issuing of the invoice and the collection of the payment. The requirement of being 'responsible for' would be met even if these functions are outsourced, provided that the intermediary has a responsibility to ensure that the invoice is issued and / or the payment is made to the underlying supplier.

This would exclude those intermediaries that are only facilitating payment (i.e. pure payment platforms only).

The definition of 'services' in section 1(1) of the VAT Act encompasses 'anything done or to be done, including the granting, cession or surrender of any right or the making available of any facility or advantage, but excluding a supply of goods….'.

Hence, where a person provides the use of its platform and meets the requirements discussed in 'A' above, such person will be required to register for VAT in the Republic.

D. Compliance

Recipients of electronic services that are registered for VAT in the Republic may claim the VAT charged as input tax credits, based on whether the expenses incurred are wholly or partially for the making of taxable supplies.

Where the supplier of the electronic services is not required to register for VAT in the Republic as a result of not meeting the requirements for VAT registration discussed above, the recipient of those services may be required to declare VAT on imported services in terms of the definition of 'imported services' in section 1(1), the provisions of section 7(1)(c) and section 14 of the VAT Act.

Currently, neither the VAT Act nor the Regulations make any distinction between business-to-business supplies and business-to-consumer supplies. This is intentional. This distinction does not exist for domestic suppliers and in the interest of fairness and equity, the distinction will not be introduced for purposes of these Regulations.

Electronic Service Suppliers may register for VAT in the Republic using the simplified registration procedures as provided for in the SARS (South African Revenue Services) VAT Registration Guide for Foreign Suppliers of Electronic Services.

Vendors may find further guidance on matters relating to registrations, tax periods, time and value of supply, tax invoices, VAT returns, etc. in the SARS VAT 404 – Guide for Vendors. This is a comprehensive guide on the application of the VAT Act.

For ease of reference, we have quoted the relevant sections of the VAT Act as 'Annexure A' hereto.

IV EFFECTIVE DATE

The proposed amendments to the Regulations will come into effect on 1 April 2019.

4. TAX CASES

4.1. C:SARS v Volkswagen South Africa (Pty) Ltd

At the end of each tax year, Volkswagen held as trading stock a number of unsold vehicles and some of these were manufactured or, in the case of trucks and buses assembled, at its plant in Uitenhage, while others were imported, and a certain number of second-hand vehicles were drawn from its own fleet.

Volkswagen, in determining its taxable income, was obliged by section 22(1)(*a*) of the Income Tax Act to attach a value to that trading stock and, ordinarily, that value was the cost price of the stock calculated in accordance with the provisions of the Income Tax Act.

Volkswagen, in its returns for the 2008, 2009 and 2010 tax years, calculated the value of its trading stock at year end using its 'net realisable value' (NRV) in accordance with the provisions of International Accounting Standard 2 (IAS 2) and the IFRS- Accounting Handbook for Volkswagen Group. This yielded an amount less than the cost price of the trading stock and it claimed a deduction from the cost price of the trading stock represented by the difference between that and NRV.

SARS conducted a lengthy audit of Volkswagen's tax affairs covering a wide range of issues for the tax years 2008, 2009 and 2010 and at the end of it SARS rejected the contention that NRV represented the diminished value of the trading stock at the end of those years. The differences between cost price and NRV for the three years in dispute were respectively R72 002 161, R24 778 855 and R5 294 643.

SARS' refusal of an allowance in these amounts resulted in the issue of revised assessments reflecting substantial increases in the value of the stock, with corresponding increases in the taxable income and hence levying additional tax for those three years and Volkswagen thereafter objected and successfully appealed to the Tax Court against those assessments.

The court *a quo*, being the Port Elizabeth Tax Court (see *ITC 1901* 80 SATC 58 *per* Eksteen J) upheld the appeal and set the revised assessments aside and the present appeal lay directly to the Supreme Court of Appeal in accordance with leave granted by Eksteen J.

During the tax years under consideration in this appeal, section 22(1)(*a*) of the Act read as follows:

> 'The amount which shall, in the determination of the taxable income derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be–
>
> *(a)* in the case of trading stock other than trading stock contemplated in paragraph (*b*), the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock…has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reasons satisfactory to the Commissioner….'

Section 22(1)(*a*) accordingly provided that a taxpayer who claimed that the NRV of an item of stock was less than its cost price would have to satisfy SARS that this claim was acceptable and the criteria for so deciding were set out in the section, these being: damage, deterioration, change of fashion, decrease in the market value or for any other reasons satisfactory to SARS.

Section 22(3) provided that the taxpayer may add to the actual price paid for the goods, the costs incurred in getting them into their current condition and location, and any further costs required to be included in terms of any generally accepted accounting practice approved by SARS.

The parties formulated their dispute in the following way: Whether the NRV of Volkswagen's trading stock, calculated in accordance with IAS 2 and taking account of the individual categories of costs referred to…above, may and should, where it is lower than the cost price of such trading stock as determined in accordance with section 22(3) of the Act, be accepted as representing the value of trading stock held and not disposed of at the end of the respective years of assessment for purposes of section 22(1)(*a*) of the Act.

The categories of costs referred to were described generally as rework/refurbishment costs; outbound logistics; marine insurance; sales incentives; distribution fees; warranty costs, costs relating to the Audi Freeway Plan and Volkswagen AutoMotion Plan and roadside assistance costs.

The dispute in this case was whether the value of Volkswagen's trading stock had diminished entitling SARS to make a just and reasonable allowance under the section. In practical terms, an allowance permits the taxpayer to reflect the value of its trading stock at less than cost price in its tax return.

Volkswagen contended that it should be entitled to do this on the basis of the NRV of its trading stock at each of the three year ends from 2008 to 2010 and it stated that the NRV reflected that the value of the trading stock had diminished.

The court *a quo* held that the NRV as set out in IAS 2 was an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment. The NRV, determined in this manner, must be compared to the cost price, computed in accordance with section 22(3) of the Act in order to determine whether a diminution in value had in fact occurred.

The court *a quo* stated further that in all the circumstances, whereas section 22(1) was silent as to the manner of valuation of trading stock at the conclusion of a year of assessment in order to determine whether a diminution in value had occurred, the adoption of the NRV as a method of the assessment of value provided a sensible, businesslike result which accorded with the purpose of section 22(1) in the context of the Act and with the weight of authority.

Wallis J held the following:

<u>As to the judgment of the court a quo</u>

(i) That the effect of the judgment was that where the valuation of trading stock at NRV at the close of a fiscal year reflected a value lower than cost price, SARS was obliged to make an allowance for the diminution in value of the trading stock in accordance with section 22(1)(*a*) of the Act. As will be appreciated, this had potentially far-reaching consequences for SARS extending beyond the present case. Under Generally Accepted Accounting Principles in South Africa ('GAAP') trading stock at the end of a year must be valued at NRV. If the judgment of the Tax Court was correct then, wherever NRV was less than the cost price of trading stock, SARS would be obliged to permit taxpayers to value trading stock at year end at the lower of cost price or NRV and the question was whether that was consistent with the provisions of section 22(1)(*a*) of the Act.

As to the application of section 22(1)(a) of the Income Tax Act 58 of 1962

(ii) That the starting point in construing the section is the cost price of the trading stock. The manner in which that has to be calculated is dealt with in section 22(3)(*a*) of the Act. The parties are agreed that in the circumstances of this case, the court *a quo* (see *ITC 1901* 80 SATC 58) correctly held that the latter section did not affect the proper interpretation of section 22(1)(*a*). The section empowers SARS to allow a deduction from the cost price, by way of a just and reasonable allowance, in certain circumstances where the value of the trading stock has diminished.

(iii) That four circumstances, namely, damage, deterioration, change of fashion or decrease in market value, are specified as causing a diminution in the value of trading stock. The section contemplates the possibility of there being other reasons for a diminution of value apart from the four that it specifies. For that reason it empowers SARS to make a just and reasonable allowance to accommodate a diminution in value of trading stock for any other reason that may be satisfactory to SARS.

(iv) That the taxpayer is required to determine the value of its trading stock at a particular point in time, namely, the end of the tax year. As is generally the case in determining the taxpayer's taxable income that is an exercise of looking back at what happened during the tax year in question. An important aspect of the language in section 22(1)(*a*) is that the allowance that SARS may think just and reasonable is 'an amount by which the value of the trading stock has been diminished.' That language is couched in the past tense. The section is accordingly not concerned with what may happen to the trading stock in the future, but with an enquiry as to whether a diminution in its value has occurred at the end of the tax year. All of the instances expressly referred to in the section, namely damage, deterioration, change of fashion and decrease in market value, relate to a diminution of value occurring prior to the taxpayer rendering its return as a result of events occurring prior to that date.

(iv) That SARS submitted that it necessarily followed that there could only be a diminution of value arising from events that had already occurred before the end of the tax year. In other words, the events relied on as demonstrating a diminution in value of the trading stock must have occurred during the tax year, even though their impact might only be felt in the following year. There was merit in this submission, although it did not entirely remove the element of futurity from the enquiry. A determination of the current value of goods that have not yet been sold, but will be sold in the future, necessarily involves a measure of prediction in regard to future events.

(v) That the correct position is that SARS may only grant a just and reasonable allowance in respect of a diminution in value of trading stock under section 22(1)(*a*) in two circumstances. The first is where some event has occurred in the tax year in question causing the value of the trading stock to diminish. The second is where it is known with reasonable certainty that an event will occur in the following tax year that will cause the value of the trading stock to diminish. Both scenarios are consistent with the basic proposition that the assessment of income tax relates to events that have already occurred rather than events that may occur in the future.

(vi) That a trading entity that manufactures or acquires goods for resale does so in the expectation that the price it pays to acquire those goods or the costs of manufacture will be less than the price at which it will be able to sell them in due course. The cost price of the goods is therefore not necessarily the value of those goods in the market place. In acquiring or manufacturing the goods in the first place the trader will make allowance for the need to incur expenditure in relation to them in order to be able to sell them at a profit. The expenditure may include expenses in making the goods marketable, for example, rectifying minor damage incurred in transit, packaging the goods, transporting them to the point of sale and the like. Fees and commissions may have to be paid to retailers who will be responsible for selling them directly to the public. Advertising costs may be incurred. In the case of many goods some allowance may have to be made for post-sale remedying of defects. None of these expenses, nor any of the many others that could be envisaged, are relevant to the cost price of the goods. From a taxation perspective they only become relevant once they have been incurred in seeking to secure the sale of the goods. They will then become 'expenses incurred in the production of income' in terms of section 11(*a*) of the Act and be taken into account in determining the taxpayer's taxable income in the year in which they are incurred.

(vii) That the cost price of acquiring or manufacturing goods may bear little relationship to the market value of those goods or the price at which the trader proposes to sell them. Yet section 22(1)(*a*) provides that in the ordinary course it is to be the statutory basis for fiscal purposes of establishing the value of trading stock at year end. It is only when the 'value of such trading stock has been diminished' that an allowance may be made. What is meant by this expression?

(ix) That the only way to make sense of the expression 'value of such trading stock' in this context is to accept that it referred to an artificial concept of value represented initially by the cost price of the goods. That is the baseline against which any diminution in the value of the goods must be measured. In turn, it raises the question of when damage, deterioration, change of fashion, decrease in market value or any other reason may be taken to reduce the value of the goods as reflected in their cost price.

(x) That some guidance was to be found in the situation in *CIR* v *Jacobsohn* 1923 CPD 221 where a dramatic decline in the future price of wool meant that the wool stocks held by the taxpayer- a trader in wool- were irretrievably devalued and one infers from the judgment that there was no prospect of any revival of the price. In those circumstances the value of the stocks of wool held by him, when measured against cost price, had been diminished. The effect was that in practical terms he had suffered the decline in value of his trading stock in the year prior to that in which the stock would be sold.

(xi) That damage and deterioration are directed at the same situation. They only provide grounds for an allowance to be made under section 22(1)(*a*) if the nature of the damage or deterioration is so severe when measured against the cost price that it can be said in common parlance 'the goods are no longer worth that.'

(xii) That, accordingly, on a proper interpretation of section 22(1)(*a*) the cost price of the goods, and not the actual or anticipated market value on their sale, is the benchmark against which any claimed diminution in value is to be measured. A claim for an allowance must be based on events that are known at the end of the tax year for which the allowance is claimed or events that it is known will occur in the following year. There will only be scope for an allowance where the events in question have led to the cost price of the goods ceasing to be a proper measure of their value. In substance, the allowance enables the taxpayer to say that, because of the diminution in value of its trading stock, it has suffered a loss in the current year in the determination of its taxable income and it should be permitted to set off that loss immediately instead of waiting for it to materialise when the goods are sold in a later year.

As to IAS 2 and NRV

(xiii) That Volkswagen had contended that there had been a reduction in the value of its trading stock 'for another reason.' It did not say that there had been a decrease in market value of its cars. Instead it contended that valuing trading stock at year end, in accordance with NRV and IAS 2, properly reflected a diminution in value of that trading stock and accordingly justified the reduction in value for which it contended. Whether that was so depended upon a consideration of IAS 2, the concept of NRV and its application to the facts of this case and that must be measured against the provisions of section 22(1)(*a*) in accordance with the interpretation set out above.

(xiv) That annual financial statements prepared in accordance with the International Financial Report Standards (IFRS), as embodied in GAAP in South Africa, serve a valuable purpose in providing a fair picture to investors, shareholders and creditors of companies about their financial affairs. In doing so, it is important that the picture is fair, both in regard to the past trading activities of the company and also as to its future prospects. It may be more important for those reading the accounts to know that prospects for the year ahead are gloomy, than that the company made substantial profits in the year past. That is why annual financial statements contain many forward-looking statements and why IAS 1 on the Presentation of Financial Accounts requires management to make a specific assessment of the entity's ability to continue as a going concern. The auditor must assess the appropriateness of management's use of the going concern basis of accounting and identify any material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

(xv) That valid though these principles may be for the purposes to which they are directed, they are not necessarily equally applicable to the determination of a taxpayer's liability to income tax in accordance with the provisions of the Act. That is to be determined from year to year and the Act's provisions do not necessarily accord with current accounting principles. Whether the concept of NRV reflects a diminution of value of trading stock for the purposes of section 22(1)(*a*) depends therefore, not on its acceptance as part of GAAP, but on its conformity to the requirements for such a diminution in value as determined on a proper interpretation of that section.

(xvi) That IAS 2 was the prescribed accounting treatment for inventories and these were defined to include all assets held for sale in the ordinary course of business. Net realisable value (NRV) is defined as the estimated selling price of inventory in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale.

As to Volkswagen's determination of NRV

(xvii) That Volkswagen had classified the items forming part of its NRV calculations as 'Distribution and Selling Costs.' The distribution costs were its rework/refurbishment costs, outbound logistics, marine insurance and distribution fees. The selling costs were sales incentives, warranty costs, costs relating to the Audi Freeway Plan and Volkswagen AutoMotion Plan and roadside assistance costs. Distribution costs were costs that were anticipated to be incurred between Volkswagen's headquarters in Uitenhage and the various dealerships through which its vehicles would be sold. Selling costs were costs that would be incurred once the vehicles were sold.

As to whether NRV represented the diminished value of trading stock in terms of section 22(1)(a)

(xviii) That there was obvious scope for an overlap between the provisions of section 22(1)(*a*) and those of IAS 2. The former refers to a diminution of value of trading stock caused by damage, deterioration, change of fashion, or decrease in market value. Clause 28 of IAS 2 records that the cost of inventories may not be recoverable if they have been damaged or have become obsolete in whole or part. To that extent the two correspond but the other elements to which IAS 2 refers do not relate to the same matters as section 22(1)(*a*).

(xix) That with the sole potential exception of some vehicles forming part of Volkswagen's stock in trade having suffered damage requiring refurbishment during the relevant year, all of the items used by Volkswagen in its calculation of NRV were concerned with costs that would be incurred in the future in the sale and distribution of vehicles. Even the extent of any damage requiring refurbishment was anticipated to be minor. The schedule attached to the stated case showed that a modest R525 per vehicle was allowed under this head. There could be no question therefore of the value of trading stock being diminished below cost price as a result of damage to the vehicles constituting such stock. This was a provision to cover minor scratches and dents and no claim for refurbishment was made in respect of used vehicles, which was a further indication that this was a minor item.

(xx) That while IAS 2 was understandable from an accounting point of view, from a taxation perspective there were problems with this approach. The *fiscus* is concerned with the value of trading stock as a whole. Writing down the value of part of the stock to NRV ignores the fact that the NRV of the remaining stock is higher than cost price. The overall position with a company that is a going concern will probably be that the NRV of the trading stock, taken as a whole, will be greater than cost price. Using NRV is a legitimate approach from an accounting perspective. However, there was no reason for SARS to accept that Volkswagen's trading stock had diminished in value on the basis of a calculation where Volkswagen took advantage of the 'swings', where the NRV was lower than cost price, but disregarded the 'roundabouts', where the reverse was true. For tax purposes the question was whether Volkswagen's trading stock as a whole had suffered a diminution in value.

(xxi) That the underlying assumption was that what was desirable and necessary from a financial accounting perspective was equally applicable to the entirely different question whether the value of the trading stock at the close of the tax year had been diminished by events occurring during that year. The assessment was of the value of the stock as if there were an arm's length disposal of the business but section 22(1)(*a*) was concerned with the value of the trading stock as trading stock at year end.

(xxii) That the use of NRV was inconsistent with two basic principles that underpin the Income Tax Act. The first is that taxable income is determined and taxation levied from year to year on the basis of events during each tax year. SARS is not concerned, save where allowances such as depreciation or provisions for bad debts are concerned, with the taxpayer's trading prospects in later years. This principle is sometimes expressed by saying that taxation is backward looking. By contrast NRV is explicitly forward looking. It is concerned with the amount that the trader is likely to receive when the goods are realised and for that reason it takes account of the expenses that will be incurred in making the sale.

(xxiii) That the second inconsistency with principle is that using NRV has the effect that expenses incurred in a future tax year in the production of income accruing to or received by the taxpayer in that future tax year, become deductible in a prior year. That is inconsistent with the basic deduction provision in section 11(*a*) of the Act, that what may be deducted in any tax year in the determination of taxable income is ‘expenditure and losses actually incurred in the production of the income.’ Allowing Volkswagen to deduct in a current year expenses that will be incurred in the following year in earning income flies in the face of that provision.

(xxiv) That the court *a quo* erred in failing to recognise that section 22(1)(*a*) was not concerned with contrasting cost price with a value determined by ‘an appropriate method by which to determine the actual value of trading stock in the hands of the taxpayer at the end of the year of assessment.’

(xxv) That the question to be answered was whether NRV should be used to determine the value of trading stock at year end for the purposes of claiming an allowance against cost price under section 22(1)(*a*) of the Act and the question was whether the result of using NRV accurately reflected the diminution in value of trading stock contemplated in the section.

(xxvi) That of the items making up the NRV calculation it appeared that only one very minor item for refurbishment necessitated by damage, could possibly qualify as diminution in value of the trading stock to the extent required to warrant SARS making an allowance in favour of the taxpayer.

Appeal upheld with costs.

Additional assessments for the 2008, 2009 and 2010 years of assessment confirmed.

4.2. C:SARS v Char-Trade 117 CC t/a Ace Packaging

Ace Packaging, during the 2007 to 2011 years of assessment, had made various loans to related close corporations and companies within its group of companies and these loans were reported by Ace Packaging in its annual financial statements and described as follows: 'unsecured, bear interest at current rates and have no fixed terms of repayment.'

SARS, during an audit of Ace Packaging's tax affairs, had discovered that the latter had provided interest-free loans or loans to a number of related close corporations and companies.

SARS had subjected the said loans to STC on the basis that these loans had constituted deemed dividends, as less than the official rate had been charged and, as a result of the non-payment of STC by Ace Packaging, it had also levied interest in terms of section 64B(9) of the Income Tax Act on the capital amounts owed by it.

SARS, on 9 November 2012, had issued assessments for STC against Ace Packaging for the 2007 to 2011 STC cycles, in terms of section 64C(2)(*g*) of the Income Tax Act and R1 812 609 was in respect of Ace Packaging's STC liability for the 2007 STC cycle.

Ace Packaging had then filed Notices of Objection against the assessments on various grounds but on 17 June 2014, relying on the provisions of section 99 of the Tax Administration Act, had introduced a new and additional defence, namely that the assessment in respect of the 2007 STC cycle, had become prescribed and fell to be set aside in its entirety and the 2007 year of assessment became, ultimately, the only focus of this appeal.

Therefore, the only issue in dispute was whether SARS was prohibited by section 99(1)(*b*) of the Tax Administration Act from issuing the assessment for STC in respect of the dividend cycle that ended in 2007 and this would be the case if more than five years had lapsed since the date of assessment of the original assessment.

The court *a quo*, being the Johannesburg Tax Court (*per* Jansen J) had found that, as the assessment for 2007 was raised on 9 November 2012, more than five years after the return, and payment was deemed to be due in terms of section 64B(7) of the Income Tax Act, the 2007 assessment had become prescribed.

It was, however, common cause that Ace Packaging never submitted any return in respect of STC in respect of the dividend cycle ending in 2007 and, furthermore, no payment of STC had been made in respect of the 2007 year.

Judge Mbha held the following:

(i) That Ace Packaging bore the *onus* in terms of section 102(1)(*a*) of the Tax Administration Act to prove that it was not liable for STC for 2007 and had to prove prescription and to do so it had to prove the jurisdictional facts required in terms of section 99(1)(*b*) of the Tax Administration Act, namely, that five years had expired after the date of assessment of an original assessment.

(ii) That the assessment in respect of STC for 2007 was issued in terms of section 64C(2) of the Income Tax Act and Ace Packaging was obliged in terms of section 64B(7) to submit a return for STC for 2007 and there was no dispute that the return that was required in terms of section 64B(7) of the Act constituted a 'self-assessment' and clearly Ace Packaging was under an obligation to submit a return but had failed to do so.

(iii) That what remained to be determined was: when did the five-year prescription period commence running? The intended effect of section 99(1)(*b*) of Act, read with the definition of 'date of assessment' was that prescription cannot commence to run against SARS until such time as a return has been submitted by the taxpayer and it was by submitting a return that the taxpayer informed SARS about a dividend, including a deemed dividend, and that STC was payable thereon.

(iv) That it followed that prescription in respect of the dividend cycle of 2007 could only have commenced once Ace Packaging had filed a return for STC and this return would have constituted the original assessment and as Ace Packaging had failed to submit the STC return, there was no original assessment from which assessment date the five-year period could have run.

(iv) That, therefore, it became apparent that prescription never commenced to run, and it could only have commenced in the event that Ace Packaging had filed a return for STC which it had failed to do.

(v) That, for the aforesaid reason, the court *a quo* had erred when it held that prescription had commenced in March 2007, which being one month following the dividend cycle for 2007 and which was the date when the Respondent was obliged to file a STC return and make payment.

Appeal upheld.

4.3. C:SARS v KWJ Investments Service (Pty) Ltd

KWJ had conducted a business in redeemable preference shares and investors who sought a return in the form of dividends subscribed for were issued preference shares by KWJ who invested the funds so raised from the preference shares and made a profit on the difference between the dividends it received and the dividends that it was obliged to pay the holders of its preference shares. As the dividends it received were at the time tax exempt, its only liability for tax related to Secondary Tax on Companies (STC). The investors received a return on their investments in the form of dividends and were entitled to the return of the capital sum which they had invested at the maturity of the investment period.

The transactions giving rise to this case were devised to make use of surplus funds held from time to time by KWJ without attracting any liability for tax.

KWJ invested the surplus proceeds from the issue of preference shares with Investec Bank Ltd (Investec) in terms of an Amended and Restated Master Investment Agreement (the agreement) entered into between Investec and KWJ initially on 24 April 2007, but subsequently amended on 12 November 2007.

In terms of the aforementioned agreement, as a *quid pro quo* for the monies invested with Investec, KWJ was issued with a Composite Note. The Note provided for a return on KWJ's investment in the form of an antecedent cession of rights to identified dividends declared but not as yet paid by entities listed on the Johannesburg Securities Exchange. Investec would acquire the right to receive these dividends from Old Mutual or Sanlam at a premium to face value and in time cede them to KWJ. In summary, Investec ceded rights to dividends prior to its entitlement to the dividends themselves; that is: the cession took place prior to the last date for registration of the shareholder, on which date the right to the dividends would have accrued to the registered shareholder. In addition, the Note provided that KWJ would receive the return of the capital so invested on a specified date.

The dividend rights were acquired by Investec for 'on-cession' to KWJ in terms of Dividend Agreements concluded between it and the untaxed policy funds of Sanlam and Old Mutual, which rights were acquired at a premium to the face value of the dividends that would accrue in the future. The premium took into account the value of the credit for the purposes of the STC that would accrue to the holder of a dividend right on payment of the dividend and would serve to offset its own liability for STC, arising when KWJ paid dividends to its own shareholders.

Investec employed the funds which it had received from KWJ as part of its floating capital in respect of which it earned taxable income. It deducted the cost of the dividend rights so purchased for income tax purposes on the basis that it was expenditure incurred in order to produce income for income tax purposes; that is, the return from investments made, using the proceeds from the issue of the Note.

Stripped to its essentials, the Dividend Agreement provided for an investment to be made by KWJ with Investec from the proceeds of the issue of its own preference shares. In terms of the Dividend Agreement the capital which it invested would be returned by Investec on the earlier of the scheduled redemption date, or an early redemption date. In addition, in terms of clause 5.2.4 of the Dividend Agreement, KWJ would receive a return on its investment in the form of a right to receive dividends declared, but not yet accrued, the face value of which was equal to the dividend amount, calculated in terms of a formula based on a dividend rate specified in the Note.

In effect, this meant that during each dividend period of the investment, Investec would 'endeavour to antecedently acquire Reference Dividend Rights for the purpose of antecedently divesting itself of such Reference Dividend Rights to the Investor, in settlement of the dividend amount which is payable by 'the issuer to the Investor' on the relevant Dividend Payment Date for that Investment Transaction.'

The Reference Dividend Rights Amount meant all of Investec's 'right, title and interest in and to dividends' declared in ordinary shares or preference shares which were listed on the JSE Limited, were acquired by Investec for the purposes of cession to KWJ in terms of the Dividend Agreement.

The first issue for determination by the court was the question of whether an amount accrued to KWJ, which accrual took place pursuant to the Dividend Agreement.

SARS contended that an accrual took place on the date of the antecedent cession of the dividend rights from Investec to KWJ. A second accrual then took place on the date when the companies so declaring the dividends paid them to KWJ, being the party so entitled to the dividends upon declaration.

KWJ, in its tax return, included in its 'gross income' (as defined in s 1 of the Income Tax Act 58 of 1962), in particular in terms of par. (*k*) thereof, all dividends which had, in due course, accrued to it as cessionary of the rights so ceded. It then treated this gross income as being exempt from tax in terms of s 10(1)(*k*) of the Act (prior to a legislative amendment thereof which took place with effect from 25 October 2012).

The reserves arising from the accrual of these dividends were utilised to pay dividends to KWJ's preferent shareholders, in respect of which no income tax deduction could be, or was, claimed by KWJ.

SARS had raised assessments against KWJ on this basis for the 2008 and 2009 years of assessment.

On 2 December 2011 SARS issued additional assessments in respect of KWJ's 2008 and 2009 years of assessment and, for the first time, these included amounts equal to the face value of the dividends, on the basis that the dividend rights received by KWJ constituted an amount which accrued to it unconditionally, in terms of gross income as defined in section 1 of the Income Tax Act.

SARS' case on the question of the taxation of the dividend rights was that the receipt by KWJ of the rights acquired in respect of dividends prior to the last day of registration as a shareholder, did not constitute dividends but stood to be classified as a separate and distinct amount which had accrued to KWJ: that is, dividend rights which were a return on its investment with Investec. This constituted an unconditional receipt or accrual of an amount which was taxable, either as 'interest' in terms of section 24J of the Income Tax Act, or as gross income under the definition thereof set out in section 1 of the Act.

The Cape Town Tax Court (*per* Van Staden AJ) in *ITC 1896* (2017) 79 SATC 191 in upholding KWJ's appeal held that the dividend rights could not be considered to be unconditional, since the last day for registration of the shareholders had not yet arrived when the rights to dividends were ceded to KWJ.

The Tax Court found that the payment of the dividends was conditional, as the identity of the shareholder entitled to the dividends had not been established at the date of cession and thus the entitlement to what the Tax Court considered to be a contingent right did not give rise to an accrual as envisaged in the definition of 'gross income' in section 1 of the Act.

The Tax Court, in light of its decision aforesaid, also found it unnecessary to consider KWJ's alternative argument, i.e. that the original assessments had been issued in accordance with SARS' 'practice generally prevailing' as provided for in section 79(1)(iii) of the Income Tax Act 58 of 1962 and that, for this reason, the additional assessments in dispute could not stand.

On appeal, however, the court found that these dividend rights fell to be included in gross income and hence SARS was precluded from raising additional assessments because the original assessments were made in accordance with the 'practice generally prevailing' as at the date of the original assessments, as envisaged in section 79(1)(iii) of the Act.

SARS contended on appeal that the rights transferred from Investec to KWJ were rights to receive whatever dividends were paid by the JSE listed companies. The subject of the rights was an entitlement to be paid money as a dividend by that company. The right had a value, notwithstanding any conditionality, as was evidenced by the acquisition of the dividend right by Investec and the subsequent disposal thereof to KWJ. This value was evidenced by the price Investec paid for the dividend rights which price included a premium as provided for in clause 5.4 of the Dividend Agreement. When KWJ received the right to dividends, what it received was 'an amount' which fell within the scope of gross income and was therefore taxable in its hands. Subsequently, when it received the dividend payment, it likewise, received an 'amount' but, by virtue of section 10(1)(*k*)(i) of the Act, this amount was exempt from tax.

Judge Davis held the following:

<u>As to accrual of the dividend rights</u>

(i) That the first question which had to be answered in the affirmative in this case in order for the appeal to succeed, was whether the dividend right constituted 'an amount' that had accrued to KWJ; that is, an independent amount from the dividend ultimately received by KWJ.

(ii) That the definition of 'gross income' in section 1 of the Act included 'the total amount in cash or otherwise, received by or accrued to or in favour of any person.' This amount included 'not only money but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal which has a money value.' (See *CIR* v *People's Stores (Walvis Bay) (Pty) Ltd* 52 SATC 9.)

(iii) That an amount accrued to a taxpayer once the taxpayer became unconditionally entitled to such an amount; that is, a taxpayer's right must be unconditional in order for the right to fall within the scope of gross income. To put it in the terms of the *People's Stores* case, *supra*: 'no more is required for an accrual in terms of the definition 'gross income' than that the person concerned has become entitled to the amount in question.'

(iv) That, in summary, SARS' case was that KWJ had acquired an unconditional entitlement to each dividend right upon the cession to it by Investec and this stood to be classified in terms of the approach set out by Hefer JA in the *People's Stores* case, *supra*: 'Any right (of a non-capital nature) required by a taxpayer during the year of assessment and to which a money value can be attached forms part of 'gross income' irrespective of whether it is immediately enforceable or not but that its value is affected if it is not immediately enforceable.'

(v) That the dispute reduced to the following: did the antecedent cession of dividend rights constitute a form of property that had a monetary value attached thereto at the time that KWJ became entitled to these dividend rights?

(vi) That the starting point for any analysis was that the right to the dividends to be declared in the future which were ceded by Investec to KWJ could not be classified as dividends. The dividend definition as set out in section 1 of the Act expressly refers to 'the amount transferred or applied by a company for the benefit of any shareholder in relation to that company.' That transfer was from the company paying the dividend to KWJ and it took place subsequent to the cession of rights by Investec and hence constituted a separate amount that fell to be taxed in terms of the definition of gross income and which was then exempt from tax in terms of section 10(1)(*k*)(i) of the Income Tax Act.

(vii) That the dividend right ceded to KWJ in terms of the agreement with Investec was a separate amount. It was ceded as the return which KWJ had obtained for the capital sum invested by KWJ with Investec. It was clear from clause 5.4 of the Dividend Agreements entered into between Investec and Sanlam and Old Mutual respectively, that these rights had a defined monetary value. Furthermore, Investec issued a reference dividend rights notice to KWJ informing the latter, for example that 'it has acquired Reference Dividend Rights in respect of the Dividend Period commencing on 31 January 2008 and ending on 30 April 2006 as follows.' Acceptance of that notice and the resulting cession clearly carried a value with it. Had KWJ sought to sell it on the open market it would clearly have carried a monetary value of a kind that falls within the scope of the definition of gross income.

(viii) That the cession of these dividend rights constituted an unconditional right described by Hefer JA in the *People's Stores* case, *supra*, as follows: 'any right (of a non-capital nature) acquired by a taxpayer during the year of assessment and to which a money value can be attached, forms part of the 'gross income' irrespective of whether it is immediately enforceable or not, but that its value is affected if it is not immediately enforceable.'

(ix) That SARS had further contended that the dividend rights constituted interest in terms of section 24J of the Income Tax Act 58 of 1962 and in this way the dividend rights could be seen to represent compensation received for the use of money advanced to Investec by KWJ in terms of the latter's investment as set out in the Dividend Agreement.

(ix) That the only distinction between the dividend rights being taxed in terms of section 24J or within the scope of gross income in terms of section 1 of the Act was that there was no distinction drawn between a capital or revenue receipt or accrual in the case of taxation under section 24J of the Act. Manifestly, in this case the dividend right was a return for the investment made by KWJ and thus was a receipt or accrual of a revenue nature. Hence, in this case, as the dividend rights fell clearly within the scope of gross income, there was no need to deal with the application of section 24J of the Act. In principle, the dividend rights stood to be taxed as they constituted an unconditional receipt of a right which had a monetary value.

As to the existence of a practice generally prevailing – section 79(1)(iii) of Act 58 of 1962

(x) That the next question to be determined by the court was that even if the dividend rights in issue stood to be taxed as forming part of KWJ's gross income, did SARS issue its revised assessments rendering KWJ liable to tax on the dividend rights in a manner which was contrary to its generally prevailing practice at the time of the issue of the original assessments as envisaged in section 79(1)(iii) of the Act?

(xi) That it was common cause between the parties that KWJ bore the *onus* to show, on a preponderance of probability, that the original assessments were in accordance with a practice generally prevailing at the time of the assessment.

(xii) That in *CIR* v *SA Mutual Unit Trust Management Co Ltd* 52 SATC 205 the court stated that 'a practice 'generally prevailing' was one which is applied generally in the different offices of the Department in the assessment of taxpayers and in seeking to establish such a practice in regard to a particular aspect of tax assessment it would not be sufficient to show that the practice was applied in merely one or two offices.'

(xiii) That, returning to the approach to a practice generally prevailing as set out in the *SA Mutual Unit Trust* case, *supra*, KWJ placed a significant amount of evidence before the Tax Court which showed that, in cases involving a cession of dividend rights, a consistent approach was applied by SARS and, in particular, the Large Business Centre that was responsible for these taxpayers and for a relatively lengthy period SARS did not levy tax on these rights.

(xiv) That the evidence before the Tax Court revealed that there had been a generally prevailing practice not to include these dividend rights in gross income at the date of the original assessments as envisaged in section 79(1)(iii) of the Act and it was only after the arrival of Dr Marcus at SARS, as someone responsible for dealing with these kinds of transactions, that a reversal was prompted of the prevailing practice which had applied when the original assessment of KWJ was generated.

(xv) That, in the circumstances, KWJ had placed sufficient evidence before the court to require SARS to provide evidence to contradict the clear inference that otherwise must be drawn from the evidence presented by KWJ. That it failed to do and for this reason, the additional assessments must be set aside on the basis of proviso (iii) to section 79(1) of the Act.

Appeal dismissed with costs, including the costs of two counsel.

5. INTERPRETATION NOTES

5.1. Deduction for energy-efficiency savings – No. 95 (Issue 2)

This Note provides guidance on the deduction for energy-efficiency savings under section 12L read with the Regulations.

In response to South Africa ranking as one of the top 20 contributors of greenhouse gas emissions in the world, the government voluntarily announced during the 2009 United Nations Climate Change Conference in Copenhagen and confirmed in Paris in 2015 that it would act to significantly reduce domestic greenhouse gas emissions.

Government has thus proposed a carbon tax policy to encourage behavioural change towards cleaner low-carbon technologies. As a complementary measure, government has introduced environmental-related tax incentives to address concerns related to global warming and energy security. Such an incentive is section 12L which allows taxpayers to claim a deduction for most forms of energy-efficiency savings that result from activities performed in the carrying on of any trade and in the production of income.

From 1 November 2013 to 28 February 2015, the rate at which the deduction was calculated was 45 cents per kilowatt hour or kilowatt hour equivalent of energy-efficiency savings. For years of assessment commencing on or after 1 March 2015, the deduction is calculated at 95 cents per kilowatt hour or kilowatt hour equivalent of energy-efficiency savings.

Section 12L provides a deduction to a taxpayer for savings derived from implementing more energy-efficient methods for conducting a trade. In claiming the deduction, regard should be had to:

- the Regulations and the standard;
- the method of calculating the baseline and the energy savings in multi-year activities;
- registration requirements;
- certificates that have to be obtained from SANEDI for each activity and year of assessment;
- exclusions and limitations; and
- the effective date of section 12L.

5.2. The taxation of foreign dividends – No. 93 (Issue 2)

This Note provides guidance on the interpretation and application of various provisions of the Act relating to foreign dividends. The Note does not deal with the income tax consequences of a dividend paid by a headquarter company, since this topic is addressed in Interpretation Note 87 'Headquarter Companies'.

This Note reflects the income tax and tax administration legislation (as amended) at the time of publication and includes the following:

- The Taxation Laws Amendment Act 17 of 2017 which was promulgated on 18 December 2017 (as per *Government Gazette* 41342).
- 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 Act 14 of 2017 which was promulgated on 14 December 2017.

With effect from 1 January 2011, a definition of 'foreign dividend' was introduced into section 1(1) and, combined with the insertion of the definition of 'foreign company' and changes to the definition of 'dividend', had the result that on or after that date foreign dividends no longer fell within the definition of 'dividend' in section 1(1). A dividend and a foreign dividend are mutually exclusive. A dividend relates solely to specified amounts transferred or applied by a resident company. A foreign dividend relates solely to specified amounts paid or payable by a foreign company, which by definition is a non-resident.

Broadly speaking, a foreign dividend is included in a person's gross income but may qualify for a full or partial exemption from normal tax under section 10B. With effect from March or April 2012(1)(*i*)(xv)(*aa*) for foreign dividends and foreign interest not otherwise exempt, was deleted and a partial exemption was introduced under section 10B(3). The partial exemption under section 10B(3) is intended to ensure that the maximum effective rate of tax on taxable foreign dividends does not exceed the dividends tax rate applicable to local dividends. With effect from years of assessment commencing on or after 1 March 2017, the maximum effective rate of tax on taxable foreign dividends increased from 15% to 20%.

A foreign dividend received by or accrued to a person is included in that person's gross income under paragraph (*k*) of the definition of 'gross income' in section 1(1).

Section 10B provides for exemptions of foreign dividends received by or accrued to a person. The exemptions under section 10B(2) are applied separately to each foreign dividend received or accrued while the partial exemption under section 10B(3) applies to the aggregate amount of foreign dividends not exempt under section 10B(2). The partial exemption is determined by applying the applicable ratio to a specific type of person. The exemptions will not apply to the extent that section 10B(4), (5) or (6) applies.

With effect from years of assessment commencing on or after 1 March 2017, the maximum effective rate of tax on taxable foreign dividends increased from 15% to 20%.

Foreign dividends received by or accrued to a person constitute income from a foreign source under section 9(4)(*a*). Foreign tax paid on foreign dividends potentially qualifies for a rebate under section 6*quat*(1).

Under section 25D a foreign dividend received by or accrued to a person is translated from a foreign currency to rand at the spot rate, or at the average exchange rate if a natural person or non-trading trust so elects. Special rules apply to foreign permanent establishments, CFCs, headquarter companies, domestic treasury management companies and international shipping companies. Foreign tax payable on a foreign dividend is translated to rand on the last day of a year of assessment at the average exchange rate for that year of assessment under section 6*quat*(4).

Section 23(*q*) prohibits the deduction of expenditure incurred in the production of foreign dividends which are not exempt from normal tax under section 10B. Section 23(*f*) prohibits the deduction of any expenses incurred in respect of amounts received or accrued which do not constitute 'income' as defined in section 1(1), such as foreign dividends exempt under section 10B.

For the purposes of determining the net income of a CFC, a CFC is deemed to be a resident for purposes of the definition of 'gross income' in section 1(1). Foreign dividends received by or accrued to a CFC are therefore included in its gross income. Section 10B also applies to foreign dividends received by or accrued to a

CFC for purposes of determining its net income for inclusion in a resident's income. Special rules apply to a CFC in calculating its net income and in determining the cost price or base cost of the right in a CFC when foreign dividends are distributed by the CFC or by another CFC in which the first-mentioned CFC has an interest.

5.3. Meaning of 'Bulk' – No. 108

This Note provides clarity on the interpretation and application of the word 'bulk' as contained in Schedule 2.

A person must pay a royalty for the benefit of the National Revenue Fund in respect of the transfer of a mineral resource extracted from within the Republic.1 The Act distinguishes between refined mineral resources (Schedule 1) and unrefined mineral resources (Schedule 2). Each Schedule contains a list of mineral resources. Apart from separating the mineral resources into refined and unrefined mineral resources, the Schedules also specify a condition for each mineral resource. The condition specified differs depending on the type of mineral and whether it is refined or unrefined.

The term 'unrefined mineral resource' is defined in section 1 and means a mineral resource:

- listed solely in Schedule 2; or
- listed in Schedule 1 and Schedule 2 that has not been refined to or beyond the condition specified in Schedule 1 for that mineral resource.

The condition specified represents the point at which the mineral is considered to be in an acceptable condition for transfer and is important in determining the royalty payable under the Act. The gross sales for a particular mineral resource will therefore be determined when that mineral has reached the condition specified in the Schedules.

The condition specified is generally represented by a numeric value contained in Schedule 1 (refined mineral resources) and Schedule 2 (unrefined mineral resources). However, the conditions specified for the following unrefined mineral resources listed in Schedule 2 do not have a numeric value attached to them and merely refer to 'bulk':

- Aggregates
- Clay used for bricks
- Kaolinite clay used by paper and ceramic sectors
- Granite
- Sandstone
- Slate
- Shale
- Gneiss
- Marble
- Sand
- Other minerals not listed elsewhere not rendered in a concentrate

The word 'bulk' is not defined in the Act and may result in inconsistent interpretation and application when determining gross sales. Differing views exist on 'bulk' as a condition specified in Schedule 2. This Note sets out what SARS's view is.

Section 6A allows for adjustments to the gross sales amount when an unrefined mineral resource has been transferred below or beyond the condition specified in Schedule 2. These adjustments will be applied in the determination of gross sales to determine the arm's length price for that mineral resource.

The gross sales amount of any unrefined mineral resource disposed of that has 'bulk' specified as its condition in Schedule 2 is equal to the amount received or accrued as set out in section 6(2)(*a*). Such amount is not subject to adjustment under section 6A because the legislature did not envisage 'bulk' to comprise a range of values.

5.4. *Lease agreements – No. 109*

This Note provides guidance on the application of paragraph (*g*) and the related deductions under section 11(*f*) and (*h*).

A number of the court cases that considered whether an amount fell within the scope of the above-mentioned paragraph and sections dealt with leases of land and buildings. The use of the words 'rent', 'lease', 'lease period', 'lease premium', 'lessor' and 'lessee', and 'sub-lessor' and 'sub-lessee' is therefore common in this Note. The use of these words is not intended to imply that the scope of the above-mentioned paragraph and sections is always limited to situations involving the use or occupation or right of use or occupation of land and buildings. The above-mentioned paragraph and sections are wider than land and buildings and cover other property, for example, machinery, motion picture films, patents and trademarks. The specific paragraph or section must be referred to in order to determine the specific property covered. Although other terminology may be used in the context of the other types of property, if the same principles apply, the requirements of the above-mentioned paragraph and sections may be met and hence require an inclusion in gross income or entitle the taxpayer to a deduction. For example, under an agreement of use a licensee may pay a patent owner a monthly royalty for the use of the patent as well as an up-front lump sum for entering into the agreement of use. The up-front lump sum is an amount that is paid for the use of the patent and it is distinct from and in addition to the royalty. It therefore falls within the scope of a premium for the right of use of a patent under paragraph (*g*)(iii) and requires a full inclusion in gross income.

The capital gains tax consequences of lease premiums are not dealt with in this Note. See the *Comprehensive Guide to Capital Gains Tax* for detail in this regard.

A lessee that incurred rent as an expense for the use of an asset will be entitled to claim a deduction for income tax purposes under section 11(*a*) provided the expenditure meets the requirements of that section. The lessor, on the other hand, who receives the rent or to whom it accrues must declare the rent as gross income.

The parties to a lease agreement may agree that the lessee must pay an amount in addition to or in lieu of the rent, known as a lease premium. This expense, in the case of the lessee, and the receipt or accrual, in the case of the lessor, are subject to specific provisions in the Act which are discussed in this Note.

This Note deals with the tax treatment of lease premiums for lessors and lessees.

Lessors that receive lease premiums are obliged under paragraph (*g*) to include the full amount of the premium in their gross income in the earlier of the year of assessment of receipt or accrual. Lessees who pay the premium to a lessor for the right of use or occupation are generally allowed an allowance under section 11(*f*) over the period of the lease. Although there are differences, paragraph (*g*) and section 11(*f*) are complementary.

In limited circumstances a lessor may be entitled to a special allowance under section 11(*h*) in respect of lease premiums included in gross income under paragraph (*g*). The amount of the allowance, if it applies, is equal to such amount as the Commissioner deems reasonable, taking into account the special circumstances of the case and the length of the lease.

Depending on the facts, an allowance granted under sections 11(*f*) and 11(*h*) must be recouped under section 8(4)(*a*).

5.5. Leasehold improvements - No. 110

This Note provides guidance on the application of paragraph (*h*) and the related deductions under section 11(*g*) and (*h*).

The capital gains tax consequences of leasehold improvements are not dealt with in this Note. See the *Comprehensive Guide to Capital Gains Tax* for detail in this regard.

A lessee that incurred rent as an expense for the use of an asset will be entitled to claim a deduction for income tax purposes under section 11(*a*) provided the expenditure meets the requirements of that section. The lessor, on the other hand, who receives the rent or to whom it accrues, must declare the rent as gross income.

The lease agreement may stipulate that the lessee is obliged to effect improvements to the lessor's land or buildings. This expense, in the case of the lessee, and receipt or accrual, in the case of the lessor, are subject to specific provisions in the Act which are discussed in this Note.

This Note deals with the tax treatment of leasehold improvements for lessors and lessees.

Paragraph (*h*) applies when a right to have improvements effected on land or to buildings by a lessee accrues to the lessor under an agreement. Depending on the facts, the amount included in the agreement as the value or cost of the improvements or the fair and reasonable value of the improvements will be included in the lessor's gross income in the year the right to have the improvements effected accrues to the lessor. Under section 11(*g*) the lessee, who is obliged to effect improvements under the lease agreement, may, subject to certain limitations, deduct the expenditure actually incurred over the remaining period of the lease calculated from the date of completion of the improvements.

In limited circumstances a lessor may be entitled to a special allowance under section 11(*h*) in respect of leasehold improvements included in gross income under paragraph (*h*). The amount of the allowance, if it applies, is equal to such amount as the Commissioner deems reasonable, taking into account the special circumstances of the case and the length of the lease. For example, an allowance may be granted when there is a significant delay for the lessor between the time of accrual of the leasehold improvement under paragraph (*h*) and the time when the lessor physically receives the benefit of the improvement.

Depending on the facts, an allowance granted under sections 11(*g*) and 11(*h*) must be recouped under section 8(4)(*a*).

5.6. *Circumstances in which certain amounts received or accrued from the disposal of share are deemed to be of a capital nature – No. 43 (Issue 7)*

This Note provides clarity on the interpretation and application of section 9C, which deems the amount derived from the disposal of specified shares held for a continuous period of at least three years to be of a capital nature.

The first step in determining a person's income tax liability on the disposal of shares is to determine whether the amount received or accrued is of a capital or revenue nature. Any amount received or accrued of a capital nature is specifically excluded from a person's 'gross income' as defined in section 1(1) unless specifically included.

The distinction between capital and revenue is fundamental to the tax system, but neither concept has proved capable of a satisfactory definition in the Act. The question whether shares are held as trading stock or as an investment will, to a large extent, depend on the intention of the taxpayer.

Despite guidelines laid down by case law, the determination of whether the amount received or accrued on the disposal of a share falls on capital or revenue account is often a contentious matter which can lead to costly and protracted legal disputes. For a discussion on the capital *versus* revenue issue, see the *Tax Guide for Share Owners* and the *Comprehensive Guide to Capital Gains Tax* in Chapter 2.

While section 9C eliminates uncertainty over the capital nature of shares falling within its ambit, it does not apply to all types of shares, nor does it apply to disposals of shares within three years of acquisition or returns of capital or foreign returns of capital received or accrued within that period.

Section 9C provides taxpayers with certainty that if they hold equity shares for at least three years, the gains and losses on disposal will be of a capital nature regardless of the intention with which the shares were originally acquired. Similarly, a return of capital or foreign return of capital will be regarded as being of a capital nature once the equity shares have been held for at least three years. Not all types of shares qualify under section 9C; for example, non-participating preference shares, shares in foreign companies (other than shares listed on a South African exchange) and participatory interests in portfolios of collective investment schemes in property fall outside section 9C. Its provisions are now mandatory and no election is required or even possible. The wider ambit of section 9C has necessitated the inclusion of a number of anti-avoidance measures. The capital or revenue nature of shares disposed of within three years of acquisition will continue to be determined according to principles laid down by case law.

5.7. Provisional tax estimates – No. 1 (Issue 3)

This Note provides guidance on the interpretation of the law relating to provisional tax and considers:

- who is a provisional taxpayer;
- the calculation of provisional tax including how estimates of taxable income must be made;
- the consequences of an incorrect or late submission of estimates;
- the consequences of a late payment of provisional tax; and
- the consequences of failure to submit an estimate on time.

Employees who earn remuneration generally pay tax in the form of employees' tax (PAYE) on a monthly basis. This results in the collection of an employee's normal tax liability being spread throughout the year with a potential additional payment or a refund at the end of the year of assessment. However, for people who do not earn 'remuneration' as defined in the Fourth Schedule, for example, a self-employed person earning business income, in the absence of a provisional tax system the full amount of tax would be payable only on assessment at the end of the year of assessment, without the option or obligation of making interim payments like those paying PAYE monthly.

Provisional tax is not a separate tax payable by certain persons. It is merely a method used to collect normal tax, that will ultimately be payable for the year of assessment concerned, during the year. Otherwise stated, provisional tax is an advance payment of a taxpayer's normal tax liability. A provisional taxpayer is generally required to make two provisional tax payments, one six months into the year of assessment and one at the end of the year of assessment, but has the option to make an additional payment, generally known as the third or top-up payment, after the end of the year of assessment.

Provisional tax payments are calculated on estimated taxable income (which includes taxable capital gains) for the particular year of assessment. These estimates of taxable income are submitted to SARS on an IRP6 return. The returns, which can be obtained through e-filing, the SARS contact centre or a SARS branch office, must be submitted even if the amount of the provisional tax payment is nil. The normal tax payable on the estimated taxable income is calculated at the relevant rate of tax that is in force on the date of payment of provisional tax. This would generally be the rate of tax as prescribed in the tax tables which are fixed annually by Parliament. The Commissioner may, from time to time, prescribe alternative tax tables for optional use by provisional taxpayers falling within a certain category.

Provisional tax payments may not be refunded or reallocated to different periods or different taxpayers. However, at the end of the year of assessment the provisional tax payments, together with any PAYE withheld during the year, are set off against the taxpayer's liability for normal tax. Any excess of provisional tax and PAYE over the liability for normal tax is refunded to the taxpayer and any shortfall is payable by the taxpayer to SARS. Interest is generally payable from the effective date, by SARS in the case of a refund and by the taxpayer in the case of a shortfall.

There are certain rules that must be adhered to when making estimates of taxable income for provisional tax purposes. Certain penalties and interest will be imposed if the estimates are inaccurate or if the submission of the estimates or the payment of provisional tax is late. This Note discusses these rules and the interest and penalties which may be imposed.

Provisional tax is a method used to collect normal tax which will ultimately be payable for a particular year of assessment. There are potentially three payments, two of which are compulsory. The first compulsory payment must be made within the first period which ends six months after the start of the year of assessment. The second compulsory payment must be made on or before the end of the second period which ends on the last day of the year of assessment. A third payment, which is voluntary, must generally be made within seven months of the end of the year of assessment for persons with a year of assessment ending on the last day of February and by companies with a different financial year, within six months of the end of such financial year.

The calculation of the amount of a provisional tax payment involves estimating taxable income for the year concerned. Depending on which payment (first, second or third) and on the facts and circumstances of the case, certain penalties may be imposed and interest levied if the estimates are not accurate.

The Act permits a refund of provisional tax payments previously made only if the taxpayer’s liability for normal tax has been assessed by the Commissioner and the sum of employees’ tax deducted and provisional tax paid in respect of that period exceeds the total liability for normal tax as assessed.

SARS has a range of guides available on its website which provide further practical guidance on provisional tax matters, such as completing an IRP6 return.

5.8. Employees' tax: Independent contractors – No. 17 (issue 5)

This Note explains the statutory tests and the common law tests to assist SARS officials and employers to classify a worker efficiently and effectively. This Note has been updated to incorporate the latest amendments made under section 5(1)(*d*) of the Tax Administration Laws Amendment Act 16 of 2016, effective from 1 March 2017, to the exclusionary subparagraph (ii) of the definition of 'remuneration' as defined in paragraph 1.

Binding General Ruling 40 'Remuneration Paid to Non-Executive Directors' and the *Non-Executive Directors FAQs on BGRs 40 and 41* address the independent contractor status of non-executive directors. This Note therefore does not apply to non-executive directors.

The concept of an 'independent trader' or 'independent contractor' (synonymous for practical purposes) still remains one of the more contentious features of the Fourth Schedule. A decision in favour of either independent contractor or employee status impacts on an employer’s liability to deduct employees’ tax.

The liability of an employer to deduct employees’ tax is dependent on whether 'remuneration' as defined in paragraph 1 is paid. Subject to certain conditions, amounts paid to an independent contractor for services rendered are excluded from 'remuneration' as defined, in which case an employer has no obligation to deduct employees' tax from the amounts paid.

Two sets of tools are available to determine whether a person is an independent contractor for employees' tax purposes. The **first tool** is referred to as the statutory tests. There are two statutory tests, and they are both conclusive in nature.

- If the first test is met, the person is deemed *not to be* carrying on a trade independently, with the result that the amount paid is deemed to be 'remuneration' and will be subject to employees' tax, unless the second test is met.
- In the event that the second test is satisfied, the person will be deemed *to be* carrying on a trade independently, and the amount earned will not be 'remuneration' as defined and will consequently not be subject to employees' tax.

It is possible that a person could meet the first test, and be deemed *not to be* carrying on an independent trade, but meet the second test and then be deemed *to be* carrying on an independent trade. The second test overrides the first test.

The **second tool** is the common law tests, used to determine whether a person is an independent contractor or an employee. Unfortunately, the common law tests as they apply in South Africa do not permit a simple 'checklist' approach. There are no hard and fast rules in determining whether a person is an independent contractor. An 'overall' or 'dominant impression' of the employment relationship must be formed.

In practice, the statutory tests are considered first. The common law tests are applied to finally determine whether the person is an independent contractor or an employee only if the statutory tests are not applicable in a particular situation.

This Note includes the interpretation of the relevant legislation, an explanation of the statutory tests, an explanation of the common law tests as captured in the dominant impression test, a flow diagram explaining the structure of the legislation, the dominant impression test grid for quick reference and a historical overview of the common law principles. This Note is not intended to be exhaustive of all scenarios which may occur in practice, and may not deal with certain issues based on specific facts. It must be accepted that this Note will be revised periodically in the light of public debate, court judgements and legislative reform.

6. DRAFT INTERPRETATION NOTES

6.1. Apportionment of surplus and minimum benefit requirement – Pension Funds Second Amendment Act

This Note provides clarity on the tax treatment of the actuarial surplus allocations or distributions made to members, former members, existing pensioners and employers by funds under the provisions of sections 15B, 15C, 15D or 15E of the Pension Funds Act.

The definition 'actuarial surplus' and sections 15A to 15K were inserted into the Pension Funds Act with effect from 7 December 2001. These changes enabled a fund to apportion any actuarial surplus between the employers, members, former members and existing pensioners of that fund.

The first surpluses were determined at the effective date of the first statutory actuarial valuation of the fund following 7 December 2001. The first surplus determined is normally referred to as the past surplus.

Section 15B(1) of the Pension Funds Act governs the distribution of the past surplus determined at the surplus apportionment date. The board of trustees of the fund had to determine how the past surplus should be distributed and allocated among the employer, former members, current members and pensioners of a fund. The surplus apportionment scheme had to be approved by the Registrar of Pension Funds before any distribution or allocation could be implemented. There is a difference in the tax treatment of the past surplus distributed and allocated in terms of surplus apportionment schemes approved before 1 January 2006, and schemes approved on or after 1 January 2006.

Paragraph 2C was inserted with effect from 1 January 2006 and provides that surplus distributions that accrue to a taxpayer on or after 1 January 2006, as a result of a surplus apportionment scheme approved on or after that date by the Registrar of Pension Funds, must not be included in the taxpayer's 'gross income'.

Any subsequent actuarial surplus arising in a fund following the approval of the surplus apportionment scheme by the Registrar of Pension Funds is referred to as 'future surplus' and is apportioned under section 15C of the Pension Funds Act.

This Note explains the tax treatment of distributions in terms of an approved scheme for the two different periods as well as the tax treatment of the future surplus distributions.

The tax treatment of actuarial surplus allocations or distributions to a member, former member or pensioner depends on when the past or future surplus accrues.

7. BINDING PRIVATE RULINGS

7.1. BPR 315 – Future Expenditure

This ruling determines the application of the definition of 'future expenditure' in section 24C(1) to a precious metals purchase contract.

In this ruling references to sections are to sections of the Income TaxAct applicable as at 26 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 the term 'future expenditure' in section 24C(1)

Parties to the proposed transaction

The applicant: A resident listed company

Holdco: A non-resident company, wholly-owned by the applicant

Opco: A non-resident company, wholly-owned by Holdco

Purchaser: A non-resident company

Description of the proposed transaction

The applicant will enter into a long-term contract with the purchaser, in terms of which the applicant will supply from time to time to the purchaser credits representing quantities of the commodities mined by Opco.

It is expected that the contract will subsist for forty years, but it may thereafter be extended for successive periods of ten years until Opco ceases to operate.

The contract provides, amongst others, that:

- In consideration for the sale and delivery of the credits, the purchaser agrees to make an advance payment to the applicant (the advance payment).
- In no circumstances will the applicant be required to refund any portion of the advance payment to the purchaser, and if at the end of the term any of the advance payment amount remains unapplied, that residual amount shall be applied as additional purchase price for credits already supplied under the contract.
- The advance payment must be used by the applicant to finance the expenditure it will incur to fulfil its contractual obligations.

The applicant intends to enter into an intercompany purchase and sale agreement with Opco in terms of which the applicant will have the right to purchase from Opco from time to time the quantity of credits which the applicant is obliged to supply to the purchaser.

The credits will be referenced to the production by Opco, and will be primarily sourced from Opco, but to the extent that such credits are insufficient to meet its obligations the applicant may source the credits from any source as the applicant may decide, including purchasing credits from a bullion bank, but not including purchases on any commodities exchange.

The purchaser will be required to make payment in cash to the applicant of between 10% and 22% of the relevant commodity spot price upon delivery of the credits in respect of the commodities (the production payment). The actual production payment percentage will in every case be determined with reference to the meaning of production payment in the contract which takes into account the investment grade rating and/or the leverage ratio of the applicant at the relevant time.

The applicant will credit the difference between the spot price and the production payment in respect of any delivery to the purchaser against the advance payment amount.

Conditions and assumptions

This binding private ruling is not subject to any additional conditions and assumptions other than those set out in the ruling.

Ruling

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

- The expenditure to be incurred in terms of the contract to acquire the credits will be future expenditure as envisaged in section 24C(1).
- No ruling is made on the determination of the allowance referred to in section 24C(2).
- No ruling is made on any pricing and transfer pricing aspects.

7.2. BPR 316 – Amalgamation of companies in terms of business rescue plan

This ruling determines the income tax and value-added tax effect of an amalgamation transaction for consideration involving the assumption of liabilities only.

In this ruling references to sections are to sections of the Act and VAT Act applicable as at 5 November 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of:

- section 44 of the Act;

- section 8(25) of the VAT Act.

Parties to the proposed transaction

The applicant: A resident company

The co-applicant: A resident company

Description of the proposed transaction

The applicant and co-applicant have the same shareholders and directors and have both been placed under business rescue in terms of Chapter 6 of the Companies Act 71 of 2008. The one carries on mixed farming activities with an emphasis on cattle farming; the other conducts a piggery.

The business rescue plan provides for the merger of the applicant into the co-applicant to form a mixed farming entity with a piggery focus, to simplify the corporate structure as the businesses are similar.

The proposed transaction will be achieved by way of the following transaction steps:

The applicant will transfer all of its assets to the co-applicant as a going concern. As consideration the co-applicant will assume all of the applicant's liabilities.

Within a period of 36 months of the date of the proposed transaction or within such further period as the Commissioner may allow, the existence of the applicant will be terminated.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- The debt that the applicant will transfer to the co-applicant as part of the amalgamation transaction which was incurred within a period of 18 months before the disposal:
  - does not constitute the refinancing of any debt incurred more than 18 months before the disposal; and
  - is attributable to and arose in the ordinary course of the applicant's

business undertaking.

- All of the debt that the applicant will transfer to the co-applicant as part of the amalgamation transaction was not incurred by the applicant for the purpose of procuring, enabling, facilitating or funding the acquisition by the co-applicant of any asset in terms of the amalgamation transaction.
- The applicant will within a period of 36 months after the date of the amalgamation transaction, or such further period as the Commissioner may allow, take the steps contemplated in section 41(4) to liquidate, wind up or deregister.
- The applicant will not at any stage withdraw any step taken to liquidate, wind up or deregister or do anything to invalidate any step so taken with the result that the applicant will not be liquidated, wound up or deregistered.

Ruling

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

- The transfer of all of the applicant's assets to the co-applicant will constitute an 'amalgamation transaction' as defined in paragraph (*a*) of that definition in section 44(1).
- The applicant and the co-applicant will qualify for the relief contemplated in section 44(2) and (3).
- The debt that the applicant will transfer to the co-applicant will comply with the requirements of section 44(4)(*b*).
- The applicant and the co-applicant will, in accordance with section 8(25) of the VAT Act, be deemed to be one and the same person.

7.3. BPR 317 – Disposal of business by way of asset-for-share transaction

This ruling determines the income tax and value-added tax (VAT) consequences of the disposal of a business by way of an 'asset-for-share transaction' as envisaged in paragraph (*a*) of that definition in section 42(1).

In this ruling references to sections and paragraphs are to sections of the relevant Act and paragraphs of the Eighth Schedule to the Act applicable as at 6 December 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of

- the Act:
  - section 7B;
  - section 11(*a*) read with section 23(g); and
  - section 42.
- the VAT Act:
  - section 1(1) – definition of 'vendor';
  - section 8(25); and
  - section 16(3).

Parties to the proposed transaction

The applicant: A resident company that is a wholly-owned subsidiary of Company A

The co-applicant: A resident company that is a wholly-owned subsidiary of the applicant

Company A: A company that is not a resident

Description of the proposed transaction

The applicant's business involves the manufacturing, sales and marketing of products and its business can be divided into two categories namely business A and business B. The co-applicant is a newly incorporated company. Both the applicant and co-applicant are registered vendors.

The applicant proposes to dispose of business A to the co-applicant and business B will remain the property of the Applicant. The proposed steps for implementing the transaction are as follows:

- The applicant will dispose of assets and liabilities associated with business A at book value to the co-applicant as a going concern by way of an asset-for-share transaction as contemplated in section 42 of the Act. The liabilities that will be transferred will include contingent liabilities. The employees of the applicant employed in business A will be transferred to the co-applicant in accordance with section 197 of the Labour Relations Act 66 of 1995 and contracts and licences of the applicant will be assigned and ceded to the co-applicant.
- As consideration, the co-applicant will therefore assume liabilities associated with business A and issue equity shares to the applicant to the value of the net asset value of the business transferred.
- On the effective date of the transaction, the applicant and co-applicant will enter into a loan agreement in terms of which the applicant will lend money to the co-applicant which it will use for the commencement of its operations.
- Pursuant to the co-applicant issuing new shares to the applicant as part of the asset-for-share transaction, the co-applicant will remain a wholly-owned subsidiary of the applicant.

<u>Conditions and assumptions</u>

This binding private ruling is subject to the following additional conditions and assumptions:

- The requirements of section 11(*a*) read with section 23(*g*) and 7B of the Act (where applicable) must be met at the time when the contingent liabilities materialise.
- For purposes of section 42(8)(*b*) of the Act, the liabilities that the applicant will transfer to the co-applicant are attributable to and arose in the ordinary course of the applicant's business undertaking.

<u>Ruling</u>

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

- The disposal of business A by the applicant to the co-applicant in exchange for the assumption of liabilities of business A by the co-applicant and the issue of equity shares in the co-applicant will constitute an 'asset-for-share transaction' as envisaged in paragraph (*a*) of that definition in section 42(1) of the Act.

- The applicant and the co-applicant will qualify for the relief contemplated in sections 42(2), 42(3) and 42(3A) of the Act in respect of the assets of business A that will be disposed of as follows: i) The applicant will, under section 42(2)(*a*)(i)(*aa*) of the Act, be deemed to have disposed of the:

  - capital assets at their respective base costs determined under paragraph 20 on the date of disposal; and

  - trading stock at the amount taken into account in respect of that trading stock as determined under section 11(*a*) or section 22(1) or (2) of the Act.

- For purposes of determining any capital gain or capital loss in respect of the disposal of the capital assets by the co-applicant, the applicant and the co-applicant will, under section 42(2)(*b*)(ii)(*aa*) of the Act, be deemed to be one and the same person with respect to:

  - the dates of acquisition of the assets and the amounts and dates of incurral by the applicant of any expenditure in respect of the assets allowable under paragraph 20; and

  - the valuation of the capital assets effected by the applicant within the period contemplated in paragraph 29(4).

- For purposes of determining any taxable income derived by the co-applicant from a trade carried on by it, the applicant and the co-applicant will be deemed to be one and the same person, under section 42(2)(*b*)(i)(*bb*) of the Act, with respect to the dates of acquisition of trading stock and the amounts and dates of incurral by the applicant of any cost or expenditure incurred in respect of the trading stock as contemplated in section 11(*a*) or 22(1) or (2) of the Act.

- Under section 42(3)(*a*)(i) of the Act, no allowance allowed to the applicant in respect of allowance assets must be recovered or recouped by the applicant or included in the applicant's income for the year of the transfer.

- Under section 42(3)(*a*)(ii) of the Act, the applicant and the co-applicant will be deemed to be one and the same person for purposes of determining the amount of any allowance or deduction:

  - to which the co-applicant may be entitled in respect of the allowance assets; or

  - that is to be recovered or recouped by or included in the income of the co-applicant.

- The applicant will, under section 42(2)(*a*)(ii) of the Act, be deemed to have acquired the equity shares in the co-applicant on the date that the applicant acquired:

  - the capital assets and for a cost equal to any expenditure incurred by the applicant that is allowable under paragraph 20 and to have incurred such cost at the date of incurral by the applicant of such expenditure; and

  - the trading stock and for a cost equal to the amount taken into account in respect of the trading stock under section 11(a) or 22(1) or (2) of the Act,

  which cost will be treated as expenditure actually incurred and paid by the applicant in respect of the equity shares issued by the co-applicant for purposes of paragraph 20.

- Under section 42(2)(*c*) of the Act, any valuation of the capital assets effected by the applicant within the period contemplated in paragraph 29(4) will be deemed to have been effected in respect of the equity shares in the co-applicant acquired by way of the proposed asset-for-share transaction.

- Under section 42(3A) of the Act, the contributed tax capital amount received by or accrued to the co-applicant for the issue of shares to the applicant will be deemed to be equal to the:

- amount taken into account by the applicant in respect of the trading stock under section 11(*a*) or 22(1) or (2) of the Act; and
- base costs of the capital assets determined at the time of disposal in relation to the applicant.

No ruling is made on the allocation method to be used in determining the dates of acquisition or dates of incurral of expenditure in respect of the assets that will be transferred by the applicant to the co-applicant and no ruling is made on the allocation method to be used in determining the base costs of capital assets and costs in respect of trading stock in relation to equity shares to be issued by the co-applicant to the applicant as contemplated in section 42(2) of the Act.

- Expenditure incurred in relation to the contingent liabilities transferred to the co-applicant will be deductible by the co-applicant when those liabilities materialise.
- Subject to compliance with the provisions of section 42 of the Act, the applicant and co-applicant are, under section 8(25) of the VAT Act, deemed to be one and the same person in respect of the disposal of business A based on the fact that:
    - each of the applicant and co-applicant is a 'vendor' as defined in section 1(1) of the VAT Act;
    - business B is distinct with its own identifiable assets, employees, contracts, licences, etc, and is therefore capable of separate operation; and
    - the applicant and the co-applicant have agreed in writing that business A is disposed of as a going concern for VAT purposes.
- Notwithstanding that the applicant and the co-applicant may be deemed to be one and the same person under section 8(25) of the VAT Act (refer paragraph d) above), the applicant may, in terms of section 16(3), deduct any VAT incurred on goods or services acquired for purposes of the

disposal of business A which qualify as 'input tax' as defined under section 1(1) of the VAT Act. The deduction of 'input tax' is subject to sections 16(2), 17(1), 17(2) and 20 of the VAT Act.

7.4. *BPR 318 – Corporatisation of a collective investment scheme in property by way of an asset-for-share transaction followed by an amalagamation transaction*

This ruling determines the tax consequences arising out of the conversion of a collective investment scheme in property to a corporate REIT in accordance with the procedure set out in Notice 42 of 2014 issued by the Registrar of Collective Investment Schemes under the Collective Investment Schemes Control Act 45 of 2001.

In this ruling references to sections are to sections of the Income Tax Act applicable as at 4 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:

- the Act:
  - section 42; and
  - section 44.
- the STT Act:
  - section 8(1)(*a*)(ii).

Parties to the proposed transaction

The applicant: A collective investment scheme in property, registered as a REIT on the JSE and a resident

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

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

Description of the proposed transaction

The applicant is the owner of an undivided share in the ownership of each of the assets that comprise a portfolio of immovable properties. The owners conduct letting enterprises in relation to the immovable properties.

The proposed steps for implementing the conversion of the collective investment scheme in property to a corporate REIT are as follows:

- Step 1: The applicant will make a final distribution declaration ('final distribution') to its unit holders of its actual profits accrued and anticipated profits to be accrued from the period of its last distribution to the effective date of the conversion. The final distribution declaration date and record date will be a date either prior to or the date on which shares will be issued by Company A in the transaction described in step 2.
- Step 2: The applicant will transfer its business (assets and debt which arose in the normal course of trade but excluding assets required for its final distribution obligation) to Company A in exchange for equity shares issued by Company A ('the exchange transaction'). The assets of which the market values are equal to or exceed their base costs will be disposed of by way of an asset-for-share transaction as contemplated in section 42(1)(*a*).
- Step 3: At least one day after the shares are issued by Company A in the exchange transaction, the applicant will transfer its Company A shares to the co-applicant in exchange for shares in the co-applicant. The applicant will thereafter distribute its shares in the co-applicant to its unit holders by way of conversion to a corporate REIT.
- Step 4: At least one day after the amalgamation transaction is implemented the applicant will delist from the JSE.
- Step 5: The applicant will settle its final distribution obligation.
- Step 6: Steps will be taken to terminate the existence of the applicant within a three year period from the date of the amalgamation transaction.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- The assets being transferred in terms of the proposed transaction were held on capital account and will be transferred on capital account.
- The delisting of the applicant from the JSE will take place after the implementation date of the amalgamation transaction.
- The applicant will, pursuant to the amalgamation transaction, take steps to terminate its existence within 36 months of the amalgamation transaction or within such further period as the Commissioner may allow.

<u>Ruling</u>

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

- The transaction described in step 3 will qualify as an 'amalgamation transaction' as defined in paragraph (*a*) of the definition of 'amalgamation transaction' in section 44(1).
- Based on the specific facts of this application, the Company A shares acquired by the applicant in the exchange transaction described in step 2 will be regarded as having been acquired and held by the applicant on capital account even though the Company A shares will be disposed of by the applicant to the co-applicant shortly after acquisition. The facts and circumstances of this transaction, taking into account all of the transaction steps, are very specific and, in the context of the corporate rules contained in Part III of Chapter II of the Act, indicate that the applicant will not deal with the assets as trading stock. As such, the provisions of section 44(2)(*a*) will apply to the disposal of the Company A shares by the applicant to the co-applicant.
- Section 42(6)(*a*) will apply to the transaction described in step 2, but the effect of its application will be nil.
- The provisions of section 44(8) will apply to the disposal of the co-applicant's shares to the applicant's unit holders as described in step 3;

therefore the applicant must disregard this disposal in determining its taxable income.

- No securities transfer tax will be payable by the co-applicant in respect of the transfer of the Company A shares by the applicant to the co-applicant in the amalgamation transaction as described in step 3, in accordance with section 8(1)(*a*)(ii) of the STT Act.
- No ruling is made with regard to the application of section 42(8)(*b*) as the result of the debt assumed by Company A in the exchange transaction described in step 2.

7.5. BPR 319 – Tax implications of group restructuring transactions

This ruling determines the tax consequences of a group restructuring.

In this ruling references to sections and paragraphs are to sections of the Income Tax Act, the STT Act and the VAT Act and paragraphs of the Eighth Schedule to the Act applicable as at 27 March 2018. Unless the context indicates otherwise any word or expression in this ruling bears the meaning ascribed to it in the relevant Act.

This is a ruling on the interpretation and application of the Income Tax Act:

- section 1(1) – definition of 'dividend';
- section 7B(2)(*b*);
- section 10(1)(*k*)(i);
- section 11(*a*);
- section 22(8)(*b*)(ii);
- section 23(*g*);
- section 42;
- section 45(6)(*e*);
- section 47;

- section 64F(1)(*a*);
- section 64FA; and
- section 64G(2)(*b*).

Also of STT Act (section 8(1)(*a*)(i)) and the VAT Act (section 8(25)).

Parties to the proposed transaction

The applicant: A resident company

Companies A, B, C and D: Resident companies forming part of the samegroup of companies as the applicant

Description of the proposed transaction

The applicant conducts a number of related businesses which are managed indifferent geographic locations. Each of these businesses has its own on-site management and own plant and equipment. Some of them are accounted for as divisions of the applicant while others are housed in company B, C, and D. The applicant directly holds shares in these companies. The applicant holds all theshares in company A.

The applicant proposes to reorganise the group, which will involve:

- the transfer of businesses from the applicant to company A; and
- the transfer of businesses from company B, C and D to company A subsequent to which company B, C and D will in due course be liquidated and deregistered.

The proposed transaction will be effected by way of the proposed steps set out below:

- Step 1

  The applicant will dispose of all its shares in company B, C and D to company A in exchange for additional equity shares in company A by way of an asset-for-share transaction as defined in paragraph (*a*) of the definition of that term in section 42(1) of the Act.

- Step 2

Company B, C and D will each dispose of its business undertaking as a going concern to company A for a nominal cash consideration and for the assumption by company A of the liabilities of each company, including certain contingent liabilities. The parties to each transaction will agree that section 45 of the Act apply to that transaction.

The contingent liabilities will in each case consist of provisions for leave pay and future staff incentive bonuses.

- Step 3

  Companies B, C and D will distribute the cash received for the disposal of their businesses to company A as a dividend to their shareholders. Steps will be taken to commence the deregistration or liquidation of those companies.

- Step 4

  The applicant will dispose of its businesses to company A in a composite transaction on the same day. The above-mentioned transfers of the businesses as going concerns will occur on the basis that all the assets are transferred in exchange for the assumption of all the liabilities and contingent liabilities of each business and the issue of additional equity shares in company A by way of an 'asset-for-share transaction', as defined in paragraph (*a*) of the definition of that term in section 42(1) of the Act. The contingent liabilities will include provisions for leave pay and provisions for future staff incentive bonuses.

Conditions and assumptions

This binding private ruling is subject to the following additional conditions and assumptions:

- In respect of proposed transaction steps 1 and 4, the market value of the assets transferred under each step will exceed or equal the base cost of the assets so transferred.
- The debt that will be assumed by company A under step 4 is debt that is attributable to and arose in the normal course of the business undertakings

of the businesses of the applicant that are transferred to company A.

Ruling

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

In respect of step 1

- Each disposal by the applicant of its shares in company B, C and D to company A in return for the issue of additional company A equity shares will constitute an 'asset-for-share transaction' as defined in paragraph (*a*) of the definition of that term in section 42(1) of the Act.
- The transfers of the shares in company B, C and D to company A will be exempt from securities transfer tax under section 8(1)(*a*)(i) of the STT Act.
- For purposes of determining any capital gain or loss on disposal of the acquired equity shares, the applicant and company A will be deemed to be one and the same person with respect to the date of acquisition of the shares by company A and the amount of any allowable base cost expenditure under paragraph 20 of the Eighth Schedule to the Act (and any paragraph 29(4) valuation of the shares).

In respect of step 2

- Section 45(6)(*e*) will apply to the disposals of the businesses of company B, C and D (the transferors) to company A for cash as each disposal will constitute a 'liquidation distribution' as defined in paragraph (*a*) of the definition of that term in section 47(1) of the Act rather than an 'intra-group transaction' as defined in paragraph (*a*) of that definition in section 45(1).
- The difference between the market value of the assets transferred by each transferor and the consideration in respect of the disposals will in each case constitute a 'dividend', as defined in section 1(1) of the Act, paid by each transferor to company A.
- The dividend will in each case be exempt from dividends tax under section 64F(1)(*a*) read with sections 64G(2)(*b*) and 64FA(1)(*b*) of the Act.
- The date of each dividend will be the same date as that of the relevant

liquidation distribution transaction.

- The dividends so accruing to company A will be exempt from normal tax under section 10(1)(*k*)(i) of the Act.
- Company A will be entitled to a deduction of the contingent liabilities of each transferor assumed under the transactions that are in respect of provisions for leave pay and future staff incentive bonuses as and when they are incurred by it under section 11(*a*) read with sections 7B and 23(*g*) of the Act.
- For purposes of determining the taxable income derived from trade or any capital gain or loss on disposal of an acquired asset, each transferor and company A are deemed to be one and the same person with respect to the following:
    - where a transferor disposes of a capital asset and company A acquires it as such, the date of acquisition of the asset by company A and the amount of any allowable base cost expenditure under paragraph 20 of the Eighth Schedule to the Act (and any paragraph 29(4) valuation of the asset);
    - where a transferor disposes of an asset which constitutes trading stock and it is acquired by company A as such, the date of acquisition by company A and the amount and date of incurral by company A of the amount taken into account for purposes of section 11(*a*) or section 22(1) or (2) of the Act; and
    - each transferor and company A are deemed, in respect of an allowance asset disposed of, to be one and the same person for purposes of determining the amount of any allowance or deduction in respect of that asset to which company A may be entitled, or the amount of any allowance or deduction in respect of that asset to be recovered, recouped or included in its income.

In respect of step 4

- The disposals by the applicant of the assets of the various businesses as going concerns to company A in return for the issue of additional company A equity shares and the assumption of liabilities that are attributable to and arose in the normal course of the businesses will each constitute an 'asset-for-share transaction', as defined in paragraph (*a)* of the definition of that term in section 42(1) of the Act.

- Section 42(8)(*b*) of the Act will apply to the disposals of the businesses by the applicant to company A in respect of the liabilities of the applicant assumed by company A that were attributable to and incurred in the normal course of the undertaking of the businesses transferred.
- Company A will be entitled to a deduction of the contingent liabilities assumed in respect of provisions for leave pay and future bonuses as and when they are incurred by it under section 11(*a*) read with sections 7B and 23(*g*) of the Act.
- Section 22(8)(*b*)(ii) of the Act will not apply in respect of the disposal of trading stock by the applicant to company A at book value as part of the sale of a going concern.
- For purposes of determining the taxable income derived from trade or any capital gain or loss on disposal of the acquired asset, the applicant and company A are deemed to be one and the same person with respect to the following:
  - where the applicant disposes of a capital asset and company A acquires it as such, the date of acquisition of the asset by company A and the amount of any allowable base cost expenditure under paragraph 20 of the Eighth Schedule to the Act (and any paragraph 29(4) valuation of the asset); and
  - where the applicant disposes of an asset which constitutes trading stock and it is acquired by company A as such, the date of acquisition by company A and the amount and date of incurral by company A of the amount taken into account for purposes of section 11(*a*) or section 22(1) or (2) of the Act; and

- the applicant and company A are deemed, in respect of an allowance asset disposed of, to be one and the same person for purposes of determining the amount of any allowance or deduction in respect of that asset to which company A may be entitled, or the amount of any allowance or deduction in respect of that asset to be recovered, recouped or included in its income.

- Section 8(25) of the VAT Act will apply to the disposal in step 4, subject to the transaction complying with all the provisions of section 42 of the Act.

8. BINDING GENERAL RULINGS

8.1. Supply and importation of sanitary towels (pads) – No. 49

For the purposes of this ruling, unless the context indicates otherwise:

- **'Item 22'** means Item 22 of Part B of Schedule 2 to the VAT Act;
- **'Part B'** means Part B of Schedule 2 to the VAT Act; and
- **'Schedule'** means a Schedule to the VAT Act.

<u>Purpose</u>

This BGR sets out the general VAT treatment of the supply and importation of sanitary towels (pads) under Item 22.

<u>Background</u>

Section 11(1)(*j*) provides for the zero-rate of the supply of goods listed in Part B. Section 13(3) read with paragraph 7(*a*) of Schedule 1, provides for an exemption from the VAT levied under section 7(1)(*b*), on goods listed in Part B. In terms of the Rates and Monetary Amounts and Amendment of Revenue Laws Act 21 of 2018, Item 22 being sanitary towels (pads) was introduced to the list of goods under Part B which provides for the zero-rating of sanitary towels (pads).

<u>Ruling</u>

<u>VAT treatment of the supply of goods under Item 22</u>

The supply of sanitary towels (pads) under Item 22 is zero-rated under section 11(1)(*j*). A sanitary towel (pad) is a female hygiene product specifically designed to absorb menstrual or vaginal blood. Absorption is by means of a towel or pad, which may be scented, unscented, disposable or reusable.

Products falling under Item 22

The following products fall under Item 22:

- Menstrual pads (all types – for example, light, medium and heavy flow, mini, super, sports, overnight, wings and no wings)
- Maternity pads designed for use in pre and post birth bleeding
- Panty liners which are similar to menstrual pads and are lighter and thinner

Products not falling under Item 22

The following products do not fall under Item 22:

- Tampons (all types, with or without an applicator)
- Menstrual cups
- Feminine sanitary wipes
- Period or leak-proof underwear
- Any incontinence towels or pads

VAT treatment of the importation of goods under Item 22

The importation of goods listed above falling within the ambit of Item 22 is, under section 13(3) read with paragraph 7(*a*) of Schedule 1, exempt from the VAT levied under section 7(1)(*b*).

The importation of goods listed above not falling within the ambit of Item 22 is subject to VAT at the standard rate of 15% under section 7(1)(*b*).

8.2. No-value provision in respect of the rendering of transport services by any employer – No. 50

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 'No-value Provision in respect of Transport Services', dated 22 March 2017.

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.

<u>Ruling</u>

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 (in that it is outsourced to a specific transport service provider), the employer makes it clear in the conditions under which transport service is provided, that:
  - the transport service is provided exclusively to employees on the basis of predetermined routes or 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*).

9. DRAFT BINDING GENERAL RULING

9.1. Transitional rules for the taxation of interest payable by SARS under section 7E

For the purposes of this ruling:

'interest' means interest payable by SARS under a tax Act on an amount owing by SARS as a result of a delay in effecting payment of that amount;

and

any other word or expression bears the meaning ascribed to it in the Act.

Purpose

This BGR sets out transitional rules to avoid double taxation when:

- a deemed accrual of interest occurs under section 7E; and
- in a prior year of assessment either the whole or a part of that interest was included in the taxpayer's income on the accrual basis.

Background

Taxpayers are required to include in their gross income for a year or period of assessment the total amount, in cash or otherwise, received by or accrued to them or in their favour, other than receipts or accruals of a capital nature but subject to specified inclusions, whether or not of a capital nature. Residents must account for their worldwide receipts or accruals while non-residents must account only for receipts or accruals from a source within South Africa.

The general rule is that an amount is included in a taxpayer's gross income at the earlier of receipt or accrual and there is no right of election in this regard.2 Since there is a necessary implication against double taxation, once an amount that has accrued to a taxpayer is included in gross income, it cannot again be included in gross income upon receipt.

SARS administers a number of tax Acts under which taxes, levies and duties are collected and paid into the National Revenue Fund. Interest may become payable by SARS in respect of these taxes, levies and duties under a variety of circumstances.

Section 7E was introduced to address complications in taxing interest that accrued in a prior year of assessment.

Section 7E came into operation on 1 March 2018 and applies to amounts of interest paid by SARS on or after that date. It stipulates that when a person becomes entitled to any amount of interest payable by SARS under a tax Act, that amount must be deemed to accrue to that person on the date on which the amount is paid to such person. The effect of section 7E is that interest payable by SARS is included in a taxpayer's gross income only when the amount is actually paid and not when the amount accrues to a person under general principles.

Discussion

A consequence of the transition period is that double taxation may arise if interest was taxed in a prior year of assessment when actual accrual took place and section 7E was not yet effective, but interest is paid after the effective date. Thus, an amount of interest payable by SARS may have been included in gross income when it accrued and the same amount may in a subsequent year of assessment be included again in gross income owing to the application of section 7E.

Since there is a necessary implication against double taxation in a statute, the view is held that section 7E should not be interpreted as applying to interest that accrued during years of assessment ending before 1 March 2018.

A taxpayer that did not account for interest that accrued before 1 March 2018 and which was paid by SARS on or after that date must declare such interest in the year of assessment in which it is paid. SARS will not seek to assess such interest on an accrual basis in earlier years of assessment.

Ruling

Interest paid to any person under a tax Act by SARS on or after 1 March 2018 must for purposes of section 7E, be included in that persons gross income only to the extent that no portion of that amount was already included in gross income in any previous year of assessment.

10. GUIDES

10.1. Guide to the urban development zone (UDZ) allowance (Issue 7)

This guide is a general guide about the urban development zone (UDZ) allowance provided for in section 13*quat* of the Income Tax Act

The guide, amongst others, provides:

- general guidance regarding the application and interpretation of the provisions of the Act that pertain to the allowance;
- an overview of the income tax consequences associated with the disposal of a building on which the allowance was previously allowed or the ceasing of a taxpayer to use such a building solely for the purposes of that person's trade; and
- particulars of municipalities that have demarcated areas for purposes of the allowance, as well as the process of demarcation that was followed.

In line with many countries, South Africa has a number of urban areas that are impoverished and suffering from extensive urban decay. In order to address these concerns and maintain existing infrastructure, governments internationally have increasingly used tax measures to support efforts aimed at regenerating these urban areas.

In 2003, the Minister of Finance announced a tax incentive in the form of an accelerated depreciation allowance under section 13*quat* to promote investment in 16 designated inner cities, 15 of which now have demarcated UDZs within their boundaries. The core objectives of the allowance are to address dereliction and dilapidation in South Africa's largest cities and to promote urban renewal and development by promoting investment by the private sector in the construction or improvement of commercial and residential buildings, including low-cost housing units situated within demarcated UDZs. The allowance is also intended to encourage investment in highly populated areas, central business districts or inner city environments and areas with existing urban transport infrastructure for trains, buses or taxis.

The allowance, when deducted, reduces the taxable income of a taxpayer and is not limited to the taxable income of a taxpayer. It can therefore create an assessed loss.

Municipalities will be given the opportunity to apply for extensions to existing designated zones and to apply for an additional demarcated UDZ in that municipal zone. Only areas which have a specific and necessary need for an extra zone will be granted UDZ status, and will be subject to Ministerial approval. This allowance is available until 31 March 2020.

In summary:

- Section 13*quat* provides for an accelerated depreciation allowance on the cost of the erection, extension, addition or improvement of any commercial or residential building or a part of a building.
- There are a number of requirements that must be met before the allowance is granted.
- A taxpayer that purchases a building or part of a building directly from a developer will be able to deduct an allowance provided the developer did not deduct any allowance on the cost of the building or part of the building within the usage or rental period. If the developer had used or let the property for longer than three years after completion, the subsequent purchaser may not deduct the allowance (even if the developer did not deduct an allowance) as the developer will no longer constitute a 'developer' as defined.

- In the event of a purchase of a building or part of a building from a developer:
    - o 55% of the purchase price of that building or part of a building, in the case of a new building erected, extended or added to by the developer; and
    - o 30% of the purchase price of that building or part of a building, in the case of a building improved by the developer,

  will be deemed to be costs incurred by the person for the erection, extension, addition to or improvement of the building or part of the building.
- Depending on the type of development involved, that is, new, improved or low-cost, the allowance is calculated at different rates.
- A lessee that effects improvements to a building that is owned by a party contemplated in section 12N, will, as the deemed owner, be able to deduct an allowance on the costs incurred in erecting, adding to, extending or improving such building.
- Taxpayers deducting the allowance must be in possession of the necessary UDZ forms, a location certificate and, if applicable, a certificate of occupation.
- Attention must be paid to all the reporting requirements provided under section 13*quat*.

11. 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.